DRAFT

FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
ARTICLE 2B - LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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With Comments

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ARTICLE 2B - LICENSES

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PREFACE
INFORMATION AGE IN CONTRACTS

> The UCC has given parties in traditional sales of goods a well-understood legal framework to establish contract formation, terms, and enforcement rights. It is timely now to adapt this framework to the digital era and to the new information products and services that will increasingly drive Global Electronic Commerce…. Article 2B can be a strong first step toward a common legal framework for digital information and software licenses. *Letter from CSPP, November 19, 1997 (a coalition of eleven major manufacturing companies)*
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> In the United States, every state government has adopted the [UCC]. … [Article 2B is] working to adapt the UCC to cyberspace. … The administration supports the prompt consideration of these proposals, and the adoption of uniform legislation by all states. *White House Report, Framework for Global Electronic Commerce, (July 1, 1997).*

INTRODUCTION

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

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

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

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

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[1] See Intellectual Property and the National Information Infrastructure, The Report of the Working Group on Intellectual Property Rights 58. ([the] challenge for commercial law . . . is to adapt to the reality of the NII by providing clear guidance as to the rights and responsibilities of those using the NII. Without certainty in electronic contracting, the NII will not fulfill its commercial potential."). Subsequent statements by the White House embody the assumption that private contract, rather than regulation should guide the new economy and that the basis for this lies in the development of a "commercial code" for electronic and other information contracts, both within the United States and internationally.

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

BENEFITS AND POSITIONS IN DRAFT ARTICLE 2B BY PARTY

GENERAL BENEFITS

+ creates balanced structure for electronic contracting
+ reduces uncertainty and non-uniformity of licensing law
+ provides contract law roadmap for converging industries
+ confirms contract freedom in commercial transactions
+ extends UCC contract formation rules to common law settings
+ innovates concept of mass market transaction
+ establishes strong protection for published informational content
+ recognizes layered contract formation occurring over time
+ clarifies enforceability of standard forms in commercial deals
+ enacts a solution for the battle of forms
+ applies "material breach" concept for both parties
+ sets performance standards for Internet contracts
+ establishes contract law rules for idea submissions
+ adjusts statute of frauds to information transactions
+ provides background rules for outsourcing contracts
+ defines relationship between retailer, publisher and end user
+ refines standards for enforcement of liquidated damages rule
+ allows parties to contract for specific performance
+ provides standard interpretations for grant terms
+ clarifies obligation to mitigate damages

LICENSOR BENEFITS

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

LICENSEE BENEFITS

+ creates cost free refund right on refusal of mass market license
+ creates procedural safeguards for mass-market contracts
+ creates right of quiet enjoyment
+ presumes perpetual term in some licenses
+ codifies that advertising can create express warranty
+ provides that retailer warranties are not disclaimed by publisher license
+ creates error correction rule for consumers in Internet
+ creates a warranty for data accuracy
+ expands implied warranty of fitness
+ creates an implied system integration warranty
+ requires disclaimers in a record (e.g., writing)
+ creates implied license rights
+ creates early transfer of informational property rights
+ enables financing without licensor consent
+ creates right to demand cure in some commercial contracts
+ increases persons to whom warranties runs for non-personal injury damage
+ enforces releases without consideration
+ rejects Article 2A theory that all failures to timely pay justifies cancellation
+ enforces term providing that a license cannot be canceled

+ limits electronic self-help by licensor

SOME ISSUES WHERE NO CHANGE OCCURS

+ general consumer protection law
+ relationship between contract and intellectual property law
+ obligation of good faith
+ unconsionability in software contracts
+ warranties: merchantability
+ warranties: express warranty
+ warranties: disclaimability
+ Article 2 contract formation rules
+ firm offer rules
+ enforceability of modification and no oral modification clauses
+ parole evidence rule
+ effect of merger clauses
+ treatment of "open terms"
+ interpretation of "shipment terms"
+ effect of course of dealing etc.
+ rules on cumulative and conflicting warranties
+ material breach under common law
+ rules on installment contracts
+ right to adequate assurance
+ repudiation rules
+ conforming tender rule in mass-market

PART 1
CONTEXT: LAW REFORM AND THE UCC

Modern Economy and Law Reform

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

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

Contracts involving information are not equivalent to transactions in goods.[5] The contracts emphasize different issues and call into play a much different social policy structure concerning when and to what extent liability risk ought to be created and imposed against the provider of the subject matter of the contract.

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

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

[5] Many court decisions place software licensing in Article 2 even though software is licensed and not sold and even though the focus of the transaction 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); RRX Industries, Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985); Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737 (2d Cir. 1979). Cases excluding software and data processing from Article 2 include: Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 1329, 1 UCC Rep. Serv.2d 29 (Ind. Ct. App. 1986); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988).

Project History

Although it today involves participation by motion picture, broadcast, publishing, banking, online and other industries, Article 2B began with a focus on the contract issues associated with software licensing, covering the entire range of contracts in this industry, including mass market and commercial transaction frameworks.

Under modern copyright law, software and most other digital products are governed by an intellectual property rights regime under which the copyright owner holds the exclusive right to authorize or make copies of the work, distribute copies, engage in public display or performance of the work, and make modifications of the work. This copyright regime (along with other intellectual property rights) creates a property law much different from that associated with goods; it places importance on the contractual terms relating to conveyance or restriction of rights in the subject matter. In this regard, software and other digital products are treated in law more like manuscripts and motion pictures, than television sets and cars. Even though a purchaser acquires a copy of the work, the producer retains rights and control with respect to various uses of the copy. In this regard, many believe that the contract is the product in that it defines what rights the licensee receives and does not receive in a work. A copy of software delivered to a licensee has far different value if the license allows only personal use of the copy as compared to if the license authorizes making and distributing twenty thousand copies, even though in each case the copy may be identical.

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

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

> **1. Distinct From Sales.** Information transactions and, especially, transactions involving licensing of information, differ substantively from transactions involving the sale or lease of **goods**. The differences are manifested in both the conditional nature of the transaction and that the value lies not in the goods, but in information and rights severable from the goods. A body of law tailored to transactions intended to pass title to tangible property can not be simply applied to transactions whose purpose is to convey rights in intangible property and information. Separate treatment of this commercially important class of transactions was needed.
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> **2. Commercial Significance.** The information industry has obvious commercial importance. Software and related information technologies account for in excess of 6% of the gross national product and the size of the industry continues to grow. Adding in other industries (publishing, motion pictures, on-line systems) swells the figure to a huge share of the economy. These industries and the transactions they engage in are major factors in the commercial landscape more than sufficient to justify coverage in a **commercial** code.

Deliberative Process

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

This project began at the recommendation of an ABA Study Committee that consideration be given to developing uniform law treatment of software contracts, either in or outside the UCC. A subsequent study committee of NCCUSL agreed and proposed a separate article of the UCC for software and related contracts. Shortly after that, however, the software industry objected. A second study committee was appointed. After extensive 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 concluded that an appropriate approach would be to develop a

"hub and spoke" configuration for Article 2 under which licensing and sales 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, information industry groups reversed their position in light of developments in the online and other areas, and the increasing gap between contracts dealing with this subject matter and contracts that deal with goods (either by lease or sale). They concluded that treatment of the contracts affecting their industries within the UCC was appropriate and desirable as a means of standardizing practice and providing a roadmap for the areas of contracting that are springing up in the modern information economy. The industry, however, advocated a separate UCC article on licensing because the unique character of the transactions merited separate treatment and separation would make the process of moving forward.

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

Working Drafts

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

PART 2: BASIC THEMES

LICENSING LAW AND PRACTICE

A paradigmatic transaction involves a **license**, rather than a sale.[6] The transaction is characterized by 1) the **conditional** nature of the rights or privileges conveyed, and 2) the **focus** on information, rather than tangible property with reference to both the value conveyed and the restrictions imposed. A license is not a lease or a sale. Both of those terms apply to transfers in goods, rather than rights in information. 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]

Many licenses regulate rights in intellectual property. There are many other situations, however, in which a license occurs in the absence of intellectual property. For example, a license also exists in situations in which one party receives permission to enter the physical premises or computer of another or where property owned by the licensor is made available to the licensee.[9] That model exists in the digital

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[6] UCC § 2B-102.

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

[8] 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).

[9] See 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).

world in transactions in which parties are licensed to access computer or other information resources of a licensor. In Article 2B, that is described as an "access contract" which, as to rights to access a facility. Section 2B-102 defines such contracts as a contract "for electronic access to a resource containing information, resource for processing information, data system, or other similar facility of a licensor, licensee, or third party." These are contracts for online access and services. The focus centers on licensed access to a resource or facility. This relationship creates various ongoing obligations (e.g., the obligation to pay per access, the obligation to maintain accessibility) not present in other licenses.

Licenses are commercial transactions that are common in modern commerce. Licensing is a dominant means of commerce in digital information and in commercial information transactions. Typically, as a simple matter of contract law, license restrictions are enforceable even though their terms do not mirror the "exclusive rights" in copyright or patent law. Indeed, while many courts use Article 2 to resolve contract disputes in software, Article 2 has never been applied to determine the effectiveness of use restrictions. Courts consistently apply licensing law paradigms to software and online contracts where the issues involve enforcing restrictions on use of information.

Courts generally enforce contract terms unless a specific term in a particular context conflicts with federal antitrust or related doctrines of patent or copyright misuse. Thus, courts have enforced license restrictions precluding non-commercial use of a digital database, limiting a right to access by barring the making of a copy of software, limiting use of software to a specific computer, limiting use to internal operations of the licensee, restricting redistribution to a particular clusters of software and hardware, precluding modification of a computer game, and various other contract limitations. Article 2B does not *create* contract law here – contracts have long been used to control distributions. Article 2B merely provides a more coherent and workable basis for contract issues.

COMMERCIAL PRACTICE

As in transactions in goods, licensing spans a wide range of commercial practices. Article 2B focuses on many of the most commercially important transactions in modern commerce.[10] For purposes of illustration, it is useful to distinguish various types of licensing.

One element drawing a distinction differentiates between licenses that relate to copies of information physically transferred 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 are used widely in Internet and online transactions.

In transactions in which copies are made available on diskette or otherwise to a licensee subject to licensed conditions, a variety of transactional formats exist. In some, a licensor deals directly with the end user. In others, a chain of distribution intervenes and the copyright owner does not deal directly with the end user. In each case, the basis of the license resides in either the existence of intellectual property rights in the information or, more simply, the fact that the licensor has control over a source of the information that the licensee desires to utilize.

In areas covered by Article 2B, copyright law is a dominant (but not sole) 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 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 in the mass market, copies are sold. In the motion picture industry, licensing is the common approach in reference to theaters who publicly perform the movies, while in the consumer market, copies are either sold or leased (with a license that precludes public performance) for a brief time. Software is typically licensed, although computer game distribution frequently involves sales of copies.

One method of distribution 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 licensing in the publishing and entertainment industries. In the software industry, direct licenses (commonly in standard form agreements) may 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, for specific purposes (e.g., internal use only), subject to confidentiality conditions, transferability limitations, and

[10]As discussed below, the Draft excludes most trademark and patent licensing.

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.

Direct licensing also involves many contractual relationships in which information (software, text, movies) is developed for the licensee. Here, it is common for smaller companies or individuals to be licensors with large 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 analogous to distribution chains employed in the sale of goods marketplace because of the intangible subject matter and the overlay of intellectual property rights which include the exclusive right to **distribute** copies. While it greatly over-simplifies the matter, it is useful to discuss two distinct frameworks.

The first involves use of a master copy and is common in the movie industry and in software contracts. In this framework, a "distributor" receives access to a single master copy of the information work and a license to make and 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. Correl may limit the distributor to 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 are 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 uses actual copies of the software. Here, for example, Quicken may license a distributor to distribute its accounting software in packages provided to the distributor by Quicken. 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 outside the license infringe the copyright.

In both 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 in 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 transfer 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.

NATURE OF A COMMERCIAL STATUTE

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

Informational Content

The convergence of technology and the evolution of the information age entails a fundamental shift in our society and in how people interact, trade and establish commercial relationships. Informational content, which consists of sights, sounds, text, and images that are communicated to people, has become important commercially. That importance does not diminish its political or social role. The technology, however, does change how informational content is distributed and enhances the importance of direct contracts in that distribution.

As contract rules evolve, basic First Amendment and other policies to encourage vibrant discourse must remain central to how law approaches this new era. Even as informational content becomes a significant commercial commodity, we must not forget that informational content and its communication in

a marketplace of ideas remains equally relevant to political and social norms in this country. What 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 informational 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 informational content for the general public or for specialized groups could not exist. How contract law, embodied in Article 2B creates (or precludes) liability risk, allows (or precludes) authors to control distribution of their works, or allows (or denies) the right to contract for licenses of information has a significant impact on the future of information in new, and in older, systems of distribution.

These underlying values argue strongly for an approach to contract law in this field that does not encumber, but supports incentives for distribution of information and its distribution. That theme permeates this draft.

Freedom of Contract

The philosophy in UCC provisions on commercial law builds on two basic assumptions about commercial contract law. The first commercial law theme assumes that a role of contract law is to preserve freedom of contract. This 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."[11]

The idea of contract flexibility is embedded in general contract law theory. The idea that parties are free to choose terms can be justified in a number of ways.[12] 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 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 regulatory rules.

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

Default Rules

The second commercial law premise defines codification as a means to facilitate commercial practice. 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.[13]

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

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[11] UCC 2A-101, Comment.

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

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

contract laws do not regulate practice. They sustain and facilitate it. The benefits of codification lie in defining principles consistent with commercial practice which can be relied on and are readily discernible and understandable to commercial parties.

In our context, the best source of substantive default rules lies not in a theoretical model, but in a reference to commercial and trade practice. This is not simple faith in empirical sources for 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.[14] 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, transactions range from a casual deal between two individuals at a garage sale to transactions between sophisticated businesses employing multiple lawyers and affecting billions of dollars of business. The approach needed is not to draft rules that an individual party would draft tailored to each case, but to select an intermediate or ordinary framework whose contours are appropriate, but whose terms will be altered in the more sophisticated environments. UCC articles design default rules that are acceptable in ordinary transactions where they can be frequently used without disruption or costly negotiation.

Intellectual Property Overlay

Many, but not all of the informational subject matter used in commerce has protection under federal intellectual property law. In most cases, patent and copyright law do not alter state contract law; they coexist with it. Article 2B does not create contract law in this field. For many years, owners of intellectual property have contracted for selective distribution of their property and placed limits on contracted-for use. Licensing law reflects this broad and long-standing contract practice and generally enforces contract options, subject only to specific restrictions in federal property law, to antitrust-related restrictions on some contracts in some settings, and in some limited types of claims or contexts, to over-riding mandatory federal policies.

As stated in the Copyright Act, federal property law precludes state law that creates rights equivalent to property rights created under copyright.[15] But as both a practical and a conceptual matter, copyright (or patent) do not generally preclude or preempt contract law.[16] Indeed, contracts are essential to use one's own property, even when the property is tangible, let alone when it is intangible. A contract defines rights between parties to the agreement, while a property right creates rights against all the world. They are not equivalent.

Important issues exist here. Federal intellectual property law, as well as other federal law and regulation, place some specific, existing, and recognized limits on contract. These include restrictions on transferability, recording requirements in some cases, a statute of frauds concept, and enforceability of property rights against good faith purchasers. A state law developed in context of these **specific** and existing rules *cannot* ignore them. While state commercial law themes might prefer a rule that a secured creditor can create and enforce a creditor's interest in a licensee's rights, federal law precludes any transfer of a licensee's rights in a non-exclusive license without the licensor's consent. A default rule that ignores this preemptive provision creates true traps for the unwary. In this draft, they are avoided insofar as possible, although in several situations, there are provisions that push against explicit federal rules insofar as reasonably possible.

This interaction of state law and specific federal yields default rules that, in some cases, do not correspond to the treatment of analogous issues in other parts of the UCC. This is true, for example, with respect to the transferability of a licensee's interest in a non-exclusive license. Federal law reflected in a series of cases holds that the licensee's interest is **not** transferable without the licensor's consent.[17]

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[14] 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); Randy E. Barnett, The Sound of Silence: Default Rules and Contractual Consent, 78 Va. L. Rev. 821, 822 (1992).

[15] 17 U.S.C. § 301.

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

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

Similarly, in patent and copyright law, no concept of good faith purchaser exists against a claim of infringement; this principle limits the ability of a party taking outside of the terms of a license to claim insulation from infringement and other property claims based on making or retaining unauthorized copies or uses.[18]

These provisions reflect a policy of correspondence of rules in addition to simple recognition that federal law preempts contrary state law. There are other situations where federal law and policy shapes contract law and practice, but the nature of that role is less clear and more controversial. Article 2B adopts a position of neutrality on such issues, leaving them to be determined under federal law.

This occurs primarily in respect to federal policies managing competition under antitrust and similar theories of intellectual property misuse and to the application of federal policy about the availability of publicly distributed information for fair use and public domain applications. Typically, in determining whether or when such policies apply, courts accept that contract law generally prevails, but ask whether a particular contract clause in a particular setting conflicts with federal policies when balanced against the general role of contracts in the economy and legal system. How far the federal policies reach remains in dispute. Not surprisingly, in light of the transformations and economic shifts yielded by digital information technology, defining the proper scope of rights as a matter of federal property law has been controversial; it remains unresolved despite extensive periods of negotiation and political discussion. The disputed issues are questions of federal law and policy. They must be resolved by courts and Congress, rather than through state legislation. Article 2B takes no position on these policy questions, but merely provides a generic contract law framework to augment and bring to modern form the existing complex network of common law, code and general industry practice.

Consumer Rules.

In the political process that surrounds any new law, many public statements have been made about the effect of Article 2B on consumer issues. Most are political positioning. The truth is that Article 2B adopts a policy of retaining current UCC consumer protections, preserving existing non-UCC consumer laws, **and** creating new protections focused on the digital transaction environment. When contrasted to law on information assets, Article 2B expands consumer protection. Nevertheless, as with Article 2, Article 2B is a commercial statute and its primary focus is not on the creation of a consumer protection code.

The following chart indicates the relevant comparison in reference to consumer protection law.

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

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT [19]
GENERAL RULES			
Contract terms enforceable	**Article 2 assumes this is true.**	**Article 2B: same rule**	**NC**
"Consumer" defined	**Article 2** no definition. **Article 9** consumer goods are acquired primarily for personal, household or family use. **Outside the UCC:** definitions vary.	**Article 2B** refers to: licensees that acquire primarily for personal, family or household use. Resolves case law conflict on profit making, investment or professional uses.	**NC**
"Mass market" defined	**Article 2:** Concept does not exist.	**Article 2B** includes transactions earmarked for the general public.	+
Mass Market: Consumer	**Article 2** does not provide for this	**Article 2B:** creates concept; businesses	+

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

[19]This column summarizes the impact of the changes based on existing UCC and common law and an assumption that: increased obligations on the vendor, reduced contract flexibility, and increased notice duties are beneficial to the consumer notwithstanding other effects on the marketplace. (NC no change; + increased protection; - reduced protection) Different assumptions of a broader analsysis would convert many question markets or negatives to a different result.

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT [19]
protections to businesses.		protected, not only small businesses.	
Non-UCC consumer rules; relationship to UCC	**Article 2** when adopted did not "impair" existing consumer statutes. **Outside the UCC:** Digital signature laws repeal signature and similar requirements	**Article 2B** expressly defers to consumer law outside U.C.C., except for selected electronic contract issues	**?**
Unconscionable clause invalid	**Article 2** allows court to invalidate unconscionable clause.	**Article 2B: same rule.**	**NC**
Unconscionable: invalidate inducement?	**Article 2:** does not provide this.	**Article 2B: same rule as Article 2** Adds procedural protections.	**+**
Parol evidence	**Article 2:** no special rule for consumers	**Article 2B: same rule.**	**NC**
Modification: clause that bars oral modification	**Article 2,** in consumer contract, clause enforceable if separately signed.	**Article 2B:** in consumer contract, clause enforced if manifest assent to clause	**?**
TRANSFER, DURATION AND BASIC PRESUMPTIONS			
Transferee right to finance license rights.	**Article 2** no provision. **Article 2A** lessor controls. **Outside UCC:** consent required.	**Article 2B** allows licensee to create security interest in contract rights even if no first sale occurred.	**?**
Fair use: relationship to contract.	**Article 2** no provision. **Outside UCC:** issues debated	**Article 2B** takes no position.	**NC**
Interpretation against licensee	**Article 2** no rule. **Outside UCC:** interpreted against licensee.	**Article 2B** requires commercial interpretation and presumes uses	**+**
Implied right to needed use.	**Article 2** no rule. **Outside UCC:** some cases adopt	**Article 2B** presumes uses necessary are granted.	**+**
Duration of contract: no successive performances	**Article 2** contains no rule for cases not involving successive performances	**Article 2B:** some terms presumed perpetual.	**+**
Duration of contract: successive performances	**Article 2:** "reasonable time" subject to termination at will. (2-309) **Outside the UCC:** similar rule.	**Article 2B: same as Article 2.**	**NC**
Termination: notice required, ordinary contracts	**Article 2** no required notification unless termination for other than an agreed event. Contract dispensing with notice is valid.	**Article 2B: same rule.**	**NC**
Termination: access contracts.	**Article 2** no rule. **Outside the UCC:** terminate without notice	**Article 2B** adopts the common law rule.	**NC**
MASS MARKET AND CONSUMER STANDARD FORMS			
Standard Forms: general enforceability	**Article 2** no rule. **Outside UCC:** cases enforce. Restatement enforces subject to eliminating refusal terms. **Contract of adhesion** analyses enforce, but scrutinize unconscionability.	**Article 2B** allows enforceability of forms only if there was an opportunity to review the form and an affirmative assent to it. Does not alter conscionability standards; form cannot alter negotiated terms.	**+**
Mass Market: require affirmative act to be bound	**Article 2** no rule, but recognizes that conduct can be acceptance. Cases do not require affirmative act.	**Article 2B**: contract not enforceable unless assent by **affirmative** act	+
Mass Market: enforceability of terms not seen until after price is paid	**Article 2** does not deal with this **except** through battle of forms and contract modification rules. Case law varies but many cases enforce post payment terms.	**Article 2B** enforces terms **only** if there is a right to a refund. Gives right to cost-free refund and repair of any system changes even if product is perfect.	**?**
Mass Market: refund if terms are not acceptable	**Article 2** does not deal with this. Cases do not routinely require a refund.	**Article 2B** requires refund. From publisher or retailer.	+
Mass Market: remote publisher contract impact on retailer	**Article 2** does not deal with this. Cases vary	**Article 2B:** retailer is not bound by and does not receive the benefits of the remote party's contract terms (2B-616)	**NC** **Or** **+**
Mass Market: contract with remote copyright owner to vary use terms to permit otherwise infringing act	**Article 2 no rule**. **Outside the UCC:** without contract with the copyright owner, party may not do any infringing act; rights depend on whether there was an authorized first sale and are limited to first sale rights..	**Article 2B** creates method for contract between end user and copyright owner. Contract terms may expand rights on first sale (e.g., multiple users, public display) or reduce rights subject to federal law restrictions.	**?**

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT [19]
LAW AND FORUM CHOICE			
Choice of forum: when is a contract term dealing with the issue enforceable?	**Article 2 no rule.**. **Outside the UCC:** modern cases often presume enforceability.	**Article 2B**: allows subject to not being "unjust and unreasonable." Subject to consumer statutes. (2B-109)	+
Choice of forum: no contractual choice.	**Article 2** does not deal with this.	**Article 2B same rule**.	**NC**
Choice of law: in the absence of a contract term dealing with the issue	**Article 2** does not deal with this. **Article 1** chooses any state with an "appropriate" relationship to transaction. No special rule for consumers. **Outside the UCC: D**ivergent rules.	**Article 2B:** Creates rule for on-line information contracts (licensor location) and delivery of tangible copies involving consumers (delivery place). Otherwise adopts Restatement (2d)	+
Choice of law: contract term enforceable	**Article 2** does not deal with this. **Art. 1** requires choice have a reasonable relationship to transaction; other articles contain different rules. **Outside the UCC:** contract generally governs unless mandatory law bars.	**Article 2B:** Allows contract choice except where it would alter a mandatory consumer rule.	**NC or +**
WARRANTIES			
Warranty: **delivery** does not infringe	**Article 2** warranty that merchant will deliver goods free of infringement	**Article 2B same warranty.**	**NC**
Warranty: quiet enjoyment	**Article 2 no warranty.** **Art. 2A** creates this warranty.	**Article 2B creates.**	+
Implied Warranty: merchantability of product	**Article 2:** given to buyer **Outside the UCC:** does not exist.	**Article 2B: same warranty**	**NC**
>> Merchantability: "pass without objection in trade"	**Article 2** requires this	**Article 2B: same rule.**	**NC**
>> Merchantability: effect on an "ordinary system"	**Article 2** does not require	**Article 2B: same rule.**	**NC**
Implied Warranty: accuracy of informational content	**Article 2:** no provision.	**Article 2B creates** a warranty except for published informational content	+
Implied Warranty: product will be fit for purchaser's purpose	**Article 2** allows warranty if seller had reason to know purpose and that buyer was relying.. **Outside the UCC:** no warranty.	**Article 2B: same warranty** if transaction is to deliver a product. **Creates** a standard to distinguish this from services contracts. (2B-405)	**NC Or +**
Implied Warranty: *services* will give result fit for transferee purpose	**Article 2** no provision. **Outside the UCC:** no warranty.	**Article 2B creates** a warranty that the services will not fail of the purpose because of a lack of effort.	+
Implied Warranty: system components will work in integration	**Article 2** contains no rule **Outside the UCC**: no warranty	**Article 2B creates** warranty that components will perform as a system	+
Express warranty: standard applicable to its creation	**Article 2** includes any affirmations or promises that become part of **basis of bargain**; except puffery. **Outside the UCC** cases do not use basis of the bargain test.	**Article 2B: same rule as Art.2, adds** advertising and retains current law regarding published informational content.	+
Express Warranty: is proof of actual reliance required?	**Article 2:** basis of bargain test intended to exclude requiring <u>specific</u> reliance.	**Article 2B: same rule.**	**NC**
Express warranties: created by advertising	**Article 2** contains no express rule. Case law varies.	**Article 2B codifies** that advertising can create an express warranty	+
DISCLAIMERS			
Title & infringement: is the warranty disclaimable?	**Article 2** allows disclaimer through specific language or circumstances	**Article 2B: same rule.**	**NC**
Express warranties: is the warranty disclaimable?	**Article 2:** most cannot be disclaimed; disclaimer & warranty must be consistent; otherwise disclaimer ineffective	**Article 2B: same rule.**	**NC**
Merchantability warranty: can disclaim the warranty?	**Article 2** allows disclaimer.	**Article 2B: same rule.**	**NC**

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT [19]
>> merchantability: general language for disclaimer:	**Article 2** provides merely that disclaimer must mention merchantability.	**Article 2B: same rule**, but provides more informative language.	**NC**
> >merchantability – how disclaim?	**Article 2** allows disclaimer without a writing: if writing used, disclaimer must be conspicuous.	**Article 2B** requires a "writing" and a plain language; requires conspicuous disclaimer	**+**
>> merchantability: can it be disclaimed by "as is"?	**Article 2** allows disclaimer subject to some limitations.	**Article 2B: same rule.**	**NC**
>> merchantability: is disclaimer potentially unconscionable?	**Article 2** contains no provision for this. Case law varies.	**Article 2B: same rule.**	**NC**
Fitness warranty: can the warranty be disclaimed?	**Article 2** allows disclaimer.	**Article 2B: same rule.**	**NC**
General disclaimer: effect of "as is" language	**Article 2** allows this language for all warranties but the warranty of good title.	**Article 2B: same rule.**	**NC**
THIRD PARTY LIABILITY			
Third party claims: general rule	**Article 2** contains three options, two focus on breach of warranty personal injury. **Outside the UCC:** most cases reject third party claims re information products. Restatement treats information as not a product; negligent misrepresentation only for third parties in intended group.	**Article 2B** does not deal with tort rules and takes a neutral position on products liability. It defines a concept of third party beneficiary consistent with contract law and current Restatement themes involving information liability.	**NC**
>> majority version: does warranty extend to the consumer's household	**Article 2** covers household for personal injury; one alternative allows for all damages. 2-318	**Article 2B: same rule as majority** version, but expands to economic loss.	**+**
>> warranty of title and non-infringement runs to third parties?	**Article 2** generally no; except for personal injury claims.	**Article 2B:** same rule.	**NC**
>> third party damages covered	**Article 2:** in majority version, personal injury only; disclaim in first transaction. Some states: no privity bar in sale of goods. **Common Law:** personal injury claims not allowed re most information.	**Article 2B** extends to third party, intended beneficiaries and allows claims for both personal injury and economic loss; party may disclaim warranty.	**?**
ACCEPTANCE AND REJECTION			
Acceptance of tender	**Article 2:** acceptance of goods can only occur after opportunity to inspect. **Outside the UCC** inspection right not separately developed; applies materiality and conditions theories	**Article 2B same rule** for delivery of copies; for services and informational content, reverts to general standards where inspection would give all value to recipient	**NC**
Acceptance: time to accept or reject	**Article 2** no specific time period; contemplates brief inspection	**Article 2B: same rule.** (2B-612)	**NC**
Right to reject extended to defined or extended period after delivery (e.g., 7 days)	**Article 2** no rejection right after extended period; remedy is revocation but only if defect substantially impairs the goods	**Article 2B: same rule.**	**NC**
Transferee's right to reject: single delivery contract	**Article 2** allows buyer to reject any tender of delivery "perfect tender"	**Article 2B: same rule** for the mass market.	**NC**
Transferee's right to reject: installment contracts	**Article 2** requires that defect cause substantial impairment	**Article 2B** requires material breach	**NC**
Transferee's right to revoke acceptance.	**Article 2** requires substantial impairment of value caused by the defect.	**Article 2B** requires material breach	**NC**
Transferor's right to cure rejected tender	**Article 2** allows cure within original time for performance or seller reasonably expected tender would be acceptable.	**Article 2B** allows cure only if the licensee did not cancel before cure; or within time for performance.	**+**
Transferor's right to reject transferee's performance other than tender of goods	**Article 2** does not deal with this. **Outside UCC:** allows contract to control; material breach is the norm.	**Article 2B** requires material breach.	**NC**

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT [19]
DAMAGES AND REMEDIES			
Damages: transferor may recover lost profits	**Article 2** allows this in reference to a "lost volume" vendor	**Article 2B: same rule.**	**NC**
Damages: transferor has a duty to mitigate	**Article 2** does not specifically require, but common law does.	**Article 2B** requires that the injured party act to mitigate damages.	**NC**
Damages: Consequential damages recovery	**Article 2** allows consequential damages unless contract indicates otherwise	**Article 2B: same rule**	**NC**
Consequential damages include personal injury	**Article 2** allows if proximate causation exists	**Article 2B: same rule**	**NC**
Contractual limitation on economic loss recovery	**Article 2** allows if limitation is not unconscionable	**Article 2B: same rule.**	**NC**
Contractual limitation on personal injury loss recovery	**Article 2** limitation is prima facie unconscionable in consumer cases. **Outside UCC:** No presumption..	**Article 2B no decision**	**?**
Contractual Modification of Remedies	**Article 2** allows this.	**Article 2B: same rule**	**NC**
>> Limiting damages to replace or repair or refund	**Article 2** allows this.	**Article 2B: same rule**	**NC**
>> Effect failure of limited remedy on consequential damages limitation	**Article 2** unclear. Case law splits on whether terms are independent or dependent.	**Article 2B** consequential damage limit fails unless contract expressly provides otherwise	+
>> Minimum adequate remedy required	**Article 2** does not require this.	**Article 2B same rule.**	**NC**
Statute of limitations: basic term	**Article 2** four years from date of breach in most cases; cannot be reduced below one year or extended.	**Article 2B:** four years from breach, extended to five by discovery rule; cannot be reduced to less than one year	+
>> If warranty to future, when does period run?	**Article 2** when breach was or should have been discovered.	**Article 2B:** when breach occurs, but no later than date warranty expires	-
Self Help Repossession	**Article 2:** if seller reserves title, Article 9 applies. **Article 9** allows if no breach of the peace.	**Article 2B** allows only for a license. Limits in terms of breach of peace and risk of harm.	**NC**
Self Help: Electronic	**Article 2** no provisions. **Article 9 and Article 2A** allow disabling in place. **Outside the UCC:** case law allows if notice or agreement, but not otherwise.	**Article 2B** allows, but requires assent to contract term permitting this and places restrictions on when and how it can be implemented that exceed restrictions under Article 9 or 2A.	+

LICENSES

TABLE OF CONTENTS

PART 1

GENERAL PROVISIONS

[A. Short Title and Definitions]

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 defined in section 2B-103. While the scope covers more than licenses, the transaction that provides the base for this article involves licensing of information. The title follows Article 2 which is designated "sales" because that was the primary transaction format used to develop provisions for that Article, but actually scope covers all "transactions" in goods.

SECTION 2B-102. DEFINITIONS.

(a) In this article unless the context otherwise requires:

(1) "Access contract" means a contract for electronic access to, or for electronic information from, an ~~separate electronic~~ information processing system. The term does not include a contract for physical access to a location, such as a theater.

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

(3) "Authenticate" means to sign, ~~or to~~ execute or adopt a symbol or sound, or ~~to~~ encrypt or process a record in whole or ~~in~~ part, with intent by the authenticating ~~party~~ person to:

(A) identify that ~~party~~person;

(B) adopt or accept a record or term that contains the authentication or to which a record containing the authentication refers; or

(C) attest to the integrity of a record or term that contains the authentication or to which a record containing the authentication refers.

(4) "Automated transaction" means a contract formed by electronic means or electronic messages in which the acts or messages of one or both parties will not be reviewed by an individual as an ordinary step in forming the contract.

(5) "Cancellation" means the ending of a contract by a party because of breach by the other party. "Cancel" has a corresponding meaning.

(6) "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. The term does not include informational content.

(7) "Consequential damages" include compensation for losses resulting from a party's general or particular requirements and needs of which the other party at the time of contracting had reason to know, which losses could not reasonably be prevented by the aggrieved party, and from injury to person or property proximately resulting from any breach of warranty. The term does not include direct or incidental damages.

(8) "Conspicuous", with reference to a term or clause, means so written, displayed or presented that a reasonable person against which it is to operate ought to have noticed it. In the case of an electronic record intended to evoke a response by an electronic agent, a term or clause is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react without review of the record by an individual. Conspicuous terms or clauses include but are not limited to the following:

(A) with respect to a person:

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

(ii) language in a record or display in larger or other

contrasting type or color than other language or set off from other language by symbols or other marks that call attention to the language; or

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

(B) with respect to a person or an electronic agent, a term or clause that is so positioned in a record or display that the person or electronic agent cannot proceed without taking some additional action ~~taken~~ with respect to the term or clause.

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

(10) "Consumer transaction" means a transaction in which a consumer is the licensee.

(11) "Contract fee" means the price, fee, rent, or royalty payable under a contract under this article.

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

(13) "Copy" means information that is fixed on a temporary or permanent basis in a medium from which the information can be perceived, reproduced, used, or

communicated, either directly or with the aid of a device. The term includes a phonorecord.

(14) "Court" includes an arbitration or other dispute-resolution forum~~tribunal~~.

(15) "Delivery", as to a contractual performance, means the voluntary physical or electronic transfer of possession or control of a copy.

(16) "Direct damages" ~~means~~ includes compensation for losses consisting of the difference between the value of the performance actually received and the value of required performance, which shall not exceed ~~as measured by~~ the contract or ~~by the~~ market value of the required performance, ~~and the value of the performance actually received,~~ or in an appropriate case, compensation for losses in the nature of reliance or restitution. The term does not include consequential or incidental damages.

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

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

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

(20) "Financier" means a person that provides a financial accommodation to a licensor or licensee under a security agreement or lease and obtains an interest in a license or related contract right of the party to which the financial accommodation is

provided.

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

(22) "Incidental damages~~.~~":

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

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

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

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

(iv) otherwise incident to the breach; and

(B) does not include consequential or direct ~~-~~damages.

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

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

(25) "Informational content" means information that is intended to be communicated to or perceived by an individual in the ordinary use of the information, or the equivalent of such information. The term does not include data used merely to control the interaction of a computer program with other devices or ~~other~~ computer programs.

(26) "Informational property rights" include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks,

publicity rights, or any other law that permits a party, independently of contract, to control or preclude another party's use ~~or disclosure~~ of information on the basis~~s~~ of the owner's interest in the information.

(27) "License" means a contract ~~n agreement~~ that authorizes ~~or permits~~ access to or use of information or of informational property rights if ~~but~~ the contract expressly limits the scope of the rights or permissions granted, expressly prohibits or controls uses, or affirmatively grants less than all informational property ~~or other~~ rights in the information. A contract may be a license ~~,~~ whether the information or informational property rights exist at the time of contract or are to be developed, created, or compiled thereafter ~~pursuant to the contract~~, and whether or not the contract transfers title to a copy. The term includes an access contract and a consignment of copies of information. The term does not include a contract to the extent that the contract is ~~: (A)~~ an unconditional transfer of ownership of all informational property rights; or ~~(B)~~ a reservation or creation of a financier's interest.

(28) "Licensee" means a person authorized to exercise rights or permissions in information or informational property rights in an agreement under this article, whether or not the agreement is a license.

(29) "Licensor" means a transferor in an agreement under this article, whether or not the agreement is a license. ~~The term includes a provider of services.~~ In an access contract, as between a provider of access and a customer, the provider is the licensor, and, as between the provider of access and a provider of the content to be accessed, the provider of content is the licensor. If performance consists of an exchange of information, each party is a licensor with respect to the information or access it provides.

(30) "Mass-market license" means a standard form that is prepared for

and used in a mass-market transaction.

(31) "Mass-market transaction" means a consumer transaction, or any other transaction in information or informational property rights directed to the general public as a whole under substantially the same terms for the same information with an end-user licensee. To constitute a mass-market transaction, if the licensee is not a consumer, the licensee must acquire the information or rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in that marketplace. Except for consumer transactions, the ~~The~~ term does not include:

(A) a contract for redistribution;

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

(C) a transaction in which the information is or becomes customized or otherwise specially prepared by the licensor for the licensee;

(D) a site license; or

(E) an access contract not involving a consumer.

(32) "Merchant" means a person that deals in information or informational property rights of the kind or that otherwise by the person's occupation holds itself out as having knowledge or skill peculiar to the practices or information involved in the transaction, whether or not the person previously engaged in such transactions, or a person to which such knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that by its occupation holds itself out as having such knowledge or skill.

(33) "Nonexclusive license" means a license that does not preclude the licensor from offering the same information, rights or permissions within the same scope to other licensees. The term includes a consignment of copies.

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

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

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

(376) "Receive" means that

(A) a person takes delivery of a copy;

(B) a notice or notification comes to a person's attention; or

(C) a notice or notification is delivered to and available at a location designated by agreement for that purpose or, in the absence of an agreed location:

(i) is delivered at the individual's residence, or the person's place of business through which the contract was made, or at any other place

held out by the person as a place for receipt of such communications, or

(ii) in the case of an electronic notification, comes into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, and the recipient uses, or otherwise has designated and holds out, that system as a place for the receipt of such notices or notifications.

(38~~7~~) "Record" means information inscribed on a tangible medium or stored in an electronic or other medium and retrievable in perceivable form.

(39~~8~~) "Refund", with respect to a rejected record or term, means:

(A) reimbursement of any contract fee paid from the person to whom it was paid or from another person who offers to reimburse the fee, and a right to stop any payment, on proof of purchase and return of the product and all copies to which the record applies within a reasonable time after delivery; or

(B) with respect to multiple products integrated into a bundled whole and transferred for one bundled price:

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

(ii) in all other cases, reimbursement of the fee paid for the rejected record or, if no fee is separately stated, an allocation of the fee attributable to information to which the rejected record applies ~~that~~ which is reasonable with respect to the licensor and the rejecting party in light of the circumstances, on proof of purchase and return of all copies to which the rejected record applies within a reasonable time after delivery.

(40~~39~~) "Release" means an agreement not to object to, or exercise legal or equitable remedies against, the use of information or ~~of~~ informational property rights, which agreement requires no affirmative acts by the party giving the release to enable or support the other party's use. The term includes a waiver of informational property rights.

(41~~0~~) "Scope", with respect to a license, means terms of the license that define:

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

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

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

(D) the duration of the license.

(42~~1~~) "Send" means to deposit in the mail or with a commercially reasonable carrier or otherwise to deliver for, or take all necessary steps that initiate, transmission to or creation within another location or system by any usual means of communication with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed. With respect to an electronic message, the term means to initiate operations that in the ordinary course will cause the record to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, and the recipient uses or by agreement or otherwise has designated or held out that system as a place for the receipt of such communications. Actual receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(43~~2~~) "Software" means a computer program, any informational content

included in the program, and any supporting information provided by a licensor as part of the transaction.

(4~~3~~) "Software contract" means a sale of a copy of software, a license of software, or a transfer of ownership of informational property rights in software, whether the software exists or is to be developed pursuant to the contract. The term includes a contract to develop software as a work for hire.

(5~~4~~) "Standard form" means a record, or a group of linked records, containing ~~contractual~~ terms that were prepared for general and repeated use in transactions and are so used without negotiation of ~~or changes in most of~~ the terms except for negotiation or customization of price, quantity, method of payment, selection among standard ~~performance~~ options, or time or method of delivery ~~does not preclude a record from being a standard form~~.

(6~~5~~) "Termination" means the ending of a contract under a power created by agreement or law for a reason other than its breach. "Terminate" has a corresponding meaning.

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

"Financial asset"	Section 8-102(a)(9)
"Funds transfer"	Section 4A-104 (as applied to credit orders)
"Identification" to the contract	Section 2-501
"Instrument"	Section 3-305
"Item"	Section 4-104
"Letter of credit"	Section 5-102
"Negotiable instrument"	Section 3-104

"Payment order"	Section 4A-103 (as applied to credit orders)
"Investment property"	Section 9-115(f)
"Sale"	Section 2-106

COMMITTEE VOTES:

1. Authenticate:

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

b. Voted to retain the use of "authentication." Vote: 5 – 3 (November, 1997)

2. Consequential damages.

a. Voted to move references to particular types of damages from definition of consequential damages to the comments except for personal injury. Vote: 8-5 (Feb. 1997)

b. In Article 2, NCCUSL Annual Meeting defeated a motion to delete the disproportionate loss test.

c. Consensus to move speculative damage issue to substantive section. (Feb. 1998)

3. Information.

a. Rejected a motion to delete "intellectual property rights" from the definition of "information." Vote: 3-5 (Feb. 1997)

b. Adopted a motion to delete informational property rights from this definition and add that term to the definition of "license." Vote: 12-0 (Feb. 1998)

4. Consequential damages.

a. Deleted reference to mitigation or otherwise without substantive change. Vote: 7 – 4 (Feb. 1998).

5. Conspicuous.

a. NCCUSL sense of the house that the terminology conspicuous should be the same in the three articles and that definition should retain safe harbor language. (Annual Meeting 1997)

b. Sense of the house that conspicuousness should be a decision by court. (Annual Meeting 1997)

c. Committee reviewed without a motion on safe harbor use. (Nov. 1997)

6. Direct damages.

a. Adopted the term "direct" rather than "general" damages. Vote: 8 – 1 (Feb. 1998).

7. Good Faith.

a. NCCUSL voted to expand concept to cover consumer obligations of fair dealing. (July, 1997)

8. Mass Market:

a. Adopted a motion to retain the limitation to retail transactions. Vote: 7 – 4 (Feb. 1998)

b. Rejected a motion to delete "in a quantity consistent". Vote: 4 – 8 (Feb. 1998)

c. Voted to retain the concept of "mass market" licenses, subject to consideration of use in specific sections as contrasted to use of the term "consumer." Vote: 13-0 (September, 1996)

d. Voted that definition of "mass market license" should refer to a market involving the general public and small retail transactions, excluding special business transactions. (December, 1996)

e. Voted 10-2 to retain the mass market concept pending consideration of its application. (Feb. 1997)

f. Voted to delete explicit coverage of all consumer transactions. Vote: 8-4 (Feb. 1997)

g. Voted to use a dollar limitation to cap the risk under definition of mass market. Vote: 10-3. (Feb. 1997)

h. Rejected a motion to delete any reference to "consumer" in the act. Vote: 4 – 8 (Nov. 1997)

i. Deleted one reference to "retail market" but retained another reference. Vote: 7 – 5

j. Agreed to retain current approach and not an adhesion contract definition. Vote: 11 – 0 (Nov. 1997)

k. Rejected a motion to rely solely on a dollar limitation. Vote: 3 – 10 (Nov. 1997)

l. Rejected a motion to delete the reference to "the general public as a whole." Vote: 2- 10. (Nov. 1997)

m. Rejected a motion to delete the language of "as a whole". Vote: 5 – 5. (Nov. 1997)

n. Deleted the dollar cap on the understanding that applications of the concept would be reviewed in light of this change. Vote: 6 – 3. (Nov. 1997)

o. Rejected a motion to delete the concept. Vote: 1 – 8. (Nov. 1997)

9. Merchant.

a. Adopted language that merchant need not previously have engaged in the type of transaction. Vote: 6-4 (Feb. 1998)

10. Record.

a. Rejected a motion to require that it be more than transitory. Vote: 0 – 10 (Feb. 1998).

REPORTER'S NOTES:

1. "Access contract." Access contracts are agreements that authorize electronic access to a facility or that allow obtaining information from a facility controlled by the licensor or another party. The contract does not depend on informational property rights, but on control of an information processing system. A party's right to preclude unauthorized access to a computer is recognized in most states and in federal law. The system may be an Internet web site, a computer containing a database, or any other electronic information processing system. The term also includes contracts for the use of remote data processing, including third party E-mail systems, as well as situations where a database in the licensee's information processing system is automatically updated either by an aspect of the program in the licensee's system automatically accessing the remote system, or the remote system automatically accessing the local database and adding updated material to it.

Access contracts are a major method of information distribution. Digital technology enables a shift from distribution in physical copies to merely making information available at a remote location. The contracts often entail what some describe a "pull technology" whereby a licensee reaches into the information processing system to obtain or use relevant information or processing. An access contract requires electronic access. The term does not cover grants of a right physically to enter, for example, a building in which information is displayed or made available in books.

The definition also does not refer to chips or systems enabling access within a product such as a smart card or programs resident in the same computer. It applies to arrangements that grant permission to access remote data, processing or similar resources.

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

2. "Attribution procedure." The concept of an attribution procedure derives from Article 4A and the use in that article of automated systems described there as a "security procedure." To be an attribution procedure, the procedure must be adopted by the parties or by law for the type of use involved. The effect of an attribution procedure is discussed in Sections 2B-114 to 2B-117. The benefits resulting from use of an attribution procedure only pertain to procedures that are commercially reasonable.

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

The definition is technologically neutral. Statutes in some states give special recognition to "digital signatures" that rely on a specific encryption technology and a certification or licensing system. The procedures set out in those statutes qualify as authentication for Article 2B. The Article 2B concept is broader, however, and recognizes that technology and commercial practice constantly change and provide many different ways of achieving an authentication. This technology neutral approach is endorsed by federal government reports on electronic commerce.

Authentication can be intended to have various effects. Which effect is intended relates to a party's intent as expressed or inferred from the circumstances of use of the authentication. Absent circumstances indicating a different intent, an authentication contemplates all three of the effects listed (see Section 2B-119).

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

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

6. "Computer program" parallels the U.S. Copyright Act (17 U.S.C. § 101), but differs from that definition in that it adds language to implement a distinction between programs as operating instructions on the one hand, and "informational content" as information communicated to people on the other hand. In this article, "computer program" refers to the functional aspects of software, while "informational content" refers to output intended to communicate to a human being. That there is overlap in terms is inevitable. However, in cases where questions arise about what aspect of a software system provides the basic qualitative and other conditions for performance of the program, the answer lies in whether the issue address functional operations and the effect of any malfunction in those operations (program) or errors or inadequacies in communicated content (informational content). In situations where a program is provided in source code form, the fact that the source code can be read by a human does not change the fact that the transaction involves a computer program and applicable merchantability or other warranties pertaining to the functioning of that program apply.

7. "Consequential damages" corresponds to existing Article 2 but provides that consequential damages may be recovered by either party. This follows common law and acknowledges the mutuality of risk characteristic of many transactions in information and informational property rights.

The losses must be an ordinary and predictable result of the breach. See Restatement (Second) of Contracts § 351(2). In the case of economic and similar losses, they must be foreseeable or, in the case of personal injury or property damage, must proximately result from the breach. This means that, in order to recover compensation for losses resulting from the special circumstances of the aggrieved party, the party in breach must have had actual notice of those circumstances at the time of contracting. Often this means that such particular needs and circumstances must be made known at the time of contracting. In contrast, losses resulting from ordinary general requirements can often be presumed to have been within the contemplation of the other party. The determination of foreseeability requires consideration of the contractual circumstances in light of ordinary standards of damage computation.

The burden of proving loss is on the party claiming damages. As in Article 2, this Article does not require proof with absolute certainty or mathematical precision. The premise that there be a liberal administration of the remedies of this Act requires that remedies be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See Section 2B-707 and Restatement (Second) of Contracts 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended. See Freund v. Washington Square Press, Inc., 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) ("[Plaintiff's] expectancy interest in the royalties … was speculative.").

Consequential damages do not include "direct" or "incidental" damages. Consequential loss lies in damages beyond the difference in value of the performance received and the performance promised. It deals with loss of benefits anticipated as a result of the performance or detriments or with costs caused by breach and not incident to the breach itself. Thus, consequential damages include lost profits or opportunity that might result from use of information, damages to reputation, damages in the lost value of a trade secret dues to wrongful disclosure or use, damages for loss of privacy associated with a contract breach, and damages from loss of data as a result of an operational defect.

Recovery of consequential damages, of course, is limited by other principles in this Article, in common law, and by contract limits. This definition does not specifically refer to the concept of mitigation, but that concept applies under Section 2B-707(c). No change in law is intended by the deletion of "cover" from the former Article 2 definition.

8. "Conspicuous." This definition follows existing Article 2, but adds new concepts for electronic commerce. Whether a term is conspicuous is determined by the court. See Section 2B-106.

With reference to persons, the basic standard is that a term is conspicuous if it is so positioned or presented that the attention of a reasonable person can reasonably be expected to be called to it. In modern commerce, however, many transactions are automated using of electronic agents capable of

independent action. These agents require a different idea of what is conspicuous; programs and devices do not "notice" text, but respond operationally. In an automated environment, presentation in a form designed to invoke or permit a response from a "reasonably configured" electronic agent suffices.

Current UCC § 1-201(10) lists four illustrations of conspicuous terms These play an important role in commercial practice. The Article 2B definition carries forward that approach. The purpose of requiring that a term be conspicuous and defining that concept with some detail blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term). The illustrations establish safe harbors that avoid uncertainty and litigation. Absent exceptional circumstances, a term that conforms to a safe harbor is conspicuous. The illustrations in (A) and (B), however, are not exclusive. In other cases, a court should apply the general standard.

Subsection (A) carries forward existing law and adds additional terms relevant to modern commerce. However, Article 2B rejects the rule that all terms in a "telegram" are conspicuous. A "telegram" includes "any mechanical method of transmission, or the like" and could include E-Mail, facsimile, and similar communications. No per se rule is justified.

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

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

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

9. "Consumer." This definition adapts language from Article 9 which defines "consumer goods." A "consumer" is a person who obtains something for personal, household, or family purposes. Whether a party is a consumer is determined at the time of contracting. Even in an on-going relationship, changes in purpose or use after a contract becomes enforceable do not alter the standards applicable to the contract.

In information transactions, many "personal" uses are not consumer uses (e.g., a stock broker using software to personally monitor client investments). Thus, distinguishing business and consumer uses requires a more refined concept than does the Article 9 theme. The definition here distinguishes profit making, professional or business use, from non-business personal or family use. It includes as consumer use ordinary asset management for a family. This resolves an issue that has arisen in many areas where making a distinction between consumer and non-consumer "personal" use has proven difficult and subject to litigation. For example, a number of decisions focus on whether or when a purchase of stocks or limited partnership assets for investment is a consumer purchase since it is for "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) (Article 9 definition "not especially helpful"). Some courts emphasize the difference between acquisition for consumption (consumer) and acquisition or use "for profit-making" (not consumer). The Truth in Lending Act, for example, uses a definition much like Article 9 but contains an express exemption for business transactions. The "profit-making" test has been applied in bankruptcy cases. 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) ("Debt used to produce income is not consumer debt primarily for a personal, family or household purposes.").

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

11. "Contractual use restriction." This term includes any enforceable restriction on use or disclosure of the information or informational property rights dealt with by a contract and created in that contract. It does not include limitations imposed by property or regulatory law, such as copyright or patent law, without contract terms. The adjective "enforceable" is intended to means that the term does not

include terms invalidated under this Article or other law, including federal intellectual property law and state laws which may preclude enforcement of some restrictions on use of knowledge or information. Thus, for example, if applicable trade secret law would preclude enforcement of a particular non-disclosure term, that term is not a contractual use restriction as used in this Article to the extent of such preclusion. Similarly, state law that restricts the enforceability of a non-competition clause in a contract applies to any contract within Article 2B. This definition makes clear that a restriction that would not be enforceable under such law is not a "contractual use restriction."

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

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

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

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

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

The definition also includes reliance and restitution damages in an appropriate case. When damages of this type are appropriate is determined by general law. However, to be direct damages, the recoveries must fall within the general concept of direct as contrasted to consequential or incidental damages.

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

17. "Electronic agent." This includes a computer program used for the stated purposes, but is not limited to that particular technology. The term recognizes that many aspects of commerce are characterized by automated responses. The agency created here, however, is not equivalent to common law agency concepts since the "agent" is not a human actor, but an automated system. To be an electronic agent, the automated system must have been affirmatively selected, used or programmed for that purpose. This is important because a party may be bound by the operations of its agent.

18. "Electronic Message." This term parallels the UNCITRAL Model Law on Electronic Commerce. A message is distinguished from the broader term "record" by the fact that it is to be communicated to another. In many systems, communication to another person does not require that the message be transmitted or sent to any new location; the recipient and the person creating the message may share a common E-mail system or other resource and the message can be "stored" for purposes of communicating to another as indicated in the definition.

19. "Financier." This term includes both secured parties and lessors. This Article does not deal with financing informational property rights. That topic is governed under Article 9 and federal or state law pertaining to those rights. The financing arrangements here involve financing of contractual rights.

20. "Good Faith." The definition extends the duty of good faith and fair dealing to consumers. It follows revised Article 3.

21. "Incidental damages." This definition integrates the two definitions of incidental damages found in current Article 2. Incidental damages include costs of seeking or arranging cover or other mitigation, but do not extend to the actual expenditure for the mitigation itself. Thus, if a licensee must obtain a different computer program because of a breach in the contractual delivery, the telephone calls and related expenses in arranging for the cover are incidental damages. The cost of the new program license is considered in computing direct damages.

22. "Information." This definition establishes a broad construction of information. The term, "work of authorship" comes from the Copyright Act and is to be interpreted as in that statute. It includes literary works, computer programs, motion pictures, compilations, and the like. In this Article, information

is the broad term; in appropriate situations more specific reference is made to particular types of information, such as computer programs and informational content.

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

24. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce.

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

26. "License." A license is a limited or conditional transfer of information or rights in information. The limitations must be express in the contract and not merely implied in law. Most transactions involving acquisition of a copy of a copyrighted work are subject to property rights retained by the copyright owner, but a license exists only if the limitations are express in the contract itself. In an unrestricted sale of a copy, the buyer receives ownership of the copy, but if copyright law applies to the information, the ownership is subject to restrictions on use of the information derived from intellectual property law. These restrictions do not create a license.

On the other hand, the presence or absence of a license is not affected by whether or not there has been a sale of a copy of a work such as a computer program. A license pertains to rights to use information and, if it involves the tangible copy, that tangible copy is the conduit, not the focus. A license deals with control of the information, while title to the goods deals simply with that - title to the goods.

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

28. "Mass-market license" and "Mass-market transaction." "Mass market" implements an expansion of protections for consumers into a consumer marketplace standard even though a particular transaction does not involve a consumer licensee. As a new framework, the definition must be applied in light of its intended function. That function is to identify relatively small dollar value, routine or anonymous transactions that occur in a retail market available to the general public. The term includes all consumer transactions and some transactions involving businesses. It does not apply to ordinary commercial transactions that occur in a marketplace characterized primarily by transactions between business entities that deal directly with each other or through ordinary commercial methods of ordering and transferring commercial information.

The definition contemplates a retail marketplace where information is made available in pre-packaged form under generally similar terms to the general public. It applies only to information that is aimed at the general public as a whole, including consumers, and does not cover products directed at a limited subgroup of the general public or to information products restricted to members of an organization or to persons with a separate relationship to the information provider. Where the line will be drawn in determining the size or scope of subgroup that would qualify as a distribution directed to the general public cannot be answered in the abstract, but courts making that judgment should do so in light of the purpose of the definition itself. The intent is that the products covered here do not include specialty software, information directed to specially targeted limited audiences, purely commercial software distributed in non-retail transactions, or professional use software, but to materials that are acquired by consumers or that appeal and intend to appeal to a general public audience as a whole, including consumers, where the identity of the eventual licensee is irrelevant to the licensor.

The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract the general public as a whole. They are also characterized by the fact that, while the retail merchants may make sales or other transactions to other businesses, the predominant transaction involves consumers. In a retail market, the vast majority of the transactions also involve relatively small quantities of particular products, non-negotiated contractual terms, and transactions to an end user rather than a purchaser who intends to resell the acquired product. The products are available to anyone who enters the retail location and can pay the applicable price.

The definition contains several exclusion that do not apply to consumer licensees, but to transactions in a retail market where the person acquiring the information is a commercial entity. A transaction for redistribution or a license for public display or performance of a copyrighted work are never mass market transactions because they involve none of the attributes of the retail marketplace. Similarly, where the information product is customized for the licensee and that licensee is not a consumer, the transaction lacks the anonymous, non-negotiated character of the mass market.

A bifurcated treatment of access (Internet) transactions occurs. Consumer transactions on Internet are mass market transactions. However, the term does not include online transactions not involving a consumer. In this new transactional environment, it is important to not regulate transactions beyond consumer issues. This gives industry room to develop while preserving consumer protections. It is consistent with the 1997 White House paper on electronic commerce.

29. "Merchant." This term comes from existing Article 2-104. The definition clarifies that a person that holds itself out as experienced in particular subject matter need not have actually engaged in prior transactions of the type involved to qualify as a merchant.

The definition otherwise follows the definition of existing Article 2. As indicated in comments to Article 2, the definition applies differently in terms of the degree of specialized expertise required to qualify for merchant status depending on the transactional issues to which a particular use of the term applies. In Article 2B, the term is used primarily as a reference to businesses with generalized knowledge of business practices, rather than solely to experts in a specific field. Section 2B-307, 2B-401 and 2B-403, however deal with liability and transactional issues where the terms should be understood to require a more focused expertise in the particular type of information involved.

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

31. "Present value." This term corresponds to Article 2A-103. It contains a modification applicable to present valuation of values other than future payment obligations.

32. "Published informational content." This definition identifies an important type of informational content. It is the information most closely associated with First Amendment and related public policy concerns. This is the material of newspapers, books, motions pictures and the like, which is distributed to the public and intended to communicate knowledge, sounds, or other experiences to a human being, rather than simply to operate a machine. The term includes interactive content products since, in those products, all of the information is generally available and the end user selects from the available information. This is like the reader of a newspaper focusing on part, but not all of the newspaper.

32a. "Reason to know." This definition refers to a term that is used in six sections of Article 2B. While Article 1 current defines notice and knowledge, it does not define reason to know. The definition adopted here is consistent with the usage of the term, which refers to knowledge and inferences from information actually known to the person. No constructive knowledge or duty to investigate exists under this concept.

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

34. "Record." This definition broadens the traditional term, "writing", and incorporates electronic records. It does not require permanent storage or anything beyond temporary recordation. The analogy is to the idea of a copy under copyright law. Fixation can be fleeting and perception can be either directly or indirectly with the aid of a machine.

35. "Refund." A refund consists of a reimbursement of fees paid on return of all copies of the information. Whether or when a refund right exists depends on the contract and the provisions of this Article. Refund is not a remedy for breach or a right of rescission. It is a right that arises when a party refuses a proffered license and has previously committed to, or paid, the contract fee. Making a refund available in such cases is essentially to allow the party presented with the license a true opportunity to accept or reject that license.

In some cases, a refund right must exist in order to obtain a manifestation of assent. See Sections 2B-111 and 2B-112. The right to refund expires if the party agrees to the license, including by manifesting assent to it. Of course, if a party accepts a license and the information is defective, the aggrieved party may have a right to restitution of the contract fee as direct damages.

Refund must be sought within a reasonable time. If a party fails to seek refund within a reasonable time, it will not be entitled to refund under this Article, but expiration of a refund right does not result in assent to the license. Affirmative agreement or assent is still required. What constitutes a reasonable time depends on the facts. However, a purchaser cannot wait several years before seeking a

refund.

The definition deals with the difficult problem of administering a refund right in "bundled" products, that is products which include numerous separate items of information transferred as a whole for a single fee. If the products are subject to separate licenses, the difficulty arises in administering a refund right where one license is refused, but others are not. A refund in such situations consists of the entire bundled product in return for the entire price if the refund is sought early. Otherwise, a refund consists of an allocated portion of the overall price as is fairly or contractually attributable to the particular, returned product.

36. "Release." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information.

37. "Scope." This term refers to contract provisions that define an integral part of a license. Scope provisions in a license are equivalent to defining the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read use and other provisions of a contract to determine that. That is not the case for the information and services industries: In many situations in the information industries, the license and its scope is the product. The same information has entirely different characteristics as a commercial subject matter depending on what scope of rights are granted with reference to that information. For example, a license that allows use of a motion picture in a single theatre is not the same product as a license to distribute the motion picture throughout the United States. Neither license transfers the same product as a license to use a copy of the motion picture for three days in one's home. The license scope provisions define the product.

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

39. "Standard form." The definition refers to forms, not standard terms. See Restatement (Second) of Contracts 211 (referring to but not defining standard forms).

A form consists of a group of terms prepared for frequent use as a contract. Use of standard forms in modern commerce is not only widespread, but virtually ubiquitous. The definition does not cover a tailored contract comprised of "terms" selected from many different prior agreements. The record, which is a composite of terms, must itself have been prepared for repeated use. Further, the record must have been so used: if a standard form is offered but then heavily negotiated or changed, the resulting contract is not a standard form contract.

40. "Terminate." This definition conforms to Article 2-106.

[B. General Scope and Terms]

SECTION 2B-103. SCOPE.

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

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

(2) ~~also to~~ agreements to provide support for, maintain, or modify ~~software~~ information related to a ~~software~~ contract covered by ~~that is included in~~ this article.

(b) Except as otherwise provided in subsection (c), this article does not apply~~: (1)~~ to the subject matter or related rights and remedies governed by the another article of the

[Uniform Commercial Code], except to the extent that this article deals with financiersal accommodation contracts.

; or (2) to the extent that an agreement: (A) is a license or software contract that is merely incidental to subject matter not governed by this article;

(B) is a license of a trademark, trade name, trade dress, patent, or related know-how not associated with a license that is otherwise within this article;

(C) is a sale or lease of a product that has a computer program , embedded in it, but this article applies if the product is:

(i) merely a copy of the program;

(ii) a computer ;

(iii) another information processing system and a primary purpose of the transaction is to give access to or use of the program.

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

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

(ii) instrument or other item;

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

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

(v) related identifying, authenticating, access enabling, authorizing, or monitoring information; or

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

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

(1) This article applies to contract issues regarding the information, informational property rights, information, and the copies of media that contains the information, its packaging, and its documentation, but Article 2 or 2A governs as to the other goods in the transaction and to including subject matter excluded under subsection (be)(32).

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

(A) the contract includes services that are not within this article, but the information subject matter that is within this article is the predominant purpose of the transaction[; or

(B) the parties agree to be bound by the contract formation rules of this article.]

(3) [Except in a consumer transaction,] the parties by their agreement may

elect to have this article or other applicable law govern contractual rights and remedies for the entire transaction.

(d) In a transaction excluded from this article by Section 2B-104, the parties may agree to have this article govern contractual rights and remedies for the entire transaction or any part thereof.

Definitional Cross Reference:
"Agreement": Section 1-201."Computer program": Section 2B-102. "Consumer": Section 2B-102. "Contract": Section 2B-102. "Copy": Section 2B-102. "Document of title": Section 1-201. "Information": Section 2B-102. "Information processing system": Section 2B-102. "License": Section 2B-102. "Money": Section 1-201. "Party": Section 1-201. "Person": Section 1-201. "Rights": Section 1-201. "Sale": Section 2B-102. "Software contract": Section 2B-102.

Committee Votes:

a. Rejected a motion to limit scope to "coded", "digital", "electronic" or similar concept. Vote:10 - 3.

b. Adopted a motion to limit scope to licenses of all information and software contracts. Vote: 10 - 0.

c. Rejected a motion to include all patent and trademark licenses in the Article. Vote: 9 - 3.

d. Rejected a motion to include all patent licenses. Vote: 8 - 4 (Feb. 1997)

e. Rejected a motion to delete exclusion of trademark and patent licenses. Vote: 7 - 4. (Feb. 1997)

f. Adopted the financial process exclusion in principle. Vote: 8 - 0 (Nov. 1997)

g. Accepted subsection (c)(3) by consensus. (Feb. 1998)

h. Consensus that financial exclusion not generally cover software provided for that purpose (Feb. 1998)

Reporter's Notes:

1. *General Premise.* This article deals with licenses and software contracts in the copyright and information industries. It does not cover sales of books, newspapers, or magazines, or personal or entertainment services contracts; these are not licenses. The transactions with which the article deals involve value that lies in the intangibles and the rights to use them. However, this is a contract statute. It deals with contractual relationships. This Article does not concern, and does not alter any law creating or limiting intellectual property rights or privileges in information.

The Article does not deal with all licensing transactions in industries, but focuses on a limited, but important subset of transactions. These deal primarily with software and multi-media contracts, access contracts involving on-line and Internet transactions, and transactions involving licenses of data, text, images, and related information.

The scope of this Article is defined by the provisions of this Section and the exclusions stated in Section 2B-103A. Because of the rapidly converging nature of technology and commercial practice in the information area, the scope has been implemented by promulgation of a broad focus in subsection (a), coupled with the specification of a number of exclusions in Section 2B-103A. This parallels the approach taken in Article 9. See Section 9-102; 9-104 (listing 13 exclusions from the that Article).

2. *Basic Scope.* Subsection (a) states the basic scope of Article 2B. That scope is subject to the limitations in Subsection (b) and Section 2B-103A. Subsection (c) deals with mixed transactions and the parties' right to opt in to Article 2B. Subsection (d) confirms an opt-in rule for excluded transactions.

a. *License.* Article 2B applies to licenses. A "license" is a contract for conditional rights, privileges, or permissions to use information, an information processing resource, or an informational property right. A license exists only if the contract expressly conditions the rights or permissions conveyed or expressly grants less than all rights in the information. Section 2B-102. Except for computer software, this Article thus does not deal with unrestricted sales of copies of information even though sales of copies are subject to restrictions under copyright or patent law. However, a license can coexist with a sale of a copy of the information. See Applied Information Management, Inc. v. Icart, 1997 WL 535813 (E.D.N.Y. March 3, 1997).

b. *Software Contracts.* A "software contract" is a (1) license of software, (2) a sale of a copy of software, or (3) a contract to develop software. For computer software, rather than a focus on express contract terms, the more important focus is the nature of software. Except for some software contained or embedded in another product, all software contracts are included.

c. *Incidental Licenses.* Article 2B adopts a gravamen of the action test which recognizes that different bodies of contract law may apply to different aspects of a transaction. This also seems to be the test as between Article 2 and Article 2A. Under Section 2B-104(1), however, notwithstanding that basic principle, this Article does not apply if the information is merely incidental to a services contract or otherwise excluded transaction. See discussion in notes to Section 2B-103A.

3. *UCC Articles.* As a general principle, Article 2B does not apply to the subject matter, rights and remedies, covered in other articles of the UCC. This principle would be implicit, but has been made explicit in Subsection (b) to avoid unnecessary uncertainty. There are two primary exceptions. One deals with the limited treatment in this Article of the relationship of financier interests and contracts to the subject matter of this Article, licenses and software contracts. See, e.g., Section 2B-503. In these contexts, Article 2B provisions control over other articles of the UCC that would otherwise be applicable. Secondly, as stated in Section 2B-103(c)(1), this Article applies to goods that comprise copies of covered information or related documentation.

5. *Transactions Covered / Transactions Excluded.* Because of the convergence of information technologies and diverse range of modern commercial uses of information, implementing the scope of this Article inevitably involves some areas in which the applicability of coverage will be uncertain. This has also been true, of course, with respect to the scope of application of Article 2 where the scope-defining term "transactions in goods" has created extensive litigation and numerous reported decisions.

a. *Computer Programs.* This Article applies to computer software transactions, whether the programs are sold or licensed. This Article covers both software that is provided as a separate and independent product (e.g., word processing software acquired in the mass market or specially developed for a licensee) as well as software provided in a transaction in which the program is part of a multi-faceted product. The vast majority of all software contracts do not occur in the mass market. The Article covers those transactions and also information licensed for inclusion in software (e.g., images or text for digital inclusion).

In mixed transactions, in allocating among the aspects of contract law that might apply, Article 2B adopts two rules. First, as a general principle, other law (e.g., Article 2 and Article 2A) applies to the goods involved in a transaction. See Section 2B-103(b). Article 2B applies to the program and the materials that comprise the copy of the program. Section 2B-103(c). This adopts a gravamen of the action test holding that, in the case of a dispute, a court must determine in reference to which aspect of the mixed deal the issue arise. Thus, Article 2B applies to software provided in a transaction in which the purchaser also leases a computer (Article 2A property).

Second, the scope rules deal with use of computer programs or chips to create more "intelligent products." In this context, Article 2B applies to a program that is part of a computer system or peripheral, but only applies to programs contained in other products if giving the purchaser access to the program's capabilities is a "primary purpose" of the transaction and the program is not merely incidental to the product. Section 2B-103A(1)&(3)(C). Thus, Article 2B does not apply to the computer program that operates the brakes in a motor vehicle and is sold along with the automobile. While the brakes are important to the vehicle, the purchaser acquires a motor vehicle and not the processing power of the program. This is entirely an Article 2 transaction. On the other hand, further up the manufacturing system, the transaction by which a vendor develops and provides the brake software to the manufacturer is an Article 2B transaction. Similarly, while a home air conditioning system has some functions that may be operated by a computer program, the program if any is either merely incidental to the overall system or, as an embedded program, is not included because acquiring it was not a primary purpose of the transaction for the purchaser. The transaction is within Article 2. The upstream development or supply contract for the program, however, is an Article 2B transaction.

b. *Books, Newspapers, Magazine, Videos and Records.* Article 2B does not apply to ordinary transactions in the mass market by which users acquire books, videos, and records. Except with respect to computer software, the coverage of the Article is limited to **licenses**. Licenses are contracts that *expressly restrict or limit* information use, rather than transactions that make an unrestricted distribution of the information, but the distribution is implicitly subject to retained intellectual property rights. The Article does not alter the contract law principles that apply to mass distribution of these traditional works. In addition to being outside the affirmative scope of Section 2B-103(a), traditional videos and records

(CD's and tapes) are excluded by Section 2B-103A(6).

Works similar to these, however, are increasingly made available through Internet and similar on-line systems. While Article 2B does not apply to broadcasts of information, it does cover on-line access contracts such as interactive systems and other systems where the information is made available at a time and place of the licensee's choosing. See Section 2B-102(a)(1). Transactions involving electronic newspapers and texts, access to which is provided in this manner, are included in Article 2B.

Modern technology has enabled the development of interactive products providing information of a type found in a less interactive manner previously in books and magazines. These multimedia products include, for example, a digital encyclopedia or a baseball dictionary that shows text, images and gives access to online updates of performance. These multi-faceted products are software products with the software-created capabilities and information central to the product; they are in Article 2B. Article 2B applies to the transactions that bring information (e.g., text and images) into these products, that provide for their development, and that deal with their distribution.

c. *Patent and Trademark Licenses.* This Article does not apply to most licenses of a patent or a trademark not associated with an access contract or a software contract. See Section 2B-103A(2). Thus, for example, a license of a biotechnology patent and associated know how, or a license of a trademark as part of a franchise agreement for a popular food store are not Article 2B transactions. In the case of the patent, the basic judgment is that the areas of general patent licensing do not involve the same commercial law concerns that are central to transactions covered in Article 2B. In fact, many pure patent licenses are primarily intended to settle or avoid litigation. In reference to trademarks, licenses often fall under state and federal franchise laws and are covered by principles unrelated to the commercial issues treated here.

Access and software contracts, however, also involve licenses of a trademark or a patent. These are included in Article 2B. Thus, a license of Windows 98 will include not only a copyright license, but also a right to practice the various technologies covered by a patent held by the software provider. The entire license is covered under Article 2B.

d. *Access Contracts and Broadcasts.* Article 2B applies to access contracts. This term includes Internet and on-line services. Thus, for example, a contract with an information provider such as Westlaw is within this Article, as are the various specific access events that occur pursuant to the contract. Also included are cases where information is available for a fee at a Website and obtained by contractual access to the information electronically. Of course, however, since this is a contract statute, it does not cover situations where information is simply made available and no contract is involved, even when this occurs on Internet.

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

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

While the access contracts are covered, the subject matter of the contract may not be within Article 2B. For example, if through an access contract a customer purchases a new television set, the access contract is within Article 2B, but the characteristics of the purchase are an Article 2 transaction. See Section 2B-103(b). Similarly, while an access contract is in Article 2B, use to order a transfer of cash deposit to pay a utility bill involves subject matter excluded from the Article. The access conduit is in Article 2B; the excluded transaction is not.

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

6. *Opt-In Rules.* Subsection (c)(3) allows the parties in a mixed transactions to elect full coverage under either Article 2B or other applicable law. This states a rule that would most likely be applicable in any event under general contract law principles. Similarly, subsection (d) provides for a comprehensive right of opt in related to transactions excluded by other provisions of this article.

SECTION 2B-103A. TRANSACTIONS EXCLUDED FROM ARTICLE. This article does not apply to the extent that an agreement:

(1) is a license or software contract that is merely incidental to subject matter not governed by this article;

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

(3) is a sale or lease of a copy of a computer program that is contained in goods that are sold or leased unless:

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

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

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

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

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

(B) an instrument or other item;

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

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

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

monitoring information;

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

(6) is a license of a linear motion picture or sound recording or of information to be included therein, except in connection with an access contract covered by this article; or

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

(8) is a compulsory license under federal or state law.

Notes to this Draft: This Section was created from material formerly in Section 2B-103(b). It was moved to a separate section for clarity and in conformance with the style followed in Article 9. The sections have been edited to fit this format. Subsections (6)(7) and (8) are new and implement the Committee's vote at the March, 1998 meeting. Subsection (3) has been revised to reflect extensive debate.

Notes to this Section.

1. *General Approach*. This Section brings together various exclusions from the scope of Article 2B. The rationale and scope of the exclusions differ. They reflect, however, a judgment that the various policy and structural decisions made in developing Article 2B may not be appropriate in the listed situations. As with existing Article 9, the fundamental scope of coverage of conditional transactions in information as a commercial activity extends to many relationships in the modern economy. Since article 2B allows most provisions to be altered by agreement, this extension has little effects in the many situations where customs of trade, course of dealing, or formal contracts define the relationship. In those contexts, Article 2B provisions defer to the agreements. Nonetheless, specific exclusions have been considered important in some cases to clarify that other law governs, including regulatory laws where applicable.

2. *Incidental Licenses.* Article 2B uses a gravamen of the action test which recognizes that different bodies of contract law may apply to different aspects of a transaction. Under this subsection, however, notwithstanding that basic principle, this Article does not apply if the information is merely minor part of or merely incidental to a services contract or otherwise excluded transaction.

The exclusion covers situations where the information transfer is merely inherent incident of the excluded services. Thus, a services contract to provide legal advice to a client may result in the delivery of a memorandum or other document containing information whose use may be restricted by contract. The information aspect of the transaction does not fall within this Article; the services are not within the scope of the Article and the information is a mere incident of that services relationship. Of course, as various personal service provides engage in related, but broader activities, Article 2B applies. Similarly, where the services are those of an independent contractor hired to develop software, Article 2B governs the transaction since it directly applies to software contract even though the software is to be created as part of the contractual relationship.

The exclusion also covers information that is only a very minor part of a transaction. What is meant here is not simply that personal services or goods predominate, but that the licensed information is so small a part of the transaction that it would be cumbersome, confusing and awkward to apply Article 2B to that small part of the transaction.

3. *Patent and Trademark Licenses.* Subsection (2) excludes patent and trademark licenses

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

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

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

The term "computer" is not defined in this Article, but has been defined in many other situations as referring to a machine or system that has the capability of performing arithmatic, logical or processing functions on data. Clearly, the scope of the term and its application will change as modern products become increasingly "intelligent – reliant of information processing and manipulation capabilities. As this occurs, the issue will center on establishing the relative distribution of coverage between this Article and Article 2 or 2A. In discussing this, however, it is important to recognize that, in the mass market, where the issues will be most significant, Article 2B contract principles are generally consistent with existing Article 2 and Article 2A. In many instances, the choice of applicable law does not alter the substantive standards.

Sub-part (C) sets out the general standard that a court should gauge scope of coverage of Article 2B as to computer programs within the inevitable gray areas by applying Article 2B to the embedded software if contained in a product whose primary purpose is to provide access to the functional or other attributes of the program, as contrasted to performing other activities. Thus, while a television set in modern practice is increasingly driven by computer programs, it remains a television set whose purpose is to provide television program reception unless or until the system evolves into something more or different in which a primary purpose is to offer software processing capability.

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

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

However, modern banks engage in many activities identical to licensing practice and online systems clearly within Article 2B, such as Netscape, Westlaw, Home Shopping, Microsoft Network, America On-Line, and others. As the information industries converge, so too is the banking industry converging into fields identical to that of the information industries. Bank ***entry*** into these fields is regulated, but this is scope regulation, not content regulation. These activities are covered by Article 2B.

The exclusion applies to the extent that the agreement gives access to performs the listed activities. Software provided by entities covered by entities involved in activities within the exclusion is not in itself an excluded transaction. When used to access the listed assets or conduct the listed transactions, however, liability and other issues are governed entirely by law applicable to that other subject matter.

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

The exclusion does not cover situations where automation creates a digital replacement

for activities previously characterized as personal services. Also, it does not remove from this Article the various forms of software development contracts, many of which today are characterized by an individual (or group) contracting to design and develop software for a client. Inclusion of these contracts in Article 2B reflects one of the primary early reasons for the Article itself since, in the absence of that inclusion, courts are wildly split in terms of whether such contracts fall within Article 2 (sales) or common law (services). Article 2B resolves that issue by bringing the contracts into a coherent framework that does not hinge on this often arbitrary classification issue.

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

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

(a) Subject to subsection (b), in the case of a conflict between this article and a statute or regulation of this State as judicially construed and in effect on the effective date of this article, the conflicting statute or regulation controls if it:

(1) establishes a right of access to or use of information or informational property rights by compulsory licensing or public access or ~~a~~ similar law;

~~(2) regulates the purchase or license of rights in motion pictures by exhibitors;~~ or

(2~~3~~) establishes a consumer protection.

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

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

(2) A requirement that a record or a ~~contractual~~ 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 ~~contractual~~ term is satisfied by an action that manifests assent to a term in accordance with this article.

(c) A statute authorizing electronic or digital signatures in effect on the effective date of this article is not affected by this article~~, but in the case of a conflict this article controls~~.

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

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

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

Definitional Cross Reference:

"Agreement": "Conspicuous": Section 2B-102. "Consumer": Section 2B-102. "Court": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Notice": Section 1-201. "Purchase": Section 1-201. "Record": Section 2B-102. "Rights": Section 1-201. "Signed": Section 1-201. "Term": Section 1-201. "Writing": Section 1-201.

Committee Votes:

a. Voted 11-1 to approve the section. (September, 1996)

b. Reviewed without substantive change. (February, 1997); (Nov. 1997); (Feb. 1998).

Reporter's Notes:

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

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

There are many other laws that are not altered or over-ridden by Article 2B, of course, because Article 2B does not deal with the same topic. For these, the differences in subject matter and focus are sufficiently clear that it was not necessary to list the particular law. Thus, Article 2B does not deal with property rights or privacy law. It deals with contract law. State law concerning trade secrecy are outside the scope and unaffected by this Article except as they interact with contracts. While these rights may be licensed by a contract within this article, Article 2B applies to the license but not the underlying right. For example, a state law might provide that an individual controls use of data concerning that person, but can contract away that right. The creation of the right and its scope, including the extent it can be waived are not considered in Article 2B.

2. *Mandated Disclosure Laws.* Conflicting statutes or regulations that compel disclosure or other access to information prevail over any Article 2B rule in the event of conflict. In some situations, the relationships that develop because of the mandated disclosure may have contractual overtones, but equally often, they arise by operation of law. A relationship that arises by operation of law does not fall within this Article. Furthermore, the relevant terms and conditions of the statutorily mandated relationship override this Article and its default rules even if the relationship also involves a license.

3. *Relationship to Consumer Law.* Article 2B does not generally alter state consumer protection statutes as enacted and judicially interpreted as of the effective date of enactment of Article 2B.

This deference to consumer protection law acknowledges the role of state consumer protection statutes as a complement to the UCC. Consistent with the stated purpose of the UCC, Article 2B deals with general contract law and commercial contract law principles. It does not promulgate a body of consumer protection laws, although it does contain consumer protections. Historically, consumer protection issues have been resolved on a state-by-state basis with often radically different outcomes. While the results differ, consumer protection statutes reflect extensive policy review about the appropriate relationship between protection and contract freedom in each state. Article 2B, as a general, commercial contract statute, does not address or override these judgments.

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

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

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

Acts that cause loss through the creation or distribution of a computer virus might also give rise to liability in tort. Article 2B does not deal with this issue. The cause of action may involve damage to property or trespass, or it may be grounded in general concepts of negligence and reasonable care. While few civil actions have been brought, the liability of a wrongdoer for actions that harm a third party involve issues other than under contract law.

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

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

There are hundreds of potentially relevant statutes that may affect electronic commerce. For transactions governed by Article 2B, the rules of this Article ordinarily supplant the other law as to contractual issues in full and the express preemption stated in this section is not necessary. That is not true for consumer transactions. In the consumer area, the four stated themes implement a limited effort that balances the modernization theme and the desire not to alter existing patterns of protection. The Article 2B rule is very limited. It implements a balance between the modernization themes in Article 2B relating to electronic commerce and existing law on consumer contracts. The limited approach, adopted here,

contrasts to non-uniform digital signature statutes enacted in several states which replace or amend all signature and writing requirements, including consumer law mandates.

The historical policy debates that led in the past to requiring a "writing" were conducted without considering digital alternatives. 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 national and international in nature, while preserving the intent of the regulations. There is no change in the substantive content of statutes or regulations, such as whether a disclaimer can ever be made, what language must be used, and like issues.

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

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

SECTION 2B-105. RELATIONSHIP TO FEDERAL LAW. A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption.

Source: None

Votes and Action:

a. At the 1997 ALI Annual Meeting, the general membership after a brief debate and by a narrow vote, approved a motion that the section on mass market licenses be amended to provide that a term inconsistent with federal copyright law does not become part of a contract under Section 2B-308.

b. At the 1997 NCCUSL Annual Meeting, the Conference adopted by a substantial majority a motion that Article 2B should not deal with federal preemption but should be neutral.

c. Rejected a motion to delete the section and remove it to comments. 9 –3 (September, 1997)

d. Rejected a motion to provide that the Article does not change state common law or competition law rules because Article 2B simply does not deal with these issues. Vote: 2 – 8 (Feb. 1998)

Reporter's Note:

1. *General Principle.* Article 2B deals with contract law, not federal intellectual property law, competition law, or regulation. The relationship between federal law and state contract law is complex. Ultimately, however, if federal law invalidates a particular contract law rule or its application in a given contract, federal law controls. If federal law precludes a particular contract provision (or its enforcement) in a particular setting, that federal law rule controls. Nothing in Article 2B alters the balance between federal mandates and contract principles.

The basic principle is that federal law controls if it applies and preempts state contract law. When or whether this occurs is not an issue of state law. State law, including the UCC, cannot alter the federal policy result and the balance it may entail and does not intend to do so. Thus, a federal rule that a specific form for disclosure creates an enforceable term cannot be altered by state law. Similarly, a limit on contract liability mandated by federal law cannot be abridged by state contract law expanding that liability. A requirement in federal law that there be a signed writing to transfer a copyright cannot be altered by abolishing a state statute of frauds. A rule that precludes transfer of a licensee's rights under a non-exclusive license without the licensor's consent as a matter of federal law precludes a contrary state law rule.

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

law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

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

2. *Sources of Preemption.* There are many potential sources of preemption. Some preemption questions stem from the fact that many of the property rights that underlie some of the transactions in this area come from federal property rights sources, rather than simply from state property rights law. In copyright, for example, Section 301 of the Copyright Act expressly preempts any state law that creates rights equivalent to copyright. As a matter of fact, this principle is seldom applied to contract terms since a contract deals with the relationship between two parties to an agreement, while property rights contained in the Copyright Act deal with questions of property interests good against persons with whom the property owner has not dealt. In addition to the statutory provision, in some cases, a preemption claim may arise under general constitutional law concepts of the Supremacy Clause or other aspects of the federal constitution. Of course, however, it is important to recognize that Article 2B is not simply an intellectual property rights licensing statute. Many Article 2B transactions do not involve the distribution of intellectual property rights.

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

The basic theme of preemption is supplemented in licensing law by the fact that federal competition, antitrust, and intellectual property rules also serve to monitor and exclude some contract terms or practices in licensing (i.e., use of particular terms in particular settings can be viewed as abusive). These policies involve questions of federal law and policy that go beyond state law. Article 2B takes no position on the competition, social policy and other issues present here. Indeed, state contract law cannot alter those policy determinations. Article 2B sets out contract principles governing the contractual relationship in information transactions. It governs the contract relationship; federal law and policy determines whether a particular contract in a particular setting is barred by federal law.

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

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

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

Thus, for example, copyright case law holds that, in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). The scope of fair use here is not clear and it is also unclear to what extent a contract term alters the analysis. Other doctrines may also apply. For example, the Fifth Circuit has suggested that a reverse engineering clause that in effect attempts to monopolize a different product market constitutes copyright misuse in that particular context. DSC Communications Corp. v. DGI Technologies, Inc., 81 F.3d 597 (5th Cir. 1996). Article 2B does not change the federal policy analysis which applies on a case-by-case basis.

Similarly, there is federal case law (and statutory provisions) which establishes a federal

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

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

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

SECTION 2B-106. EFFECT OF AGREEMENT; RULES OF CONSTRUCTION; ISSUES DECIDED BY COURT~~AS A MATTER OF LAW~~.

(a) Except as otherwise expressly provided in this article or in Article 1, the effect of any provision of this article, including allocation of risk or imposition of a burden, may be varied by agreement of the parties. However, except to the extent stated in the following sections, the agreement may not vary:

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

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

(3) the right to relief from an unconscionable contract or clause in Section 2B-110;

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

(5) the right~~s~~ to correct electronic errors in Section 2B-118;

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

(7) the rights under ~~in~~ Section 2B-208;

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

(9) the limitations on contractual transfer restrictions Section 2B-5023~~3~~(b) and 2B-5034~~4~~;

(10) the limitations on dispensing with ~~excluding~~ notice in Section 2B-626;

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

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

(13) the limitations on self-help repossession in Section 2B-716.

(b) In applying this article, the following rules apply:

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

(2) The fact that a provision of this article states a precondition for a result does not of itself imply that the absence of that precondition yields the opposite result.

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

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

Uniform Law Source: None.
Definitional Cross Reference:
"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Court".

Section 2B-102. "Notice". Section 1-201. "Reason to know": Section 2B-102. "Rights". Section 1-201. "Term". Section 1-201.

Committee Actions:

a. Reviewed without substantive change at three meeting.

b. Rejected a motion to delete subsection (b)(2). Vote: 2 – 7 (Feb. 1998)

Reporter's Notes:

1. *Basic Principle.* Article 2B adopts the basic commercial law principle of contractual freedom. Contract choices control unless there are direct, tangible and over-riding policy considerations that mandate direct restraints on contract choice. The parties are free, by agreement, to alter the effect of any provision of this Article except for the few mandatory rules provided in Article 1 or referenced in this section, subject, of course, to the basic contract law restraint that contracts and their terms must not be unconscionable.

The parties' ability to exercise their right to alter the effect of provisions of this Article by agreement does not require a formal, written contract and express terms to achieve that result. That may occur as the result of course of dealing, trade use or other circumstances; the idea of "agreement" encompasses the entire bargain of the parties in fact.

2. *Drafting Style.* The dominance of agreed terms over statutory rules characterizes all U.C.C. transactional articles. It is especially important to state the principle here because of the drafting style used in this Article. Article 2B was drafted without use of the phrase "unless otherwise agreed" and frequently use mandatory language, such as "shall" or "must." These do not change the basic principle that the contract controls. Subsection (a) makes that clear. The style preference does not alter the basic policy. All Article 2B provisions can be altered by agreement unless otherwise indicated. This section expressly rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware*, 910 F. Supp. 1009 (D. Del. 1995) (terms of Article 9 provision superseded the contract choice principle in UCC § 1-102).

Subsection (a) provides a cross reference to the limited number of contexts in Article 2B where a contract cannot alter mandatory rules. In addition, of course, term are some similar limitations in Article 1 and in some state regulations of contracting practice.

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

4. *Issues as a Matter of Law.* Subsection (c) provides that whether a term is conspicuous is a matter of law and applies that principle to related issues under 2B-208. This follows current law.

SECTION 2B-107. CHOICE OF LAW.

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

(b) Except as otherwise provided by an enforceable choice-of-law term, the following rules apply:

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

(2) A consumer transaction that requires delivery of a copy on a physical medium to the consumer is governed by the law of the jurisdiction in which the copy is delivered or, in the event of nondelivery, the jurisdiction in which delivery was to have occurred.

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

(c) If the jurisdiction whose law governs under subsection (b) is outside the United States, the laws of that jurisdiction govern only if they provide substantially similar protections and rights to a party not located in that jurisdiction as are provided under this article. Otherwise, the law of the jurisdiction in the United States which has the most significant relationship to the transaction governs.

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

Uniform Law Source: Restatement (Second) of Conflicts 188; U.C.C. §§ 1-105; 9-103.
Definitional Cross Reference:
"Access contract". Section 2B-102. "Agreement". Section 1-201. "Consumer". Section 2B-102. "Contract". Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Electronic". Section 2B-102. "Licensor". Section 2B-201. "Party". Section 1-201. "Rights". Section 1-201. "Term". Section 1-201.
Committee Votes and Actions:
a. Voted 9-1 to use consumer, rather than mass market.
b. Voted 8-5 to validate contract choice of law. (Feb. 1997)
c. Voted 11-0 to adopt significant relationship test as back-up rule. (Feb. 1997)
d. Voted 10-0 to make contract ineffective to alter mandatory consumer protections (Nov. 1997)
e. Reviewed without substantive change. (Feb. 1998)
Reporter's Notes:
1. *Contractual Choice of Law: General Rule.* This section addresses two questions. The first concerns the enforceability of contract terms choosing the applicable law. Choice of law clauses are routine in commercial licenses and are important in how parties structure commercial deals. The information economy accentuates that importance through expanded communications capabilities and, with

respect to transactions in information, the fact that remote parties frequently engage in contract formation and performance through remote systems spanning two or more jurisdictions and not dependent on the physical location of either party or of the information itself.

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

Common law generally enforces contractual choice of law in transactions in information. See Finch v. Hughes Aircraft Co., 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985); Medtronic Inc. v. Janss, 729 F.2d 1395 (11th Cir. 1984); Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products, 229 U.S.P.Q. 335 (D. Md. 1985); Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co., 986 F.2d 607 (1st Cir. 1993). The major exception is if the choice contradicts a fundamental, mandatory policy of the state that would otherwise have its law apply; the reported cases applying this theory are typically consumer protection cases.

The Restatement allows contract terms to govern in any case where the issue could be resolved by contract. In addition, **even** if contract rules might not otherwise govern, under the Restatement, the contract choice is presumed to be valid, subject to limited exceptions. Restatement (Second) of Conflict of Laws 187 (may be invalid if not resolvable by contract and either there was no "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.").

2. *Contract Choice: Consumer Contracts.* In an information economy, there are strong reasons to allow contract choice; those reasons include the reasons that led to the Restatement position years ago, but go further because of the increasing nationalization and internationalization of commerce. Despite strong reasons for enforcing all contract choices, Article 2B takes the position that the contract cannot override mandatory consumer protections that otherwise apply. A mandatory rule is a rule that, under applicable law, cannot be altered by agreement. Such rules exist in most states, but their content varies widely. The reference to consumer protections includes under both the UCC and non-UCC law (see 2B-104(a)(3)). Within Article 2B, it includes mandatory consumer protection rules whether phrased in terms of consumer or "mass-market" rules.

3. *Contract Choice: Rejected Limitations.* Article 2B rejects current Section 1-105 which allows choice of law only if the chosen state has a "reasonable relationship" to the transaction. This rule is more restrictive than the Restatement and the law of most states outside Section 1-105. It reflects law that existed when the UCC was adopted five decades ago, but that has little merit in modern electronic transactions and does not fit with modern scholarship about choice of law as reflected in the Restatement (Second) and elsewhere.

It also rejects Article 2A-106 which, for *consumer* leases, restricts the contract choice to the jurisdiction in which the lessee resides on or within thirty days after the contract becomes enforceable. That rule is inappropriate for the intangible property and would create a situation in which an on-line provider would be subject to the law in all fifty states even though the states themselves have not designated their particular rules as mandatory. That would be true even though no discernible consumer protection interest justifies the contractual choice limitation. The residence rule does not exist under Article 2, Article 1 or 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 the consumer. In cyberspace environments, it frustrates goals of providing uniformity and being able to control the number of divergent laws with which a contract must comply.

4. *Default rule: no contract provision.* The second issue in this Section involves choice of law in the absence of contract terms and is covered in subsection (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain if they so choose and a basis for planning transactions with a reasonable understanding of the applicable risk. Under current 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 support commercial development and creates substantial uncertainty. While Article 2B adopts the modern Restatement (Second) of Conflicts as a general rule, it provides two specific, commercially useful and discernable rules that supersede the general background concept.

5. *Default rule: Internet Transactions.* The most important rule is in subsection (b)(1). It deals with electronic transactional environments and creates a presumptive choice of law based on the location of the licensor. Where an on-line vendor automatically provides direct marketing to the world through Internet, any other formulation would require the vendor to comply with the law of fifty states and 170 countries since it will often not be clear where the information is being sent. Some states or countries mandate such compliance through local laws, such as for example, recent amendments to California warranty law applicable to the sale of goods. Opting for a more stable and identifiable choice of law is an important in facilitating electronic commerce in digital products.

In this section, the licensor's location refers to its chief executive office (as in Article 9), rather than the location of the computer that contains or provides the information. Unlike other choices (such as the licensee's location, the location of the data), this choice provides a single, routinely identifiable background for commerce. 6. *Default Rule: Consumer Deliverables.* Subsection (b)(2) creates a consumer rule for cases of physical delivery of tangible copies (not involving online contracts). The rule focuses on the location where the copy is received. In most, but not all cases, this will be the state in which the consumer resides. That location would typically be chosen under any choice of law regime, but this section makes the choice clear. Thus, for example, a consumer acquiring software in Chicago will be subject to the law of Illinois in the absence of contract terms. That rule is consistent with concerns about the "place of performance" and similar considerations under current law. It is also followed in many European consumer protection rules relating to contract choice of law involving sales of goods and services. This rule deals with situations in which the licensor will know where delivery will occur because it delivers a physical copy and is not engaged in an electronic communication. This allows electronic transactions to be governed by a choice of law rule that enables commercial decision-making based on an identifiable body of law and does not impose costs on the transaction by requiring that the electronic vendor determine what physical location corresponds to an electronic location.

The Section, of course, only deals with contract issues. It does not affect tax or similar concerns. In Quill Corp. v. North Dakota, 504 U.S. 298 (1992) the Supreme Court held that no adequate nexus for tax purposes was established where the only contact of an entity with a state was advertising and delivery through common carrier. This Article, of course, deals only with contract issues.

7. *Default Rule: Restatement Concept.* The residual rule adopts the Restatement (Second) test and case interpreting it. The Restatement (Second) of Conflicts uses a "most significant relationship" standard to be judged by considering a variety of factors that include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. (f) the needs of the interstate and international systems, (g) the relevant policies of the forum, (h) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (i) the protection of justified expectations, (j) the basic policies underlying the particular field of law, (k) certainty, predictability and uniformity of result, and (l) ease in the determination and application of the law to be applied. Restatement (Second) §§ 6, 188.

This rule is not uniformly accepted in current practice. Many states use principles from the Restatement (First) or theories evolved by academic authors. Indeed, one text states: "[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 disarray argues for giving guidance for contracts in cyberspace.

8. *Default Rule: Foreign Jurisdictions.* Subsection (c) provides a 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-108. CONTRACTUAL CHOICE OF FORUM.

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

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

Definitional Cross Reference:
"Agreement": Section 1-202. "Term": Section 1-202.

Committee Votes:

a. Rejected a motion to delete the section. Vote 4 - 9 (February, 1997).
b. Voted to adopt the term consumer and not "mass market" Vote: 8-5 (February, 1997)
c. Consensus that Draft should deal separately with arbitration clauses if at all. (February, 1997)
d. Rejected a motion to delete the section Vote: 10 -2 (Nov. 1997)
e. Applied the limitation on enforcement to all contracts. Vote: 7 - 3 (Nov. 1997)
f. Rejected motion to preclude choice if small claims jurisdiction applies. Vote: 2-7 (Feb. 1998)

Reporter's Notes:

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

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

2. *Fairness Limitation.* Concerns about fairness and notice may limit enforcement of the clause. This Section adopts the approach to such questions established in the Breman decision and followed in most modern decisions. Breman indicated that the contract term could be rejected if it was "unreasonable and unjust." See Perkins v. CCH Computax, Inc., 106 N.C. App. 210, 415 S.E.2d 755 (1992); Lauro Lines v. Chasser, 490 U.S. 495 (1989); Sterling Forest Assocs., Ltd. v. Barnett-Range Corp., 840 F.2d 249 (4th Cir. 1988). While some later courts phrase this in the disjunctive, the difference in terminology does not alter the general support for such clauses unless the primary or sole purpose is to obtain a grossly unfair advantage or to deny the other party its day in court without reason for the choice itself.

This section adopts the limiting language that has become the dominant theme in the case law. "Unjust and unreasonable" has become the dominant standard as many courts suggest that choice of forum clauses are presumptively enforceable. The intent in this section is to conform to Supreme Court and other holdings in reference to what type of limits on choice of forum are appropriate.

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

3. *Internet and Cyberspace.* The importance of choice of forum provisions is recognized in general commerce, but is heightened in transactions in cyberspace as reflected by a line of contentious and inconsistent personal jurisdiction ruling. The cases on personal jurisdiction in this environment are split between those requiring active involvement in a state in order to find jurisdiction from Internet activity and those that hold a passive Internet use sufficient to confirm jurisdiction on all states to which Internet reaches. In this context, the importance of being able to delineate by contract the scope of exposure is commercially crucial. This was emphasized in a 1997 White House Report on Global Electronic Commerce.

In Internet transactions, choice of forum rules are ordinarily enforceable. The Supreme Court enforced a choice of forum in a standard form contract even though the choice effectively denied a 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 Court's comments have 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….

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

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

(a) Whether a party is in breach of contract is determined by the contract. Breach of contract includes a party's failure to perform an obligation in a timely manner, repudiation of a contract, or exceeding a contractual use restriction. A breach of contract, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach of contract is a material breach if the contact so provides or the breach is a failure to perform an agreed term that is an essential element of the agreement. Otherwise, the following rules apply:

(1) A breach is material if the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the trade or industry, or the character of the breach, indicate that:

(A) the breach caused or reasonably may cause substantial harm to the aggrieved party, such as costs or losses that significantly exceed the contract value; or

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

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

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

Definitional Cross Reference:
"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 2B-102.
"Information": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Committee Votes:

a. Approved a motion to delete a list of acts that are material. Vote: 11 - 0 (Feb. 1997)

b. Rejected a motion to delete the definition of material other than by contract and to point to common law rules. Vote: 5 – 6 (Feb. 1998).

c. Approved reference to terms that are an essential element of agreement. Vote: 6-5 (Feb. 1998)

Reporter's Notes:

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

2. *Breach Related to What Remedies Apply.* For purposes of remedies, Article 2B distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 and Article 2A except for acceptance or rejection of a single delivery of a product. The concept also corresponds to common law and the Restatement (Second) of Contracts. A similar standard exists in international law. See Convention on the International Sale of Goods (CISG) Art. 25 ("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."); UNIDROIT Principles of International Commercial Law art. 7.3.1 ("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.").

If one party fails to conform to the contract, the aggrieved party is entitled to remedies for breach. The aggrieved party's right to cancel the contract and refuse to perform its further obligations, however, hinges on whether the breach was material. A party may not cancel the contract for a non-material breach. For immaterial breaches, the remedy is an action for damages. If the breach is material, however, it may cancel. Restatement (Second) of Contracts § 237 expresses the rule as follows: "[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." See 2B-601. Under Article 2B, as in Article 2, an intermediate remedy lies in the right of a party whose expectations of future performance are reasonably impaired by the other's acts or words, to suspend performance and demand adequate assurance of future performance by the other party.

The basic policy is that, while parties are entitled to the contract performance for which they bargained, some breaches are sufficiently immaterial that they do not justify forfeiture of the entire bargain. This does not contemplate a right to not perform, but a rule that prevents forfeiture for minor flaws. For example, a one day delay in payment may or may not be material. A failure to fully meet general, advertised claims of handling 10,000 files may not be material where the licensee's needs never exceed 4,000 if the system handles 9,999 and the contract did not expressly require 10,000 files

The material breach concept, which permeates U.S. and international law, rests on the common law belief that it is better to preserve a contract despite minor problems and the related belief that allowing one party to cancel for minor defects may cause unwarranted forfeiture and encourage unfair opportunism. Materiality relates to the aggrieved party's perspective and the benefits it expected from full performance of the contract. The distinction between material and non-material breach applies to performance of both parties.

3. *Contract Terms.* The materiality concept provides a flexible standard. That flexibility, however, creates uncertainty. It is important, therefore, that materiality hinge on the terms of the contract. The contract defines what is material. That can happen in three ways. The first two involve either expressly providing a remedy for a particular breach (e.g., failure to meet "X" test permits cancellation of the contract) or expressly defining a particular breach per se material. In either case, there is no reason to ignore what the parties have stated to be important to their bargain. The third involves what, under common law, is described as "express conditions." These are express contract terms conformance to which is a precondition to the performance of the other party. Here, the express agreement conditions the remedy.

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

product.

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

Illustration 3. A contract requires delivery of a database program but does not expressly describe the characteristics required of the program. The database fails to function in a manner comparable to other similar programs. Materiality hinges on whether the defect causes substantial harm to the licensee.

4. *What constitutes a material breach?* A statute cannot define materiality in detail any more than one can define concepts such as negligence, reasonable care, merchantability, or the like. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements: contract terms and the extent to which breach causes significant harm to the aggrieved party. See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) ("breach … is material if it is so substantial as to defeat the purpose of the transaction or so severe as to justify the other party's suspension of performance").

The Restatement (Second) of Contracts lists five significant circumstances: 1) the extent to which the injured party will be deprived of the benefit he or she reasonably expected; 2) the extent to which the injured party can be adequately compensated for the benefit of which he will be deprived; 3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; 4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into account all the circumstances, including any reasonable assurances; and 5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing. Restatement (Second) of Contracts § 241 (1981).

The factors in subsection (b) are not exclusive. Courts should draw on common law cases. For example, the concept 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.

SECTION 2B-110. UNCONSCIONABLE CONTRACT OR CLAUSE.

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

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

Uniform Law Source: Section 2-302; 2A-108. Conforms to 2-302.

Definitional Cross Reference:

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

Conference and Committee Action:

1. At the 1997 NCCUSL Annual Meeting, the Conference adopted a motion that the three

transactional articles should follow a consistent "core" definition.

Reporter's Note:

1. *Current law and derivation.* Article 2B follows current Article 2. Since many of the transactions covered by Article 2B are not now within the UCC, it thus expands the ability of courts to monitor transactions beyond the law that current governs. The intent is to adopt modern decisions on unconscionable contracts and terms. In addition, of course, courts should consider the nature of the subject matter and types of transactions covered by this Article in continuing to evolve concepts of what constitutes an unconscionable term.

2. *Inducement.* Article 2B does not allow a court to invalidate a contract or a term based on unconscionable inducement. Traditional theories of fraud, duress and the like continue to apply, but the inducement concept is law only in Article 2A, where it is limited to consumer leases. While it may have a proper role in that context, there is no case law developing or suggesting the contours or limits of the theory and its applicability to general transactional environments is not established. In this article, of course, many situations where inducement may be an issue are dealt with by the concept of manifesting assent and opportunity to review. Other situations fall within concepts of fraud in the inducement and the like in common law.

SECTION 2B-111. MANIFESTING ASSENT.

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

(1) authenticates the record or term; or

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

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

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

(d) A manifestation of assent may be proved in any manner, including by a showing that a procedure existed by which a person or an electronic agent must have engaged in conduct or operations that manifested assent to the record or term in order to proceed further in the use it made of the information or informational property rights.

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

Definitional Cross Reference.

"Authenticate". Section 2B-102. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Committee Actions:

1. Reviewed without substantive changes

Reporter's Notes:

1. *Indicia of Agreement.* Manifesting assent has several distinct functions, depending on the context. One function is as an indicia of agreement to or acceptance of a contractual relationship. Assent to a record frequently indicates not only assent to the record, but also an intent to accept the agreement itself. That is implicit in general contract law. The fact that Article 2B identifies additional functions of the concept of manifest assent, that is the concept of being bound by objective indications of assent through conduct or signature, does not alter this underlying tradition. Manifesting assent is one, but not the only way to indicate acceptance of, or agreement to a contractual relationship.

2. *Adopting a Record.* Beyond this, in this Article and in general law, manifest assent also has a role in determining whether or when a party adopts the terms of a record as defining the terms of the contractual relationship. The term is used in the Restatement (Second) of Contracts § 211 and in the UNIDROIT Principles of International Commercial Contract Law in this sense. It defines when a party is bound to the terms of a standard form record. In these other bodies of law, the term is used, but not defined. In Article 2B, it is used in the same way, as one method of indicating assent to a record as defining the contract, but this Section and Section 2B-112 provide important procedural and substantive standards indicating when assent can be said to have been given to a record. The effect of assenting to, or otherwise accepting, a record is spelled out in Section 2B-207 and Section 2B-208.

The recognition of objective manifestations of assent is especially important in electronic commerce. In that environment, direct contact between individuals is less common; information providers must rely on actions as confirming the existence or non-existence of a contract, and the acceptance or rejection of contract terms.

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

4. *Objective Indicia of Assent.* "Manifesting assent" entails objective indicia of assent to, or adoption of an agreement, a record, or a term in a record. Objective manifestations of assent bind a party to the record if there was an opportunity to review the record and an affirmative act indicating assent. In this Article, however, three elements are required before the objective manifestation constitutes assent.

a. *Authority to Act.* The person manifesting assent must be one that can bind the party being charged with the benefits or restrictions of the agreement or the record. This Article does not generally address questions of agency law. See § 1-103. If a party proposing a record desires to bind the other party, it must establish that the person who acted for the entity to be bound had authority to do so or, at least, that the conduct of that entity accepted the benefits of the contract and, thus, ratified the conduct of the individual. Of course, however, if the person who acted did not have authority to contract and the contract was not ratified or otherwise adopted , there may be no license. Often, if this is the case, use of the information infringes a copyright.

Assent by an unauthorized party is not assent as to the supposed principal unless concepts of apparent authority apply. Additionally, there must be a link between the person who has the opportunity to review the terms and one whose acts constitute assent. Thus, an email sent to the company at large, or to the company's computer, does not trigger assent to the 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 can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when she instructs the secretary to sign up for Westlaw online or to install a newly acquired program that is subject to a screen license.

Questions of this sort lie in agency law as augmented in this Article. In appropriate cases, Article 2B rules regarding attribution play a role in resolving the issue of whether the ultimate party is bound to the contract terms. Section 2B-115 spells out questions of when, in an electronic environment, a party is bound to records purporting to have come from that party.

b. *Affirmative Conduct.* There must be an affirmative act to constitute assent. This

requirement flows from the concept that manifestations of assent refer to objective indicia of assent. A signature or other authentication, of course, manifests assent, initials attached to a particular contract term assent to that term. So too, in the electronic world would an affirmative act figuratively pressing (e.g., clicking) a displayed button indicated as indicating assent and acceptance of a particular term or an entire record. Assent does not require a formal event, although notarization or other formalities certainly qualify.

This Article rejects the idea, suggested in some reported decisions, that a mere failure to object constitutes assent to a record. Objective indicia of assent under this Article requires an affirmative act that the circumstances or the record clearly indicate will have that effect. A failure to object is not assent, but affirmative use of the information or access to it can be assent if that act was defined as sufficient in the circumstances.

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

> **Illustration 1:** In its pre-registration information screen, NYT on-line states: "Please read the license. Click here to review the License. If you agree to the license, indicate your agreement by clicking the "I agree" button. If you do not agree to the License, click the "I decline" button." The underlined text is a hypertext link which, if selected, displays the license.
>
> | I Agree | I Decline |
> |---|---|
>
> Here, a party who indicates "I agree" manifests assent to the license. Its conduct in going forward to use the information also indicates it accepted the contract and adopted the terms of the license.

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

> **Illustration 2:** A license, which is available and readable on the outside of the envelope containing the diskette, provides:
> OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR AGREEMENT TO THE LICENSE WHICH IS CONTAINED ON THE OUTSIDE OF THE ENVELOPE.
> WE CALL YOUR ATTENTION SPECIFICALLY TO:
> **Contract Term No. 5, Precluding use at home,** and
> **Contract Term No. 16, Imposing a $100 annual fee if you choose to use the help line**.

In this case, manifesting assent is an enhanced form of conspicuousness in that it requires an affirmative act with respect to a clause or term.

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

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

> **Illustration 3:** A copyrighted software package states: "THIS PRODUCT IS LICENSED FOR CONSUMER USE ONLY." It does not specify that opening the product or using it accepts this term. The circumstances here clearly indicate that the

product is licensed solely for consumer use. The terms are effective as an inherent part of the agreement, without requiring pro forma language in a record or conduct accepting that record.

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

7. *Proof of Terms.* Of course, it will be necessary for the party, if it relies on the terms of linked text or other electronic records, to prove the content of the text at the time of the licensee's assent. One way of doing so is to retain records of the content at all periods of time or maintaining a changes occurred in particular records.. The issues of proof, while potentially difficult, are matters of evidence law and reflect ordinary problems encountered in dealing with proof of electronic records.

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

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

(1) would call it to the attention of a reasonable person and permit review,~~:~~ or

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

(b) Except as otherwise provided in subsection (c), ~~I~~if a record or term is available for review only after a person becomes obligated to pay, the person has an opportunity to review only if the person has a right to a refund if it rejects the record or term.

(c) If a ~~the~~ record or term is a proposal to modify a contract or is governed by Section 2B-207(a)(2) and is not a mass market license, a refund is not required.

Committee Action: Reviewed without changes.

Definitional Cross Reference.

"Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

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

What constitutes an opportunity to review may differ depending on whether one deals with a paper record or electronic terms. If access to the record is exceptionally cumbersome and difficult to achieve, there may be no opportunity to review.

On the other hand, the mere fact that a person chooses to forego or ignore the opportunity and proceed with a transaction does not mean that there was no opportunity to review. Thus,

for example, contract terms presented to the party during an over the counter transaction or conspicuously made available in a binder as required for some transactions under federal law give an opportunity for review even if the party does not avail itself of that opportunity. This is not changed by the fact that the party may desire to hurry through and complete the transaction unless, of course, the other party uses undue pressure to cause that hurry or to force the party to not review the record.

2. *Refund.* The opportunity to review can come at or after payment. If it follows payment, there is no opportunity to review for purposes of this Article unless the party can return the product an receive a refund if it declines the terms of the record. This refund right does not exist in current law as a condition to the enforceability of records presented after payment. See Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997). It creates important protection for the licensee and, in effect, requires that the party be placed back into the position it would have been in had the record been presented prior to payment.

Illustration: Sam acquires a copy of a movie from Blockbuster on a three day rental. When Same places the copy on screen, a statement appears that the copy is for home and personal use only, and not for display to an audience for a fee. Sam is bound as a matter of contract by this limitation if he had a right to return the copy for a refund without viewing the movie because he rejected the terms. The restriction may also be effective as a matter of direct copyright law.

While this section does not create an obligation to make a refund, this Article conditions the creation of terms of contract between the licensor and the licensee that arise on the existence of that opportunity. Failure to provide a refund is not a breach of contract, but results in failure of the terms to become part of the bargain. Under Section 2B-617, a retailer is required to refund the price paid if an end user declines the publisher's license. That right to a refund, if and when it occurs, fulfills the refund option stated here.

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

4. *First User.* Typically, the refund is present only for the first user of the information, although the rights owner may also seek contractual relationships of this type with subsequent parties. In general, subsequent parties are bound by the terms of the first contract without assent to it in the sense that they are not authorized to exceed the limitations of the first agreement. If they do so, however, unless they assumed the obligations of the first contract, the remedy is a claim for infringement.

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

[B. Electronic Contracts: Generally]

SECTION 2B-113. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND AUTHENTICATIONS.

A record or authentication may not be denied legal effect, validity, or enforceability solely on the ground that it is in electronic form.

Committee Action:

a. Reviewed without substantive change. (Nov. 1997)

Definitional Cross References:

"Authentication". Section 2B-102. "Electronic". Section 2B-102. "Record." Section 2B-102.

Reporter's Notes:

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

SECTION 2B-114. COMMERCIAL REASONABLENESS OF ATTRIBUTION PROCEDURE. ~~(a)~~ The commercial reasonableness of an attribution procedure is determined by the court. ~~(b)~~ In making this~~a~~ determination ~~about the commercial reasonableness of an attribution procedure~~, the following rules apply:

(1) An attribution procedure established by law or regulation is commercially reasonable for the purposes for which it was established.

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

(3) A commercially reasonable attribution procedure may require the use of any security devices that are reasonable under the circumstances.

Uniform Law Source: Article 4A-201; 202.
Definitional Cross References:
Attribution procedure, Section 2B-102; Person, Section 2-102.
Reporter's Note:

1. *Purpose and Effect of a Commercially Reasonable Attribution Procedure.* Attribution procedures are relevant to authentication of electronic records, attributing performance to a party, and allocating risk in reference to alleged errors or changes in a record or message.. If a commercially reasonable attribution procedure is established between persons and followed, enhanced legal recognition is accorded to a message or performance. Conforming to a commercially reasonable attribution procedure for that purpose results in an authentication as a matter of law. In other contexts, if there is a question of who sent the message or performance, compliance with a commercially reasonable attribution procedure to identify a party makes the alleged originator of the message attributable for the message or performance. On the other hand, failure to use a commercially reasonable authentication procedure does not indicate that there is no authentication or that the purported sender is not responsible for the message or performance.

2. *Agreement or Adoption.* This Article does not dictate the form of a commercially reasonable attribution procedure. Evolving technology and commercial practice make it impractical to attempt to predict future developments and unwise to preclude these developments by a statutory mandate. Instead, the Article relies on the parties to select a procedure. An attribution procedure must be established by agreement or adopted by both parties. A procedure of which one party is not aware, does not qualify. On the other hand, agreement or adoption need not precede the transaction. Parties dealing for the first time may adopt a procedure for authentication of messages. The adopted procedure would have the full force of an attribution procedure if it is commercially reasonable.

3. *Commercially Reasonable.* Use of an attribution procedure establishes presumptions concerning the authentication, record or message to which the procedure was applied only if the procedures is commercially reasonable. This requirement buffers against over-reaching and protects parties who lack knowledge of technology. The cost of requiring that this standard be met lies in a degree of uncertainty that the parties cannot control by agreement. Yet, it is an important protection for users of these

systems. Consider the following:

Illustration: General Motors creates a procedure 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.

What is a commercially reasonable procedure must take into account the cost relative to value of transactions. This is implicit in the idea of commercial reasonableness. How one gauges commercial reasonableness obviously depends on a variety of factors, including the agreement, the then current technology, the types of transactions affected by the procedure and other variables.

The procedure may include various approaches, including algorithms, codes, identifying words or numbers, encryption, callback procedures or any other reasonable security device.

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

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

(b) The responsibility of ~~the~~ a party that requires use of the commercially unreasonable procedure is limited to losses in the nature of reliance or restitution. The party's responsibility does not allow a double recovery for the same loss and does not extend to:

(1) loss of expected benefit, including consequential damages;

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

(3) a loss, the risk of which was assumed by the other party.

(c) A person does not require a procedure under subsection (a) if it makes commercially reasonable alternative procedures available to the other person.

Reporter's Notes:

Notes to this Draft:

This Section was revised after consultation with the Electronic Transactions Act (ETA) Reporter and Committee chair and in light of the discussion at the February 1998 meeting**.** The ETA draft presents an alternative approach:

"(a) If a person requires, as a condition of entering into a transaction with another person, that the parties use a security procedure that is not commercially reasonable, the following rules apply:

(1) If the other party reasonably relies to its detriment on an electronic record or

electronic signature purporting to be that of the requiring party, the requiring party is estopped to deny the source or informational integrity of the electronic record or authenticity of the electronic signature to which the procedure was applied.

(2) If the requiring party receives an electronic record or electronic signature purporting to be that of the other party, the requiring party is not entitled to the benefit of any presumption that may arise under [other sections].

(b) A person does not require a security procedure under subsection (a) if it makes commercially reasonable alternative security procedures available to the other party."

General Notes:

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

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

b. Transactions Not Affected. Additionally, since this entire article deals with licensing and related transactions, the losses are confined to such transactions. The Section does not apply to credit card, funds transfer or other types of transactions in which attribution procedures are used, but which fall outside the scope of Article 2B and, in many cases, are at least partially regulated by federal or other state laws. Thus, for example, use of an identifying code for a credit card payment is not governed by this section. However, if a contracting party requires that the other party use a credit card number as an attribution procedure, credit card law applies as to the payment transaction, but as to the contractual relationship, Section 2B-115 applies if the procedure is regarded as commercially reasonable and this Section applies if the procedure was "required" and is commercially unreasonable.

c. Relationship to Reasonable Procedures. The loss allocation principle expressed in this Section contrasts to the principles stated in Section 2B-116 and 2B-117. Those sections provide the parties with presumptions about the authenticity and accuracy of the electronic records to which the procedures are applied. The presumptions are potentially significant in litigation and planning transactions. As expressed there, the presumptions arise only if the procedure is commercially reasonable. Thus, a commercially reasonable procedure vitiates the presumption, leaving the parties to general proof of content and source of the record. In addition, if the procedure comes within this section, the use of an unreasonable procedure may have an impact on loss allocation.

2. *Party Responsible.* The section refers to the person that required the procedure as being responsible for the loss. In modern commerce, the person making such requirement is in some cases the licensor and in some cases the licensee. The principle used here applies in either direction. The procedure must, however, be one that the parties have agreed to or adopted. That elements is implicit in the definition of what constitutes an "attribution procedure."

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

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

The loss must, initially, come from use of the procedure. This excludes losses that flow from other, perhaps parallel causes. Thus, if an identifier is unreasonable, but the party actually did engage in the transaction, but suffered loss due to a breach of contract, this section does not apply. The losses

addressed here are in the nature of loss from misattribution of who sent a message, tampering with the content of a message, or errors caused by transmission or other factors.

Second, the Section only applies to losses incurred in transactions to which the requirement and use of the procedure between the parties applies. It does not address the difficult problem of liability for the situation where a third party wrongdoer obtains social security or other important identifies of an innocent third party and uses them to fraudulently obtain goods and services from numerous vendors. That issue lies in the realm of tort law, criminal law, and other forms of regulation that are just now beginning to develop. Of course, to the extent that these other sources of law preempt or preclude operation of this section, ordinary preemption rules apply.

Third, the losses do not include lost benefits of the transactional relationship. They are limited to reliance and restitution recovery. In some cases, however, the existence and non-performance of a contractual relationship may allow expectations recovery. The basic premise here, however, is limited to avoiding a shift of losses through a required procedure that fails to protect the interests of the parties.

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

4. *Illustrations.* The following suggest some applications of this Section.

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

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

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

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

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

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

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

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

Illustration 4. M requires that L use an unreasonable attribution procedure for transmitting orders and acceptances. L agrees and adopts the procedure. It places an order for ten software widgets. Because the procedure is flawed, the message arrives at M requesting 100 software

widgets. M ships on that basis. L desires to ship the ninety excess widgets back to M and not pay. One could argue that no contract exists because of mistake. Alternatively, a contract might be formed on the offer as sent or as received. Case law support exists for either result. This section, however, focuses on reliance loss. Either L or M could be said to suffer loss because of reliance on the procedure. Since M required it, M bears responsibility for the loss. It cannot demand the price for the ninety widgets unless, of course, L decides to accept and retain them. If L had required the use of the procedure, it would be responsible for reliance losses and restitution.

SECTION 2B-116. DETERMINING TO WHOM AN ELECTRONIC AUTHENTICATION, MESSAGE, RECORD, OR PERFORMANCE IS ~~SHOULD BE~~ ATTRIBUTED.

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

(1) it was in fact the action of that person, a person authorized by it, or the person's electronic agent; or

(2) the other person, in accordance with a commercially reasonable attribution procedure for identifying a person, in good faith reasonably concluded that it was an act of the other person, a person authorized by it, or the person's electronic agent.

(b) Attribution under subsection (a) (2) has the effect provided for by the law, regulation, or agreement regarding the attribution procedure and, in the absence of terms about ~~such~~ the effect, creates a presumption that the authentication, message, record, or performance was that of the person to which it is attributed.

(c) A person is liable for losses in the nature of reliance, if the losses occur because:

(1) the person failed to exercise reasonable care;

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

(3) that reliance resulted from acts of a third person that obtained access numbers, codes, computer programs, or the like from a source under the control of the person that failed to exercise reasonable care; and

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

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

Definitional Cross Reference.

"Computer program". Section 2B-102. "Electronic agent". Section 2B-102. "Electronic message". Section 2B-102. "Good faith". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Presumption". Section 1-201. "Record". Section 2B-102.

Committee Votes:

a. Reasonable care standard in (a)(3) selected by consensus.

b. Reviewed without change. (Nov. 1997).

Reporter's Notes:

1. *Attribution to a Person.* Attribution to a person means that the electronic record is treated in law as having come from that person. The section thus deals with risk allocation highly relevant to the anonymous nature of electronic commerce. The section balances goals of enabling electronic commerce in an open environment (as contrasted to the closed systems such as funds transfer and credit card transactions), while stating reasonable standards to apportion risk in that open system. The rules here do not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside Article 2B.

2. *Act of the Person or Electronic Agent.* There are three circumstances under which a message or action is attributed to a party. The first (subsection (a)(1)) simply makes a person responsible for the record or performance if the person or its agent actually performed or actually created the record. General agency law applies where the issues deal with human agents. In addition, a person is responsible for the actions of its electronic agent. An "electronic agent" is an automated system that responds to or initiates actions without human review and is selected or adopted by a person for that purpose. Having opted to use an automated system, the person is held responsible for its operations. The idea of an electronic agent does not exist under current law, but has importance in electronic contracting for information because of the increasing use of preprogrammed software to acquire information assets. The principle underlying this concept is that a person who created and set out the automated system has responsibility for its conduct. The rules here parallel 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."

3. *Use of Attribution Procedure.* Subsection (a)(2) focuses on attribution procedures for authentication. It makes a message attributable to a person if the other party used the procedure and reached the conclusion that it came from the other person because of that use. This establishes a level of certainty when the parties adopt a commercially reasonable system of identification. Attribution in this form creates a presumption that it was the party identified who in fact sent the message, created the record, or engaged in the performance or authentication. The presumption is rebuttable.

4. *Duty of Care.* Subsection (c) deals with when can a person be held accountable for messages not sent by it and not within an attribution procedure, but on which the other party relied. The underlying loss allocation principle recognizes a limited concept of protected reliance where the cause of the reliance lies in a lack of reasonable care by the person to whom the message is attributed. Since this is reliance-based liability, if the message, performance or context clearly indicates that the indicated source is incorrect or gives reason to doubt the source, reliance may not be protected. Where the reliance is reasonable, the receiving party has a protected right under this article if a lack of reasonable care lies at the heart of the actions that caused the reliance..

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

The Drafting Committee elected the intermediate position reflected in this Draft. The position draws a balance between limiting the risk exposure of alleged senders and protecting reliance interests of recipients of messages. Unlike in credit card and funds transfer systems, one cannot safely predict the relative nature of the sending and receiving parties, their economic strength, or technological

sophistication. Individuals with limited resources are as likely to be on either side of a transaction in electronic commerce as are large corporations. Because of this, the rule creating a dollar cap for consumer risk for credit cards and funds transfers is not viable in this open system, heterogeneous environment. In cases where the electronic process involves transactions between large businesses and consumers, allocation of the risk of fraud or false attribution developed in a way that responds to the better ability of the system operator to spread loss than the consumer. Our context requires a more general structure that goes beyond consumer issues; the problems will not routinely entail consumer protection questions or, even, a licensor with better ability to spread loss. Nor can the loss be placed on the operator of the system as a means of spreading loss since unlike in some other context, the messages here entail in a publicly run system.

One alternative would use communications law rules for allocation of risk. In telephone systems, 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. Here, however, it is between two other parties.

SECTION 2B-117. ATTRIBUTION PROCEDURE FOR DETECTION OF CHANGES AND ERRORS:~~;~~ EFFECT OF USE. If the parties use a commercially reasonable attribution procedure to detect errors or changes in the content of an electronic record, as between the parties, the following rules apply:

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

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

(3) If the sender complied with the attribution procedure, but the other party did not, and the change or error would have been detected had the other party also complied, the sender is not bound by the error or change.

Definitional Cross Reference.

"Consumer". Section 2B-102. "Electronic message". Section 2B-102. "Good faith". Section 2B-102. "Information". Section 2B-102. "Information processing system". Section 2B-102. "Notifies". Section 1-201. "Party". Section 1-201. "Person". Section 1-201. "Presumed." Section 1-201. "Receive". Section 2B-102. "Record". Section 2B-102. "Value". Section 1-201.

Committee Action:

a. Reviewed without change. (Nov. 1997); (Feb. 1998)

Reporter's Notes:

1. This Section deals with the effect of commercially reasonable attribution procedures dealing with the detection of error or of changes in the content of electronic records. Use of such procedures creates a presumption regarding the accuracy or unchanged nature of the record.. Other presumptions may be appropriate depending on the nature of the procedure and this section does not foreclose their development by courts. The underlying principle is that, if the parties agree to or adopt a

commercially reasonable procedure, records created or transferred in compliance with that procedure are entitled to enhanced legal recognition. The presumption is rebuttable and is conditioned on the procedure used qualifying as a commercially reasonable attribution procedure. This means not only that the procedure was commercially reasonable, but that the procedure was agreed to or adopted by the parties.. The language here comes largely from pending Illinois Digital Signature statute which contains more detailed provisions regarding secure electronic records. Since the principle enacted here hinges on agreement and general considerations of commercial reasonableness, the concept is technologically neutral.

2. The presumptions are limited to issues to which the error detection procedure applies. Proof or disproof of alleged errors in other aspects of an electronic transaction are, with the exception of consumer cases, left to law outside this Article. The common law of mistake obviously applies as does the case law developed for dealing with the legal consequences of garbled transmissions or records that have been allegedly tampered with.

3. The presumptions here not only reflect a deference to the choices of the parties, if commercially reasonable, but the greater certainty available to parties through a commercially reasonable procedure also provides an incentive for commercially reasonable procedures to be developed and deployed in commerce. The development of Internet and similar technology for commerce will occur through numerous, private commercial choices that establish a viable marketplace. The provisions of this Section provide at least limited support for that development.

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

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

(a) In this section, "electronic error" means an error created by an information processing system, by electronic transmission, or by a consumer in an electronic system that did not reasonably allow for correction or avoidance of such errors.

(b) In an automated transaction for providing information to a consumer, the consumer is not responsible for an electronic message that the consumer did not intend and which was caused by an electronic error if the consumer:

(1) promptly on the earlier of learning of error or of the other party's reliance on the message:

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

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

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

Prior Uniform Law: None.

Committee Action:

Adopted the section. Vote: 10 – 0 (Feb. 1998).

Definitional Cross Reference.

"Copy". Section 2B-102. "Electronic agent". Section 2B-102. "Good Faith": Section 2B-102. "Information". Section 2B-102. "Notify": Section 2B-201. "Party": Section 1-201. "Record". Section 2B-102.

Reporter's Notes:

1. *Nature of the Issue.* Some observers of developing electronic commerce express concern about the capability of errors occurring in the automated systems to impose unexpected losses on persons who are not sophisticated in their operation. In contract creation and performance, common law principles about mistakes provide the basic framework and fundamental principles against which such problems will be resolved. This Section provides a specific application of those principles to establish a major new protection for consumers tailored for automated transactions. The defense to contract formation created here provides a simple method for a consumer to contest errors in his or her transmissions to a third party. Under common law, in many instances, in a unilateral mistake, the party making that error is liable for its consequences. This Section enables a consumer to avoid the consequences of a unilateral mistake by acting promptly to return copies and correct the mistake without receiving value from the other party's reliance on the error.

2. *Policy of the Defense.* The defense is grounded in equity principles that allow a party to avoid the adverse consequences of its error if the error causes no detrimental effect on another party and does not produce a benefit for the person making the mistake. Of course, there will be unavoidable detrimental effects on the party who receives an erroneous message (e.g., costs of filling, handling and delivering erroneous orders), so courts should apply this rule with care even though the consumer pays the costs of returning the mistakenly ordered product. The basic assumption that there is no detrimental effect on the person who did not cause the error is particularly suspect if manufacturing, production, or other costs are significant. Also, a vendor who fills erroneous orders in a just-in-time inventory system can incur considerable costs for products such as computers or cars; where the product is information, the premise is that the lesser cost of manufacturing justifies the rule.

This section does not create a right to rescind a contract after agreed to performance is received because a consumer changes its mind regarding whether it desires that performance. The section deals solely with errors in the creation of a contract. It is not sufficient to establish the defense that the consumer reconsidered its order. Rather, the standard requires that there was no intent to make the order or, at least, to order under the terms transmitted in error, and that an electronic error be the cause of the problem.

The Section creates an error resolution system, allowing immediate return to place the other party in the position of having to establish that there was no electronic error.

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

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

SECTION 2B-119. AUTHENTICATION PROOF; ELECTRONIC AGENT

OPERATIONS.

(a) Operations of an electronic agent constitute the authentication or manifestation of assent of a party if the party used, selected, or programmed the electronic agent for the purpose of achieving results of that type.

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

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

Definitional Cross Reference.
"Contract". Section 1-201. "Electronic agent". Section 2B-102. "Electronic message". Section 2B-102. "Information". Section 2B-102. "Notice". Section 1-201. "Party." Section 1-201. "Receive". Section 2B-102.

Reporter's Notes:

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

2. Under subsection (b), compliance with an attribution procedure for that purpose removes fact questions about whether an authentication occurred. The procedure exists and is used because of an affirmative choice by the party. In addition, the stated effect occurs only if the procedure is commercially reasonable Section 2B-102. Commercial reasonableness is an element of the definition of an authentication procedure.

3. In the absence of use of an authentication procedure, proof of an authentication can occur in any manner. Included in the methods of proving authentication is proof that shows that a process exists that required an authentication in order to enable an automated system to proceed further in use or other operations. This rule reflect on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

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

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

(1) when a response signifying acceptance is received; or

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

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

(1) A message expressly conditioned on receipt of an acknowledgment does not bind the originator until acknowledgment is received and the message is no longer effective if acknowledgment is not received within a reasonable time after the message was sent.

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

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

(B) specify a further time for acknowledgment and, if acknowledgment is not received within that time, treat the message as expired and ineffective.

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

Committee Vote:

a. Approved current subsection (a) in principle.

b. Rejected motion to delete section containing current subsection (b). Vote: 5-6. (February, 1997)

c. Reviewed without substantive change. (April, 1997) (November, 1997)

Reporter's Notes:

1. Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages. This rule is also followed in Article 4A (§§ 4A-406, 104(a)).

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

3. In Article 2B, a contract can exist even if no human being reviews or reacts to the electronic message or the information delivered. This adapts traditional theories of consent and agreement to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention; when parties choose to use these systems, there is no reason not to allow contract formation. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

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

5. This section deals with functional acknowledgments. It does not create presumptions other than that an acknowledgment indicates that the message was received. Questions about accuracy of the received message and about time of receipt, content and other issues are not treated. Of course, by agreement the parties can extend this concept to cover such issues.

PART 2

FORMATION AND TERMS

[A. General]

SECTION 2B-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, an agreement is not enforceable by way of action or defense unless:

(1) there is a record authenticated by the party against which enforcement is sought sufficient to indicate that a contract has been made and reasonably to identify the copies or subject matter of the agreement; or

(2) the agreement:

(A) requires no or nominal consideration for the rights acquired;

(B) requires payment of less than [$20,000], excluding payments for options to renew or buy; or

(C) is a license for an agreed duration of less than [90 days][~~one year~~].

(b) A record is sufficient under subsection (a)(2) even if it omits or incorrectly states a term, but the contract is not enforceable beyond the copies or subject matter shown in the record.

(c) An agreement that does not satisfy the requirements of subsection (a), but which is valid and enforceable in all other respects, is enforceable to the extent that:

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

(2) the party against which enforcement is sought admits in its pleading or testimony or otherwise in court that a contract was made, but the agreement is not enforceable under this provision beyond the copies or subject matter admitted.

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

(e) The rules in Section 2B-307 may not be varied except by a record that is:

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

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

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

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

Definitional Cross Reference:

"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 2B-102. "Court": Section 2B-102. "License": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Reporter's Notes:

This section was redrafted in light of Committee discussion and a memorandum from a subgroup of the committee. As drafted, it proposed a $20,000 dollar figure, based on a reference to the index-increased estimate of the Article 1 statute of frauds referenced in the subgroup report. It proposes a 90 day short term license exclusion. The Draft does not recommend adopting the idea of a "mass market access" contract because the concept adds significant complexity without clear justification in policy. An attempt was made to draft an exception for information put into a product but, to the extent this is not covered already by (c)(1), no such provision was recommended since, unlike other exceptions, that exception would become effective on the unilateral action of the person arguing that a contract exists and would gut the fraud-prevention role of the statute.

Committee Votes:

1. In Article 2 at the Annual Meeting, repeal of the statute of frauds sustained by a narrow vote (**65-52**). Subsequently, the Article 2 drafting committee voted to include a statute of frauds.

2. Voted to retain a statute of frauds. Vote: 10 –4 (September, 1996)

3. Rejected a motion to remove the dollar limitation in then subsection (e)(1). Vote: 5 – 8 (September, 1996)

4. Rejected motion to exclude mass market licenses from statute of frauds. (September, 1996)

5. Consensus to move former (f) on enforceability without filing into another section in part 5.

6. At the 1997 Annual Meeting, the sense of the house motion passed to harmonize the three articles with respect to the judicial denial requirement. Passed

7. At the 1997 Annual Meeting, a sense of the house motion to harmonize by deleting the "denial of agreement" exception was rejected.

8. After extended discussion, the Committee did not include a requirement that the party asserting the statute plead the non-existence of a contract. (September, 1997)

9. Deleted rule allowing manifest assent to satisfy statute of frauds. Vote: 10 – 0 (Feb. 1998)

10. Adopted a motion to reset dollar limit and expand length exclusion to one year. Vote: 6- 4.

Reporter's Notes:

1. *General Policy and Background.* A statute of frauds provides important protections in commerce focused on intangible subject matter. This is true because of the character of the subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights in one party while rights or privileges to use or to possess a copy vest in another party. These considerations augment arguments that propose that providing some protection against fraudulent practices and unfounded claims justify the cost of the statute.

Current law imposes a statute of frauds in all Article 2 and 2A transactions as well as under the law of forty-seven states for transactions outside the UCC. Restatement (Second) of Contracts ch. 5, Statutory Note, at 282 (1979). The rules for compliance and scope vary. Copyright law requires a writing 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 writing requirement does not apply to rights in data or to non-exclusive licenses. However, in copyright law, a nonexclusive license that is not in writing may lose priority to a subsequent transfer of the copyright.

2. *Basic Rule: Subject Matter and Value.* The requirements of the statute must be tailored to the subject matter and transactions involved. Article 2B focuses on a core requirement that the record, when required, must reasonably describe the subject matter and copies involved in the contract. This leaves significant elements of scope of a license not required in the required documentation. Disputes about these other elements of scope, however, may indicate that no contract exists. See Section 2B-202. Obviously, if not contained in the record and not subject to dispute, the remaining elements of scope must be proven by parol evidence, as must other terms of the agreement.

3. *Basic Rule: Transactions Covered.* A record is required only if the transaction requires payments in excess of $20,000 and is a license whose duration exceed ninety days.

The dollar figure applies to required or fixed payments, not to potential payments. The $20,000 amount excludes from coverage the large number of small value transactions which in ordinary practice frequently do not entail contractual formalities and do not present the same level of risk in the

event a fraudulent claim is made. It compares to the $5000 limitation in current Article 1, a $500 limit in current Article 2, and a $1,000 limit in Article 2A.

> **Illustration 1:** Booker acquires releases from various parties to enable completion and publication of its books. The releases are often not acquired for any payments to the releasing party. This section allows enforcement without a record because total payments were less than $20,000, i.e., no payments.

In addition to the dollar limitation, a contract is enforceable if the license has a duration of less than ninety days [or one year]. This is a partial reflection of the general "one year" rule found in common law rules about the statute of frauds. In context of information transfers of the various types encountered in Article 2B, a one year provision is too long and the ninety day rule is the preferred alternative to cover truly short term licenses.

In reference to both the $20,000 and the ninety day rules, the reference is to what the contract specifically requires. Thus, an indefinite term contract which can be terminated at will does not require a writing since the term is not in excess of 90 days [one year]. A contract calling for royalty payments whose value entirely hinges on the success of a product does not exceed the $20,000 amount.

4. *Basic Rule: Record and Assent.* There is no requirement that the record be retained. Obviously, on questions of proof, retaining a record of a contract is good practice, but this Act merely requires that the record exist at one point in time. In electronic systems, a "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information must be in this form. In copyright law, the cases do not impose a minimum time period, but do distinguish between a copy and an ephemeral manifestation of information. That distinction carries forward into Article 2B.

The record must be authenticated by the party to be bound. The basic theme of a statute of frauds is that there be a record that documents the existence of a contract. A party can prove prior existence of an authenticated record by showing that a procedure exists by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity.

5. *Transactional Exceptions: Performance and Admissions.* There are several circumstances in which the requirements of subsection (a) are moot because of other events in the transaction or the litigation. Two are described in subsection (c). The first, which is a variation of current Article 2, obviates the requirements of the statute of frauds to the extent that performance has been offered and accepted. This event adequately documents the existence of the contract to the extent of the performance and the minimal record required under the statute is not necessary. The second, also derived from Article 2, supplants the statutory requirements to the extent a person admits the existence of the contract in a sworn statement in connection with litigation. Here, again, the statement confirms the existence of the contract and supplants the writing requirement.

6. *Transactional Exceptions: Confirming Memoranda.* As in Article 2, this Section provides that, as between merchants, confirming memoranda satisfy the statute if the receiving party does not object within ten days after their receipt. This validates practice in a number of industries where the volume of transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum can be in various forms, but it serves to place the other party on notice that a contract has apparently been formed. This memorandum has a validating effect only as between merchants.

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

8. *Other Rules.* The statute of fraud provisions here supplant all other existing statute of fraud provisions pertaining to Article 2B subject matter. Thus, the one year of performance rule found in many state common law rules does not apply to Article 2B transactions.

SECTION 2B-202. FORMATION IN GENERAL.

(a) A contract may be made in any manner sufficient to show agreement, including by conduct by both parties or operations of an electronic agent which recognize

the existence of a contract.

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

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

(d) Subject to Section 2B-203, in the absence of conduct or performance by both parties to the contrary, ~~no~~ a contract is not formed if there is a material disagreement about a material term, such as scope.

(e) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is fixed or agreed, a contract is not formed if the term is not fixed or agreed. In that case, each party shall return or, with the consent of the other party, destroy all copies of information and other materials already received. The licensor shall return any portion of the contract fee paid for which performance has not been received and retained by the licensee. The parties remain bound with respect to any ~~obligation of confidentiality or other~~ contractual use restriction.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Contract fee". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Reason to know": Section 2B-102. "Receive". Section 2B-102. "Remedy". Section 1-201. "Term". Section 1-201.

Committee Votes:

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

b. Reviewed in November, 1997 and February 1998.

Reporter's Note:

1. *Basic Rule.* Subsection (a) conforms to current Article 2 and continues without change the basic policy of recognizing any manner of expression of agreement, oral, written, electronic, or otherwise. It follows the language of current Article 2, but adds an express reference to the operations of electronic agents as a form of establishing or showing agreement.

This Article separates two issues. One deals with whether a contract was formed. The second concerns what terms govern that contract. That issue is discussed in reference to records in Section 2B-207, 2B-208, and 2B-209. In many cases, the creation of a contract and its terms are simultaneous. But in modern commerce, the two are partially separable processes. That is true, for example, where the parties exchange conflicting forms and subsequently perform in a manner that creates a contract.

2. *Electronic Agents.* Article 2B clarifies that a contract can be formed by the operations of electronic agents. An electronic agent is an automated system selected or used by a person for purposes of achieving contract-related effects such as offer, acceptance, performance, and the like without review by a human being. The fact that the operations of an electronic agent are attributable to a party that selected the agent is confirmed in Section 2B-116.

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

3. *Open Terms and Layered Transactions.* Although recognizing a broad range of indicia of agreement, the standards adopted here require distinguishing preliminary negotiations or incomplete efforts to make a deal that do not create a contract and actions or statements that manifest an intent to be bound even though terms are left open or the time of formation cannot be determined. Ultimately, the distinction here as under current Article 2 from which these rules derive, often requires consideration of all of the circumstances relating to the alleged agreement.

As made clear in subsection (b), the distinction among these situations lies in the question of the existence of an intent to contract as manifested by the language, conduct or operations of the parties or their agents. Given an intent to contract and agreement on terms or performance that gives an adequate basis to grant a remedy, a contract can be formed despite the existence of terms remaining to be agreed and terms that are left open, that is, not addressed by the parties. In the latter case, this Article, general expectations of the trade, and general intellectual property law often provide background rules that flesh out the details of the relationship.

The background rules will not apply if the parties in fact disagree about the term. While disagreement may not always bar creation of a contract, it often indicates no agreement.

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

4. *Material Terms and Scope of a License.* Subsection (d) clarifies an obvious principle. It provides simply that a material disagreement about an important (material) term indicates that no intent to enter a contract exists at that time. This rule is important in reference to general formation concepts in an environment where open terms and to be agreed terms are permitted. It is also important in the treatment of an exchange of purported offers and acceptances that contain varying terms. As described in Section 2B-203, a contract can be formed by an acceptance that varies the terms of the offer. Yet, it is clear that not all variances indicate an intent to contract. See White & Summers, The Uniform Commercial Code (1995) (discussion of battle of forms).

In information commerce, the most significant terms of a contract deal with the scope of the license. Scope is a defined term. See Section 2B-102. It goes to the fundamentals of the transaction and what the licensor intends to transfer and what the licensee expects to receive. Indeed, in many respects, in this field of commerce, the contract is the product and scope is the basic product description. Disagreements about this fundamental issue are like ordering a Corvette and confirming purchase of a Volkswagon. They indicate fundamental disagreement about the nature of the contract and its subject matter.

This Section does not require complete and detailed agreement about scope in order to form a contract. It does confirm, however, that material disagreement about scope indicates a lack of an agreement sufficient to form a contract.

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

(a) Unless otherwise unambiguously indicated by the language of the offer or the circumstances:

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

(2) An order or other offer for prompt or current delivery invites acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming copies, but a shipment of non-conforming copies is not an acceptance if the party that provides the shipment seasonably notifies the transferee that the shipment is offered only as an accommodation to the other party.

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

(b) Except as otherwise provided in subsection (c), a definite and seasonable expression of acceptance ~~may a record~~ may create a binding obligation, even if the acceptance contains terms that vary the terms of the offer. If the offer and acceptance are in records that contain varying terms, the following rules apply:

(1) If the acceptance materially conflicts with a material term of the offer or otherwise materially alters the offer, a ~~no~~ contract is not formed by the purported acceptance unless from all the other circumstances, including the conduct of the parties, it appears that an agreement existed. If a contract is formed under this subsection, the terms of the contract are determined:

(A) under Section 2B-207 or 2B-208, if one party agrees, by

manifesting assent or otherwise, to the other party's terms other than by the acceptance that contained the varying terms;

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

(2) If a contract is formed and ~~there is no conflict or alteration to which~~ subsection (b)(1) does not apply~~ies,~~ the terms of the contract are those of the offer. Nonmaterial additional terms contained in the acceptance are treated as proposals for additional terms. Between merchants, the proposed nonmaterial additional terms ~~and~~ become part of the contract unless notification of objection to them has already been given or the ~~only if they are not objected to by the~~ offeror gives notice of objection to them within a reasonable time after it receives notice of the proposed terms~~them is received~~.

(c) An offer or acceptance that because of the circumstances or the language is conditional on agreement by the other party to the terms of the offer or acceptance precludes contract formation unless the party agrees, by manifesting assent or otherwise, to its terms. However, if the offer and acceptance are contained in standard forms and one or both are conditional on acceptance of their terms, ~~in this case,~~ the following rules apply:

(1) ~~A party may waive the conditional language in its offer or acceptance by its conduct or otherwise. Such c~~Conditional language in a standard term of the standard form precludes the formation of a contract only if the party proposing the form ~~containing the conditional language~~ acts in a manner consistent with that language, such as by refusing to perform, refusing to permit performance, or refusing to accept the benefits of the contract until the proposed terms are accepted.

(2) If a party agrees, by manifesting assent or otherwise, to an effective

conditional offer ~~in a record~~, it adopts the terms of that offer under Section 2B-207 or 2B-208, as applicable, except as excluded under the law of mistake, fraud or the like because they conflict with the express agreement of the parties.

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

Definitional Cross Reference:

"Agreement": Section 1-201. "Contract". Section 2B-102. "Information". Section 2B-102. "Notifies". Section 1-201. "Party". Section 1-201. "Receive". Section 2B-102. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Notes to this Draft:

This Draft was rewritten based on the committee discussion. Because of the confusion about the relationship between sentence 1 and sentence 2 of c(1), the draft proposes deletion of the first sentence. If rewritten along the lines of the committee vote, it would read: "Conditional language in an offer or acceptance may be made ineffective by a party's conduct or otherwise." That would cure confusion some saw as to whether the concept was waiver or estoppel. However, by making that cure, the implication is that the preclusion can be found by conduct other than conduct inconsistent with the condition (inference from the second sentence). That would make a clear change in current law leaving a large amount of uncertainty on a topic in reference to which there is no showing that current decisions create a problem. On balance, it is best to leave the first issue untouched.

The second sentence of c(1) was edited to make clear that the rule making a conditional term ineffective is limited to terms contained in the boiler plate of the standard form.

Section (c) was also edited to focus the subsections on the battle of forms context, leaving unaffected how courts interpret and enforce conditional offers and acceptances in all other settings.

Committee Vote:

a. Approved in principle. (September, 1996).

b. Delete the reference to standard form in c. Vote: 10 – 0 (March, 1998)

c. Retain the waiver language in c. Vote: 4 – 6 (March, 1998)

d. Provide that conditional language in an offer or acceptance may be rendered ineffective by such party's conduct or otherwise. Vote 8 - 3 (March, 1998)

e. Reconsider the first standard form deletion: adopted 10 –1 (March, 1998)

f. **R**einsert standard form language: adopted 6 – 4 (March, 1998)

Reporter's Notes:

1. *Basic Premise and Coverage.* This Section deals with three recurrent issues involving offer and acceptance in the creation of a contract: general methods of indicating acceptance, acceptances that vary the terms of the offer, and condition offers or acceptances. While the Section provides guidance on determining the terms of a contract if one is formed, this Section must be read in connection with Section 2B-207, 2B-208and 2B-209 for that purpose.

2. *Methods of Acceptance and Formation.* Subsection (a) conforms to Article 2-206(1). It allows acceptance of an offer by a variety of means, including the exchange of conflicting standard forms and behavior, but also recognizes the right of the offeror to control the terms and nature of the acceptance if it does so unambiguously in the offer itself.

3. *Acceptance that Varies the Terms of an Offer.* Subsection (b) follows Article 2-207 and rejects the mirror image rule which would permit a binding contract only if the acceptance fully matches the offer. This allows contract formation by offer and acceptance even though the acceptance varies the terms of the offer. That recognition corresponds to commercial practice throughout all areas of commerce. As in Article 2, the varying acceptance must be an acceptance; no contract is formed by a counteroffer unless that counteroffer is accepted.

Contract formation by an acceptances that varies the terms of an offer creates several conceptual and practical issues. The problems are not that the parties have paid inadequate attention to their contract, but that legal concepts must be fitted to a setting in which commercial practice does not necessarily focus on the details of conformance between an offer and an acceptance. In such unstructured settings, the purpose of the rules of contract formation and the rules that determine the terms of an agreement is to provide fair guidance that corresponds to the type of commercial issues that must be resolved in this open or unstructured environment.

3. *Varying Terms: Material Variance.* One issue, addressed in subsection (b), concerns

how courts distinguish cases of a contract formed by a varying acceptance and cases where the variance indicates that no contract can reasonably be said to be formed by the offer and acceptance alone. Consistent with Section 2B-202, material variance, either a conflict with a material term or a material modification of the offer, precludes formation based on the purported acceptance. This reflects the basic policy that a contract requires a meeting of the minds; it is an underlying premise of existing Article 2 rules, although not specifically stated in that statute. The rule protects both parties in that it precludes the formation of a contract when a material disagreement about terms exists. What constitutes a material term or a material alteration of the offer depends on the context, including what the parties might reasonably expect to find in contracts in light of applicable trade use and course of dealing. Comments to Section 2-207 contains a list of what the drafters then thought would be material, but that list may or may not be applicable in modern commerce. In licensing, however, scope is always a material term since it defines the focus of the contract itself.

The rule does not preclude formation of a contract other than through the offer and purported acceptance. It allows contract formation by conduct or through a showing of other circumstances indicating agreement, even if the formal offer and acceptance materially diverge. This is spelled out in subsection (b)(1). The circumstances adequate to show agreement despite material conflict in the records exchanged by the parties as a purported offer and acceptance correspond to the broad concept of contract formation outlined in Section 2B-202. The relevant standard contemplates an inclusive, rather than limited consideration of relevant circumstances.

If a contract is formed based on the circumstances, the important issues center on what terms are applicable to the contract. By hypothesis, the records exchanged as an offer and acceptance materially diverge. Subsection (b)(1) contemplates two distinct approaches to determining the terms of the contract. The first arises if one party agreed to the terms of the other. In that case, the terms, if in a record, are adopted pursuant to and subject to the limitations in Section 2B-207 and 2B-208. The agreement to these terms can be manifested in any manner that is relevant except that it cannot be found solely in the "acceptance" that contains a materially varying term. thus, for example, if the parties exchange records that contain a material conflict, but one calls the other and agrees to either the other party's form or to otherwise delineated terms, the contract forms around those terms.

The second circumstance is where the exchanged offer and acceptance materially conflict, but a contract is formed by conduct. This places the relationship under Section 2B-209. That Section requires a court to apply general interpretation rules to discerning the terms that are part of the contract, unless the cases involves conflicting standard forms. In that latter situation, Section 2B-209 applies a "knock out" rule modeled on current Section 2B-209.

4. *Varying Terms: Non-Material Variance.* If the offer and acceptance do not materially vary, they form a contract. Subsection (b)(2) indicates that, as under general contract law and current Article 2, the terms of the contract are the terms of the accepted offer. Subsection (b)(2), however, also allows for the introduction of non-material additional terms from the acceptance unless the offeror timely objects to those terms. This rule is taken from existing Article 2. It does not apply to terms that provide conflicting treatment of the same subject matter. Where the offer and acceptance conflict on a term and the conflict or term is not material, the contract is governed by the terms of the accepted offer.

5. *Conditional Offers and Acceptances.* As recognized in subsection (c), as a matter of general contract law, a person has a right to state preconditions for its offer or its acceptance. The most common conditional offer or acceptance is one that conditions its effect on adherence to its own contractual terms. In effect, read literally, these conditional offers or acceptances state: "there is no contract except on the terms and conditions that I propose." There is no principle in contract law that would generally preclude a party from engaging is such conditional offers or acceptances and being able to rely on the conditional terms.

Subsection (c) recognizes that these conditional statements are entitled to recognition. Subsection (c)(2) provides the necessary corollary to this proposition. Agreement to the terms of a conditional offer or acceptance by the other party creates a contract based on the terms of that conditional offer or acceptance.

While language of condition should generally be acknowledged and enforced by courts, use of conditional language in standard form offers and acceptances creates special problems. The typical scenario occurs in a traditional "battle of forms" transaction in which either or both parties make the acceptance or offer expressly conditional on adherence to its specific contractual terms, but nevertheless proceed to engage in performance recognizing a contract irrespective of any acceptance of the terms of condition. Subsection (c) treats this as a question involving the effectiveness of the conditional language. There are three scenarios where forms are exchanged that contain varying terms and one or both contains conditional language limiting their legal effect in forming a contract to the condition that the other party

accept all of the stated terms.

In the first, the party receiving the conditional form is contacted by the other party and assents to the conditions. Under these circumstances, the terms of the agreed to form govern the contract that was created.

In the second, nothing more happens other than the exchange of forms (e.g., no performance and no acceptance of a form by the other party), no contract exists. Since there is no performance, the behavior of the party stating the condition is consistent with that condition and the standard form cannot form a contract unless it is accepted by the other. No contract exists.

In the third, both parties proceed to perform recognizing the existence of a contract. Under current Article 2 law, it is not clear how this situation would be examined in the case where one of the parties' forms was conditional. Some would argue that the performance of the one accepts the conditional terms of the other. Other courts reject that analysis. Under subsection (c)(2), the fact that the person tendering the conditional form performed as it there were an agreement renders the conditional language ineffective. To be effective language of condition in a standard form, the party's behavior must be consistent with the conditions. Thus, the situation is shifted to a simple exchange of forms containing varying terms.

Illustration 1. Purchaser sends a standard order form indicating that its order is conditional on the Licensor's assent to terms on the form. Licensor ships with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. Here, neither party acted consistent with the language of condition. A contract exists, however, based on conduct (e.g., shipment and acceptance). The terms are governed by 2B-209; the conflicting terms drop out.

Illustration 2. In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser of the conditions of shipment. It does not ship until Purchaser agrees to terms. Until that occurs, there is no contract. If it occurs, the contract exists based on terms actually agreed to (e.g., the Licensor's terms). See 2B-209 regarding the superseding effect of actually conditional offers.

Illustration 3. In Illustration 1, assume Licensor ships pursuant to a "conditional" form, but when the shipment arrives, Purchaser refuses it because its original conditional terms are changed. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language. When agreement occurred, that agreement sets the terms of the contract (e.g., the Purchaser's terms) the conflicting forms no longer purport to state the contract of the parties.

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

(1) A contract may be formed by the interaction of electronic agents. A contract is formed if the interaction results in the electronic agents engaging in operations that confirm or indicate the existence of a contract ~~or indicate agreement~~. The terms of the contract are determined under Section 2B-209(b).

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

(A) the individual knows or should know will cause the agent to

perform, provide benefits, or permit use of the information, the informational property rights, or the access that is the subject of the contract; or

(B) are clearly indicated as constituting acceptance regardless of other expressions or actions by the individual to which the electronic agent cannot react.

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

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

Definitional Cross Reference:
"Agreement". Section 1-201. "Automated transaction". Section 2B-102. "Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Committee Vote:

a. Approved in principle. (September, 1996). Reviewed without change. (Nov. 1997)

Reporter's Notes:

1. Subsection (a) deals with two contexts: 1) interaction between a human and an electronic agent, and 2) an interaction between two electronic agents without human intervention. In both, electronic methodology is in widespread use, but there are questions of under what circumstances agreement is inferred from behavior and of to what terms an electronic agent can agree. The following illustrations, although not within Article 2B scope, illustrate 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. Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the software being order if there is a 120 day no questions return policy. Otherwise: "I don't want the damn things." Tootie orders shipment.

There is a contract. The verbal addition or condition is ineffective. Stating conditions clearly outside the capability of the electronic agent to make a reaction does not eliminate the agreement reached by taking the steps needed to initiate the shipment. Similarly, the verbal 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 the circumstances, User's "counter offer" is ineffective; it could not be reacted to by the ATT computer. The charge for the use should include the additional $1.00.

2. As between electronic agents operations that signify a contract form an enforceable contract. The automated agents were selected or used by the parties to achieve these results and Article 2B acknowledges the efficacy of the choice in law. See discussion in notes to Section 2B-202. The agents act within parameters set by their programming and selected by their principals. The terms of the contract are determined as indicated, allowing for prior agreement, terms reflecting "consensus" of the two agents, and default rules. Terms in one agent's system that are not capable of being reacted to by the other are not part

of the contract.

SECTION 2B-205. 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 providing assurance that the offer will be held open which is contained in a standard form supplied by the party receiving the offer and used by the party making the offer is ineffective unless the party making the offer authenticates the term.

Uniform Law Source: Section 2A-205; Section 2-205.
Definitional Cross Reference:
"Authenticate". Section 2B-102. "Contract". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.
Committee Actions:

a. Committee voted unanimously to approve this in principle. (September, 1996)
b. Agreed to use 90 days as a standard in lieu of three months. (September, 1996)
c. Reviewed in April 1997 with no substantive changes.

Reporter's Note: This Section adopts existing Article 2 clarifying language on terms contained in a form supplied by the offeree..

SECTION 2B-206. RELEASES; CONTRACTS FOR IDEAS.

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

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

(A) it is contained in a record to which the releasing party agreed, by manifest ~~ed~~ assent or otherwise, and which identifies the informational property rights released; or

(B) it is enforceable under other law, including estoppel, implied license, and other rules allowing enforcement of a release.

(2) A release continues for the duration of the informational property rights released if the agreement does not specify its duration and does not require on-going affirmative performance:

(A) by the party granting the release; or

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

(b) The following rules apply to submissions of information or an idea for the creation, development, or enhancement of information:

(1) If the submission is other than under a preexisting agreement for such submission:

(A) a contract ~~or obligation~~ does not arise and is not implied from the mere receipt of an unsolicited disclosure;

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

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

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

(ii) the recipient expressly agrees to a contract ~~ual terms~~ concerning the submission.

(2) An agreement to disclose an idea does not create an enforceable contract unless ~~if~~ the idea is ~~not~~ confidential, concrete, ~~or~~ and novel to the trade or industry.

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

Committee Action: Reviewed without substantive revision.

Reporter's Note:

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

The release does not relate to claims based on breach of contract, but refers to releases of intellectual property and similar rights.

2. *Enforceability.* Subsection (a)(1) adopts the view that a release is enforceable without consideration, but places a limitation on that concept as an affirmative premise by focusing on a release contained in a record to which the releasing party manifested assent. The section clarifies existing law. It provides that a release of informational property rights in a certain form is enforceable, but does not alter other existing law with respect to when releases are enforceable.

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

Illustration 1. West operates an on-line chat room. It uses comments of users in its monthly newsletter. The first time an individual joins the chat room, the screen stated that: "By participating in this on-line conversation, you grant West the right to use your comments as edited in subsequent publications in any medium." By joining the conversation, the participant releases its rights in its copyright comments for the purposes stated. Subsection (a) eliminates the need for consideration. The act of participating constitutes manifesting assent if the release language was prominent and called the party's attention.

While the section refers to assent to a record, it does not preclude modern means of recording assent, such as by filming assent by the participant as part of the "record" itself. In this case, the film itself serves as the record. The filmed assent is in effect no different from signing a writing. In both cases, the included act or signing authenticates the record.

3. *Duration.* Subsection (a)(2) is a specific application of rules in Section 2B-308, creating presumption that some single or no-payment contracts create rights for the duration of the underlying information property right if no definite term is specified. This deals with issues common to industries where parties develop products in part on reliance on general releases or waivers that do not contain specific duration terms. Leaving those cases to the general "reasonable time" standard in Section 2B-308 would create unwarranted and costly uncertainty.

The "minor acts" in this section include giving acknowledgments or credits in subsequent uses of the information or providing a small number of copies of works utilizing the released information.

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

[B. Terms of Records]

SECTION 2B-207. ADOPTING TERMS OF RECORDS.

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

(1) before or in connection with the initial performance or use of or access to the information or informational property rights; or

(2) at any time after the party has had an opportunity to review the record, if the parties agreed to be bound or commenced performance or use with the expectation

that the agreement would be represented in whole or in part by a record that the party did not have an opportunity to review or that had not been completed at that time.

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

Uniform Law Sources: Common law decisions; Restatement (Second) of Contracts 211.

Definitional Cross Reference:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Opportunity to review." Section 2B-112. "Manifest assent." Section 2B-111 "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Votes:

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

b. Rejected a motion to make specific reference to excluding terms that are unconscionable in addition to general exclusion under section 2B-109. (September, 1996)

c. Consensus to expand section to cover all records, rather than merely standard forms, provided that it be made clear that standard forms are covered. (September, 1996)

d. Reviewed without substantive change. (April, 1997)

e. Rejected a motion to subsume both 207 and 208 into one section. Vote: 3 – 7 (March, 1998).

Reporter's Notes:

1. *General Structure: Terms of Contract.* This Section deals with adoption by a party of the terms of a record, including a standard form, in non-mass-market transactions.

Article 2B deals with the terms of a contract, records that document those terms, and with standard forms in three sections. Section 2B-207 and 2B-208 deal with "single form" or single record cases. Section 2B-209 deals with cases where records are exchanged that do not create a contract on their face, but a contract nevertheless exists because conduct of both parties indicates agreement.

These three sections do not address formation issues. If no contract is formed under other rule in this Article, the sections are inapplicable. What these sections address is: given a contract, what are the terms? The distinction between formation and term delineation concepts is modeled after the Restatement (Second) of Contracts. Of course, however, in many situations, the actions that adopt a record also reflect the formation of an agreement.

2. *Adopting Terms: Enforceability.* Subsection (b) states the simple principle that when a party agrees or assents to a record, whether a standard form or not, this act adopts the terms of the record as part of the contract. This does not alter traditional UCC limitations on enforceability of terms, such as the doctrine of unconscionability.

The adoption of a record includes a standard forms. The effect is to reject in commercial deals the rule in some states that a term that is not unconscionable and was not induced by fraud or other active misconduct may still be excluded by a judge viewing the transaction in retrospect. This confirms an important aspect of commercial law and commercial practice expectations. The enforceability principle adopted here is followed in the vast majority of modern case law. It flows from the belief that in the absence of unconscionability or fraud or similar conduct, commercial parties are bound by the records to which they assent and cannot later claim surprise or a failure to read the language presented to them.

3. *Adopting Terms: Knowledge.* Adoption of the terms of a record does not require that the adopting party actually read, understand, or negotiate the terms. This reflects virtually universal law in the United States. In many situations, parties do not closely review or dicker about each term of a record.

Subsection (b) recognizes that fact. Equally important, the Section provides that the defense that "I did not read" the contract does not enable a party to avoid the effect of the terms of a record it adopted.

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

The definition of manifesting assent identifies two of these. One involves authenticating (signing) the record. This is a traditional means of adopting the terms of a record, but has never been the sole method of doing so. An authentication of a record often serves not only to adopt the terms of the record, but also to accept the contract offered by or through the record.

Authentication is one way of "manifesting assent." In the absence of an authentication, this Section follows common law and expressly recognizes that conduct can indicate assent to a record or a contract. This concept, as defined in Section 2B-111, focuses on objective manifestations of assent and adopts procedural safeguards requiring that the party to be bound by the standard form or other record have a fair an opportunity to review the terms before assenting and to reject the agreement if the terms are not acceptable. See Section 2B-112. A party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. Except in contract modifications, 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).

These two structured options are inadequate to cover the full range of situations in which it can be fairly said that a party agreed to a record. This Section accommodates the breadth and diversity that exits in modern practice by allowing a court to find that a record was adopted when or if a party agreed to that record. This general standard is more subjective and deals with the entire context.

5. *Rolling or Layered Term Adoption.* A basic theme in Article 2B is that, while some contracts are formed and their terms delineated at a single point in time, in many modern transactions a rolling or layering process occurs. An agreement exists and terms are provided, clarified or introduced over a period of time point. Contract formation and term definition is a process, rather than a single event. This theme was introduced in current Article 2; enacted in contract formation rules that acknowledge the creation of a contract even if terms are left open or to be specified in the future. It is amplified here

Subsection (a) implements that theme and rejects the idea that a contract and all of its terms must be formed at a single point in time. Case law adopts a more fluid conception of the process of contracting, where parties define the agreement over a period of time that is not constrained to an instantaneous "closing" in most cases. See, e.g., Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997). This rolling contract concept reflects that, in many agreements, terms are considered at two different points in time (some at the initial discussion and others when the products arrives), while in still others, terms may continue to be created and modified over time.

Terms can and often are created in modern commerce by assent after beginning performance. Thus, in the entertainment industry and in many development contracts, contract terms are developed and drafted **while** performance occurs, not before performance begins. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section accommodates that process as well as the common practice of providing terms for assent at some point prior to the initial performance, even if not at the first step in the agreement process.

SECTION 2B-208. MASS-MARKET LICENSES.

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

(1) if it is unconscionable; or

(2) subject to Section 2B-301 with regard to parol or extrinsic evidence, if

it conflicts with terms to which the parties to the license expressly agreed.

(b) If a party does not have an opportunity to review a mass-market license before becoming obligated to pay for the information and does not agree, by manifesting assent or otherwise, to the license after having that opportunity, ~~the party is entitled to receive from the licensor~~ on delivering ~~returning~~ all copies of the information dealt with by the license or destroying ~~such~~ the copies pursuant to ~~the licensor's~~ instructions, the party has a right to:

(1) a refund;

(2) reimbursement of any reasonable expenses of obtaining the refund and incurred in complying with any instructions of the licensor ~~other party~~ for return or destruction of the information or, in the absence of such instructions, reasonable expenses in connection with return of the information; and

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

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

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

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

Definitional Cross Reference:

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

Committee and other Votes:

a. During Article 2 discussion at the 1996 annual meeting, a motion to delete exclusion of terms in consumer contracts was defeated based on Committee assurance that Article 2 would use an objective test.

b. Deleted reference to allowing terms consistent with "customary industry practice." Vote: 11-1

c. Deleted reference to allow terms giving no rights no less than under a first sale. (12-0)

d. Voted 12-0 to support an approach to refusal terms that focuses on the perspective of the party proposing the form.

e. Rejected a motion to substitute refusal term concept with an expanded refund right. Vote: 2- 6 (April, 1997)

f. Did not adopt a motion to add the expanded refund right and restrict the refusal term concept to consumers. Vote: 5 - 5 (April, 1997)

g. Rejected a motion to limit the section to consumer licenses. Vote: 2 - 8 (April, 1997).

h. Adopted a motion to delete refusal term concept and use refund right proposed by an ABA committee. Vote: 10 – 2 (Sept. 1997).

Reporter's Notes:

1. *General Structure and Approach.* This section deals with standard forms in a mass market (retail) context. It places significant procedural and substantive restrictions on the use of forms in the mass market. Those restrictions entail a general rule that applies to all mass market forms in a retail setting and additional, special protections in cases where the form involves an undertaking proposed by a remote third party that was not a party to the retail transaction, but requires terms.

This Section must be read in connection with Section 2B-207. Adoption of the terms of a mass market license occurs only when the limitations stated in 2B-207 and the restrictions stated here are met. As is true generally, while this section deals specifically with the adoption of the terms of a record, in many situations the same acts adopt the terms and constitute agreement to the contract itself.

The Section provides express protections against use of hidden terms in forms to alter the basics of the actual bargain of the parties to a license. These are outlined in subsection (a) and the concept of "manifest assent." The Section does not adopt Restatement (Second) of Contracts § 211 which allows a court to invalidate terms that are not unconscionable if the court later concludes that they are not within presumed expectations of a party. The section does respond to the policies that underlie that Restatement concept which are to prevent bizarre and oppressive terms (unconscionable terms) or terms that vitiate the basic deal of the parties. In the more than twenty years since it was proposed, the Restatement approach has been adopted in less than ten states for general transactions. It creates significant uncertainty based on criteria that are not well-defined.

2. *Scope: Mass Market.* This Section is not limited to consumer transactions or to transactions involving so-called "shrink wrap" licenses. Compare Section 2-206 (Proposed Revision Draft, July 1997). Subsection (a) deals with all transactions in the retail market.

In the retail mass market, and in many non-retail transactions, most modern transactions are standardized. An information provider defines the terms under which its information products are made available to the retail market place and end users in that marketplace elect to either acquire or not acquire the information on these terms. The transactions are anonymous in that the information provider does not restrict those to whom the information is given except based on the licensee's willingness to agree to terms and to pay the applicable license fee. This standardized contracting characterizes the vast majority of all mass market and non-mass-market transactions. It is a vital part of commerce and a broadly enforced method of contracting.

The section is not limited to "shrink wrap" licenses. In common parlance, these are contracts that are entered into after an initial transaction in a retail or other context. Often, especially in the retail mass market, licenses of this type involve creating a relationship between a remote information publisher and an end user who acquires a copy of information from a retailer.

The section also applies to all consumer transactions.

3. *Records Presented Prior to Payment.* Where the terms of a mass-market license are presented before a price is paid, the contract presents relatively few unique issues and involves questions that have been presented to courts for years. Courts generally enforce the terms of the record if the party manifests assents to that form. The fact that the terms are non-negotiable or may even rise to the level of a "contract of adhesion" does not invalidate the contract terms. It may suggest a need for close scrutiny of *terms* under general standards of unconscionability. Section 208(a)(1) forces this scrutiny as a uniform matter.

In this setting, as in many other contract formats, ideas of assent and agreement reflect the position of both parties (or all three parties in most retail licenses). In a typical non-negotiated transaction in the mass market, the information provider does not assent or agree to license under any terms other than those set out in its license, while the other party assents to the terms or is free to forego the transaction. So long as there is an opportunity to review the contract, a lack of fraud, and no unconscionable terms, contract law principles do not vitiate the deal proposed and adopted (subject, of course, to terms required by this Article). An information provider (or other vendor) may choose the terms under which it provides

its product and the terms that define the product itself.

This section provides enhanced procedural protections for mass market licensees in the form of a requirement of an opportunity to review the terms of the form and a requirement that assent be in the form of an affirmative act indicating agreement to the license.

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

a. Assent and Agreement. As explained in Section 2B-207, a party becomes bound to the terms of a record if it agrees to the record. Agreement can be shown in various ways. One of these under subsection (a) is by manifesting assent to the record. This term derives from the Restatement (Second) of Contracts. The idea of manifesting assent is that the party adopts the record by taking some action that objectively indicates agreement to the record. Unlike in the Restatement, the term in Article 2B-111 is defined to include significant procedural protections. These restrictions ensure that the record be available for review and that the assenting party make some **affirmative** indication of assent.

This rejects cases such as Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997) to the extent that they hold that a mere failure to object adequately adopts the terms of the record. The issue in any disputed case is whether there is indicia of assent in the parties conduct with reference to the license or the information. In addition, as spelled out in Section 2B-111, a party cannot manifest assent unless it has had an opportunity to review the record. This requires an opportunity in the sense that the record be reasonably available. It does not require, however, that the party actually read the record.

b. Unconscionability. Even if a party adopts the terms of a record, subsection (a) makes clear that this does not adopt terms that are unconscionable. The general UCC policy disallowing enforcement of unconscionable terms controls. While this is true in any event, the specific reference here makes clear that the policy is important in mass market contracting.

The well-established doctrine that disallows unconscionable terms provides a basis to avoid bizarre and oppressive results in standard form contracting. How that theory evolves in modern markets for information and licenses of informational property rights remains to be determined and ultimately requires judicial decisions applicable to particular cases. This Section expressly carries forward existing UCC concepts to this modern market. Traditionally, unconscionability doctrine blends questions about the contracting process (procedural) with questions about the substantive character of the terms (substantive). It prevents abuse and unfair surprise in standard form contracts. In an non-bargained market where purchasers make choices mainly about price and about whether or not to enter into a transaction, this doctrine provides an important safeguard against over-reaching.

The doctrine might apply to invalidate terms that are bizarre and oppressive and that are hidden in boilerplate language. For example, a contract term buried in a mass market license that provides that default on the mass market contract involving a $50 software results in a cross default on all other negotiated, multi-million dollar licenses between two companies may be unconscionable in setting where there was no reason to suspect that the linkage of the small and the larger licenses. Similarly, a clause abrogating all responsibility for intentional wrongful acts buried in a license form violates public policy in most states and, in addition to being unenforceable on that basis, might also be unconscionable.

Unconscionability doctrine requires a contextual analysis to avoid abuse by the licensor or the licensee. It is not possible to fully describe the various situations in which it may apply. The doctrine is sufficiently flexible that, in information transactions, it can encompass a consideration of underlying public policies and protection of public interests in free flow of ideas. Article 2B takes a neutral position relating to the difficult federal policy issues that arise in reference to federal law preemption, intellectual property fair use and misuse and federal competition law. Within that approach, issues about the relationship between a contract clause and underlying principles of free speech, free idea flow, and the like in a mass market are appropriate elements in an unconscionability analysis. Thus, for example, a contract term purporting to prevent the buyer of a publicly distributed magazine from quoting the magazine's observations about consumer products might in context be unconscionable.

In practice, however, the primary standards under which clauses dealing with this subject matter are measured comes from the federal law concepts themselves. The fact that the contract itself is generally enforceable under Article 2B does not alter the application of these broader federal law concepts. See Section 2B-105.

c. Agreed Terms. Subsection (a) adopts a new premise that a mass market form in itself cannot alter the terms agreed to between the parties to the license. This deals with an issue discussed in the Restatement (Second) of Contracts § 211, but does so in terms that do not create an open-ended right of a

litigant and a court to rewrite a contract adopted by the parties.

The basic concept holds that the form cannot alter agreed-to terms in the mass market. The concept treats such terms as current Article 2 treats express warranties. As with express warranties, it is subject to the application of parol evidence concepts. The basic theme is that a form in this marketplace cannot vitiate the terms of the agreement between the parties.

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

This concept corresponds to comments to Restatement (Second) § 211 which refer to invalidating "bizarre and oppressive" (unconscionable) terms and terms that vitiate the basic agreement of the parties.

The concept is especially important in mass market information transactions in that the importance of the contract is far greater than in sales of goods. The contract defines the product (e.g., what rights are conveyed and which are withheld). This concept is, of course, subject to the parole evidence rule.

4. *Case Law.* In single form cases, no appellate case law rejects the enforceability of mass market licenses and recent cases expressly support it. See ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). Compare Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th 1988) (lower court held contract invalid as contract of adhesion; appellate court did not address contract issue). Cases are less clear in reference to cases of conflicting forms (battle of forms) where differing terms create questions about assent to either form. See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir.1991); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). The cases in this field do not contest the enforceability of standard forms. See Douglas G. Baird & Robert Weisberg, Rules, Standards, and the Battle of the Forms: A Reassessment of § 2-207, 68 Va. L.Rev. 1217, 1227-31 (1982).

5. *Forms presented after payment.* In modern commerce, licenses are often presented after a price is paid or committed to be paid to a retailer. These licenses often entail a three party transaction: the license is between the remote publisher (informational property rights holder) and the end user, while the retail purchase was between the end user and the retailer. While these relationships create many benefits for the end user and establish a direct contractual privity between the publisher (who controls the intellectual property rights) and the end user, they also present issues about treating the end user in a fair manner.

a. Distribution and Intellectual Property Rights. Distribution channels in licensed information are not identical to those in the sale of goods. The differences lie in the existence of intellectual property rights in the publisher and the choices by the rights owner (publisher) to provide grants of those rights beyond and different than the uses created if it simply sold products to a distributor for resale to an end user. In many (most) cases, the license ultimately gives benefits to the end user that are not conveyed in the contract with the retailer (who does not own the informational property rights). The fact that this is a three party structure is also dealt with in Section 2B-616.

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

In establishing a distribution system for the mass market, an informational property rights owner may elect to establish a transaction in which it gives its distributors either (1) ownership of a copy and a right to sell copies of its work to others, or (2) a license (permission) to the distributor to license copies to others. Copyright and other intellectual property law supports either choice. It also provides that, if a license is created and the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected under bona fide purchaser concepts. See Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994); Major League Baseball Promotion v. Colour-Tex, 729 F. Supp. 1035 (D. N.J. 1990); Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077 (D. Md. 1995); Marshall v. New Kids on the Block, 780 F. Supp. 1005 (S.D.N.Y. 1991).

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

market and otherwise typically create rights that go beyond the rights that arise in the event of mere sales of copies.

A common licensing distribution situation in information is:

1) copyright owner permits distributor to distribute, but not sell, copies, and only subject to a license (copyright gives owner the exclusive right to "distribute" copies and, thus, this limit is consistent with copyright law);

2) distributor (retailer) transfers copies to end users, but this is not an authorized "first sale" since the rights holder did not authorize a sale;

3) end user has possession, but an uncertain status under copyright (or patent) law until is assents to a license with the rights owner; and

4) license with the publisher (rights holder) creates affirmative rights of use if assented to by the end user, but the rights do not exist if the license is rejected.

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

The "post-payment" license in these transactions is the first and often the only contract between the end user and the copyright owner. It is the only setting in which the end user can obtain rights that exceed rights to a first sale buyer of a copy and the first setting in which it obtains any rights under a distribution system that does not authorize mere sales of copies to end users.

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

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

Illustration 2: Two end users desire information under a mass market license. End user #1 goes to a web site and, after reviewing the license terms, provides his credit card number and downloads the information. Subsection (b) does not apply because opportunity to review the license contract existed before payment. End user #2 places a telephone order and provides his credit card, but the license is not available for review until the information arrives in the mail. Subsection (b) applies.

Illustration 3: In the above example, End user #2 opens the package and finds a license on an envelope that contains a copy of the information. The envelope clearly states that opening the envelope constitutes consent to the license. The user reads the license and rejects it, deciding not to open the envelope. Subsections (b)(i) and (ii) entitle him to return the information with return costs covered by the licensor. Subsection (b)(iii) does not apply; it was not necessary to install the license in order to read it.

Illustration 4: In the same circumstances, end user tests the information to see if he likes it. Subsection (b) does not apply; the end user assented to the license. Any right to test is governed by the inspection rules of Article 2B which assume the existence of a contract and focus on determining and providing a remedy for breach if the product is defective.

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

Modern copyright cases hold that, in certain circumstances, making intermediate copies of

copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). In some contexts contractual bars on reverse engineering are clearly enforceable in that they create confidential or other requisite relationships. In others, they may not be enforceable as a matter of federal policy. In the mass market, the issue is in dispute. It involves a decision about federal policy, rather than contract law. That federal policy if applicable, is not affected by this Article.

Similarly, federal case law (and statutory provisions) establish a federal interest in the broad distribution and use of ideas and concepts that have been distributed to the public. See Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989). On the other hand, it is clear that federal policy on dissemination of information co-exists with the ability of parties to make confidential disclosures and deal with information to be kept secret. See Computer Assoc. Int'l, Inc. v. Altai, Inc., 982 F2d 693 (2d Cir. 1992). Some case law supports the view that, in some situations of mass distribution of the information in an unrestricted form, the provision is unenforceable. See Consumers Union v. General Signal Corp., 724 F.2d 1044 (1983).

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

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

(a) Except as otherwise provided in subsections (b) and (d), if the records of the parties do not establish a contract but a contract is formed by conduct of the parties, in ~~the court shall~~ determining~~e~~ the terms of the contract the court shall consider ~~ing~~ the commercial context, including any applicable trade use or course of dealing, the conduct of the parties, the terms on which the parties ~~expressly~~ agreed, the information or informational property rights involved, the supplementary terms provided by any other provision of [the Uniform Commercial Code] that apply to the transaction, and all other relevant circumstances.

(b) If a contract is formed by conduct and the only material records exchanged were standard forms purporting to state the terms of an offer or acceptance, the terms of the contract are:

(1) terms expressly agreed to by the parties;

(2) terms with respect to which the forms do not conflict;

(3) terms supplied by use of trade or course of dealing applicable to the transaction;

(4) supplementary terms incorporated under any other provisions of [the Uniform Commercial Code] that apply to the transaction.

(c) In a case governed by subsection (b), the following rules apply:

(1) Terms stated in subsection (b) rank in priority in the order listed.

(2) If a standard form of one party deals with a subject, the fact that the other standard form does not deal with the subject does not create a conflicting term unless the term materially alters the contract otherwise established. In determining whether a term materially alters an agreement, a court shall consider the extent to which the term is consistent with expressly agreed terms, the approach to similar issues in the record that is silent on the issue, the course of dealing of the parties, and the ordinary customs and practices of the applicable trade or industry for transactions of the type.

(d) Notwithstanding any other provision of this section, if after consideration of all the circumstances, including any applicable course of dealing and use of trade, it appears that the parties and the records containing the offer and acceptance did not agree on an element of scope, the elements of scope on which the parties did not agree are determined by the licensor's record. ~~if the parties have not expressly agreed on scope and records exchanged by the parties conflict on scope, the terms of the licensor's record governs the scope.~~

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

terms of the contract are determined under Section 2B-207 or 2B-208, as applicable.

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

Definitional Cross Reference:

"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 2B-102. "Court": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Scope": Section 2B-102. "Standard form": Section 2B-102. "Term": Section 1-201.

Committee Votes:

a. Consensus to rewrite former current (d) to deal with terms basic to defining the product.

b. Failed to adopt a motion that in the battle of forms the presumption should be no consequential damages. (4 - 4) (April, 1997)

c. Voted to clarify that the language in d is the last step and even then if it does not conflict with the agreement as a whole. Vote 8 – 2 (March, 1998)

d. Rejected motion that knock out rule not apply to consequential damages clause. Vote 5 – 6 (March, 1998)

Reporter's Note:

1. *Scope and General Effect.* This Section deals with cases where no contract is formed by records exchanged by the parties, but a contract is formed by conduct. Given that limitation. It assumes that a contract exists and provides guidance on determining what terms apply to the contract. Article 2 describes this situation in Section 2-207(c). In transactions governed by law other than Article 2, common law themes apply general interpretation concepts to the circumstance of conduct-based contracts.

The section distinguishes between the general circumstance of contracts created by conduct (subsection a) and cases where a battle of forms occurred and neither party accepted the form of the other, but conduct created a contract. Subsection (b) adopts current Article 2-207(c) for this variation of the battle of forms. Article 2-207 is not limited to standard forms, but the cases and literature concentrate on the problem of the exchange of forms that disagree on important matters.

If the exchanged forms create a contract or one party agrees to the terms proposed by the other in a record or otherwise, this section does not apply. Under 2B-203, a contract forms around the terms of the offer. Subsection (d) confirms that result. This is also true where a party accepts an offer in a setting where records are not used. The Section only applies in cases where the existence of a contract is premised solely on conduct of the parties. See 2B-202.

2. *General Rule: Interpret based on Context.* Subsection (a) states the general rule. It directs attention to the entire context including terms of exchanged records and the nature of the intellectual property rights held by the licensor or licensee. This conforms to common law concepts and the basic UCC theme of building enforceable terms based on practical construction of the relationship. The interpretation approach requires considering terms of all records and other circumstances. See Abram & Tracy, Inc. v. Smith, 88 Ohio App.3d 253, 623 N.E.2d 704, 708 (1993) ("a writing should be interpreted as a whole and all the writings that are part of the same transaction should be interpreted together."); Restatement (Second) of Contracts § 202(1) (2) (1981); 2 Farnsworth, Contracts § 7.10 (1990).

In the variety of transactional conditions in which conduct, rather than records or acceptance of a particular offer, a priori or formalistic rules cannot control; they cannot account for the diversity and contextual nuances that exist in a rich environment of transactional practice. Subsection (a) thus rejects any general application of a "knock-out" rule which requires that a court apply a set formula rejecting any terms in one record that are not matched in another without consideration of the overall context. Any such rigid rule needlessly places restraints that preclude a court's focus on more generally determining the intent of the parties.

Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., this rule allows courts to continue existing practice, rather than enforcing a new and inappropriate legal regime on the contract interpretation process.

3. *Battle of Forms and Behavior.* Subsection (b) creates an exception to the general interpretation rule. The exception focuses on the battle of forms. The battle of forms has, in sales of goods, created significant controversy and uncertain results. Subsection (b) adopts current Article 2-207(c) with a special provision in reference to scope terms that have significance in Article 2B transactions.

Under subsection (b), if the standard forms of the parties do not establish a contract (e.g., due to a material conflict or due to conflicting conditional offers), but conduct creates a contract, this section adopts a "knock-out" rule. Neither form controls.

The battle of standard forms deals with a case where the parties exchange forms, but

ignore those forms in determining to perform or not. Where this is true, the subsection states simply that, except with respect to scope of the license, if the parties did not do so, law will not retroactively create a rule in which the standard forms of one party have greater significance than suggested by their behavior. Discussing UCC § 2-207, the Third Circuit Court of Appeals noted:

> The insight behind [Article 2] is that it would be unfair to bind [a party to the standard terms of the other party] when neither party cared sufficiently to establish expressly the terms of their agreement, simply because [one party] sent the last form.

The rule in subsection (b) excludes conflicting terms regardless of which form was the first received or sent.

> **Illustration 1:** In response to a standard form from DuPont, Developer ships software subject to a standard form invoice. The two forms disagree on warranties. Neither party insists in fact on their own terms. Both warranty terms drop out; default rules apply.
>
> **Illustration 2:** Developer sends a letter, rejecting the DuPont warranty terms, but ships without obtaining assent to its terms or precluding use of the product without such assent. Determining what terms govern poses a difficult, but ordinary contract interpretation issue about the intent of the parties. Subsection (a) governs.

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

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

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

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

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

4). If there is a material variance and no acceptance, a contract is formed only by conduct. Section 2B-209 determines its terms based either on a general assessment of the context or on the "knock-out" rule in subsection (b).

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

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

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

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

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

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

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

disturb that result.

6. *Signed or Authenticated Records.* Subsection (e) clarifies that the rules of this section are inapplicable if a party signs and thus accepts a record of the other. This Section applies only where the contract is based merely on conduct; and provides guidance on what terms of the contract apply. Where by signature or otherwise, a party adopts a proposal from the other party, that set of proposed terms governs.

Authentication (signature) of a record supersedes other records, subject of course to parole evidence issues. An executed agreement better indicates intent and throws the case outside the knock out rule. Clearly, it would be a major change in law to regard a signed writing as being no different in substance that unsigned and conflicting forms. Consistent with this section courts should use general concepts of contract interpretation to discern the meaning of the contract incorporated in a signed record.

7. *Scope of License.* In information products, the contract terms relating to scope of use define the product. Being licensed. The same subject matter (e.g., a copy of a motion picture) has entirely different value and substance depending on what rights in that subject matter are granted. Thus, the "subject matter" is different if the copy is licensed solely for personal use as compared to being licensed for distribution in theaters throughout Latin America. In this environment, the license, especially its scope, is the product.

That being true, this section gives special deference to the provider's definition of scope in cases where not express agreement occurs with reference to that issue. In the absence of contrary agreement, the information provider can define what it is providing. More relevant, the other party cannot resort to a court to obtain that product which it failed to obtain from the licensor by negotiation.

"Scope" is a defined term that refers to contract terms restricting field of use, duration and similar terms that in effect define the nature of the information product being licensed. The scope of a license in effect defines the "product" or "focus" of the deal. The mere fact that one form disagrees with the licensor's form on issues of scope cannot be held to throw the case back on general default rules. A vendor who provides a consumer version of software cannot be forced to have given an unlimited, license in the software for development and other use simply because a competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms define the product being sold (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware of what can be granted (e.g., it holds rights to a screen play only for use in television). In cases where forms disagree on basic points, the true issue is whether a contract exists (that is, was there agreement) notwithstanding the records exchanged or the conduct of the parties. In many cases, without an agreement about the fundamental scope of the license, no agreement to a contract exists.

PART 3

CONSTRUCTION

[A. General]

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

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

(2) evidence of consistent additional terms unless the court finds the record to

have been intended as a complete and exclusive statement of the terms of the agreement.

Uniform Law Source: Section 2A-202; Section 2-202.
Definitional Cross Reference:
"Agreement": Section 1-201. "Court": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.
Committee Votes and Action:

a. Voted 11-0 to strike suggested presumption re merger clauses and return to current Article 2 rule.

b. Reviewed in April 1997 without substantive comment.

c. At 1997 Annual Meeting, a sense of the house motion adopted to harmonize parol evidence rules in the three articles.

Reporter's Notes: Follows current Article 2.

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

(a) Where the contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

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

(c) Subject to Section 2B-303 and 2B-606, course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

UNIFORM LAW SOURCE: Section 2A-207; Section 2-208; Section 1-205. Revised.
Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.
Committee Vote:

a. The Committee voted unanimously to adopt this section. (September, 1996)

b. Reviewed without substantive comment. (April, 1997).

Reporter's Note: Conforms to Article 2.

SECTION 2B-303. MODIFICATION AND RESCISSION.

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

(b) An authenticated record that precludes modification or rescission except by an authenticated record cannot otherwise be modified or rescinded. However, in a standard form supplied by a merchant to a consumer, a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.

(c) The requirements of Section 2B-201 must be satisfied if the contract as modified is within its provisions.

(d) An attempt at modification or rescission which does not satisfy the requirements of subsection (b) or (c) can operate as a waiver under Section 2B-606.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Authenticate". Section 2B-102. "Consumer". Section 2B-102. "Contract". Section 2B-102. "Merchant". Section 2B-102. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Votes:

a. Voted 12-1 to approve the section and the use of manifest assent.

b. Voted to retain reference to consumer, rather than mass market. (11-1) (Feb. 1997).

c. Voted to reject a motion to make a "no oral modification" clause unenforceable in a consumer transaction. (1-10) (April, 1997).

Reporter's Notes:

This Section follows existing Article 2-209 except for the use of "manifest assent" regarding the use of a no modification term in a consumer contract. The content of Section 2-209(5) is included in Section 2B-806 on waiver. In subsection (b), Article 2 and Article 2A require no oral modification terms to be signed by the consumer; that concept appears here in the form of a requirement of manifestation of assent to the term, rather than signature. This allows the concept to operate in electronic environments if authentication is not feasible, while still protecting the consumer.

If the agreement of the parties limits enforceability to modifications that are in a record, that agreement will be enforced. The rule is especially important in the on-going relationships in many commercial licenses and development contracts.

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of a contract involving successive performances apply to all later performances unless the terms are modified in accordance with this article or the contract, even if the terms are not subsequently displayed or otherwise brought to the attention of the parties.

(b) Subject to Section 2B-303(b), ~~I~~if a contract provides that it may be modified as to future performances by compliance with a described procedure, a change proposed in good-faith pursuant to that procedure is effective as a modification if:

(1) the procedure reasonably notifies the other party of the change; and

(2) in a mass-market license, the procedure permits the other party to terminate the contract as to future performance if the modification deals with a material term and the party in good faith determines that the modification is unacceptable.

(c) The parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light of the commercial circumstances.

Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 2B-102. "Electronic agent": Section 2B-102. "Good faith": Section 2B-102. "Mass-market license": Section 2B-102. "Notifies": Section 1-201. "Party": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Committee Action:

a. Vote to extend (b)(2) to mass market, rather than only consumers.

b. Deleted limitation that change be "materially adverse" to licensee and substituted "unacceptable in good faith." (7-5) (April, 1997)

Reporter's Notes:

1. *Continuing Terms.* Subsection (a) states the simple principle that contract terms, if enforceable, cover all contractual performance. In the language of the section, terms are continuing and need not be restated for each performance or use of a system. This principle is not limited to cases where the agreement requires future performances. It applies in any case where the subsequent performances are covered by the prior agreement. Terms of a purchase of information do not necessarily carry forward if the first agreement only pertains to the first performance. However, if the first agreement does apply to the first and to any subsequent purchases, the rule of this Section applies.

2. *Modifications of Continuing Contracts: General Issue.* Subsection (b) addresses a common practice in online or other continuing service contracts, such as outsourcing arrangements. In these contracts, frequent changes occur in the terms of service and separate discussion or negotiation of each change is often not feasible or desired by the parties. Common practice entails posting changes in service conditions in a particular location or file and providing that the posted changes are effective when posted or at a later point in time.

Subsection (b) specifies a fair method for changes in on-going relationships without disturbing other law or circumstances that might provide additional methods. See Section 2B-115(c). For example, a signed modification is effective. Similarly, Section 2B-303 states that modifications of contract do not require consideration. General common law, principles of waiver (see, e.g., Section 2B-606) and provisions on course of performance (Section 2B-302) among other sources of law also deal with enforceability of modifications of on-going contracts. Thus, some changes do not require the procedures described here.

In general, what constitutes an effective modification may hinge on agreement, but changes in contractual terms, including both course of performance and waivers are routinely found based on objective indicia of assent, such as awareness or notice, couples with a pattern of behavior not objecting to the changes in terms or performance. For example, even in a fixed term mortgage not subject to termination, federal rules allow unilateral changes in consumer contracts if the changes meet any of several criteria, including that either the change benefits the consumer or makes an "insignificant change" to the

contract. FRB Regulation Z, 12 CFR § 226.5b. The contracts covered here which often involve contracts subject to termination at will present a clearer case to allow non-material modifications.

3. *Contractual Authorization and Notice.* Subsection (b) provides a safe harbor, indicating that methods that comply with this are enforceable without indicating that other methods are not available. The safe harbor in subsection (b) requires a contractual authorization of a modification procedure and that the procedure entail notification of the other party.

What constitutes notification varies depending on the circumstances. In many cases, reasonable notification requires notification before the change is effect, but in some emergency situations, notice that coincides with the change or follows the change would be sufficient (e.g., blocking access to a virus infected site, or a change in the access codes required for access). See 12 CFR 205.8(a)(2) as an example. The standard requires that the party be notified of the change. A procedure for the posting of changes in an accessible location of which the other party is aware will ordinarily satisfy this section.

4. *Mass-Market Contracts.* Subsection (b)(2) modifies the safe harbor provision in the case of a mass-market transaction. In this situation, the procedure must not only have been agreed to and provide reasonable notification, it must permit the licensee an opportunity to withdraw as to future performance. This additional restriction is not appropriate in general commercial practice where by prior agreement the parties may provide that they are bound by good faith changes proposed by the other party. See generally Section 2B-305(b) which adopts current Article 2 on this point). See also Section 2B-202(b)(2).

The requirement of a termination right reasonably should extend only to changes that are significant. Consistent with this, it applies only with reference to changes in material terms that are adverse to the consumer. Price would be a material term in all cases. Beyond that, a variety of other changes in a mass market may relate to material matters in the on-going relationship. Of course, a reduction in service charges would not produce a right to terminate. Withdrawal is without penalty, but the mass market licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due at that time).

In many mass-market contracts that entail continuing performance, the contract itself may be subject to termination at will under Section 2B-310. Subsection (b) does not alter that result.

5. *Changes in Content.* This subsection deals with changes in contract terms and does not cover changes in the content made available under an access contract, such as one involving a multifaceted database. Under Section 2B-614(a), an access contract grants rights of access to materials **as changed and modified** by the licensor over time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete an element of the databases made available does not modify the contract, but merely constitutes performance by the licensor and is not within this subsection.

SECTION 2B-305. PERFORMANCE UNDER OPEN TERMS; TERMS TO BE SPECIFIED; PERFORMANCE TO PARTY'S SATISFACTION.

(a) If the performance required of a party is not fixed or determinable from the agreement or this article, the party must ~~agreement requires~~ perform~~ance~~ in a manner that is reasonable in light of the commercial circumstances existing at the time of agreement.

(b) An agreement that is otherwise sufficiently definite to be a contract is not invalid merely because it leaves particulars of performance to be specified by one of the parties. If a term of an agreement is to be specified by a party, the following rules apply:

(1) Specification must be made in good faith and within limits set by commercial reasonableness.

(2) If a specification to be made by one party substantially affects the

other party's future performance but is not seasonably made, the other party:

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

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

(c) An agreement that provides that the performance of one party be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied. However, the agreement requires performance to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by providing that the satisfaction or approval is to be in the "sole discretion" of the party, or words of similar import; or

(2) the performance is the creation or delivery of informational content in a context in which it is to be evaluated in reference to aesthetics, market appeal, suitability to taste, or similar characteristics.

Uniform Law Source: Section 2-305; Section 2-311; Restatement 228. Revised.

Definitional Cross Reference:

"Agreement": Section 1-201. "Contract": Section 2B-102. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Party": Section 1-201. "Person": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. *Open Terms.* Subsection (a) and (b) bring together rules relating to open terms under current Article 2.

2. *Performance to the Satisfaction of a Party.* Subsection (c) focuses on cases where performance is to be to the satisfaction of the other party. Two different approaches reflect different traditions and case law in commercial areas affected by Article 2B and differences in qualitative standards that are appropriate to the commercial relationships. A factor that distinguishes the information industries is that many of the information products that they obtain or distribute focus on aesthetics and marketability, rather than merely on the capability of performance of the product. This focus, when it applies, leaves it important that the judgment of the licensee be unfettered about whether the proffered performance is appropriate. Here, "to the satisfaction clauses" create a subjective standard, rather than one defined by reference to a reasonable person test. The converse rule is more appropriate in cases involving the development of computer programs and the like with respect to performance of the programs.

Restatement (Second) of Contracts § 228 "prefers" a reasonable man approach if the context permits objective standards for determining satisfaction. This leaves too much uncertainty for the information industries affected here. The Restatement cites an entertainment industry example as one in which no reasonable standard of satisfaction is possible. The language in (c) provides guidance for determining when the subjective standard is appropriate for information industry performances.

3. *Contractual Language.* Subsection (c)(1) gives a court guidance and provides safe harbor language, indicating what language achieves a subjective satisfaction standard where the issue is specifically addressed in the agreement..

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

(a) A term that measures the quantity or amount of use by the output of the licensor or the requirements of the licensee means such actual output or requirements as may occur in good faith. No quantity or amount of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements may be tendered or demanded, but this limitation does not apply if the party in good faith has no output or requirements.

(b) A lawful agreement for exclusive dealing in the information or informational property rights concerned imposes an obligation on a licensor that is the exclusive supplier to use good-faith efforts to supply the information and on a licensee that is the exclusive distributor to use good-faith efforts to promote the information commercially if the value received by the other party substantially depends on that performance.

Uniform Statutory Source: Section 2-306.

Definitional Cross Reference:

"Agreement". Section 1-201."Good faith". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Term". Section 1-201.

Committee Vote:

1. Voted unanimously to approve the section in principle. (Oct. 1996)

Reporter's Notes:

1. *Out-put and Requirements.* Subsection (a) adopts existing Article 2. In practice, however, many information transactions that would come within its scope do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. Courts must recognize and adjust their approach to this fact. A prime characteristic of information as a subject matter of a transaction lies in the fact that the information is 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. *Exclusive Dealing.* Subsection (b) accommodates the various bodies of law that pertain to exclusive dealing relationships in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for resale by the other party. Case law dealing with patent licensing creates a best efforts default rule subject to consideration of the terms of the license and whether adequate compensation is received by the patent holder without such effort by the licensee.. Article 2-306 creates a best efforts rule for goods. That rule, however, is not the law in other fields governed by Article 2B. In any event, the best effort standard has been difficult if not impossible to define with reliability.

This Section adopts a good faith effort standard: honesty in fact and adherence to commercial standards of fair dealing. This allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. Interpretation]

SECTION 2B-307. INTERPRETATION OF GRANT.

(a) A license grants the informational property ~~all~~ right~~s~~ to use:

(1) ~~the identified~~ information or informational property rights which are expressly described; and

(2) ~~and~~ all informational property rights ~~which are~~ within the licensor's control during the duration of the license that ~~and~~ are necessary in the ordinary course to exercise the expressly granted rights.

(b) A licensee impliedly agrees ~~contains an implied limitation that the licensee will~~ not to exceed ~~the terms of the agreement regarding~~ the expressly granted rights or exercise rights in the information other than those in subsection (a). However, ~~U~~use of the information or informational property rights in a manner inconsistent with ~~that exceeds the agreement does not breach~~ this implied limitation is not a breach if the use ~~was necessary to the expressly granted uses, or the use~~ would be permitted under applicable law in the absence of the implied limitation.

(c~~b~~) An agreement ~~license~~ that does not specify the number of permitted users permits a number of users that is reasonable in light of the informational property rights and the commercial circumstances existing at the time of agreement.

(d~~c~~) Except as otherwise provided under informational property law, neither party is entitled to any rights in improvements or modifications made by the other party after the license becomes enforceable. A licensor's agreement to provide, after acceptance of the completed information, new versions, improvements or modifications requires that the licensor provide the agreed information as developed from time to time and made generally commercially available by the licensor.~~,~~

(e) Neither party is entitled ~~or~~ to receive copies of source code, object code,

schematics, master copy, or other design material, or other information used by the other party in creating, developing, or implementing the information. ~~A licensor's agreement to provide improvements or modifications requires provision of the agreed information as developed by the licensor from time to time for use by other persons and made generally commercially available.~~

(f~~d~~) Terms dealing with the scope of an agreement must be construed under ordinary principles of contract interpretation in light of the informational property rights and the commercial context. In addition, the following rules apply:

(1) A grant of "all possible rights and media", "all rights and media now known or later developed", or a grant in similar terms, includes all rights then existing or created by law in the future, and all uses, media, and methods of distribution or exhibition then existing or developed in the future, whether or not anticipated at the time of the grant.

(2) ~~A grant of a "quitclaim", or a grant in similar terms, between merchants grants the information or informational property rights without a representation or implied warranty as to infringement or as to the rights actually possessed or transferred by the grantor.~~

~~(3)~~ A grant of an "exclusive license", or a grant in similar terms, affirms for the duration of the license and as to the scope of the exclusive grant that the licensor will not exercise and will not grant to any other party rights in the same information within the same scope and that the licensor has not previously done so in a contract in force at the time the licensee's rights begin.

Definitional Cross Reference:
"Agreement". Section 1-201. "Contract"; Section 2B-102. "Copy"; Section 2B-102. "Information"; Section 2B-102. "Informational property rights"; Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Merchant". Section 2B-102. "Party"; Section 1-201. "Person"; Section 1-201. "Receive"; Section 2B-102. "Rights"; Section 1-201. "Scope"; Section 2B-102. "Term"; Section 1-201.
Notes:

Restructured in light of discussion. Subsection (f)(2) moved to 2B-401.

Committee Action:

Reviewed without substantive change.

Reporter's Notes:

1. *Implied Licenses and Implied Limitations.* The subsection (a) deals with a subject that common law courts often address under the general theory of implied licenses. It approaches the question as one of interpreting a contract grant. The issue deals with the appropriate treatment of the case where rights not expressly granted are essential to the licensee's use of the information in a manner consistent with the expressly granted rights. The Section adopts the reasonable interpretation that the affirmative grant includes all necessary rights to use that grant, to the extent that these are within the control of the licensor. For example, a license to use a film clip in a CD ROM product conveys the right to crop or modify the size of the clip to fit the media unless that right to make a modification is excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to make modified versions of that software. The implied license relates to rights transferred and to materials provided to the party; it does not require a transfer of additional materials (such as source code), unless that transfer was agreed to by the parties. Contract terms precluding this treatment are effective.

Subsection (b) deals with an important interpretation issue that is accentuated as more information transactions occur among persons who are not expert in intellectual property law rules. The question involves what interpretation is placed on a grant "to do X." Under current law, it is clear that uses of licensed information outside the express scope of a license are breaches of contract if the scope is defined in terms of "to do only X" or otherwise expressly precludes the use. If the word "only" does not appear, the cases are less clear; some cases suggest that the omission of the word in formal grant language means that there is no contract breach if the licensee exceed the grant. This approach is not universally followed; some cases hold that federal policy requires that the proper interpretation of a copyright license is that any use not expressly granted is withheld. A rule that hinges on the use of the word "only" provides a true trap for unwary drafters and unwary licensees. It is rejected in this section.

Subsection (b) adopts the ordinary commercial understanding that an affirmative grant implicitly excludes uses that exceed the grant. The implied limitation, however, is not as strong as an express limitation. It does not yield a breach of contract if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a quotation from a licensed material not subject to trade secrecy restraints, if a fair use, would not conflict with the implied limitation. However, if a grant does not use the magic word "only" and gives a right to use a motion picture in one location, a licensee that makes and distributes multiple copies for sale violates the copyright (as a non-fair use) and breaches the contract. Also, a grant to use a work in Peoria implies the lack of a contract right to do so in Detroit.

Illustration 1: Disney licenses to Acme the right "to show Snow White during a six month period in Kansas." 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 unauthorized use infringes the copyright. Whether it breaches the contract depends on whether the grant precludes other uses of the work and derivative copies. Under section (b), the limitation exists unless: 1) the use was a fair use without that implied limitation, or 2) the use was necessary to the granted use. Neither condition is met here.

Illustration 2: Licensor grants the "right to use X software in the development of motion pictures." The licensee uses the software to develop a television series that is not a motion picture. The contract breach issue is whether television use "exceeds" the grant.

Illustration 3: Same as illustration 2, except that the license grant states that it grants "the right to use X software only in developing motion pictures." Use in television violates an express limit and is a breach. Whether such difference in result should flow from the addition or omission of the word "solely" is at issue. Requiring that word may be a trap for less well-counseled parties.

Illustration 4: Same as illustration 2, except that the license provides that "all uses not expressly granted are expressly reserved to the licensor." Same result as Illustration 3.

Illustration 5. EXL licenses copyrighted software to Dangerfield. The license is silent on reverse engineering and consumer use, but gives Dangerfield the right to use the software in the 1000 person network of employees. Dangerfield disassembles or decompiles the software to examine the code. Also, an employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is authorized if it would be a fair use in the absence of the implied limit. The making of copies for

purposes of examining the software involves the same analysis; if a fair use in the absence of the implied limit, it would not breach the term.

2. *Number of Users.* Subsection (c) uses a commercial reasonableness test to deal with cases where a license fails to specify the number of simultaneous users that are permitted for the particular information. In some cases, especially in the mass market, a single simultaneous user limitation would be appropriately assumed for a computer program. In other contexts, multi-use or network use concepts would be more appropriate. The ideas of the section is to guide a court, and the parties, by making reference to commercially reasonable assumptions about this important variable.

3. *Modifications.* As a basic principle a party receives no right in contract to subsequent modifications made by the other party, nor is access to typically confidential material. Arrangements for improvements and source code or designs constitute separate valuable relationships handled by express contract terms, rather than presumed away from their owner by the simple fact of forming a general contract.

Illustration 6: Word Company licenses B to use Word's robotics software. 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 7: In the Word license, two years after the license is established, Party B's software engineers discover several modifications that 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 exists about whether the license granted the right to make such a derivative work.

4. *Grant Clauses.* Subsection (d) (1) provides guidance for whether (when) a license grants rights only in existing media or methods of use of information or whether it extends to future uses. The draft adopts the majority approach in a number of recent cases. 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.

Subsection (d)(2) deals with how, in a commercial context, parties can transfer information without giving assurances about rights. The concept of a quitclaim of rights is most common in entertainment contexts, but like the idea of a quitclaim in real estate, it is essentially a grant only of whatever rights the grantor holds.

Subsection (d)(3) deals with the effect of language of exclusivity in a grant. The case law and treatises are in conflict. The issue focuses on two distinct elements: a looking forward and looking backward issue about exclusivity as to other persons, and the issue of whether the exclusivity also applies to actions of the licensor.

SECTION 2B-308. DURATION OF CONTRACT. If an agreement ~~is~~ does not specify ~~the~~ its duration ~~of the license~~, except as otherwise provided by other applicable law, the following rules apply:

(1) Except as otherwise provided in paragraph (2), the agreement is enforceable for a reasonable time in light of the commercial circumstances~~,~~ but may be terminated as to future performances at will by either party during that time on reasonable notice to the other party~~. The effect of termination is determined under Sections 2B-624 and 2B-626.~~.

(2) ~~Subject to cancellation for breach and except as to services, t~~The duration of a license is a reasonable time in light of the informational property rights and the commercial circumstances, but the license is perpetual as to the rights and contractual use restrictions, to the extent allowed by other law, if:

(A) the agreement is a software contract that ~~and~~ transfers ownership of a copy or provides for delivery of a copy for a single fee fixed at the beginning ~~outset~~ of the contract; or

(B) the license authorizes the licensee to integrate the licensed information or informational property rights into a product ~~or on a physical media~~ intended for distribution or public performance by the licensee.

Uniform Law Source: Section 2-309(1)(2).

Definitional Cross Reference:

"Agreement". Section 1-201. "Rights". Section 1-201. "Cancellation". Section 2B-102. "Contract": Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Notice". Section 1-201. "Party". Section 1-201. "Termination": Section 2B-102.

Committee Votes:

1. The Committee voted to approve this section in principle.

2. Rejected a motion to delete the section. Vote: 2 – 10.

Reporter's Note:

1. *Basic Scope and Theme.* Paragraph (1) follows current Article 2, but contains provisions tailored to licensing issues that are not addressed in Article 2.

The section applies to agreements that do not specify their duration. The basic policy in such cases is that the person making an open-ended commitment should be held to performance over a time that is reasonable in light of the payment and the type of commercial setting, but would typically not be placed in a position of perpetual servitude without a very clear indication that should be the case. Consistent with Article 2 and common law, this section makes the contract in such cases subject to termination at will on reasonable notice.

The section assumes that there is an agreement. In some cases, a failure to agree on duration will, like failure to agree on any other scope provision, indicate that no contract exists. In addition, the section does not apply simply because a record that documents the agreement is silent. Agreement refers to the entire bargain of the parties. This includes oral agreements, trade use, and the entire commercial setting as relevant. This section applies only if the total of all of the circumstances defining the bargain yield no understanding about duration. Thus, for example, a license reached in an industry setting where, for the particular information, licenses are typically for hourly, daily, weekly, or monthly terms, would typically not fall within this section because the ordinary term for licenses of the type would supply the duration.

The Section does not deal with contracts that contain provisions defining their term, even if those terms do not specify a fixed date. Thus, a contract providing that a license continues for "the life of the edition" or "for so long as the work remains in print" defines the term of the license in the same manner as does a contract term of, for example, ten years. The contract terms control. On the other hand, decisions interpreting the analogous Article 2 rule for cases where there are commitments to "lifetime" service or "perpetual" maintenance, would provide guidance on whether language of that sort in a services obligation creates a definite term.

2. *Standard for Termination: Reasonable Time.* The basic rule is that in the absence of terms in the agreement referring to the duration of the contract, the duration of a contract is presumed to be

a "reasonable" time. This follows both existing Article 2 and common law.

The follows current common law which makes indefinite contracts subject to termination at will on reasonable notice to the other party. This is an important method of implementing the "reasonable time" duration concepts since it allows a non-judicial method of ending the contract. As indicated in Section 2B-624, termination does not end all obligations or rights. Thus, it does not end rights that have become vested based on prior performance. Which rights these include in a given transaction, of course, depends on the terms of the agreement.

The reasonable time presumption is an important base for dealing with myriad types of transactions involved in this field. Thus, for example, consider a situation in which X obtains an exclusive license to distribute the motion pictures of Y Corporation in the United States. A presumption that makes this license perpetual would bind the licensor and licensee over an extended term where the business context might not justify the presumption. The reasonable time standard allows the parties and the court, if needed, to make determinations of what duration is appropriate in light of the commercial context.

In some cases, what constitutes a reasonable term can be determined by reference to other law. In this field, there are various federal policy considerations that impinge on the duration of licenses and which may have an impact here. This occurs either by direct application of the other law or by its influence on determining what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed as extending for no more than the life and validity of the patent. A similar premise exists for an indefinite copyright license. It is important, however, that the reasonable time presumption only applies if the contract calls for successive performances. This is consistent with existing Article 2. This rule is limited to cases where a party has on-going, affirmative performance obligations to be rendered to the other party. These obligations may include payment obligations (e.g., royalties) or affirmative conduct (e.g., repair or maintenance). The premise here is identical to current Article 2.

3. *Effect of Termination.* This Section clarifies that termination occurs under and with the limitations indicated in 2B-624 and 2B-626. Specifically, termination cancels executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. Thus, for example, assume a license for software that would be perpetual under subsection (2), but with respect to which the licensor agrees to an indefinite obligation to provide telephone support to the end user. The successive performances in that support obligation create a situation to which subsection (1) applies. Assuming that the license and the support obligation are separable, if the support provider properly terminates that obligation, it can end the executory obligation to provide support. That does not, however, alter the rights to use that are vested in the underlying license.

3. *Perpetual Licenses.* Paragraph (2) differs from Article 2 and common law, creating a potentially important right or presumption favoring the licensee by presuming a perpetual term for two types of licenses.

The first involves a license associated with the sale or delivery of a copy of software. This rule corresponds to software licensing practice in general. The perpetual term assumption does not apply to services, such as ancillary support obligations, which when separable from the underlying license, are governed under the general reasonable time presumption. It also does not apply where the licensee has an on-going obligation to deliver affirmative performances to the other party. This language clarifies a result that, under current Article 2, would occur with reference to a contract that does not entail "successive performances." A rule analogous to that in Paragraph (2) is applied to intellectual property releases in another section.

The second situation deals with cases where the licensed information is intended to be incorporated into a product for third parties. The rule recognizes the reliance concerns that would be affected by a termination right.

SECTION 2B-309. RIGHTS TO INFORMATION IN ORIGINATING PARTY.

(a) Between merchantss, if an agreement obligates a party to handle or process confidential commercial, scientific, or technical information of the other party and does not authorize republication of that information, and the receiving party has reason to

know that the information is confidential, the following rules apply:

(1) As between the parties, the information and any summaries or tabulations based on it may be used by the other party only in a manner and for the purposes expressly authorized by the agreement or necessary for its performance.

(2) The party receiving, summarizing, or tabulating the information shall:

(A) act in a manner consistent with ordinary standards of the recipient's industry to hold the information in confidence; and

(B) on termination, make the information available to be destroyed or delivered to the other party ~~on termination of the agreement~~ pursuant ~~according~~ to the terms of the agreement or the instructions of that party.

(b) This section does not apply to information collected to ~~initiate or perform a contract, maintained to~~ effect or make a record of a transaction, or used to describe the subject matter of the transaction, or similar transactional information.

Uniform Law Source: None.
Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 2B-102. "Information": Section 2B-102. "Licensee": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201.
Committee Votes:
1. Approved the section in principle.
Reporter's Notes:
1. *General Principle.* Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person about whose business the commercial data relates maintains control of the data. This deals with an important issue relating to cases in which one party transfers data to another in the course of the transaction and for enabling that other party's performance of the contract. The rule applies to cases involving information that has not been released to the public and that the recipient knows is unlikely to be released. The presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee. In effect, the circumstances themselves establish a presumption of retained ownership.

Illustration 1: Staten Hospital contracts for Computer Company to provide a computer program and data processing for Staten's records on treatment and billing. Staten data are transferred electronically to Computer and processed in Computer's system. Staten remains the owner of its data. There is an obligation to return the data at the end of the contract. See Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351 (D.N.J. 1992).

2. *Remedies.* The remedies for breach of the obligations described in this section are for breach of contract. Ordinary contract remedies apply as do ordinary contract remedy limitations.

3. *Exceptions.* Subsection (b) states two general situations under which the presumptions and obligations o subsection (a) are not appropriate under current law or practice.

SECTION 2B-310. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, "restraint" means a program, code, device, or similar electronic or physical limitation that restricts use of information.

(b) A party entitled to enforce a limitation on use of information ~~that~~ which does not depend on the existence of a breach of contract may include in the information and utilize a restraint if:

(1) a term in the agreement authorizes use of the restraint;

(2) the restraint prevents uses of the information which~~that~~ are inconsistent with the agreement~~,~~ or with ~~a licensor's~~ rights under informational property rights law which were not granted to the licensee;

(3) the restraint prevents use of the information after expiration of the stated duration of the license ~~[~~or stated number of uses; or

(4) the restraint prevents use when the license terminates, other than on expiration of a stated duration or number of uses, and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) Unless allowed by a term of the agreement under subsection ~~Subsection~~ (b)(1~~2~~), ~~(3), or (4)~~ nothing in this Section ~~does not~~ authorizes a restraint that affirmatively prevents a licensee's access to its own information without use of the licensor's information or informational property rights.

(d) A restraint authorized under subsection (b) is not a breach of contract, and the party that included or used the restraint is not liable for any loss created by it. A restraint that prevents use authorized by the agreement is a breach of contract.

(e) This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy or version under an agreement with the licensee to electronically replace or upgrade the earlier copy.

Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of Section.* This section deals with electronic limitations on use that involve enforcement of contract terms by preventing breach. It does not involve electronic devices used to make a repossession or force discontinuation of use in the event of breach. Those are covered in Section 2B-716. The electronic restrictions discussed here all derive from contract terms; they limit use consistent with contract terms or terminate a license at its natural end. Of course, electronic regulation assumes that the licensor is enforcing a restriction that is, itself, enforceable. The few reported cases that deal with electronic devices support use of electronic devices even in the case of breach if disclosed to the licensee; the cases have not considered the less intrusive use of devices not associated with enforcing claims of breach.

2. *Policy.* The basic principle is that a contract can be enforced. Where the contract places time or other limits on a party's use of licensed information, electronic devices that merely enforce those limitations are appropriate. This reflects an important new capability created by digital information systems.

3. *Passive or Active Devices.* This Section distinguishes between active and passive electronic devices. An active device terminates the ability to make any further use of the information, while a passive device merely precludes actions that go beyond the license and would constitute a breach. Passive devices merely prevent unauthorized use, but leave the subject matter otherwise unaltered. Nothing in this Section authorizes active devices that impact the licensee's ability to access its own information through its own means other than the licensed information itself.

4. *Bases for Use.* Subsection (b) states alternative bases for the use of automated restraints. The section does not state exclusive rules. Federal or other law (including other sources of contract law) may also allow limiting devices designed to enforce copyright and copyright management information. In effect, this section contains an affirmative statement of when such limiting devices are enforceable under contract law, without limiting the enforceability of other methods.

a. Contract Authorization. The first option arises if the contract authorizes the party to use the restrictive tool. In this respect, the authorization must be in addition to the contract term that the tool enforces.

b. Passive Restraints Preventing Breach. Subsection (b)(2) provides that for passive devices, notice is not required if the electronics merely restrict use outside contract limitations or applicable informational property rights, without otherwise disabling the information. Thus, for example, assume that the contract restricts the lie licensee to making no more than one back-up copy of a work and that applicable copyright law rules provide that same limitation. This subsection authorizes use of a devices to enforce that limitation, so long as the device does not destroy the licensed information. The permitted restraint is one that enforces a contract, not one that imposes a penalty for its attempted breach. 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 counter which can be used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation inconsistent with the licensor's rights constitutes a breach of contract.

> **Illustration 1:** The license provides that no more than five users may employ the word processing software at any one time. An electronic counter is embedded in the software and, if a sixth user attempt to sign on for simultaneous use, that sixth user is denied access until another user discontinues use. This limiting device is effective without prior notice or contractual authorization.
>
> **Illustration 2:** The same situation as in Illustration 1, except that the limiting device permanently disables the software if a sixth user attempts access. This is not authorized by subsection (b)(2).

c. Enforcing Property Rights. Subsection (b)(2) also allows use of passive devices that merely preclude infringing intellectual property rights reserved to the licensor. Merely preventing the act does not require contract or other notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically.

A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so is authorized under (b)(2).

d. Enforcing Termination of the Contract. The restraints described in subsections (b)(3) and (b)(4) deal with restraints that enforce termination of the license. Termination means the end of the license for reasons other than breach. Subsection (3) corresponds to the licensor's basic right to terminate without notice either at the end of the fixed duration of the license, or on its termination on the happening of an agreed event. Both Article 2B and Article 2 recognize termination without notice in these cases and there is no principled reason to distinguish between termination enforced by automated means and any other form of termination. Subsection (b)(4), on the other hand, requires notice if termination is other than for the happening of an agreed event.

Illustration 3. A software license requires monthly payments of $1,000 due on the first of the month and a one year term with a right to renew based on written notice before expiration of the term. Licensee makes a payment five days late. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract.

Illustration 4. Assume there was no late payment, but the licensee fails to give notice of renewal in the contractual time period. The restraint turns off the software. This is covered by this section. The termination is valid if either the contract contained a term authorizing that action, or the licensor or the device gave prior, reasonable notice of termination to the licensee.

5. *Proper and Improper Enforcement.* Subsection (c) states the obvious. Actions consistent with a contract are not a breach and do not give rise to liability under this Article or the contract. The section permits enforcement of contract terms. It does not deal with rights to exclude, block out, or otherwise impact other information owned by or licensed to the licensee.

SECTION 2B-311. SHIPMENT TERMS. Shipment terms such as "F.O.B." and~~,~~ "C.I.F." ~~, and the like~~ must be interpreted according to Article 2 and any applicable custom or usage of trade.

Definitional Cross Reference:
"Term". Section 1-201.

Reporter's Notes:
This section was added to reflect the deletion of the detailed treatment of shipment terms found in existing Article 2. Rather than repeat or restate the variety of provisions in that statute or in applicable international or other laws, this section refers to Article 2 as a whole to provide meaning for such terms.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) Except in a financial accommodation contract, a~~A~~ licensor of information or of informational property rights other than a patent, ~~other than a financier or the licensor of a patent,~~ which is a merchant regularly dealing in information or rights of the kind, warrants that the information and rights shall be delivered free of the rightful claim of any third person by way of infringement or misappropriation~~the like~~, but a licensee that

furnishes specifications to the licensor must hold the licensor harmless against any such claim that arises out of compliance with the specifications ~~[~~except for claims that result from the failure of the licensor to adopt a noninfringing alternative of which the licensor had reason to know~~]~~.

(b) A licensor warrants that:

(1) for the duration of the license~~contract~~, no person holds a claim to or interest in the information which arose from an act or omission of the licensor, other than a claim by way of infringement or the like, which will interfere with the licensee's enjoyment of its license interest; and

(2) as to rights granted exclusively to the licensee, the informational property rights that are the subject of the license are valid and exclusive within the scope of the license for the information as a whole to the extent the rights are recognized under applicable law.

(c) The warranties in this section are subject to the following:

(1) If informational property rights are subject to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) The obligations under subsections (a) and (b)(2) apply solely to rights arising under the informational property laws of the United States or a State thereof.

(3) The obligations in subsection (a) and (b)(2) extend to other countries if the contract expressly so provides. Language is sufficient for this purpose if it states "Licensor warrants exclusivity and non-infringement in [specified country] [worldwide]," or words of similar import. ~~and any other country specifically named in the scope of the license.~~

(d) A warranty under this section will be excluded or modified only by specific language or by circumstances ~~which~~ that give the licensee reason to know that the

licensor does not warrant that competing claims do not exist or that the licensor purports to grant only such rights as it may have. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient ~~if it language of a type described in Section 2B-307(d)(2) or~~ if it states "There is no warranty against interference with your ~~of quiet~~ enjoyment of the information or against infringement", or words of similar import.

(e) A grant of a "quitclaim", or a grant in similar terms, between merchants grants the information or informational property rights without a representation or implied warranty as to infringement or as to the rights actually possessed or transferred by the grantor.

UNIFORM LAW SOURCE: Section 2A-211; Section 2-312. Revised.

Definitional Cross Reference:

"Conspicuous": Section 2B-102. "Contract": Section 2B-102. "Financier": Section 2B-102. "Information": Section 2B-102. "Informational property rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Person": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Notes to this Draft: Edited based on committee discussion. The term "reason to know" has been defined in Section 2B-102, a definition that might be moved to Article 1 (the term is currently used in six sections of this Article). Article 1 does **not** currently define "reason to know", but does define notice and knowledge. Article 1-201(25). As defined in 2B-102, the idea does not include constructive notice and does not include a duty to investigate. The provisions of (c) were modified to reconcile treatment of software and motion picture licenses, requiring express undertaking to make an assurance about worldwide validity or non-infringement.

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.
c. Voted to move the section toward standards applicable under current Article 2. Vote 11- 0.
d. Deleted express exception for conduits with comments to indicate that mere passive transmittal entity is covered in this context. Vote 12 – 0.

REPORTER'S NOTES:

1. *Non-Infringement Warranty.* Subsection (a) contains the affirmative warranty of non-infringement. It is taken from Article 2. The language used here and in Article 2 requires the information to be delivered free of any claim of infringement or the like. This means (1) that, hypothetically, if the information were used and the licensed rights exercised in all of the ways granted by the licensor at the time of delivery, the use would not be subject to a claim of infringement and (2) that the delivery itself does not infringe a third party informational property right which would subject the licensee to liability for receiving that delivery. In the case where no infringement claim exists on this basis, but, for example, a contract grants a three year license when the transferor's rights are limited to two years, the cause of action is for breach of contract, not breach of the infringement warranty. Liability under this warranty accrues based on conditions at the time the copy is delivered.

The basic interpretation of the warranty applied here extends to warranty to warrant noninfringing use. This expands existing Article 2 rules, but gives a more appropriate interpretation of the infringement concept and better protection for the licensee. Compare Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N.D. Tex. 1986).

Illustration 1. To illustrate the nature of this warranty, consider a license of clip art under which the licensor provides a copy of the clip art and conveys to the licensee a right to make derivative works from the clip art and to publicly perform or display the art for any purpose. The warranty requires that the licensor be authorized by the copyright owner to have made the copy it delivered and to distribute that copy. It also requires that the purported license of the derivative work and public display rights give the licensee an actual right to do so without there being an infringement claim. That latter warranty would be tested by asking whether, at the time of delivery, if the licensee had made a derivative work and a public display, these would constitute infringement. They might do so, for example, if the licensor had not itself been authorized to license these rights by the copyright owner.

Since the subsection conforms, except for the bracketed language, to existing Article 2, the comments to existing law, Section 2-312, Comment 3, apply and describe the intended scope and effect of the subsection. The warranty is made only by a person that is a merchant in information of this kind. The "hold harmless" obligation only applies in cases where the infringement arises as a result of compliance with licensee specifications, not because of choices of the licensor in implementing general specifications or goals of the licensee.

2. *Non-Infringement and Passive Transmission.* The obligation in subsection (a) deals only with licensors of information and applies only within the scope of this Article. It does not apply to persons who merely provide transmission services, even though those services may transmit information from and two other parties. In the area of copyright infringement, the issue of under what circumstances a transmittal entity has liability for infringement is controversial. Article 2B is a contract statute and has no effect on or direct relationship to federal questions about what acts constitute direct or contributory infringement. See 2B-105. This section states an affirmative obligation which, as drafted, creates an implied warranty of non-infringement by licensors of information. This excludes many of the cases where the copyright infringement issue is most difficult. It follows the contract law premise that commitments about the absence of infringing material between two parties to a contract are appropriate in transactions where one party provides information to another, as compared to services contracts that might (or might not) constitute an access contract. Whether, a particular contracting party is a "licensor of information" for contract law, will depend on the circumstances of the contract. It has no bearing on whether a passive transmission provider has liability to the owner of the intellectual property rights.

3. *Quiet Enjoyment Warranty.* Subsection (b)(1) deals with issues other than intellectual property infringement. The licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. Non-interference represent the essence of the contract. See 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. den. 484 U.S. 1063 (1988). This "quiet enjoyment" warranty comes from Article 2A and is to be construed in a manner consistent with that Article. It basically reflects the licensor's implied commitment to not act in a manner that detracts from the rights granted to the licensee for the term of the license by interfering with the licensee's use.

4. *Public Domain and Exclusivity Warranty.* Subsections (b)(2) deals with two intellectual property risks in exclusive licenses. General intellectual property risks in contracting encompass three different issues:

public domain risk: Whether enforceable rights exist in the information transferred? This asks whether the information is in the public domain and thus useable by anyone with access to it.

exclusivity risk: Whether the transferor has the sole right to the information or whether that right is also held by third parties (e.g., assignees, joint authors or coinventors).

infringement risk: Whether the transferor can convey rights enable the licensee to exercise those rights without infringing third party rights in the technology?

Subsection (a) deals with the infringement risk. Subsection (b)(2) deals with the other two risks. Both of these are relevant only in contracts that purport to give exclusive rights since each focuses on whether the licensor can grant such rights good against all third parties.

Validity corresponds to the public domain risk. It important especially if a licensee relies on the rights transferred to create a product for third parties. The converse of validity is that the information is in the public domain and, thus, can be used or recreated by anyone. See 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). Validity is not relevant to the ordinary end user license since it does not affect the licensee's right to use the information.

Subsection (b)(2) also deals with exclusivity: the risk 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 agreement, 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.

Exclusivity is an important issue where a licensee undertakes significant investment on the assumption that its rights are exclusive as to other competitors. For non-exclusive licenses, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant. It does not alter the end user's ability to continue to use the licensed rights without challenge. A license from one co-owner adequately grants rights to the licensee and the dispute would then shift to one between the two co-owners to determine accounting for and distribution of the proceeds f the license.

5. *International Issues.* Intellectual property rights are territorial in character in that they extend only within the territory of the state that creates them, except as some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) parallels this facet of intellectual property law and provides that the obligations created about exclusivity and infringement extend only within this country and to a country specifically named in the scope of the license. Unless a country is specifically so designated, the assumption is that the licensor and the licensee undertake obligations only with respect t this country.

6. *Disclaimer.* Article 2B provides for disclaimer of the warranties under this Section based on language from existing Article 2. This requires specific language or circumstances indicating that the warranties are not given. In addition, consistent with the general approach of contract law as a planning tool, illustrative language is provided for purposes of disclaimer.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) Subject to subsection (c), express warranties by ~~the~~ a licensor are created as follows:

(1) Any affirmation of fact or promise made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising or in product documentation, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information required under the agreement shall conform to the affirmation or promise.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the information shall conform to the description.

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will reasonably conform to the performance illustrated by the ~~model,~~ sample, model, or demonstration, taking into account such differences between the sample, model, or demonstration and the information as it would be used as would appear

to a reasonable person in the position of the licensee.

(b) It is not necessary to the creation of an express warranty that the licensor use formal words such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, an affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics or market appeal of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) The provisions of this ~~This~~ section do not apply to the creation of ~~es not create~~ an express warranty for published informational content. However, they ~~it~~ do~~es~~ not preclude the creation of an express warranty under other law or the creation of an express contractual obligation for published informational content. If an express warranty or contractual obligation is established for published informational content and is breached, the remedies of the aggrieved party arise under this article.

Uniform Law Source: Section 2A-210. Section 2-313.
Definitional Cross Reference:
"Aggrieved party": Section 1-201. "Information": Section 2B-102. "Licensor": 2B-102. "Party": Section 1-201. "Published Informational Content": Section 2B-102.
Committee Votes:

a. Deleted former subsection (b) that warranties are limited to the time of transfer because this merely restates current law and issue can be made clear in the comments.

b. Rejected motion to limit section to the immediate parties. Vote: 4-5

c. Adopted motion to add "except for published informational content" to make it clear draft is neutral on the law development here. Vote: 7-3.

d. Adopted motion to accept statement in (c) that leaves the development of obligations for informational content to common law. Vote: 6-2 (June, 1997)

e. Rejected a motion to delete subsection (c). Vote: 2-7 (March, 1998)

Reporter's Note:

1. *Basis of the Bargain: General Approach.* This section adopts existing Article 2, except with respect to published informational content, where it preserves current common law rules relating to express obligations without changing standards applicable under this other law.

Subsection (a) retains the "basis of the bargain" standard from current Article 2 and Article 2A. This allows courts and parties to draw on an extensive body of case law for distinguishing express warranties from puffing and other, non-enforceable statements. While the cases involve many difficult factual determinations, they provide better guidance than would an entirely new standard. 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); Cricket Alley Corp. v. Data Terminal Systems, Inc., 240 Kan. 661, 732 P.2d 719 (Kan. 1987).

While there has been some dispute about the meaning of the traditional "basis of the bargain" standard, the basic concept is that express affirmations, promises and the like are enforceable as express

warranties if they fit within the matrix of elements that constitute the bargain of the parties, but that they are not enforceable as express warranties if they are not part of the basis of the contractual deal. This standard does not require proof of reliance in the sense of a particular representation being relied on to make the deal, but rather enables a more general showing that the statements are part of the deal and basic to it.

2. *Basis of the Bargain: Advertising.* Subsection (a)(1) conforms to existing Article 2, except that it expressly provides that advertising or other forms of general communication may serve as a basis for the existence of an express warranty. This clarifies the rule; it expands the scope of express warranty law in some states. Statements made in advertising, of course, become express warranties under the standards applicable to any form of statement regarding the information. Mere puffing does not create a warranty and expressions of fact or promises are warranties only if they are part of the basis of the bargain. Of course, this requires that a bargain occur between the licensor making the representations and the licensee. In the absence of such a relationship, liability for advertising statements, if any arise, would not be under contract law, but under tort or advertising law rules.

3. *Basis of the Bargain: Samples and Models.* Subsection (a)(3) deals with samples and similar demonstrations. It expands current Article 2 by expressly referring to express warranties created by demonstrations of an information product.

The subsection also deals with beta models, which are employed in testing 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).

More generally, the subsection indicates that the representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the sample. In the world of goods, showing a sample of a keg of raw beans by lifting out a cup-full and allowing the buyer to inspect it communications one inference as to a whole, while a demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files. The standard stated here captures the approach of most courts to such issues.

4. *Published Informational Content.* Subsection (c) preserves current law for published informational content. While there are many reported cases dealing with express warranties in goods and using the standards adopted here, no case law exists for published informational content using the Article 2 standards. This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability risks pertaining to this subject matter must balance contract themes with more general social policies.

The intent is to leave undisturbed any existing law dealing with under what obligations can be created and how they are established with reference to published information. Courts, if inclined to find contract liability for published information, may do so under any general contract law theory. Many will conclude that the broad risk in the published content situation and the potentially stifling effect that imposing contract liability in that realm might have on the dissemination of speech should lean toward limiting or excluding liability in that context. However, that dispute evolves in particular cases, merely adopting Article 2 concepts from sales of goods to this much different context would risk a large and largely unknown change or over-reaching of liability in a sensitive area.

The term, "published information content" focuses on information content not customized to particular end users. The exclusion follows current law, requiring more than just general, undifferentiated statement for expanding liability in the public market of ideas and content. The basic assumption in 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 contract theory.

SECTION 2B-403. IMPLIED WARRANTY: MERCHANTABILITY AND QUALITY OF COMPUTER PROGRAM.

(a) Unless disclaimed or modified, a warranty that a delivered computer program

and physical medium are merchantable is implied if the licensor is a merchant with respect to computer programs of that kind.

(b) To be merchantable, a computer program and any physical medium on which it is delivered must:

(1) pass without objection in the trade under the contract description;

(2) be fit for the ordinary purposes for which it is distributed;

(3) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved;

(4) be adequately contained, packaged, and labeled as the agreement may require; and

(5) conform to the promises or affirmations of fact made on the container or label, if any.

~~(c) In cases not governed by subsection (a), unless otherwise disclaimed or modified, a licensor that is a merchant with respect to computer programs of that kind warrants to its licensee that:~~

~~(1) any physical medium on which the program is delivered is merchantable; and~~

~~(2) the delivered computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation provided by the licensor at or before the delivery of the program.~~

~~(d) Whether a warranty arises under subsection (c)(2) with respect to documentation is determined in light of the standards of Section 2B-402(b).~~

(c) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade.

(d) Warranties created under this section pertain to the functionality of a computer program, but do not pertain to informational content, including the subjective quality, aesthetics, market appeal, accuracy, or other characteristics of informational content, whether or not the content is included in or created by a computer program.

Uniform Law Source: Section 2-314; 2A-212. Revised.

Definitional Cross Reference:

"Agreement": Section 1-201. "Computer program": Section 2B-102. "Contract": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor". Section 2B-102. "Mass-market transaction". Section 2B-102. "Merchant". Section 2B-102. "Software". Section 2B-102. "Value". Section 1-201.

Committee Votes:

a. Rejected motion to add language warranting that the program will not damage ordinary

configured systems because no "ordinary system" exists in modern practice and the general premise is covered under the language of existing Article 2 as brought forward here.

b. Voted 10-2 to use "mass market" in this section, rather than "consumer." (Feb. 1997)

c. Voted 10-0 to apply the warranty of merchantability to all computer programs. (March, 1998)

Reporter's Notes:

1. *Background and Policy.* Article 2B warranties blend three different legal traditions. **One** stems from Article 2 and focuses on the quality of the product. This centers on the result delivered: a product that conforms to ordinary standards for products of that type. The **second** stems from common law, including cases on licenses, services contracts and information contracts. This tradition focuses on how a contract is performed, the process rather than the result. The transferor's obligations are to perform in a reasonably careful and workmanlike manner. See Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986). The **third** comes from contracts for informational content and, in many states, services contracts. See, e.g., ; Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W. D. Pa. 1991); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987). It disallows implied warranties and implied obligations of accuracy in information transferred other than in a special relationship of reliance. 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).

Current case law selects the applicable rule in part based on a court's characterizations about whether a transaction involves goods or not. That distinction is not reliable. It is unnecessary and unworkable in Article 2B. In this and the following Section, Article 2B distinctions are drawn between computer programs, on the one hand, to which an implied warranty of result is applied, and information or services, on the other hand, to which a process warranty applies. The policy is that qualitative warranties focused on result and merchantability concepts are appropriate for information that most closely resemble functional products - computer programs. Within that category of information products, a further distinction is drawn between mass-market and other types of computer programs.

2. *Expanded Application.* Since this Section applies to all computer programs provided to a licensee by a merchant with reference to the particular type of program, it expands the scope of the quality warranty by including cases where under current law the transaction is a services contract with no warranties or with warranties limited to making a reasonable effort. 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).

The warranty does not apply if the contract is for processing, analysis or other services and the licensor merely uses a computer program in its own activities. The warranty applies to cases where the program itself is the subject matter of the agreement.

> **Illustration 1:** 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 is for use of B's facility. Under current law, this is a services contract containing at most a warranty of workmanlike conduct; it is governed here under Section 2B-404.

3. *Dual Application.* The implied warranty in this Section and the warranty in Section 2B-404 may both apply to the same transaction and the same information product (e.g., an encyclopedia). The one would apply to the program and its functions, while the other would apply to the accuracy of data provided to the end user.

> **Illustration 2:** Party A contracts to license software to Party B to process B's accounts receivable. Whether the transfer is by diskette or by electronic conveyance, the merchantability warranty applies.
>
> **Illustration 3:** Party A licenses B to use a copy of the Marvel Encyclopedia. This Section applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia. Under current law, there would be no warranty of accuracy of the information.

4. *Merchantability.* Mass-market transactions in computer programs involving a licensor who is a merchant in programs of the type contain an implied warranty of merchantability. In the mass market, the idea of comparing a particular program to other mass market programs of similar type. The merchantability warranty generally corresponds to original Article 2, except where the difference between software and goods requires a difference in the formulation of the definition.

Since most modern agreements disclaim the warranty of merchantability, there are very few reported commercial cases involving merchantability in any industry, including the software industry. Merchantability standards ask what are normal characteristics of ordinary products of the type.

This Section limits the implied warranty to programs provided by a merchant in computer programs of the kind. This is not made by the casual provider of computer programs.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Unless disclaimed or modified and subject to subsections (b) and (c), a merchant that in a special relationship of reliance provides informational content or services to collect, compile, process, or transmit informational content, warrants to its licensee that there is no inaccuracy in the informational content caused by its failure to exercise reasonable care in its performance.

(b) A warranty does not arise under subsection (a) with respect to:

(1) the subjective quality, aesthetics, or market appeal of the content;

(2) published informational content; or

(3) a party that acts as a conduit or provides only editorial services in collecting, compiling or distributing informational content identified ~~in distributing informational content, if the distributing party identified the informational content~~ as having been prepared or created by a third party~~, unless the distributing party's own lack of care caused the inaccuracy resulting in the loss~~.

Uniform Law Source: Restatement (Second) of Torts 552.
Definitional Cross Reference:
"Informational content". Section 2B-102. "Licensee". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Published informational content". Section 2B-102. "Value". Section 1-201.
Committee Actions: Reviewed several times without substantive change.
Reporter's Notes:

1. *Scope and Effect.* This section creates a new implied warranty for consulting, data processing, and informational content contracts. The warranty focuses on the accuracy of data and reports, but incorporates a concept from common law process-related obligations typically found in services contracts. The Section expands protection for licensees in many states.

The standard adopted for the warranty is consistent with the process-oriented rules that the common law courts that find any obligation typically apply in similar contexts. See, e.g., Restatement (Second) of Torts § 552 ("One who … supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."). The appropriate approach here is not an absolute liability standard for accuracy, but a protected assurance that no errors are caused by a failure of reasonable care. See 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) ("[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."); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988).

2. *Terms and Existence of the Warranty.*

a. Accuracy and Care. Subsection (a) gives a warranty that no inaccuracy exists due to the provider's lack of reasonable care. This does not imply assurances about aesthetics or marketability. These are subjective issues not appropriate for an implied warranty because they cannot reasonably be objectively measured. Assurances on these issues require express contract terms.

Accuracy relates to what the information purports to be. A license of a large mailing list of addresses does not create an implied warranty of 100% accuracy. A contract to estimate the number of end users in Houston does not imply an accurate estimate, but merely an estimate. An agreement to provide a stock index number does not necessarily warrant that the published number was correctly computed. Lockwood v. Standard & Poor's Corp., No. 1-95-3063, 1997 WL 323659 (Ill. App. June 13, 1997).

Inaccuracy does not, in itself, establish breach of warranty. An actionable inaccuracy is one caused by a lack of reasonable care. See Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (liability disclaimed in this case).

b. Merchants. The warranty applies only to merchants in the particular information providing context. When dealing with a merchant, the licensee has a rightful expectation that errors are not created by lack of care. In dealing with persons who are not in the business of dealing with the particular type of information, however, that expectation is not implicitly reasonable; to exist, it must be made express.

c. Special Relationship of Reliance. The warranty arises only if the information is provided in context of a special relationship of reliance. This language follows the approach of most cases applying the Restatement standard. The warranty-creating transaction involves more than merely making information generally available. It does not require a fiduciary relationship, but does require indicia of special reliance. The case law under the Restatement provides applicable guidance. See A.T. Kearney v. IBM, -- F.3d – (9th Cir. 1997); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service like a newspaper; no liability).

This excludes information distributed to the public. That is made explicit in subsection (b)(2). "Published informational content" refers to information made available without being customized for a particular licensee and where no special relationship of reliance exists. This exclusion reflects the vast majority of cases under the Restatement. The policy stems from First Amendment and general social norms about the value of encouraging distribution of information.

> **Illustration 1:** Sam's website provides information on restaurants for a small monthly fee. The website contains published informational content and no implied warranty. The same is true of a restaurant review in the New York Times under non-Article 2B law.
>
> **Illustration 2:** Sam, an expert on restaurants, contracts to give advice on which restaurants should be included in Able's book on the "most profitable" Chicago restaurants. Sam makes the warranty under this section to Able since the information is not "published informational content" but was tailored to the purposes of the specific client. When the book is published, however, no warranty is made by either Sam or Able to an end user since the book is "published informational content."

Information systems analogous to newspapers, magazines, or books and are treated as such here for purposes of contract law. "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information." Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987).

3. *Exclusions.* Subsection (b) lists various exclusions from the warranty.

a. Aesthetics and Published Content. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy. Subsection (b)(2) exempts published informational content. Both points, although they could be inferred from the terms of the warranty itself and were added for clarity based on suggestions from a licensee involved with entertainment issues.

b. Conduits. Subsection (b)(3) states a principle that holds the publisher harmless from claims based on inaccuracies in third party materials merely distributed by it. Merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to the data provided by the third party. On the related issue of tort liability, see Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991).

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless disclaimed or modified, and except as otherwise provided in subsection (b), if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, there is an implied warranty that the information will be fit for that purpose.

(b) If from all the circumstances, it appears that ~~the~~ a licensor was to be paid for the amount of its time or effort regardless of the fitness of the information, the implied warranty is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable care ~~and workmanlike effort~~ to achieve that purpose.

(c) Subsections (a) and (b) do not apply to:

(1) the subjective quality, aesthetics, or market appeal of informational content; or

(2) ~~to~~ published informational content, but ~~except that~~ the subsections do apply to the selection among copies of different existing published informational content for the purposes of a particular licensee.

(d) If an agreement requires a licensor to provide or select an integrated system consisting of computer programs, hardware, or similar components and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an additional implied warranty that the components selected will function together as a system.

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.
Definitional Cross Reference:
"Agreement": Section 1-201. "Computer program": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102.

"Published informational content": Section 2B-102.

Committee Action:

a. Consensus to expand this section to cover all information with the possibility of an exception or special treatment for published informational content and manufacturer/ publishers.

Reporter's Note:

1. *General Approach.* This Section reconciles diverse case law and also creates, in subsection (d), a new implied warranty that does not exist under any current law. It clarifies the standard under which a licensee receives an implied assurances of a particular result, expanding the circumstances in development and design contracts under which this assurance occurs.

Subsection (a) states as a general rule that the stated reliance creates an implied warranty of a result fit for the licensee's purpose. Subsection (b) applies the common law "efforts" standard in some cases. This bifurcation deals with the issue of whether the appropriate implied obligation is an obligation to produce a result (present in sales of goods) or an obligation to make an effort to achieve a result (common law). Under prior case law in software and other fields, the decision is based on whether a court views the transaction as a sale of goods (result) or a contract for services (effort). The reported decisions are split; the decisions often lack a principled basis. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. 108, 546 N.E.2d 888 (1989) (result); Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987) (result) with Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988) (effort); Wharton Management Group v. Sigma Consultants, Inc., 1990 WL 18360, aff'd 582 A.2d 936 (Del. 1990) (effort); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) (no obligation).

Since all software development contracts are covered under Article 2B, a different approach is adopted in subsection (a) to determining which type of implied obligation is appropriate. The section presumes that (in an appropriate case) the Article 2 rules apply. This most completely protects the licensee. To accommodate the existence of services contract formats, the in effect directly identifies a consistent factor that indicates that to be true. The presumed Article 2 model is altered if the agreement hinges payment on the time and effort spent (services like) irrespective of completion of a product.

Of course, express contract terms control over either variation of the implied warranty.

2. *Warranty of Fitness.* Subsection (a)(1) adopts the rule of existing Article 2-305.

This obligates the provider to meet known licensee needs if the circumstances indicate that the licensee is relying on the provider's expertise to achieve this result. There are many development contract and other situations where no such reliance exists, including cases where the licensee provides the contract performance standards, rather than relying on the provider to fill an acknowledged need of the licensee. Then there is no reliance on the licensor about whether meeting the specifications will meet applicable needs.

3. *Services and Warranty.* This section does not override the general law of services contracts. Under that law, the services provider in a skilled context does not guaranty suitability unless it expressly agrees to do so. 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). Subsection (a)(2) proposes one standard to determine when a contract calls for services, rather than a result. Other standards evolved under general common law may also indicate that the parties intended a services obligation as delineated in subsection (a)(2).

4. *Aesthetics and Market Appeal.* Outside the case of computer software, the services contract (efforts) assumption universally applies.

More important, the implied fitness (result) obligation is never appropriate under current case law in reference to aesthetics, market appeal and the like. Subsection (c) adopts that principle. The relationship obligates the party to an effort, not an outcome unless an express contrary obligation is stated in the agreement.

5. *System Integration.* Subsection (d) creates a new implied warranty that requires integration and systems performance in cases of systems integration contracts. While closely related to the implied fitness warranty, it expands that concept creating new protection for licensees. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a) and (b), will fit the licensee's needs. Neither does it mean that use of the system does not or may not infringe third party rights. That infringement concept pertains to Section 2B-401 warranties. This warranty simply refers to an assurance that the parts will functionally operate as a system. It is an additional assurance beyond the fact that each component must be separately functional in a manner consistent with the contract.

SECTION 2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Words or conduct relevant to the creation of an express warranty and words

or conduct tending to disclaim or modify an express warranty shall be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, disclaimer or modification is inoperative to the extent that ~~such~~ this construction is unreasonable.

(b) Except as otherwise provided in subsections (c), (d) and (e), to disclaim or modify an implied warranty or any part of it, but not ~~other than~~ the statutory warranty in Section 2B-401, the following rules apply:

(1) 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 "quality" or "merchantability" is sufficient as to Section 2B-403, and language that mentions "accuracy", or words of similar import, is sufficient as to Section 2B-404.

(3) To disclaim or modify an implied warranty arising under Section 2B-405, it is sufficient to state: "There is no warranty that this information or my efforts will fulfill any of your particular purposes or needs", or words of similar import.

(4) In a mass-market license, ~~,~~ language in a record that disclaims or modifies an implied warranty must be conspicuous.

(5) Notwithstanding any other provision of this subsection, language sufficient to disclaim or modify the implied warranty of merchantability under Article 2 or 2A is sufficient to disclaim or modify the warranties under Sections 2B-403 and 2B-404, and language sufficient to disclaim or modify a warranty of fitness for a particular purpose under Article 2 or 2A is sufficient to disclaim or modify the warranty under Section 2B-405.

(c) ~~Notwithstanding subsection (b), the following rules apply:~~

~~(1)~~ Unless the circumstances indicate otherwise, all implied warranties,

other than the warranty in Section 2B-401, are disclaimed by:

(1A) [except in a consumer transaction,] expressions like "as is" or, "with all faults" or other language that in common understanding calls the licensee's attention to the exclusion of warranties and makes plain that there is no implied warranty; or

(2b) language in a record that states: "Except for express warranties stated in this contract, if any, this [information] [computer program] is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user", or words of similar import.

(d2) There is no implied warranty under Sections 2B-403, 2B-404, or 2B-405 with respect to a defect that before entering the contract was known to, discovered by, or disclosed to the licensee, or that would have been discovered by the licensee if it made use of a reasonable opportunity provided to it before entering into the contract to examine, inspect, or test the information or a relevant sample thereof, unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time.

(e3) An implied warranty may can also be excluded or modified by course of dealing, or course of performance, or usage of trade.

(fd) 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 performances that occur after the contract is formed.

(ge) Remedies for breach of warranty may be limited in accordance with this article. Sections 2B-703 and 2B-705.

Uniform Law Source: Section 2A-214. Revised.
Definitional Cross Reference:
"Computer program": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 2B-102. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Mass-market license": Section 2B-102. "Record": Section 2B-102.

Committee Votes:

a. Accepted motion to delete requirement of conspicuousness for non-mass market disclaimers.

b. Rejected a motion to delete conspicuousness for mass market contracts.

c. Rejected a motion to delete former (b)(5) by a vote of 3 - 6.

d. Accepted a motion to delete former (b)(6) by a vote of 6 -4 with the ability to rewrite.

e. Deleted the reference to use of trade in former (b)(5). Vote: 8 - 2.

f. Adopted a motion to restrict "as is" language to exclude then-existing fitness warranty because at that time that warranty created a services obligation. Vote: 6- 3.

g. Adopted motion to use mass market, rather than the idea of consumer. Vote: 8-2 (Dec. 1996)

h. Rejected motion to adopt Article 2 language precluding disclaimer of consequential damages for personal injury. Vote: 2-8.

i. Accepted motion that a conspicuous term is not a refusal term under former 2B-308. Vote: 9-1

j. Voted 7-6 to use mass market, rather than consumer in this section. (Feb. 1997).

Reporter's Note:

1. *General Structure and Policy.* This Section brings together various rules relating to the disclaimer of warranties. As in current Article 2, disclaimer of the warranties relating to infringement is not in this Section, but is contained in Section 2B-401.

The general approach corresponds to existing Article 2 and Article 2A. U.S. law recognizes that parties may disclaim or limit implied warranties. This reflects that implied warranties are default, rather than mandatory or immutable rules. Disclaimer and limitation is integral to the contract choice paradigm under which commerce occurs and to the ability of a party to choose the terms under which it markets information and the risk it elects to undertake.

This Section does not alter consumer protection laws and regulations. See Section 2B-104.

2. *Express Warranties.* Subsection (a) restates current Article 2 law, bringing that law to bear on other transactions covered by this Article, but not within the U.C.C. under existing Article 2. It uses modern language of "disclaimer" and "modification", rather than current Article 2 language, without substantive change.

3. *Disclaimer of Implied Warranties: General Rules.* Subsection (b) brings together various provisions on disclaimer of implied warranties. It differentiates between mass-market and non-mass-market cases. Specific treatment of mass-market licenses is in subsection (b)(4).

a. Record Required. Article 2B changes existing law and, except for cases noted in subsection (c) and (d), requires that a disclaimer of an implied warranty be in a record. This increases the likelihood that the disclaimer will be brought to the other party's attention and provides a form of statute of frauds requirement against fraudulent claims that a disclaimer occurred.

b. Conspicuousness. Except for mass-market licenses, Article 2B does not require that a disclaimer be conspicuous. Outside the mass market, this requirement is often superfluous and provides a trap for persons drafting contracts who are found later to have failed to meet applicable standards that the language be conspicuous. Article 2 in current law requires a conspicuous disclaimer only if the disclaimer is in writing.

c. Merchantability and Accuracy Warranties. Subsection (b)(2) follows current law and provides language that suffices to disclaim the merchantability, quality and accuracy warranties. Importantly, as in existing Article 2, the specified language is not mandatory. This language works, but other language also works if it reasonably achieves the purpose of indicating that the pertinent warranty is are not given in the particular case.

d. Fitness Warranty. Subsection (b)(3) follows current law and provides language adequate to disclaim the warranty under Section 2B-405. The language used in this Article is more explicit than that authorized under Article 2. As in existing Article 2, the specified language is not mandatory. This language works, but other language may also work if it reasonably achieves the purpose; that purpose is to indicate that the pertinent warranty is not given in the particular case.

e. Article 2 and 2A Disclaimers. Subsection (b)(5) provides for cross-article validity of disclaimer language. The intent is to avoid parties having to make a priori determinations about the extent of Article 2B or Article 2 coverage. In effect, language adequate to disclaim a warranty under the one article is adequate to disclaim the equivalent warranty under the other.

4. *Mass-Market Disclaimers.* Subsection (b)(4) provides that a disclaimer in a mass market

environment must be conspicuous and in a record. This retains existing law under Article 2 and creates a new protection for transactions not previously governed by Article 2.

5. *"As is" and General Disclaimers.* Subsection (c)(1) deals with the effect of language or circumstances indicating that the information product is provided on an "as is" basis. It follows existing Article 2 language, providing parties with a means of conducting business without giving assurances of quality. The "as is" language need not be in a record. It is not effective with respect to the infringement warranty unless the circumstances or language satisfy the standard stated in Section 2B-401.

Subsection (c)(2) deals with where the intent is to disclaim all warranties in a single sentence. The subsection sets out a common language disclaimer based on proposals by the software industry as a means of giving more disclosure to the consumer of what is disclaimed. Importantly, as in existing Article 2, the specified language is not mandatory. This language works, but other language also works if it reasonably achieves the purpose of indicating that the warranties are not given in the particular case.

6. *Excluding Warranties by Inspection or General Circumstances.* Subsection (d) and (e) are taken from Article 2 with modifications.

a. Inspection and Disclosure. As in Article 2, an information provider is not responsible for defects that were either 1) known by or disclosed to the other party, or 2) could have been discovered on reasonable inspection if the opportunity to inspect was available. On the inspection issue, the language of this exclusionary principle was modified from existing Article 2 to reflect realities of inspection in complex computer program systems and to make clear that the inspection opportunity must be before the contract is formed since it relates to the existence or non-existence of warranties in that contract.

b. Course of Dealing, etc. Subsection (e) is taken from existing Article 2.

SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM.

Modification of a computer program by a licensee after acceptance of a copy of the completed program which was not made using a capability of the program intended for that purpose in the ordinary course of operation of the program invalidates any warranties, express or implied, regarding the performance of the modified copy of the program, but not the unmodified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to the computer program.

Uniform Law Source: None

Definitional Cross Reference:

"Computer program". Section 2B-102. "Copy". Section 2B-102. "Licensee". Section 2B-102.

Reporter's Notes:

1. *Scope.* This method of losing warranty protection applies only to warranties related to the performance or results of the software. It does not apply to title and non-infringement warranties. More importantly, the voiding of performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

2. *Policy.* The basis for the provision lies in the fact that because of the complexity of software systems changes may cause unanticipated and uncertain results. The complexity of the software enterprise means that it will often not be possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

3. *Application.* The section voids the warranties unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes in the program that are not part of the program options. Thus, if a user employs the built-in capacity of a word processing program to tailor a menu of options suited to the end user's use, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties as to the altered copy.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES. Warranties, whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications displace an inconsistent sample or model, or general language of description.

(2) A sample displaces inconsistent general language of description.

(3) Express warranties displace inconsistent implied warranties other than the implied warranty under Section 2B-405(a).

Uniform Law Source: § 2-317.
Committee Action: Approved.
Reporter's Note: This Section follows existing Article 2.

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for published informational content, a warranty to a licensee extends to persons for whose benefit the licensor intends to supply the information and which rightfully use the information in a transaction or application of a kind in which the licensor intends the information to be used.

(b) For purposes of subsection (a), a licensor in a consumer transaction is deemed to have intended to supply the information to all individuals in the immediate family or household of the licensee if it was reasonable to expect that the individual would rightfully use the information.

(c) A disclaimer or modification of a warranty, rights, or remedies which is effective against the licensee is effective against any third party under this section.

(d) A term of the agreement that states an ~~licensor's~~ intent to exclude or limit third-party beneficiaries excludes any contractual obligation or liability to the third persons other than persons described in subsection (b).

Definitional Cross Reference:
"Consumer". Section 2B-102. "Consumer transaction". Section 2B-102. "Copy". Section 2B-102. "Information". Section 2B-102. "Informational content". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Published informational content". Section 2B-102. "Rights": Section 1-201.

Committee Action:

a. Rejected a motion to bar disclaimer of consequential damage for personal injury. Vote: 2 - 8.

b. Reviewed without substantive comment or change.

Reporter's Notes:

1. *Focus and Policy.* This section defines third-party beneficiary concepts under contract law. It adopts an approach based on the contract law theory of "intended beneficiary" and on the *Restatement (Second) of Torts* § 552 dealing with the scope of liability exposure to third parties undertaken by a provider of information. It expands both concepts as applied to household uses. For a modern discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994).

Dealing with an information product, the California Supreme Court adopted the Restatement concept and, in Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

> By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

The basic theme is that, in dealing with information, to impose liability under contract-related theories, the information provider must have known of and clearly intended to have an effect on the third parties before the liability can be imposed. This in effect requires a conscious assumption of risk or responsibility for particular third parties. Even within that scope, courts are not aggressive in finding the requisite intention. Thus, for example, an Illinois appellate court recently held that the supplier of information to a commodities exchange for use in investor trading had no obligation under the Restatement or otherwise to the investors with respect to the accuracy of the furnished information.

All of this relates to the unique role of information in our culture and to the uniquely difficult nature of proving a causal connection between a release of information and harmful conduct. The cases and this section also reflect a sensitivity to not placing excessive liability exposure on information providers without their expressly undertaking that risk for fear of chilling the willingness of those providers to disseminate information.

2. *Product Liability Law.* This Section does not deal with products liability issues. It thus neither expands nor restricts tort concepts that might apply for third party risk in reference to information. Products liability is outside the scope of this Article; it is governed by tort law. In the absence of prior law creating third party liability for information, Article 2B declines to create such law leaves development of any appropriate doctrine to common law courts.

As a matter of fact, unlike in goods distributions, few courts impose third party liability in information. The *Restatement (Third) on Products Liability* recognizes this; it notes that informational content is not a product for purposes of that law. The only reported cases that impose product liability on information involve air flight charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context.

Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. See Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991); Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817, 824 (3rd Cir. 1951); Berkert v. Petrol Plus of Naugatuck, 216 Conn. 65, 579 A.2d 26 (Conn. 1990) ("[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); E.H. Harmon v. National Automotive Parts, 720 F. Supp. 79 (N. D. Miss. 1989); Snyder v. ISC Alloys, Ltd, 772 F Supp. 244 (W. D. Pa. 1991); Jones v. Clark, 36 N. C. App. 327, 244 S.E.2d 183 (N. C. App. 1978).

3. *Embedded Software.* While there may be a different policy for software embedded in tangible products, this Article does not deal with embedded software. See Section 2B-103. Tort law and contract privity issues regarding, for example, the software that operates the brakes in an automobile falls

within Article 2. In general, however, no reported cases place products liability on software products that are not embedded in hardware products.

4. *Restatement (Second) of Torts § 552.* The Restatement establishes limited third party liability for persons who provide information to guide others in business decisions. It limits liability to pecuniary loss suffered 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 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 unless a "special relationship" exists between the information provider and the injured party. Modern case law widely adopts the Restatement. See Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992).

5. *Intended Effect Required.* Subsection (a) derives from and should be interpreted in light of both the contract law concept of "intended beneficiary" and the concept in the Restatement (Second) of Torts § 552. In both instances, contract-based liability is restricted to intended third parties and those in a special relationship with the information provider. The liability extends to transactions that the provider of information intended to influence. This Section incorporates these concepts.

The section also must be considered in light of the scope of warranties under this Article which create no implied warranty of accuracy pertaining to published informational content.

Illustration 1: Clanc contracts for publication of his text on chemical interactions. Publisher obtains an express warranty that Clanc exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published information), nor Clanc (excluded under (a) makes a warranty to a general buyer of the book.

6. *Family Effects.* Subsection (b) modifies beneficiary concepts to include the family of a licensee. This goes beyond the relevant alternative in current Article 2-318 which limits that extension to personal injury claims. The extension here covers both personal injury and economic losses.

7. *Limitation by Contract.* The policy framework for contract liability adopted here focuses on the information provider's original intention with respect to third parties to be impacted by the information that it released. Subsection (c) flows from the fact that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. This follows current law applicable to information liability. See, e.g., Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (license for use of information by commodities exchange created no liability for inaccuracy by persons conducting trades where license disclaimed warranties).

PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If a contract provides for ~~n agreement~~ transfer~~s~~ of ownership of informational property rights ~~and does not specify when ownership is to pass~~, ownership passes ~~to the licensee~~:

(1) at the time and place specified in the contract; or

(2) in the absence of such specification

(A) when the contract becomes enforceable, if the informational property rights are then in existence and identified to the contract; or

(B~~2~~) when the information and the informational property rights are identified to the contract, if the information is not in existence or identified to the contract when the contract becomes enforceable.

(b) ~~Transfer of a copy does not transfer ownership of informational property rights in the information.(c)~~ The following rules apply to copies:

(1) Transfer of a copy does not transfer ownership of informational property rights in the information.

(2~~1~~) In a license:

(A) Title to a copy is determined by the contract.

(B) 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.

(C) Reservation of title to a copy reserves title in that copy and any copies made of it, unless the license grants the licensee a right to make and transfer copies to others, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(c)~~2~~) If the contract provides for ~~parties agree to~~ transfer of title to a copy ~~and the agreement does not specify when title transfers~~, title vests in the transferee~~the following rules apply~~:

(1~~A~~) at the time and place specified by contract; or

(2) in the absence of such specification

(A) in a ~~D~~delivery of a copy on a physical medium, ~~transfers title to the copy~~ at the time and place at which the ~~licensor~~ transferor completed its obligations with respect to delivery of that copy.

(B~~B~~) in an ~~E~~electronic delivery of a copy ~~to the licensee, transfers title of the copy~~ if a first sale occurs under federal copyright law, ~~in which case title~~

~~transfers~~ at the time and place at which the ~~licensor~~ transferor completed its obligations with respect to delivery of that copy.

(d)~~(C)~~ If the party to which title passes under the contract r~~R~~efuses ~~al of~~ delivery of the copy or refuses ~~of~~ the license title revests ~~title to the copy~~ in the other party~~licensor~~.

Uniform Law Source: Section 2-401; section 2A-302. Revised.

Definitional Cross Reference:

"Agreement": Section 1-201. "Contract": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Identified": Section 2-501. "Information": Section 2B-102. "Informational property rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Rights": Section 1-201. "Sale": Section 2B-102.

Committee Vote:

a. Voted 11-0 to delete a sentence restricting exercise of rights until licensee pays according to terms of contract. Concept transferred to comments in form that accommodates in kind and other value.

Reporter's Notes:

Edited for clarity with no substantive change.

1. *Copy vs. Rights Ownership.* This section distinguishes title to the copy from ownership of the intellectual property rights. That point is made explicit in subsection (b)(1). The distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may carry with it some rights with respect to that copy, it does not convey ownership of the underlying rights to the work of authorship or the patented technology. This represents a basic theme in differentiating intangibles and tangible objects. The media is not the message, but merely the conduit.

2. *Timing of Rights Ownership Transfer.* Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that 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.). Transfer of rights ownership (as compared to ownership of a copy) does not hinge on delivery of a copy. Rather, it refers to identification to the contract, including completion to a sufficient level that separates the transferred property from other property of the transferor. See In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) (no transfer of ownership where "new" code could not be separately identified from old).

3. *Ownership of a Copy.* Although separate from a transfer of ownership of informational property rights, the location of title to copies of the information may be important. In a license, under subsection (b), title to the copy of information depends on the intent and the terms of the contract. As in Article 2A, this article does not create a presumption of a transfer of title with reference to licenses. The determination of intent on whether or not title to a copy transfers may require consideration of the entire terms of the transfer and the nature of the marketplace. Especially in commercial licenses, it is inappropriate to presume that title passes to the licensee in the absence of an express contractual reservation. See Applied Information Management, Inc. v. Icart, 1997 WL 535813 (EDNY March 3, 1997); DSC Communications Corp. v. Pulse Communications, Inc., 1997 US Dist. LEXIS 10048 (ED Va. 1997).

4. *Reservation of Title.* Under subsection (b)(2), a reservation of title in a copy extends that reservation to all copies made by the licensee. That presumption is altered in cases where the license contemplates the licensee making copies for sale or other distribution. Thus, for example, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all the books. This concept does not apply where the expectation is that the licensee will transfer copies by a further license.

5. *When Title to a Copy Passes.* Subsection (c) deals only with contracts where the parties

agreed to transfer title to a copy. It states presumptions relating to when title passes to copies. The contract controls. Absent contract terms, the Section distinguishes between tangible and electronic transfers. The rule for tangible transfers of a physical copy parallels current Article 2. The electronic transfer approach defers to federal law 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.

SECTION 2B-5023. CONTRACTUAL RESTRICTIONS ON TRANSFER.

(a) [A party's contractual rights may be transferred, including by an assignment or through a financier's interest, unless the transfer would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose trade secrets or confidential of the other party, or materially impair the other party's likelihood or expectation of obtaining return performance.]

(b) Subject to ~~Except as otherwise provided in~~ subsection~~s~~ (c~~b~~) ~~and (c)~~, a contractual restriction ~~term in a license restricting~~ on transfer of a license ~~contractual interest~~ or of informational property rights is enforceable~~.~~ and a ~~A~~ transfer made in breach of the restriction ~~an enforceable term that prohibits transfer~~ is ineffective unless:~~.~~

(1) the license was for incorporation of the information or use of the licensed rights in an informational product that contains information or rights from other sources and the transfer is of the combined informational product; or

(2) the transfer ~~(b) A party may~~ create~~s~~ a financier's interest, in which case, ~~notwithstanding~~ the following rules apply:

(A) The transfer is effective if the other party to the license consents or the transfer would not 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 or expectation of obtaining return performance.

(B) The ~~subsection (a), except to the extent that~~ creation of the financier's interest ~~would be precluded under Section 2B-502 in the absence of a term~~

~~restricting transfer. However, creation of the financier's interest in violation of a term restricting transfer constitutes~~ is a breach of contract.

(c~~e~~) A term that prohibits, or requires the other party's consent for, transfer of a party's interest in an account or in a general intangible for money due or to become due~~,~~ is not enforceable.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).
Definitional Cross Reference:
"Contract". Section 2B-102. "Financier". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Licensor". Section 2B-102. "Money". Section 1-201. "Party". Section 1-201. "Rights". Section 1-201.
"Term". Section 1-201.
Committee Vote:
a. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license.
b. Voted 10 – 0 to delete rule on transferability in the absence of relevant contractual terms. (March, 1998)
Note to this Section:
At the March meeting, the committee voted to delete former section 502 which contained rules on transferability in the absence of contractual restrictions. If applied literally, this would also mean that Article 2B would delete basic materiality standards found in current Article 2, even though these considerations are far more relevant here than in Article 2. The bracketed language in (a) raises the question of whether the vote intended this result or intended merely to take no position on the issue of transferability of non-exclusive licenses that have no contractual terms on the matter. Deletion of the language that is proposed for reinstatement in the bracketed language may create an inference that the current law relating to contract in goods is not applicable to limit transfers of information contracts.
Reporter's Note:
1. *General Enforceability.* Bracketed subsection (a) generally provides that interests in a contract can be transferred, but limits that principle by reference to standards that protect the non-transferring party's interest. The language generally follows existing Article 2 and, therefore, represents current law with respect to those software licenses that have been held to be within Article 2. The concepts here seem especially relevant to licensing where, in many transactions outside retail markets, important reliance and confidentiality interests are involved that may be compromised by a transfer of the contract.
2. *Transfer.* This section, and other sections of Part 5 use the word "transfer" to what in many contexts is described as an "assignment of a contract." The term here does not refer to a "transfer of a copyright" or similar intellectual property interest. It does not refer to delegation of performance under a license. Delegation, which is covered in a later section, occurs when a third party performs the duties or rights of the licensee, while transfer (assignment) involves conveying those contract rights to the third party.
3. *Contractual Restrictions.* Subsection (b) validates contractual restrictions on the transfer of a contractual interest. This is consistent with both the underlying theme of this article recognizing contractual choice and with the importance of the retained interest of the licensor in a license arrangement. It is also consistent with Article 2A on contract restrictions of the transfer of a lease. In practice, under federal and general law, many licenses may not be transferable without licensor consent even in the absence of a contract provision to that effect. Except for the general law provisions in bracketed subsection (a), Article 2B takes no position on when or whether this is true. The bracketed provisions follow long-standing state law policy in Article 2.
A transfer in violation of the contract restriction is ineffective. This rule is appropriate as a general principle, rather than merely allowing the term to create a breach, because of the important interests involved in the licensor's position in a license. If the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), this would create a significant period in which the transferee would be protected by the license before it could be cancelled in litigation against the licensee. For example, assume a license for $5,000 that allows licensee (ABC, a small company) to make as many copies

as needed for use in the licensee's enterprise for employees. ABC has ten employees and the license is expressly not transferable. ABC transfers the license to AT&T, a much larger company with 50,000 employees. If it had requested an enterprise license, the fee would have been $10,000,000. If the transfer is merely a breach, ATT may be licensed to make as many copies as it needs for its (as licensee) employees. Until licensor sues and obtains cancellation of the license against ABC, all copies made are non-infringing. In contrast, a rule making the prohibited transfer ineffective precludes the licensee from without permission going into competition with its licensor, having obtained a license based on the lower use expectations associated with the original licensee.

4. *Financier Interests.* A contract restriction on transfer is not fully enforceable with respect to creation of some financing arrangements. Contract terms that to limit the transfer cash flow are not enforceable, unless of course, they fall within the terms of bracketed subsection (a) if adopted. The preclusion on enforcement is consistent with current Article 9. Additionally, subsection (b) allows the creation of a security interest in a license despite a contract provision precluding that if the interest could be created under Section 2B-502. This does not authorize or all enforcement of the interest. Additionally, the other party to the contract is entitled to enforcement of its contract terms in the sense that creation of an interest in violation of a contract clause barring it constitutes a breach.

SECTION 2B-5034. FINANCIER'S INTEREST IN LICENSE.

(a) Except as otherwise provided in subsection (b), with respect to ~~the creation of~~ a financier's interest in a ~~party's contractual rights under a~~ license, the creation of the interest, or ~~without the consent of the other party to the license is effective if the creation would be effective and permitted under Section 2B-502 and Section 2B-503. Enforcement of a financier's interest that results in a transfer or~~ any change of possession or control, use, sale or other disposition of licensed copies or informational property rights in connection with the interest is effective without the consent of the other party ~~and permitted~~ only if the creation, change, use, sale or other disposition:

(1) is ~~the transfer would also be~~ effective ~~and permitted~~ under Section ~~2B-502 and Section~~ 2B-5023 and otherwise applicable law; and

(2) does ~~the change of possession would~~ not 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 or expectation of obtaining return performance~~cause the effects that would prohibit transfer under Section 2B-502(1)~~.

(b) The following rules apply to ~~the creation or enforcement of~~ a financier's interest in a licensee's rights under a nonexclusive license which ~~that~~ is not effective

under subsection (a):

(1) ~~Subject to paragraph (2), t~~The creation ~~or enforcement of~~ of the interest is effective only to the extent that it does not result in:

(A) an actual transfer or change of the use, control, or possession of, or access to the information; or

(B) a material change in the duty of the licensor, materially increase the burden or risk imposed on the licensor, disclose or threaten to disclose trade secrets or confidential information of the licensor, or materially impair the licensor's likelihood or expectation of obtaining return performance ~~a result precluded by Section 2B-502(a)~~.

(2) Upon a material breach of the financial accommodation contract by the licensee, as between the financier and the licensee, the financier has the rights of an aggrieved party under Section 2B-715 and is subject to the limitations of Section 2B-716 except that:

. ~~However,~~(A) the financier may take possession or prevent use ~~control~~ of ~~, or have access to~~ the information or copies or related materials covered by its interest, only if the licensor consents or if doing so would not ~~create a~~ result in a material change in the duty of the licensor, materially increase the burden or risk imposed on the licensor, disclose or threaten to disclose trade secrets or confidential information of the licensor, or materially impair the licensor's likelihood or expectation of obtaining return performance~~-~~; and

(B) ~~precluded under Section 2B-502(a). T~~the financier may not otherwise exercise control of, have access to, or sell, transfer or otherwise use the information or copies without the consent of the licensor.

(3) Paragraphs (1) and (2) do not apply to a license that was for

incorporation of the information or use of the licensed rights in an information product that contains information or rights from other sources and the transfer is a transfer of the informational product.

(cc) A ~~person that obtains or enforces a~~ financier ~~'s interest~~ and any transferee of a financier ~~that person~~ is subject to the terms and limitations of the license and to the licensor's informational property rights.

(dd) ~~The creation or enforcement of a~~A financier's interest imposes no obligations or duties on the licensor with respect to the financier or the licensee.

Definitional Cross Reference:
"Contract": Section 2B-102. "Financier": Section 2B-102. "Information": Section 2B-102. "Informational property rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Committee Action:

a. Consensus that Article 2B should allow creation of limited rights in licensee side of non-exclusive licenses, but not permit sale and the like without consent of the licensor.

Reporter's Notes:

1. *General Rule.* Subsection (a) makes clear that, in general, a financier's interest can be created in any contractual right that can be transferred under general transferability rules. Also, consent by the other party to the contract makes transfer possible.

In determining transferability, however, the act of creating a security interest and the act of enforcing that interest are separate events. Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's property rights dominate. In dealing with these three parties, a material difference may exist between creation of a non-possessory interest and enforcement by repossession, foreclosure, or sale or by creation of a non-possessory interest.

2. *Non-exclusive Licenses.* For non-exclusive licenses, the transferability of a licensee's rights is constrained in law by federal policy limitations that presume non-transferability without licensor consent. See 2B-502(b). See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996). See also In re Patient Education Media, Inc., 210 BR 237 (Bankr. SD NY 1997) (copyright license). It is also constrained by a general state law policy, reflected in Article 2A, that in three party transactions of this type, the rights owner is entitled to protection. Article 2A-303(3) limits the enforceability of lease provisions restricting security interests, stating: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3. As in Article 2A, the licensor has a right to control who is in effective possession (including use and access) of the subject matter of the license. This policy has been enforced by a number of courts in reference to assignments of a licensee interest to third parties, either by contract or by operation of law.

This Article pushes secured lending in the absence of licensor consent as far are possible in light of that contrary federal policy and traditional (Article 2A) recognition of the rights owner's interests. Subsection (b) sets out a right to **create** a security interest without the licensor's consent unless creation would be barred by other law or the interest results in either a change of possession or a material impairment of the licensor's interests. However, while an interest can be created under these conditions, enforcement cannot, without the licensor's consent, result in an actual change of control, access or use or any sale of the information. This preserves the licensor's protected interest in controlling the resale market and the identity of the licensee.

3. *Enforcement, Possession and the Like.* Enforcement rights are measured separately. Consistent with this, subsection (b) allows a financier to enforce rights between it and the licensee, but precludes acts of enforcement to the extent that those acts are prohibited under the standards stated which reflect the dominant rights of the other party. The financier may, for example, obtain a court order prevent

further use of the information by its debtor if the licensor consent or that action would not materially impair the non-consenting licensor's interests. The licensor in a case governed by subsection (b) cannot transfer the information or contract rights to a third party without consent of the licensor.

4. *Taking Subject to the License.* Subsection (c) states the basic principle, applicable to all cases, that the financier and any transferee the takes subject to the limiting terms of the license and the intellectual property rights of the licensor. The license is the dominant agreement in that it defines the licensee's rights. A lender can not abrogate those rights and the limitations that are attached to the rights. This does not mean that the transferee undertakes or is bound by affirmative obligations, such as any duty to pay royalties. However, if through non-payment or otherwise, a breach occurs and the license is cancelled, the cancellation vitiates the fincncier's further rights to use the information.

SECTION 2B-5045. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

(a) A transfer of "the contract", or of "all my rights under the contract", or a transfer in similar general terms, is an assignment of all contractual rights.

(b) The following rules apply to a A transfer or an assignment of a party's contractual rights:

(1) The transferee is subject to all contractual use restrictions

(2) and, uUnless the language or circumstances indicate to the contrary, as in a transfer for security, the transfer is a delegation of performance of the duties of the transferor that is subject to Section 2B-5056.

(3) Acceptance of the transfer constitutes a promise by the transferee to perform the delegated ose duties. The promise is enforceable by the transferor or any other party to the original contract.

(4b) The A transfer of contractual rights does not relieve the transferor of a duty under the contract to pay or perform, or of liability for breach of contract, unless the other party to the original contract agrees that to the transfer has having that effect.

(be) The other party may treat any transfer that delegates performance without its consent as creating reasonable grounds for insecurity and may without prejudice to its rights against the transferor demand assurances from the transferee pursuant to Section 2B-62019.

Uniform Law Source: 2-210; 2A-303.

Committee Action: Discussed without substantial comment.
Notes to this Draft: Edited to conform to Section 2-210(4). Subsection (c) added to conform to 2-210(5).
Reporter's Note:

1. This section conforms to current Article 2 and Article 2A. 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.

2. This section also clarifies that an effective transfer (assignment or otherwise) of rights under a contract constitutes a transfer of those contract rights and, a delegation of duties if accepted by the transferee. This language follows Article 2 (which uses the word assignment) and Article 2A (which refers to transfers).

3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent to the novation.

SECTION 2B-505~~6~~. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may perform its contractual duties through a delegate or a subcontract unless:

(1) the contract prohibits delegation or subcontracting; or

(2) the other party has a substantial interest in having the original promissor perform or control the performance.

(b) No delegation or subcontract of performance relieves the party delegating the performance of any duty to perform or of any liability for breach of contract.

Committee Action:
Reviewed in November, 1996, without substantial comment except that adjustments should be made to clarify that the section is subject to restrictions on transfer.
Uniform Law Source: Section 2-210; Section 2A-303.
Reporter's Notes:

1. *Nature of Delegation.* Delegation or subcontracting of performance refers to a party's ability to use a third party in making an affirmative performance dues under a contract. Compare "transfer" as described in notes to Section 2B-502. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. *Effect of Contract.* The ability to delegate is subject to contrary agreement. Thus, a contract that permits use of licensed information only by a named person or entity controls and precludes delegation. The result in such cases is determined by both the general principle that contract terms control and the more specific principle that the other party has, by the contract, expressed an interest limiting performance to the designated party.

3. *Delegation in the Absence of a Contract Restriction.* In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original promissor perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions outlined in 2B-502(a). On the other hand, this provision would not deny a right to delegate performance in a mass market transaction which can be transferred by the licensee.

SECTION 2B-506~~7~~. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer of ownership of informational property rights is subject

to any ~~previous~~ nonexclusive license ~~if the license is~~ enforceable under Section 2B-201 and made prior to ~~before~~ the transfer ~~of ownership~~.

(b) Except as otherwise required by federal intellectual property law, ~~between a financier's interest in information or informational property rights and~~ a nonexclusive license in the information or rights ~~, the license~~ has priority over a financier's interest in information or informational property rights if the ~~it~~ license was:

(1) created in a transaction authorized by the financier;

(2) documented in a record authenticated by the licensor before the creation of the financier's interest; or

(3) transferred in the ordinary course of the licensor's business to a licensee that acquired the license in good faith and without knowledge that it was in violation of the financier's interest.

Uniform Law Source: Section 2A-304. Revised.

Definitional Cross References: "Authentication": Section 2B-102. "Financier": Section 2B-102. "Good faith": Section 2B-102. "Informational property rights": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102.

Reporter's Note:

1. *Background.* This is an area heavily influenced by federal copyright law as to copyright interests and the rules here trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption for data, trade secrets and other non-federal rights in reference to priority. For security interests and their relationship in terms of priority to the rights created under a 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. *Prior Oral Licenses.* The basic priority rule in subsection (a) grants priority to a prior license contained in an authenticated record. This rule parallels modern copyright law, and while somewhat inconsistent with modern trends, was made part of the Copyright Act in 1976. Statement of that rule here alerts persons who engage in commercial transactions about a priority rule that may not otherwise be expected. It also avoids inconsistent treatment with reference to situations where the copyright rule may not apply to the entire transaction. This avoids traps for unwary licensees.

However, the Copyright Act refers to signed writings. The use in this section of the terms "record" and "authentication" employs concepts whose match with the copyright language has not been explored in court.

Illustration 1: Computer Associates sells the copyright in its data compression program to Major. Five days before that sale, Computer Associates entered a non-exclusive license with Boeing for a 100 user 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 (a) and federal law, the licensees' rights are subordinate to the Major's copyright ownership.

Illustration 2: Lotus grants a non-exclusive license allowing Distributor to make and distribute copies of Spreadsheet in the mass market subject to a standard form license for

end users. Later, Lotus sells the copyright to Taylor. After the sale, Distributor provides a copy of Spreadsheet to Smith, who assents to the license. If the distribution license was a signed writing, it has priority over Taylor. Smith has also 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.

3. *Security Interests and Licenses.* Subsection (b) deals with priority between a security interest and a license. While there are preemption issues here, the case for preemption is less strong since the UCC generally controls priorities and other law relating to security interests. Federal concerns in the priority statute are more focused on title transfers. This section 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.

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 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.

4. *Preemption Issues.* For rights not created under federal law, priority issues are questions of state law. The same is apparently true for non-ownership rights in patent. 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. The situation is different in copyright law. Section 205(f) of the Copyright Act provides:

> A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if:
>
> (1) the license was taken before execution of the transfer; or
>
> (2) the license was taken in good faith before recordation of the transfer and without notice of it.

17 U.S.C. § 205(f). There is no case law under this provision.

This provision of the Copyright Act can be viewed either as a comprehensive rule of priority (e.g., unwritten license never superior to transfer of ownership; priority of written license entirely controlled by Section 205(f)), or as a minimum condition for a particular result (e.g., that a written nonexclusive license has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This Article adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, a nonexclusive license prevails in the listed situations, but priority of a nonexclusive license in cases not covered by Section 205 is not controlled by federal law.

SECTION 2B-5078. ~~PRIORITY OF~~ TRANSFERS BY LICENSEE.

(a) If a ~~A transferee of a~~ licensee transfers, voluntarily or involuntarily, all or any part of its interest in a license, the following rules apply:

(1) The transferee acquires no interest in information, copies, or contractual rights of the licensee unless the conditions for transfer under this article and the license are met.

(2) If the ~~a~~ transfer is effective, the transferee takes subject to the terms of

the license.

(b) Except as otherwise provided under ~~for rights under [the Uniform Trade Secrets Act] and other~~ trade secret law, a transferee ~~person~~ that acquires information that is subject to the informational property rights of a third party acquires only the contractual rights that its transferor was authorized to transfer.

Uniform Law Source: Section 2A-305

Committee Action: This section was considered in November, 1996, without substantial comment.

Reporter's Notes:

Edited for clarity; no substantive change.

1. *Transferee Interests: General.* A license governs rights in the information and copies of the information. Subsection (a) provides that a transferee of the licensee acquires only the rights that the license and the provisions of this Article on transferability allow. As a general principle, a license does not create vested rights and is not generally susceptible to free transfer in the stream of commerce. Subsection (a) is consistent with Article 2A.

2. *Transfers and Underlying Property Rights.* Subsection (b) states the rule that a transferee of a licensee acquires only those rights that the licensee was authorized to transfer. This reflect an important principle under current intellectual property law which differs from that applicable in transactions involving the sale of goods. A transferee who takes a transfer of a license or copy that was not authorized by the underlying rights holder does not acquire greater rights than its transferee was authorized to transfer, even if the acquisition was in good faith and without knowledge. Compare

The idea of entrustment and bona fide purchase, which play a role in dealing with title to goods, has no similar role in information covered by patent or copyright law. In part, this comes from the rights-protective nature of these bodies of law. Also, the bona fide purchase concept tends to revolve around the appearance of a rightful transfer captured by the concept of possession being given over (entrusted) in a manner that creates the appearance of being able to convey the valuable property. With respect to information assets, possession focuses on the tangible material (if any), while the value resides in the intangibles.

Neither copyright nor patent recognize ideas of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred. Copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, but the first sale must be authorized.

Transfers 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. See Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994) (distribution that violated license by separating software from hardware did not create a first sale and lack of knowledge did not insulate the purchaser from infringement claim. "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).

> **Illustration 1:** Core delivers copies of software to DAC a distributor. DAC is licensed to transfer the software for educational uses only. Instead, DAC transfers a copy to Mobil business use. Mobil has no knowledge of the Core license. DAC breached its contract and its distribution constitutes copyright infringement. DAC also breached its warranty of non-infringement to Mobil. Mobil's copying (use) of the software is not authorized and is an infringement. A good faith acquisition does not cut off the underlying property right. Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (E.D.N.Y. 1994).

As this illustration indicates, the transfer is, itself, an infringement of the copyright owner's exclusive right to distribute works in copies to the public. The transferee's protection lies in a right of action under implied or express warranties against the transferor.

3. *Trade Secret and Unprotected Information.* The rule stated in subsection (b) contains two important limitations. The rule allows for a bona fide purchaser in reference to trade secret claims. These are state law created property rights. The essence of a trade secret lies in enforcing confidentiality. If a party takes without notice of such restrictions, it is not bound by them; it is in effect a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

Additionally, the subsection applies only to information that is subject to informational property rights of a person other than the transferor.

PART 6

PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) Except as otherwise provided in Section 2B-609(b), a party's obligation to perform, other than with respect to contractual use restrictions, is contingent on the absence of an uncured material breach by the other party that precedes in time the aggrieved party's performance.

(c) Tender of performance entitles a party to acceptance of that performance. A tender of performance occurs when a party, with manifest present ability and willingness to do so, offers to complete the performance. If a performance by the other party is due at the same time as the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete the tendered performance.

(d) Except as otherwise provided in Section 2B-610, a party may refuse a performance that is a material breach as to that performance or if refusal is permitted under Section 2B-609(b). The aggrieved party may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides.

(e) A party that accepts a performance shall pay or render any consideration required under the agreement for any performance it accepts. The burden is on the party that accepted the performance to establish a breach of contract with respect to the

performance accepted.

(f) To the extent of a conflict, and except as otherwise provided in Sections 2B-603 and 2B-604, the provisions of this section are subject to Sections 2B-607 through 2B-614 on performance with respect to a copy.

Uniform Law Source: Restatement (Second) of Contracts § 237. Substantially revised.
Committee Vote:

a. Adopted motion to make exception to material breach rule for mass market contracts on the issue covered by Article 2. Vote: 12-0

b. Voted 10-3 to use mass market license, rather than consumer in this section.

c. Voted 1-7 to reject a motion to use the idea of perfect tender as the standard for the right to reject and cancel for breach in any performance of any type of contract term.

Reporter's Notes:

1. *General Approach.* This section brings together a number of general principles pertaining to performance of a contract. The provisions of the Section are supplemented and supplanted by sections on tender and acceptance (or refusal) of copies. The general approach follows the Restatement (Second) of Contracts and applies the concept of material breach as a measure of what remedies an aggrieved party has, other than in the mass market where a standard of fully conforming tender applies.

2. *Duty to Conform.* Subsection (a) states the obvious principle that a party is obligated to conform to its contractual commitments. The material breach concept does not hold that a party need only substantially conform to its contract. Any failure to conform gives the aggrieved party a right to remedy under this Article and subject to concepts of waiver and the contrary terms of the contract.

Whether a performance conforms to the contract depends on the terms of the contract as interpreted and applied under general standards of interpretation consider the express terms of the agreement as understood in the commercial context.

3. *Material Breach: General Standard.* Subsection (b) describes the doctrine of material breach (or substantial performance) for determining when a right to cancel, to refuse a performance, or to decline to perform in response arises in reaction to a breach of contract; that rule is applied throughout the Article except in certain mass market transactions. As described in the Restatement, the rule holds that a duty to perform is contingent on the prior performance by the other party without a material failure of performance. Restatement (Second) of Contracts § 237 states. This is also the general common law rule.

The concept is simple: a minor (immaterial) defect in performance does not warrant rejection or cancellation of a contract. While minor problems constitute a breach, the remedy lies in compensation for damages. The policy objective is to avoid undue forfeiture for small errors and to recognize that, especially if performance involves ongoing activity, fully perfect performance cannot be expected as a default rule. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. Unless the contract provides otherwise, unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem.

Subsection (b) makes clear that the contingent relationship set out here does not refer to contractual use restrictions. A breach does not allow a party to ignore contractual use restrictions. This is true even if there is a duty to mitigate loss. The contractual use restrictions trump the duty to mitigate since they define and limit what rights the party obtained in use of the information. As defined in Section 2B-102, a contractual use restriction means an enforceable restriction on use of the licensed information. A breach of a license by the licensor does not give the licensee unfettered rights to act in derogation of the licensor's rights and the use restrictions that these support which are often buttressed by intellectual property rights.

3. *Material Breach: Other Law.* In adopting a material breach concept, Article 2B parallels 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: "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. 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 alone in modern contract law in not using material breach theory (requiring so-called "perfect tender") but do so in only a single fact situation: a single delivery of goods not part of an installment contract. Outside that single context, materiality as a standard for when reciprocal performance is not required is virtually unanimous. Article 2B creates a parallel rule to Article 2 in reference to single delivery, mass-market transactions.

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. It 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). Additionally, of course, the "perfect tender" rule is a misnomer even when applicable under Article 2. Even in a single delivery context, the idea that a performance must conform to the contract is hemmed in by a myriad of countervailing legal considerations. As 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, one case involving software 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).

4. *Material Breach: Mass Market.* As described in Section 2B-609(b), Article 2B does not apply the material breach theme to mass market transactions involving tender of delivery of a copy other than in an installment contract setting. This adopts current Article 2 standards in this setting, including general concepts of cure, contract interpretation and course of performance that affect the determination of when the tender conforms to the contract. 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 vendor's sole performance (e.g., delivery of a television set, delivery of the diskette containing the software).

5. *Duty to Accept and Tender.* Subsection (c) brings together general rules from the Restatement and current Article 2 regarding sequencing of performance. It is subject to the more specific rules on tender of delivery of a copy and acceptance of copies that are contained in Part B of this part of the Article.

The primary principle, found in both Article 2 and common law, is that tender of performance entitles the tendering party to acceptance of that performance. The rule is stated in general terms here, applicable to tenders of payment, of services, access, and of copies. Of course, if the tendered performance is a material breach, under subsection (b), the party receiving the tender is not required to perform its obligation because of an existing, uncured breach by the other party preceding in time its own performance duty. That principle is made explicit in subsection (d) with a cross reference to Section 2B-609(b) (which gives a right to refuse an non-conforming tender in some cases) and Section 2B-610 (which precludes refusing a delivery in an installment contract in some cases based on existing Article 2 language).

6. *Refusing a Performance and Cancellation.* An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. That distinction is reflected in Article 2 and in common law; it is more central in Article 2B than in Article 2 because of the nature of the contracts involved.

A party may refuse a particular performance if the performance itself fails to conform to the contract and consists of a material breach as to that performance. Whether that breach and the resulting refusal also allows the aprty to cancel the entire contract depends on whether the breach is material as to the entire contractual relationship. In cases where the entire performance consists of a delivery of a single copy, of course, the right to refuse that c opy corresponds to the right to cancel the contract. In more complex situations, however, a single breach may not be material to the whole relationship. Thus, for example, a payment that is only one-half the required amount is most like a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the terms of the contract.

Current Article 2 Section 2-612 recognizes a similar distinction for installment contracts, but does not allow the buyer to reject the defective installment unless it is a material breach as to the whole. While Article 2B applies that same rule to cases involving installment deliveries of copies, that restriction on the licensee is not justified as a general principle for the range of performances covered by this Article.

SECTION 2B-602. LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) In this section, "enable use" means to grant a contractual right or permission

with respect to information or informational property rights coupled with acts, if any, required under the agreement to make the information available ~~to the transferee~~.

(b) A licensor shall ~~must~~ enable use by the licensee. In determining what constitutes enabling use, the following rules apply:

(1) If no act other than the grant of a contractual right or permission is required under the agreement to enable use, the licensor's obligations are performed when the contract becomes enforceable between the parties.

(2) In an access contract, enabling use includes providing any documents, authorizations, addresses, access codes, acknowledgments, and other materials necessary to obtain the agreed ~~contracted for~~ access.

(3) If filing a record is ~~required~~ allowed by law to establish priority of ownership of informational property rights and the agreement requires a transfer of ownership, the licensor shall deliver a record for that purpose on request by the licensee.

Reporter's Notes:
This Section was created as part of the restructuring of this group of sections. The provisions of the Section derive from former 2B-603(a)(b)(d) and are included in this general section based on the view that they reflect rules of general applicability that are relevant beyond delivery of copies.

SECTION 2B-603. SUBMISSIONS OF INFORMATIONAL CONTENT: PERFORMANCE. If a party submits informational content under an agreement that requires that the informational content be to the satisfaction of the other party, the following rules apply:

(1) The provisions of Section 2B-607 through 2B-614 do not apply to the submission except as otherwise provided in this section.

(2) If the informational content is not satisfactory to the recipient, the parties may engage in efforts to correct the deficiencies over a period of time and in a manner consistent with the ordinary standards of the trade or industry without that conduct being treated as acceptance or refusal of the submission.

(3) Neither refusal nor acceptance of the informational content occurs unless the recipient ~~-~~expressly refuses or accepts the submission.

Prior Uniform Law: None.

Committee Action:

a. Reviewed without substantive changes in May, 1997.

Reporter's Notes:

1. *General Purpose.* Article 2 rules concerning tender, acceptance and rejection of goods are not appropriate in many situations involving information transactions. This Section deals with one such context in which information is submitted (perhaps in the form of a copy) under an agreement that the submission be to the satisfaction of the receiving party. Such transactions are common in all of the information industries and involve, for example, submission of an author's manuscript, submission of a digital design for inclusion in a broader product, or submission of a script for a film. The Article 2 model assumes that copies when tendered can be judged in terms of performance capability and that the delivery is the crucial event around which the transaction centers. In information transactions of the type described in this section, neither premise applies.

The delivery of informational content in this context triggers a process that centers around the fact that the recipient has the right to refuse if the content does not satisfy its expectations, but that often neither an immediate acceptance or reject is expected. Rather, a process of revision and tailoring occurs. Once that fact is recognized, the inapplicability of the various rules on acceptance and the like becomes apparent. The provisions of subsection (a) define basic principles of content submission in such case.

2. *Express Choices.* An important aspect of the difference in the two circumstances lies in subsection (a)(3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since the circumstances are keyed to the subjective satisfaction of the receiving party.

SECTION 2B-604. SELF-COMPLETING PERFORMANCES. If performance involves delivery of information or services covered by this article which, because of their nature, provide the licensee substantially with the benefit of the information or services or with other significant benefit on performance or delivery and the benefit received cannot be returned once delivery or performance is received by the licensee, the following rules apply:

(1) Sections 2B-607 through 2B-610 and Section2 2B-612 through 2B-614 do not apply.

(2) The rights of the parties are determined under Section 2B-601 and the ordinary standards of the applicable business, trade, or industry.

(3) Before ~~payment~~rendering any performance then due, a party may inspect the media and label or packaging of a performance but may not view or receive the performance unless the agreement so provides.

Committee Action:

a. Reviewed without substantive changes

Reporter's Notes:

This section deals with a problem arising from the nature of the subject matter covered in this article. Some subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection, rejection and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. The parties are left to general, common law remedies as described in section 2B-601. If the delivered performance constitutes a material breach, the receiving party can obtain its money back or sue for damages, but it cannot demand full performance prior to payment as would be the case with anything other than the limited inspection right described in subsection (b).

SECTION 2B-605. CURE OF BREACH OF CONTRACT.

(a) A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not yet expired, the party seasonably notifies the aggrieved party of its intention to cure and, within the contract time for performance, makes a conforming performance;

(2) the party had reasonable grounds to believe the performance would be acceptable with or without money allowance, seasonably notifies the other party of its intent to cure, and provides a conforming tender within a further reasonable time after the contract time for performance; or

(3) in cases not governed by ~~subsection~~ paragraph (1) or (2), the party seasonably notifies the aggrieved party of its intent to provide a conforming tender ~~cure~~ and ~~effects cure~~ promptly does so before cancellation by the aggrieved party.

(b) In a license other than a mass-market license, the party in breach shall promptly and in good faith make an effort to cure if:

(1) it receives timely notice of a specified nonconformity and a demand for cure from the aggrieved party;

(2) the nonconformity was in ~~aggrieved party was required to accept a nonconforming~~ a tender of a copy ~~performance~~ that completed the initial act enabling ~~of~~ use;

(3) ~~because~~ the nonconformity was not a material breach of contract; and

(43) the cost of the effort to cure for the party in breach of contract would not be disproportionately larger than ~~to~~ the direct damages caused by ~~adverse effect of~~ the nonconformity to ~~on~~ the aggrieved party.

(c) A breach of contract that has been cured may not be used to cancel a contract or refuse a performance. However, mere notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source: Sections 2-508; 2A-513

Reporter's Notes:

1. *General Application.* This section gives both the licensor or the licensee (whichever is in breach) an opportunity to cure under the stated conditions. For licensees' cure often relates to missed payments, failures to give required accounting or other reports, and misuse of information. For licensors, the issues often focus on timeliness of performance, adequacy of delivery product, breach of warranty and the like.

The ideas that a breaching party may, if it acts promptly and effectively, eliminate the effect of its breach and preserve the contract is embedded in modern law. See, e.g., Restatement (Second) of Contracts § 237. However, there is significant disagreement about the scope of the right.

a. The UNIDROIT Principles go the furthest in establishing a **right** to cure providing that cure is not precluded by termination for breach and by not limiting the right to cure in any manner related to the timing of the performance. The UNIDROIT Principles condition cure on "prompt" action and if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing cure. UNIDROIT art. 7.1.4

b. Article 2 distinguishes between cure made within the original time for performance (essentially a right to cure) and cure occurring afterwards (restricted to cases where vendor expected the tender to be acceptable).

c. The UN Sales Convention does not distinguish between cure within or after the original agreed date for performance. It allows the seller to cure if it can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty. Sales Convention art. 48. However, the cure right is subject to the party's right to declare the contract "avoided" if the breach was a fundamental breach of contract.

2. *Right to Cure.* This Article employs the standard of materiality of breach as a precondition for cancellation or refusal of a performance and this may shape the scope of the cure right. The Section allows cure if it is prompt. The proposed language follows existing Article 2 in creating a right to cure if cure occurs before the end of the contract period for the performance or if there was a prompt cure after a reasonable expectation that the performance would be acceptable.

3. *Permissive Cure.* In all other cases, cure is subject to prior cancellation by the other party. This places control in the aggrieved party who suffered a material breach.

In the mass market and in other cases of contracts involving rights in a copy of information, refusal of the tender of the copy may constitute cancellation because the entire transaction focused on providing rights and capabilities associated with the information delivered on a copy. In such cases, no special notice or words of cancellation are required.

As indicate in subsection (c), the aggrieved party is not required to withhold cancellation because of a notice of intent to cure received from the other party.

4. *Obligation to Cure.* Subsection (b) applies to cases where the licensee accepts a performance because the material breach standard is not met even though some defect exists. It creates an obligation to attempt a cure. Failure to undertake the effort is a breach, but if the effort occurs and fails, there is no additional breach of contract. The obligation to cure is properly limited by a concept of proportionality. As drafted, no obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five non-material names, has no obligation to cure if obtaining those additional names would cost $50,000. The proper remedy this is the difference in value of the performance rendered and the

performance promised. Recall, that the obligation to cure arises only in the case of non-material breach.

SECTION 2B-606. WAIVER OF BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record to which the party agrees, by manifesting assent or otherwise.

(b) A party that accepts a performance knowing that the performance constitutes a breach of contract waives all remedies for the breach if the party fails within a reasonable time after acceptance to notify the other party of the breach.

(c) Except for a failure to meet a contractual requirement that performance be to the satisfaction of a party, a party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on the unstated defect to justify refusal if:

(1) the other party could have cured the defect if stated seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.

(d) Waiver of breach of contract in one performance does not waive the same or similar breach in future performances unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance will be required in the future of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Committee Action: Considered several times without substantive changes.

Reporter's Notes:

1. *General Rule.* A "waiver" is "the voluntary relinquishment" of a right. Conduct and words may constitute a waiver by either the licensor or the licensee. This section brings together rules from various portions of 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. The section also applies principles from the Restatement.

2. *Waivers in a Record.* Subsection (a) stems from 2A-107. Waivers contained in a record are contractual modifications which, under current law and this Article, are enforceable without consideration. The Restatement is consistent with this view. See Restatement (Second) 277 ("a written renunciation signed and delivered by the obligee discharges without consideration a duty arising out of a breach of contract."). Subsection (a) does not preclude other ways of making an effective waiver, but merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a state, remains effective.

This subsection does not require delivery of the record. The requirement of delivery seems unimportant and is not required for modifications of a contract.

3. *Waiver by Accepting a Performance.* Subsection (b) and (c) deal with waivers by performance in the form of accepting the performance of the other party without objecting to known or ascertainable defects.

Subsection (b) applies to cases where the non-conformity was known and imposes a waiver rule where the known defect was accepted without objection and the other party is not notified of the breach within a reasonable time. This generalizes the rule in Section 2-607(3)(a). The waiver here is implied from the combination of knowledge of the problem and silence beyond a reasonable time after accepting the performance. The rule does not apply where the party merely knows that performance under the license is not consistent with the contract. The performance must have been tendered to and accepted by it. Compare Section 2B-612 (acceptance based on expectation that the defect will be cured). The following illustrates the rule:

> **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. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts 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.

4. *Waiver by Failure to Particularize.* Subsection (c) is a narrower rule than Subsection (b). In implies a waiver from a failure to particularize the basis for a refusal of a performance, but only in a limited number of circumstances. A failure to particularize is a waiver if the other party could have cured the problem had it known of the basis for refusal. Additionally, in the case of a contract between merchants, waiver occurs when the breaching party asks for a specification in writing of the reasons for refusal and a basis for that refusal is not listed among the given reasons. This generalizes the language of Section 2-605.

5. *Executory and Waived Performances.* Subsection (d) states a presumption consistent with common law that, unless the intent is express or the circumstances clearly indicate to the contrary, a waiver applies only to the specific performance defect waived. This principle does not, of course, 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.

Subsection (e) comes from current UCC Article 2 setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see Restatement (Second) of Contracts § 84, comment f.

[B. Performance in Delivery of Copies]

SECTION 2B-607. TENDER OF DELIVERY OF COPIES.

(a) In this section, "access material" means any documents, authorizations,

addresses, access codes, acknowledgments, or other materials necessary for a party to obtain authorized access to, control, or possession of a copy.

(b) If performance requires delivery of a copy, the party required to deliver shall tender delivery of the copy first but need not complete the delivery until the other party tenders any performance required at that time.

(c) Tender of delivery of a copy requires that the tendering party put and hold a conforming copy at the other party's disposition and give the other party any notice reasonably necessary to enable it to obtain access, control, or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires the tendering party to tender appropriate access material. The party receiving the tender shall furnish facilities reasonably suited to receive tender. In addition, the following rules apply:

(d~~1~~) Except as otherwise provided in subsections ~~paragraphs~~ (e~~2~~), (f~~3~~) and (g~~4~~):

(1~~A~~) The place for tender of a copy on a physical medium is the tendering party's place of business or, if it has none, its residence, but if the parties know at the time of contracting that the copy is located in some other place, that place is the place for its delivery.

(2~~B~~) In an electronic delivery of a copy, tender requires the tendering party to make the information available in an information processing system designated by it and tender appropriate access material to the other party.

(3~~C~~) Documents of title may be delivered through customary banking channels.

(e~~2~~) If the contract requires or authorizes delivery of a copy held by a third party to be delivered without being moved, the tendering party shall deliver appropriate access material to the other party.

———(f3) If the tendering party is required or authorized to send a copy of the information to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, the following rules apply:.

———(1A) In a delivery of a copy on a physical medium, the tendering party shallmust:

———(Ai) put the copy in the possession of a carrier and make a contract for its transportation that is reasonable having regard to the nature of the information and other circumstances, with expenses to be borne by the other party; and

———(Bii) obtain and promptly tender any appropriate access materials or any document otherwise required by the agreement or, in the absence of agreed terms, by usage of trade.

———(2B) In an electronic delivery of a copy, the tendering party must shall initiate a transmission that is reasonable having regard to the nature of the information and other circumstances, with expenses to be borne by the other party.

———(g4) If the tendering party is required to deliver a copy at a particular destination, the tendering party shall make a copy available at that destination, with expenses to be borne by it, and tender any appropriate access material.

(hd) If payment is due on delivery of a copy, the following rules apply:

(1) Tender of delivery of a copy is a condition of the other party's duty to accept the copy and of that party's duty to pay.

(2) Tender entitles the tendering party to acceptance of the copy and payment according to the contract.

(3) All copies called for by a contract must be tendered in a single delivery and payment is due only on the tender.; However, but if the circumstances give either party the right to make or demand delivery in lots, the contract fee, if it can be

apportioned, may be demanded for each lot.

(4) If payment is demanded on delivery of copies or on delivery of documents of title, the right of the party receiving tender to retain or dispose of the copies or documents as against the tendering party is conditional on making the payment due.

Reporter's Notes:
This is a composite section which has been restructured to focus on tender and delivery of copies and to correspond to existing Article 2 rules. The Section stems from former 2B-603(c)(e) and 2B-607(c).

SECTION 2B-608. RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as otherwise provided in Sections 2B-603 and 2B-604, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, the party receiving the copy has a right to inspect at a reasonable place and time and in a reasonable manner in order to determine conformance to the contract before payment or acceptance.

(2) Expenses of inspection must be borne by the party making the inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method, or standard does not postpone identification to the contract or shift the place for delivery or for passing of title or the risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was an indispensable condition whose failure avoids the contract.

(4) A party's right to inspect is subject to obligations of confidentiality if any exist.

(b) If a right to inspect exists under subsection (a) but the agreement is inconsistent with an opportunity to inspect before payment, the party does not have a

right to inspect before payment.

(c) If the contract requires payment before inspection of a copy, nonconformity in the tender of the copy does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-609; or

(2) in a documentary transaction and despite tender of the required documents, the circumstances would justify an injunction against honor of a letter of credit under Article 5.

(d) Payment made under the circumstances described in subsection (b) or (c) does not constitute acceptance of the copy and does not impair a party's right to inspect or preclude any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Section 2-512; 513. Substantially revised.
Reporter's Note:

1. Subsection (a)(4) deals with the relationship between confidentiality and the right to inspect. Absent contrary agreement, inspection prior to payment is not appropriate if the type of inspection involved would reveal designated trade secrets or confidential information. This does not bar any inspection, but merely indicates that a right to see trade secret information cannot be presumed. Also, the balance here is limited to situations where the licensor designates information as confidential or a trade secret.

SECTION 2B-609. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Sections 2B-610 and 2B-611, if a tender of delivery of a copy constitutes a material breach as to the particular delivery, the party to which it is tendered may:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market license, a licensee may refuse a tender of delivery of a copy in a contract that calls for delivery in a single lot or single tender that constitutes the

initial act enabling use if the tender does not conform to the contract. Such refusal cancels the contract.

(c) Refusal is ineffective unless it is made before acceptance and within a reasonable time after tender or completion of any permitted effort to cure, and the refusing party seasonably notifies the tendering party.

(d) Except as otherwise provided in subsection (b), an ~~An~~ aggrieved party that refuses tender of a copy may cancel the entire contract only if the breach is a material breach of the entire contract or the agreement so provides.

Uniform Law Source: Combines 2-601, 2-602, 2A-509. Substantially revised.

Votes:

1. The Committee adopted a "conforming tender" carve out for cases involving the tender of delivery of a copy in circumstances equivalent to those where the rule applies in Article 2.

Reporter's Notes:

1. *Scope and Effect.* This section deals with refusal of tendered copies; it is a specific application of the general rule in Section 2B-601. The word "refuse" is used in lieu of the Article 2 term "reject" to avoid confusion with situations where a party rejects an offer or particular contract terms in an offer. 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.

As in existing Article 2, the right to refuse a copy is subject to the provisions on installment contracts in the next section. The installment contract rules require acceptance of a defective tender in some cases in light of the over-riding importance of the on-going relationship.

2. *Conforming Tender Rule.* Subsection (b) implements the "conforming tender" or "perfect tender" rule for mass market transactions under standards that are consistent with Article 2 in the sale of goods. While often described as a "perfect tender" rule, this concept does not require the tender of a "perfect" copy or, under analogous Article 2 cases, a "perfect" product. It simply displaces the material breach standard with a requirement that the tender conform to the contract. In modern commerce3, very few contracts require perfection in an absolute sense. More often, under applicable trade use standards, general product descriptions, and concepts of merchantability, what is required is a tender that is consistent with ordinary expectations under the contract description.

Subsection (b) adopts current Article 2 law in determining when a tender conforms to the contract in this type of mass market transaction.

3. *Effective Refusal.* Subsection (c) follows current Article 2 with respect to refusal of tenders of delivery of a copy. Refusal becomes ineffective if the refusing party does not timely notify the other party of its refusal of the tender.

SECTION 2B-610. INSTALLMENT CONRACTS; REFUSAL AND DEFAULT.

(a) In this section, installment contract" means a contract in which the terms require or the circumstances permit the delivery of copies in lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(b) In an installment contract, the party receiving tender may refuse any installment which is non-conforming if the non-conformity is a material breach as to that installment and cannot be cured or if the non-conformity is a material defect in ~~the~~ any required documents. However, if the non-conformity does not fall within subsection (c) and the tendering party gives adequate assurance of its cure, the aggrieved party must accept that installment and may not cancel the whole contract if the tendering party timely completes the cure.

(c) Whenever non-conformity or default with respect to one or more installments is a breach that is material as to the whole contract, there is a breach as to the whole. However, the aggrieved party reinstates the contract if it accepts a non-conforming installment without seasonably notifying the party in breach of contract of cancellation or if the aggrieved party brings an action with respect only to past installments or demands performance as to future installments.

Reporter's Note:
This Section derives from current Section 2-612 and Article 2A.

SECTION 2B-611. CONTRACTS WITH A PREVIOUS~~PRIOR~~ VESTED GRANT OF RIGHTS. If ~~the~~ an agreement creates rights or permissions to use informational property rights which precede in time ~~and~~ or are independent of delivery of a copy, the following rules apply:

(1) A party ~~The licensee~~ may refuse a tender of a copy that is a material breach as to that copy, but refusal of the copy does not cancel the contract.

(2) Except as otherwise provided in ~~subsection~~ paragraph (~~c~~3), the tendering party ~~licensor~~ may cure in accordance with Section 2B-605 by providing a conforming copy within a commercially reasonable time after the tender was refused and before the breach becomes material as to the entire contract.

(3) A material breach with respect to a copy does not allow cancellation

of the contract unless there is a material breach of the entire contract which cannot be seasonably cured.

Reporter's Notes:

1. *Scope and Purpose.* This Section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts in Article 2. The similarity lies in that more than one performance occurs under the contract. The difference is that the performances involve a grant of rights followed by delivery of a copy, while installment contracts deal with sequential deliveries of copies.

The section distinguishes between (1) agreements where a grant to use informational property rights vests independent of any copy, and (2) agreements where the purpose is to obtain rights associated with a copy of information. It deals only with transactions in which, under the agreement, the vesting of rights to use informational property is independent of delivery of a copy. The Section describes the relationship between a tender of a copy in such cases and cancellation the entire contract or cure of the tender. Consistent with Section 2B-601, it indicates that refusal of the copy does not necessarily permit or result in cancellation of the contract. This is because the independent grant of rights (already vested) is an independent, performed part of the agreement and the copy may be a non-material aspect of the transaction.

If the refused tender of a copy does not materially breach the entire contract, the tendering party has a right to cure the defective tender by acting in a commercially reasonable time. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement.

2. *Nature of the Transaction.* The section applies only if the grant to use the informational property rights vests and can be exercised without receipt of a copy. Whether or when this circumstance exists depends on the agreement. It is, however, a routine type of transaction in information industries, especially with respect to distribution relationships and performance rights. In cases where this form of transaction exists, the parties view any copy as a mere conduit to complete an already vested conveyance. In such cases, a court must not view a material defect in the copy as necessarily material to the entire contract.

In contrast to cases under this section, if the agreement does not create a prior vesting of intellectual property use rights and the transaction does not entail an installment contract, a material defect in the copy and associated rights to which the transaction pertains is more often material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the intellectual property rights have vested by agreement independent of a copy, the licensee can refuse the copy and still (1) expect and insist on performance and (2) exercise rights under the non-cancelled contract.

Illustration 1. IBM grants ABC the right to distribute up to twenty thousand copies of its Fast-Pace Internet software in the United States over a one year period. Several weeks after the contract becomes enforceable, IBM delivers a master disk of the software for ABC to its use in producing copies for distribution. The master disk contains a manufacturing flaw that prevents making any copies from it. On learning of the defect, IBM replaces the disk. The contract is within this section. ABC can refuse the copy since the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. If it was not, ABC can still recover damages for the delay, if any.

Illustration 2. Houston orders a one hundred person site license from Micro for its operating system software, agreeing to the price for the license. Micro ships a copy of the software, but the copy is warped and defective and arrives several weeks later than agreed. This contract does not come within this Section because there was no vested right to use informational property rights independent of the rights associated with the copy to be delivered. The issue is solely whether the tender was a material breach as to the copy and, if so, Houston's rejection also cancels the contract.

Illustration 3. Warn ~~g~~grants Theo an exclusive license in Chicago to show the movie "Bond" during June, 1999, also giving Theo the right to display clips from the movie for advertising purposes. A copy of the movie is to be delivered one week before the first showing. Warn delivers several days late and the copy is technically defective and cannot be used. Theo refuses the copy. The contract falls in this Section because the grant of rights is independent of the copy. Refusal is

not cancellation of the contract. Theo can continue to advertise using clips. Warn can cure in a reasonable time unless it delays to the point that it creates an incurable material breach of the entire contract.

SECTION 2B-612. DUTIES FOLLOWING RIGHTFUL REFUSAL OF A COPY. After a rightful refusal of a copy, if the entire contract is rightfully cancelled, Section 2B-702 applies ~~concerning~~ with respect to the refused copy and other obligations. However, if the contract has not been canceled, the parties remain bound by all contractual obligations, and the following rules apply:

(1) Any use of the information or copies by the party refusing tender, or any wrongful disclosure of a trade secret or confidential information that violates the agreement, constitutes a breach of contract ~~and is wrongful against the other party~~. However, use for a limited time solely to avoid or mitigate loss after the other party is notified of refusal is ~~not in~~consistent with the aggrieved party's refusal of the tender if such use is not contrary to instructions received from the party in breach.

(2) An aggrieved party in possession of refused copies or any copies made from them, shall return or deliver all copies and documentation to the tendering party or hold them with reasonable care for disposal at that party's instructions for a reasonable time. ~~In addition , the following rules apply:~~

~~———~~(3~~A~~) The aggrieved party shall follow any reasonable instructions for delivery received from the tendering party. However, instructions are not reasonable if the tendering party does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

~~———~~(4~~B~~) If the tendering party does not give instructions within a reasonable time after being notified of refusal, the aggrieved party may, in a reasonable manner to avoid or mitigate loss, store the copies and documentation for the tendering party's account or ship them to that party with a right of reimbursement for reasonable costs of storage and shipment.

(53) An aggrieved party in possession of a refused copy has no further obligations with respect to the information or copy and documentation that were refused. However, both parties remain bound by any ~~obligations of nondisclosure or confidentiality or other~~ contractual use restrictions that would have been enforceable had the performance not been refused.

(64) In complying with this section, an aggrieved party in possession of a refused copy licensee is held 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.

Uniform Law Source: Section 2-602(2), 2-603, 2-604.

Reporter's Note:

1. *Cancellation and Refusal.* Subsection (a) reflects that a refusal of a delivery of a copy may or may not lead to a cancellation of the entire contract. When it does result in cancellation, the rules of Section 2B-702 apply to the entire contract and all related materials. If the contract is not cancelled, this section applies and the parties remain bound by all contractual obligations, except of course, as altered by the breach itself.

2. *No Right to Use.* Subsection (1) limits the refusing person's right to use the information in its possession. In general, a refusing party has no right to continue to use the refused copies. Uses inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse.

The section does permit, however, limited uses for purposes of minimizing loss. That use does not extend to disclosure of confidential information or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to reach the balance discussed in Can-Key Industries v. Industrial Leasing Corp., 593 P.2d 1125 (Or. 1979) and Harrington v. Holiday Rambler Corp., 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved here.

3. *Handling Copies.* Subsection (2) is adapted from current law in article 2. This section does not give the refusing party 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 other party. 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 tendering party's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

4. *Confidentiality.* Subsection (3) makes clear that, following refusal or revocation, both parties remain bound by confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate.

SECTION 2B-613. ACCEPTANCE OF COPY; EFFECT.

(a) Acceptance of a copy occurs when the party to which the copy is tendered:

(1) signifies or acts with respect to the copy in a manner that ~~signifies~~

indicates that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(2) fails to make an effective refusal;

(3) acts in a manner that makes compliance with the party's duties after refusal impossible because of commingling; or

(4) substantially obtains the benefit or access from the copy and cannot return that benefit or access.

(b) Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect ~~exists~~ under Section 2B-608 or the agreement, acceptance of a copy occurs only after the party has a reasonable opportunity to inspect.

(c) If an agreement requires delivery in stages involving separate portions of the whole which taken together comprise the whole, acceptance of any stage is conditional until acceptance of the whole.

(d) Acceptance of a copy precludes refusal of the copy and, if made with knowledge of a non-conformity, cannot be revoked or the contract canceled because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured.~~,~~ However, ~~but~~ acceptance does not in itself impair any other remedy provided by this article for non-conformity.

Uniform Law Source: Section 2-607(2); Section 2A-515. Revised.

Reporter's Notes:

1. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general remedies sections.

2. Subsections (a)(1) and (2) 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)(3) and (4) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(3), the key fact is that it would be inequitable or impossible to reject the data or information having received and commingled the material. The receiving party can exercise rights in the event of breach, but refusal is not a helpful paradigm. A rejecting licensee must return or keep the digital information available for return to the licensor. Commingling does not refer only to placing the information into a common mass from which 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.

4. Subsection (a)(4) involves use or exploitation of the value of the material by the licensee. In information transactions, it is the case that in many instances merely being exposed to the factual or other material transfers the significant value. Often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due.

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. However, acceptance has 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.

Illustration 2: A contracts with B to obtain the formula to Coca Cola along with information about how to mix the formula. B delivers the formula, but the mixing information is 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)(4) 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, the 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 Motorola 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)(4) 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-614. REVOCATION OF ACCEPTANCE OF COPY.

(a) A party that has accepted a copy may revoke acceptance if the nonconformity is a material breach as to that copy and the party accepted the performance:

(1) on the reasonable assumption that the nonconformity would be cured, and it has not been seasonably cured;

(2) during a period of continuing efforts at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the nonconformity, if the acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party notifies the other party of the revocation.

(c) Revocation is barred if the revocation:

(1) does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) occurs after a substantial change in condition or identifiability not caused by defects in the information; or

(3) occurs after the party attempting to revoke received a substantial benefit from the information which benefit cannot be returned.

(de) A party that rightfully revokes acceptance has the same duties and is under the same restrictions with regard to the information, informational property rights, any documentation or copies as if the party had refused the copy.

Uniform Law Source: Section 2A-516; 2-608.

Reporter's Note:

1. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. This section deals with revocation of acceptance as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention of article 2.

2. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. 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 question is whether or not the licensee is obligated for the contract price, less a right to damages for breach by the licensor.

There has been substantial litigation in Article 2 on 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).

3. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation does not, however, serve as a precondition to suing for damages. In information transactions, revocation is not appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection (c~~b~~)(3).

[C. Special Types of Contracts]

SECTION 2B-615. ACCESS CONTRACTS.

(a) A licensee under an access contract that provides for access over a period of time has rights of access to the information as modified from time to time and made commercially available by the licensor during the duration of the license. In addition, the following rules apply:

(1) A change in the content of the information is not a breach of contract unless it conflicts with an express term of the ~~contract~~agreement.

(2) Unless it is subject to a contractual use restriction in a license or in the access contract, information obtained by a licensee through an access contract is free of any use restriction by the licensor other than restrictions resulting from informational property rights of any person~~,~~ or resulting from other applicable law.

(3) Access must be available at times and in a manner:

(A) conforming to the express terms of the agreement; and

(B) to the extent not dealt with by the terms of the agreement, in a manner and with a quality that is reasonable in light of the ordinary standards of the business, trade, or industry for the particular type of agreement.

(b) In an access contract that affords the licensee a right of access at times substantially of its own choosing during agreed periods of time, intermittent and occasional failures to have access available during those times do not constitute a breach of contract if they are consistent with:

(1) the express terms of the agreement;

(2) ordinary standards of the business, trade, or industry for the particular type of agreement; or

(3) scheduled downtime, reasonable needs for maintenance, reasonable periods of equipment, software, or communications failure, or events reasonably beyond the licensor's control.

Uniform Law Source: None

Reporter's Note:

1. *Nature of an Access Contract.* This section deals with "access" contracts. Access contracts come in two types. In one, access and contract occur essentially at the same time and there is no on-going relationship between the parties. In the other, a continuous access contract, the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This relationship is illustrated by on-line services such as Westlaw and Lexis. The transaction is not only that the transferee receives the functionality or the information, but that the subject matter be accessible on a consistent basis. A continuous access contract is unlike installment contracts under Article 2 which are segmented into tender-acceptance sequences. Often, the licensor here merely keeps the system on-line and available for the licensee to access when it chooses.

Access contracts are licenses in the pure common law sense that they 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. See *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 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). Under current law, these contracts are not within Article 2 or 2A.

2. *Basic Obligation.* The contract obligation in a continuous access contract is an obligation to make and keep the system available in a reasonable manner consistent with the contract. As indicated in subsection (a)(3), availability standards are subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v. Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

3. *Content Changes.* Subsection (a)(1) outlines an important default rule with respect to the treatment of information obtained through an access contract. The access arrangement does not bind the provider of access to making available specific configurations of information unless the express contract terms require this. This is a significant default rule in reference to multi-element commercial databases provided to licensees by electronic access.

4. *Use of Received Information.* Subsection (a)(2) deals with use restrictions. Unless there are terms dealing with restrictions on use of the information obtained through access, information obtained by access is received on an unrestricted basis, subject only to intellectual property rights. Thus, for example, if an access contract merely enables access to news articles, but does not limit their use by the licensee, no limitation exists other than as applied under copyright law. In contrast, if the agreement contains license restrictions on use of the articles obtained by the access, those terms would be governed under Article 2B.

Under the proposed deletion of former (a)(3), this Section takes no position and creates no default rule regarding the licensee's ability to make permanent copies of the information accessed.

5. In an on-going or continuous access contract, 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-616. CORRECTION AND SUPPORT CONTRACTS.

(a) If a person agrees to correct performance problems or provide similar services, the following rules apply:

(1) If the services are part of a limited contractual remedy in an agreement for the information between the parties, the licensor undertakes that its performance will provide the licensee with information that conforms to that agreement.

(2) In cases not covered by paragraph (1), a person that agrees to correct performance problems or provide similar services with respect to information that has been accepted by the licensee shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the express terms, in a workmanlike manner and with a quality that is reasonable in light of ordinary standards of the business, trade, or industry. The person does not warrant that its services will correct all performance problems unless the agreement expressly so provides.

(b) A licensor is not required to provide instruction or other support for the licensee's use of information or licensed access. If a person agrees to provide support , the person shall make the support available in a manner and with a quality consistent with the express terms of the support agreement and, to the extent not dealt with by the agreement, in a workmanlike manner and with a quality that is reasonable in light of the ordinary standards of the business, trade, or industry.

Uniform Law Source: Restatement (Second) of Torts § 299A.

Reporter's Notes:

1. *Nature of the Obligation.* The section deals with obligations to correct performance problems and to provide support. It does not deal with questions about infringement or third party rights claims. Obligations to correct performance problems are different from an obligation to provide updates or enhanced versions. In modern practice, contracts to provide updates, generally described as maintenance contracts in the software industry, are a source of revenue for software providers. Under Section 2B-310,

no implied obligation exists to provide updates or new versions.

The reference to error corrections covers contracts where, for example, a vendor agrees to be available to come on site and correct or attempt to correct bugs in the software for a 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 with new products .

3. *Services Obligation.* Contracts to correct problems are services contracts. The primary performance obligation is stated in subsection (a)(2). 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. 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.

4. *Services in Lieu of Warranty.* Subsection (a)(1) recognizes an important alternative formulation of the provider's obligations. It deals with situations in which the circumstances indicate that promissor agrees to a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort. The obligation arises if the repair/ correction obligation is set out as part of a limited remedy in lieu of a warranty. The prototype is the classic "replace or repair" warranty. When the obligation to correct errors arises in that context, the obligation is to complete a product that conforms to the contract.

5. Subsection (b) provides a default rule regarding support agreements. As another form of services contract, the appropriate standard is a workmanlike effort obligation consistent with reasonable standards of the industry.

SECTION 2B-617. PUBLISHERS, DISTRIBUTORS, AND END USERS.

(a) In this section:

(1) "Distributor" means a merchant licensee that receives information from a licensor and sells or licenses the information to end users.

(2) "End user" means a licensee that acquires a copy of the information from a distributor by delivery on a physical medium for its own use and not for the purpose of distribution or transmission to third parties, or of public display or performance.

(3) "Publisher" means a licensor, other than a distributor, that offers a license to an end user with respect to information distributed by a distributor.

(b) In a contract between a distributor and an end user, if the end user's right to use the information or informational property right is subject to a license from the publisher with respect to which there was no opportunity to review before the end user became obligated to pay the distributor, the following rules apply:

(1) The contract between the end user and the distributor is conditional on

the end user's agreement to the publisher's license.

(2) If the end user does not agree, by manifest assent or otherwise, to the terms of the publisher's license, the end user has a right to a refund on ~~may~~ return the information to the distributor. ~~and receive a refund.~~ Refund under this paragraph is a refund under Sections 2B-112 and 2B-208.

(3) The distributor is not bound by the terms of, and does not receive the benefits of, an agreement between the publisher and the end-user unless the distributor and end user adopt those terms as part of the distributor and end-user agreement.

~~(c) If a refund is made in good faith, the following rules apply:~~

~~(1) A distributor that makes the refund to its end user because the end user did not agree, by manifest assent or otherwise, to the publisher's license is entitled to reimbursement from the person from which the distributor obtained the copy. Reimbursement must be for the amount paid for the copy by the distributor on delivery by it of the copy and documentation with proof of refund.~~

~~(2) A publisher that makes the refund to the end user is entitled to reimbursement from the distributor of the difference between the amount refunded and the amount paid by the distributor for the information.~~

(c~~d~~) If an agreement contemplates distribution of copies on a physical medium provided by the publisher, a distributor shall distribute the copies and documentation:

(1) in the form as received from the publisher or authorized third party; and

(2) subject to any contractual terms of the publisher provided for end users.

(d~~e~~) A distributor that enters into an agreement with an end user is a licensor of the end user.

Uniform Law Source: None
Committee Action: Reviewed several times with no substantive changes.
Note to this Draft: Subsection (c) was deleted based on discussion at the meeting and the ABA committee meeting that the reimbursement obligations are properly questions of express contract and that the solution here was too simplistic to function in context of complex and divergent distribution systems.
Reporter's Note:

1. *Scope and Context: Three Party Relationship.* This section deals with a three party relationship common in information transactions, especially for digital products. The three party transaction involves a publisher, distributor, and end user. While the end user acquires the copy of information from a distributor, whether the distributor has authority to convey a right to use the work or the right to transfer title to the copy is determined by its contract with the publisher. That contract often precludes conveyance of rights without compliance with specified conditions. In such cases, the end user's right to "use" (e.g., copy) arises by a separate agreement between the end user and the producer (party with or control of the copyright). Often, in retail markets, this latter agreement is an on-screen license or a shrink wrap license.

2. *Distributor and End User.* While there are three parties and three separate relationships, the relationships are linked. Subsection (b) deals with that relationship from the perspective of the distributor's contract with the end user.

a. Contracts are Separable. The basic principle in subsection (b)(3) is that a distributor is not bound by nor does it benefit from any contract created by the producer with the end user. This mirrors modern law and limited case law dealing with sales of goods where manufacturer warranties and warranty limitations do not bind the distributor, but also do not benefit that distributor. This means that the distributor does not have the benefit of warranty disclaimers made in a publisher's license. That can be changed by contract, of course. However, it gives the end user two different points of recourse - distributor and publisher.

b. Distributor is a Licensor. Subsection (d) confirms that warranties exist on the part of the distributor by stating that the distributor is a licensor with respect to its licensee.

c. Conditional Rights. Subsection (b)(1) and (b)(2) deal with the reality that performance of the distributor's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the distributor and that this depends on the license between the producer and the end user. The effect is to give the end user who declines a license a right to refund. and to not being forced to pay the purchase price to the distributor. This creates a refund *right*, rather than an option. It reflects the conditional nature of the transaction with the end user. It differs from the publisher's option to provide a refund opportunity as a means of enabling the effective assent to the publisher's license terms. While they are distinct, however, a refund made by the distributor under the conditions of subsection (b) satisfies the refund opportunity required under 2B-112 for creating an opportunity to review.

There are several ways to view the relationship. One treats the publisher's license as part of the distributor's contract, understood as present by both the distributor and the end user from the outset, even if the precise terms are not yet known. See *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). An alternative treats the distributor's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter until the end user assents to the publisher's license if, as in most cases, the distributor's contract with the publisher authorizes only distributions subject to end user licenses. The end user's assent to the producer's license is then, as to the distributor, either a condition precedent (no final agreement until the end user assents to or rejects the license) or a condition subsequent (agreement subject to rescission if the license is unacceptable). In either case, if the end user declines the license, it can return the product to the distributor and obtain a refund or, if it has not already paid, avoid being forced to pay the contract fee.

Subsection (b)(1) and (b)(2) create this latter result. See *Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd.* The contract between the distributor and end user is a license in that the end user's use rights are subject to assent to and the terms of the publisher's license. When the end user assents to the license, the publisher's license in effect replaces the distributor-end user license except as to obligations expressly created and earmarked as continuing on the part of the distributor (such as a services or support obligation). Of course, if the information breaches a warranty, the right to recover from the distributor remains present unless it was disclaimed by the distributor's contract.

> **Illustration 1:** User acquires three programs from Distributor for $1,000 each. User is aware that each software comes subject to a publisher license. When it reviews one license, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since distributor did not provide a useable package and the end user did not pay simply for a diskette. An alternative refund option would be from the publisher who cannot obtain consent to its license unless it offers a refund for those who decline the terms.

3. *Distributor and Publisher.* In most cases where an end user license is intended, the publisher's arrangement with the distributor is a license that retain ownership of copies in the publisher and permits distribution only subject to an end user license. The legislative history of the Copyright Act indicates that, whether there was a sale of the copy or not, contractual restrictions on use are appropriate under contract law. "[The] outright sale of an authorized copy of a book frees it from any *copyright* control over … its future disposition…. This does not mean that conditions … imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).

4. 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-618. DEVELOPMENT CONTRACTS.

(a) In this section: ~~:~~

(1) "~~c~~Client" means a person that hires a developer. ~~, and~~

(2) "~~d~~Developer" means a person hired or commissioned to create or develop software for a client but the term does not include an employee of a client. ~~.~~

~~(b) If an agreement requires development of software, as between the developer and the client, the following rules apply:~~

~~(1) Unless an authenticated record provides for a different result, the developer retains ownership of the informational property rights to the extent provided under applicable informational property law, but the client receives a nonexclusive license to utilize the software in any manner consistent with the agreement.~~

~~(2) If an authenticated record or the provisions of applicable informational property rights law provide that ownership of informational property rights in the software passes to the client, but does not otherwise deal with the following issues, the following rules apply:~~

~~(A) If the contract is not a work for hire, ownership of the completed software vests in the client under Section 2B-501, but revests in the developer if the developer cancels for breach of contract before the information is delivered to the client.~~

~~(B) The developer retains any ownership reserved to it under applicable law and the right to use methods, components, or code developed before or independent of the contract, or developed during the duration of the contract but not required by the contract to be delivered to the client.~~

~~(C) The client has a nonexclusive license to use the components or code delivered as part of the software to which it did not obtain ownership under applicable law.~~

~~(c) Neither party has the right to use confidential information of the other party which was identified as confidential except as provided in the agreement.~~

~~(d) Language in an authenticated record is sufficient to indicate an intent to place ownership in the designated party if it states "All right, title, and interest in the software will be owned by [named party]", or words of similar import.~~

(b) On request of the client made in a record delivered to the developer, the developer shall notify the client if it used independent contractors or information provided by other third parties and shall provide the client with a statement that either confirms that all applicable informational property rights have been obtained or will be obtained, or that it makes no representation about those rights beyond any stated in the agreement. The statement must be made within 30 days after the request is received unless the time for performance of the development contract is less than 30 days, in which case the statement must be before completion of performance.

Uniform Law Source: None

Committee Action:

a. Motion to delete the clause in (b)(2)(D) following the word "but", rejected 2-5 (June, 1997).

b. Motion to delete rule on ownership allocation, accepted 8-1 (September 1997)

c. Motion to delete the section. Vote: 8 – 2

d. Motion to not include subsection (d). Vote: 10 – 0

e. Motion to include (e). Vote: 7 - 2

REPORTER'S NOTES:

The Section provides important protection for a licensee not found in current law. The section

reacts to a problem created under federal intellectual property law, especially as to copyright ownership. Copyright law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to potentially avoid those problems.

SECTION 2B-619. AGREEMENTS BETWEEN FINANCIERS AND LICENSEES~~FINANCIAL ACCOMMODATION CONTRACTS~~.

(a) If a financier does not become a licensee, the following rules apply:

(1) The financier does not receive the benefits or burdens of the license.

(2) The licensee's rights and obligations with respect to the information and informational property rights are governed by:

(A) the ~~terms of the~~ license contract~~and this article~~;

(B) any rights of the licensor under other applicable law; and

(C) to the extent not inconsistent with subparagraph (B) and (C)~~the above~~, the ~~financial accommodation~~ agreement between the licensee and the financier.

(b) If a financier becomes a licensee and transfers the license to a licensee receiving the financial accommodation, the following rules apply:

(1) A transfer to the accommodated licensee is not effective unless:

(A) the transfer is effective ~~meets the conditions for transfer~~ under Section~~s~~ 2B-502 and 2B-503; or

(B) the following conditions are met:

(i) before the licensor delivered the information or granted the license, the licensor received notice from the financier giving the name and location of the accommodated licensee and clearly indicating that the license is being obtained in order to transfer it to the accommodated licensee;

(ii) the financier became a licensee solely to make the

financial accommodation; and

(iii) the accommodated licensee ~~accepts~~ adopts the terms of the license.~~, the financier becomes a licensee solely to make the financial accommodation; and before the licensor provides the information or grants the license in informational property rights, the financier delivered notice to the licensor giving the name and location of the accommodated licensee and clearly indicating that the accommodated licensee will be the only licensee of the information or informational property rights.~~

(2) A financier that makes ~~ing~~ a transfer effective under paragraph (1)(B) may make only the single transfer contemplated by the notice unless the licensor consents to a subsequent transfer~~ or any subsequent transfer is effective under Section 2B-504~~.

(c) ~~(3)~~ If a financier effectively transferred a license to an ~~After an effective transfer to the~~ accommodated licensee, the following rules apply:

(1) The accommodated licensee becomes a party to the original license and ~~the~~ its ~~accommodated licensee's~~ rights and obligations ~~with respect to the information and informational property rights~~ are governed by:

(A) the ~~terms of the~~ license contract~~or, if applicable, the provisions of this article~~;

(B) any rights of the licensor under other applicable law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B)~~the above~~, the ~~terms of the financial accommodation~~ agreement between the financier and the licensee.

(2) ~~On completion of an effective transfer to the accommodated licensee, t~~The financier is no longer a licensor.~~

(5) The financier makes no warranties to the accommodated licensee other than any express warranties in the financial accommodation agreement and the warranty of quiet enjoyment under Section 2B-401(b) and any express warranties in the agreement between the financier and the licensee.

(ed) Unless the accommodated licensee is a consumer, a provision in if the financial accommodation agreement that so provides the accommodated licensee's obligations promises under that agreement and any related agreements become are irrevocable and independent is enforceable. of the license as between the financier, the licensee and any transferee of either party. The obligations y become irrevocable and independent upon

(1) the licensee's acceptance of the license or on payment by the financier to the licensor, unless:

(A) the information or informational property right was selected, created, or supplied by the financier;

(B) the financier provides support, modifications, or maintenance for the information; or

(C) the financier holds informational property rights in the information; or

(2) the licensee's acceptance of the license and the transfer to a third party of the financial accommodation contract agreement between the licensee and by the financier to a third party.

(fe) As between the financier and the accommodated licensee, the parties may agree which of them financier is entitled to the possession of any copies, improvements, or modifications of the information provided by the licensor, but the effect of such an agreement on under the license if the financial accommodation agreement so provides.

~~However, the financier's rights with respect to~~ the licensor is ~~are~~ determined by ~~under~~ Section 2B-503~~4~~.

(g~~f~~) On material breach by ~~of a financial accommodation agreement by~~ the accommodated licensee, the financier may:

(1) cancel its ~~th~~contract with the accommodated licensee ~~at agreement~~ but may not cancel the license; and

(2) subject to Section 2B-503~~4~~, exercise against the accommodated licensee its ~~other~~ remedies under the contract ~~financial accommodation agreement~~ or this article.

Committee Action:

a. In December, 1996, the Committee concluded, by a consensus, that treatment of financing arrangements should be limited and generic. The concept is to allow creation of an interest, but not sale without consent.

b. Did not adopt a motion that the "hell and high water" rules should apply even though the contract does not so provide. Vote: 5 - 5 (April, 1997).

Reporter's Notes:

1. *Scope.* This section integrates treatment of security interests and finance leases. It deals with the rights among the parties, while Section 2B-503 deals with the creation of the interest in a license. The critical distinction, implemented here, is between a traditional loan arrangement where the financier does not become a party to the license and the relationship that exists more in reference to three party leases where the lessor (financier) acquires the property (license) and transfers it to the licensee.

The financial accommodation is conditional on the licensee's assent to the license. In the absence of such assent, the licensee may have no rights to use the information and, thus, the transaction is illusory from its standpoint. This transaction is different from the ordinary equipment lease because of the central importance of this license agreement and the provisions here recognize that importance. (see also the treatment of when promises become irrevocable).

2. *Licensor and Licensee Direct Contracts.* Subsection (a) involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract relationship with the licensee. The key fact is that the financier is not bound by the obligations of the license, but is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement.

3. *Financier as a Transferor.* Subsection (b) deals with the less common situation where the license is actually provided to the financier and then passed through to the licensee. Here, when the eventual licensee takes on the license, the financier is taken out of the transaction as between the licensee and financier for purposes of qualitative performance issues. The licensee becomes a direct party to the license.

4. *Hell and High Water Clauses.* Subsection (e) provides rules pertaining to hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context.

Article 2A-407 provides that the promises become irrevocable on the lessee's acceptance of the goods. In a transaction under that article, goods are sold to the lessor and sent to the lessee. If there is non-payment by the lessor, the seller's remedies are against the lessor (not the lessee). In a license transaction, however, there are two different elements. First, if the licensee contracts directly with the licensor, non-payment may give a contractual right of action for the price against the licensee even though its financial accommodation contract called for payment by the lessor. Second, in a license, payment is

typically a condition on the licensee's rights to continue to use the information. Thus, although the financier was to pay, the licensee may be placed in a position of paying twice if the lessor fails to do so.

To reflect these problems, the irrevocability concept as between the two parties is limited here not only to acceptance of the transfer, but also payment to the licensor. Subsection (e)(2) refers to the common situation where the contract allows irrevocability when it is transferred to a third party.

5. *Right to New Versions.* Subsection (f) deals with an area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As to the licensor, however, Section 2B-503 controls.

6. *Remedy.* Subsection (g) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. Performance Problems]

SECTION 2B-620. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other party may demand in a record adequate assurance of due performance and, until the demanding party receives such assurance may if commercially reasonable suspend any performance, other than with respect to contractual use restrictions, for which the party has not already received the agreed return.

(b) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(c) Acceptance of any improper delivery or payment does not prejudice the 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 thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

Committee Action: Considered without substantial substantive comment.
Uniform Law Source: 2-609.
Reporter's Note: Corresponds to existing Article 2.

SECTION 2B-621. ANTICIPATORY REPUDIATION. When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(1) for a commercially reasonable time await performance by the repudiating party; or

(2) resort to any remedy for breach, even though it has notified the repudiating party that it would await the latter's performance and has urged retraction; and

(3) in either case, suspend or cease its own performance or proceed in accordance with the provisions of Sections 2B-712 or 2B-713 as applicable.

Committee Action: Considered without substantial substantive comment.
Uniform Law Source: 2-610.
Reporter's Note: Corresponds to Article 2; deletes language in (b) which is not in current Article 2.

SECTION 2B-622. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) Until the repudiating party's next performance is due it can retract its repudiation unless the aggrieved party has since the repudiation canceled or materially changed its position in reliance on the repudiation or otherwise indicated that it considers the repudiation final.

(b) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under Section 2B-620.

(c) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay occasioned by the repudiation.

Committee Action: This section was considered without substantial substantive comment.
Uniform Law Source: Section 2-611.
Reporter's Note: Corresponds to existing Article 2.

[E. Loss and Impossibility]

SECTION 2B-623. RISK OF LOSS FOR COPIES.

(a) Except as otherwise provided in this section, the risk of loss as to a copy passes to the licensee on receipt of the copy.

(b) If a contract allows a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require delivery at a particular destination, the risk of loss passes to the licensee when the copy is delivered to the carrier even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the copy arrives there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered at that destination.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains with the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, or a copy is to be delivered by making access available to a physical resource containing a tangible copy, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing the third party to make delivery or authorizing the third party to allow access.

Uniform Law Source: Section 2-509
Committee Action: Reviewed twice without substantive change.
Notes to this Section: Sentence in subsection (a) deleted as redundant.
Reporter's Notes:

1. *Nature of the Issue.* Risk of loss issues relate to copies of the information and eventually deal with the obligation to pay for or provide additional copies or additional access to obtain new copies of the information. This section uses a concept of transfer of possession or control as the general standard for when risk of loss is transferred to the other party. Unlike in the sale of goods, however, the issue may go in either or both directions as there are many transactions in which licensees provide information to licensors.

Under subsection (a), in an access contract, risk remains with the access provider or licensor as to the information that it controls and retains, but passes to the licensee as to copies made by the licensee on the making of that copy.

2. *Transfer by Carrier.* The rules in subsection (b) deal with shipment contracts and generally correspond to current Article 2.

SECTION 2B-624. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Except so far as a party may have assumed a greater obligation, ~~D~~delay in performance or nonperformance in whole are in part by a party is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or

(2) compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not it later proves to be invalid.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance.

(c) If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall allocate performance among its customers in any manner that is fair and reasonable and notify the other party of the estimated quota to be made available. However, the party claiming excuse may include regular customers not then under contract as well as its own requirements.

(d~~c~~) A party that receives notice in a record of a material or indefinite delay, or of an allocation that would be a material breach of the entire contract, may:

(1) terminate and thereby discharge any executory portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(e~~d~~) If, after receipt of notice under subsection (b), 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.

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.
Committee Votes:
a. Voted unanimously to delete former section 2B-624.
b. Voted 12-1 to delete section on invalidity of intellectual property.
Note: This section states the ordinary UCC formulation of force majeure and related impossibility themes.

[F. Termination]

SECTION 2B-625. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) The following obligations survive termination of a contract:

(1) a right based on ~~prior~~ previous breach of contract or performance;

(2) a contractual use restriction with respect to any licensed copies or information received from the other party and not returned or returnable to the other party;

(3) an obligation of confidentiality or nondisclosure to the extent enforceable after termination under other applicable law;

(4) an obligation to return, deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party or to obtain information from an escrow agent;

(5) a term establishing a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes by means of alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for providing notice;

(8) an indemnity term;

(9) a limitation of remedy or disclaimer of warranty and a warranty that

extends to future claims;

(10) an obligation to provide an accounting and make any payment due;

and

(11) any right, remedy, or obligation stated in the agreement as surviving.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).
Committee Action:
a. Reviewed twice with no substantive changes.
Reporter's Note:
1. *Effect of Termination.* Subsection (a) states the effect of termination, which refers to the discharge of *executory* obligations. Termination does not end vested rights or remedies. This rule corresponds to current law and to commercial practice..
2. *Survival Rules.* Subsection (b) provides a list of provisions and rights that survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The list indicates terms that would ordinarily survive in a commercial contract. The intent is to provide background support, reducing the need for specification in the contract with resulting risk of error.

Of course, additional surviving terms can be added and the terms provided here can be made to be non-surviving. The contract terms can clearly add additional surviving obligations. The contract can also negate the survival of the listed rights. To do so, however, the contract would require specific reference and negation.

SECTION 2B-626. NOTICE OF TERMINATION.

(a) A party may not terminate a contract except on the happening of an agreed event such as the expiration of the stated duration, unless the party gives reasonable notification of termination to the other party.

(b) An access contract may be terminated without notice. However, if the access contract pertains to information owned by the licensee, termination by the licensor other than on the happening of an agreed event requires reasonable notification to the licensee.

(c) A term dispensing with notification required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for notification is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)
Committee Action: Reviewed without substantive change.
Reporter's Notes:
1. *Termination in General.* Termination involves an end to the contract for reasons other than breach of the contract. The rules stated here do not apply to cancellation for breach
2. *Termination on the Happening of an Event.* For termination based on an agreed event (e.g., the end of the stated license term), no notice is required. This corresponds to current Article 2 and common law.
2. *Notice in Other Cases.* If termination occur based on a judgment of one party (such as an "at will termination") notice must be given of the termination. The notice must be reasonable. What is

reasonable varies with the circumstances. Thus, for example, where the reason for termination involves criminal conduct or a desire to prevent harmful acts by the other party, notice at or immediately after the time of termination may suffice. In other, less exigent circumstances, advance notice of some reasonable time is needed. As indicated in subsection (c), the notice requirement may be waived or the terms and timing of notice specified by agreement.

This section requires "giving" notice. A requirement that notice be received would create potential uncertainty and the party here is merely exercising a contractual right. The uncertainty is especially important in online or Internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

3. *Access Contracts.* Under subsection (b), termination of access contracts does not require notice. In these cases, the contractual rights granted to the licensee are to access a resource owned by the licensor. When the contract terminates, the access privilege also terminates. This is consistent with current law in licenses of this type. *See Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993). In fact, in many cases, unless the contract otherwise provides, a license to use resources or property of the licensor is subject to termination at will without notice. The no-notice rule of subsection (b) is especially important in modern access contract situations where thousands of licensees may be involved and addresses may not be available. Of course, the concept of termination refers to events not associated with breach. Where the reason to end the access is a breach, the section on discontinuing access controls. See Section 2B-714.

This section provides a limited exception to the common law rule in cases where the access contract involves information provided to the licensor and owned by the licensee. The language change in this draft was intended to clarify the circumstances under which this notice requirement occurs. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

4. *Contract Modification.* Subsection (c) sets out standards for measuring the validity of contract provisions relating to time, place and method of termination notice. Current Article 2 allows the dispensing with notice if the term is not unconscionable. Subsection (c) retains that concept. In addition, Article 2B refers to concepts set out in Article 9-501 allowing standards to be set for notification. As in Article 9, that standard creates substantial room for effective exercise of contract freedom.

SECTION 2B-627. TERMINATION: ENFORCEMENT AND ELECTRONICS.

(a) On termination of a license, a party in possession or control of information, documentation, copies, or other materials that are the property of the other party or are subject to a contractual obligation to be returned or delivered to that party shall use commercially reasonable efforts to deliver all of those materials or hold them for disposal on instructions of the party to which they are to be delivered. If any materials are jointly owned, the party in possession or control shall make the jointly owned materials available to the other joint owner.

(b) Termination of a license ends any right to use the information, informational property rights or copies under the contract. Continued exercise of the terminated rights or other use is a breach of contract unless authorized by a term that expressly survives

termination.

(c) Each party is entitled to enforce its rights under subsections (a) and (b) by judicial process, including by an order that the party or an officer of the court:

(1) deliver or take possession of all materials to be delivered;

(2) render unusable or eliminate the capability to exercise rights in or use the licensed information and any other materials to be delivered without removal;

(3) destroy or prevent access to any materials to be delivered; and

(4) require that the party or any other person in possession or control of the materials to be delivered assemble and make them available to the other party at a place designated by that party which is reasonably convenient to both parties.

(d) In an appropriate case, a court may grant injunctive relief ~~may be granted~~ to enforce the rights under this section.

(e) A party may use an electronic means to enforce termination under Section 2B-310.

Uniform Law Source: None.
Committee Actions: Reviewed without substantive change.
Reporter's Notes:

1. *Obligation to Return.* Subsection (a) states the unexceptional principle that the expiration of the contract, the party is entitled to return and delivery of materials held by the other party that it owns or that the contract provides are to be returned at the end of the relationship. The obligation is conditioned by a reference to commercially reasonable efforts to deliver because of the difficulties that may be involved in modern systems with multiple back-up systems. A reasonable effort here, however, does not include any intent or knowing retention of copies and is subject to the terms of subsection (b) which define any use of the information after termination as a breach. Such use would also constitute infringement in the ordinary case where the licensed information is protected under copyright or patent law.

2. *Termination of Rights of Use.* Under subsection (b), in a license, termination ends future rights of use unless those rights are stated to survive or are otherwise irrevocable. This is a natural by-product of the conditional nature of a license. Continued use that is not authorized by the terminated license constitutes a breach of contract. Where intellectual property rights are involved, that use will often also constitute an infringement of those rights.

3. *Electronic Rights.* Subsection (e) 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. Section 2B-310 provides standards for use of such systems.

The ability to use electronic means to effectuate a termination does **not** allow use of those means to destroy or recapture records, but merely to preclude further use of the information. The electronic means 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.

REMEDIES

[A. In General]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same loss.

(b) A court may deny or limit a remedy other than liquidated damages if, under the circumstances, the remedy would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) If a party is in breach of contract, whether or not material, the other party has the rights and remedies provided in the agreement or the applicable provisions of this article, but the aggrieved party shall continue to comply with contractual use restrictions. Unless the contract otherwise expressly so provides, the aggrieved party also has the rights and remedies under other law, including applicable informational property law.

Uniform Law Source: Section 2A-523.

Reporter's Note:

1. *General Purpose of Remedies.* The basic theme of contract remedies is set out in Article 1. The goal is to place an aggrieved party in the position that would occur if performance had occurred as agreed. Section 1-106(1) provides that "remedies ... shall be administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." That principle applies to Article 2B.

2. *Cumulative Remedies.* The remedies in this article are cumulative to the extent that is consistent with the general goal of applying remedy rules. As in other UCC articles, Article 2B rejects any concept of election of remedies that would bar seeking multiple or inconsistent remedies. See Section 2A-501(4).

3. *Aggrieved Party Choice.* The basic structure of damage and other remedies in Article 2B allows the injured party to choose its remedy, subject to the substantive limitations applicable to the various remedies under this Article or the agreement of the parties. To prevent abuse, subsection (b) gives a court a limited right to deny a remedy if the remedy would place the injured party in a substantially better position than performance would have. This is a general review power, applicable only to the court to be exercised to prevent extreme abuse. It does not justify close scrutiny 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.

SECTION 2B-702. CANCELLATION.

(a) A party may cancel a contract if:

(1) there is a material breach of the entire contract and the breach has not

been cured or waived; or

(2) the agreement allows cancellation for the breach.

(b) On cancellation, the following rules apply:

(1) A party in possession or control of information, materials, or copies shall comply with:

(A) Section 2B-612 as to any rightfully refused copies; and

(B) Section 2B-627 as to all other information, materials, or copies.

(2) All obligations that are executory at the time of cancellation are discharged.

(3) The rights, duties, and remedies described in Section 2B-625(b) survive.

(4) Cancellation of a license ends any right to use the information, informational property rights, or copies under the contract, except for use for a limited time solely to mitigate loss ~~as~~ if required by Section 2B-707(c) and permitted by Section 2B-612.

(c) A term providing that a contract may not be canceled is enforceable and precludes cancellation~~,~~ but leaves all other rights and remedies unimpaired.

(d) Unless a contrary intention clearly appears, expressions such as "cancellation" or "rescission" or the like may~~shall~~ not be construed as 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.

Reporter's Note:

1. *Nature of Cancellation.* Cancellation means putting an end to the contract for breach as compared to termination because the contract expired. Cancellation terminates executory obligations but not rights earned by prior performance or fixed as a result of prior breach.

2. *Cancellation: Breach of Entire Contract.* A right to cancel exists if the breaching party's conduct constitutes a material breach of the entire contract **or** if the contract creates the right to cancel under the circumstances. It is one remedy of an aggrieved party, but exists only in the case of material breach or contract terms providing for it.

What constitutes a material breach of the entire contract depends on the nature of the

breach and the overall agreement, including whether the contract involves a single delivery of a copy, a grant of rights implemented by a later delivery of a copy, or a series of on-going performances. Courts applying Article 2B should draw on case law from licensing and other contexts on what constitutes a material breach. Section 2B-109 provides guidance on the issue. 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); cases from those areas of law are also relevant.

Of course, a material breach does not require that the aggrieved party cancel. The aggrieved party may continue to perform, demand reciprocal performance, and collect damages. However, if the injured party does not cancel and the breaching party cures the breach, cure precludes cancellation.

3. *Cancellation: Ongoing Contracts.* The remedy of cancellation is important in two ways. First, it ends the injured party's duty to continue to perform executory obligations under the agreement. Thus, for example, cancellation in a continuous access contract ends the access provider's obligation to make access available. Second, in licenses involving informational property rights, cancellation ends the contractual permission for future uses.

A license grants permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If the license terminates or is canceled, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying intellectual property rights of the licensor exposes itself to an infringement claim. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228 (2d Cir.1982).

Intellectual property remedies for infringement are in addition to contract remedies. Properly stated, infringement and contract remedies deal with a different injury (breach of contract expectation as compared to damage to the value of the exclusive rights).

4. *Cancellation and Federal Jurisdiction.* Cancellation affects judicial jurisdiction if the information is covered by federal intellectual property rights. A copyright or patent infringement claim is under exclusive federal jurisdiction. To sue for infringement for post-breach conduct of the licensee (in addition to or in lieu of breach of contract), the licensor must prove that the contract no longer permits the licensee to act. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992).

6. *Waiver of Right to Cancel.* Subsection (c) clarifies the enforceability of contract terms that provide that a licensee's right cannot be canceled, even for material breach. This limitation is common in transactions where the licensee contemplates distribution of an information product by the other party who makes a significant investment in developing the product based on the license.

SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages or a party's other remedies, such as by:

(1) precluding a party's right to cancel for breach of contract;

(2) limiting remedies to return or delivery of copies and refund of the contract fee; or

(3) limiting the remedies to repair or replacement.

(b) Resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. However, if an exclusive remedy requires performance by the party that breached the contract and the party

~~performance~~ fails to give the aggrieved party the remedy, the exclusive remedy fails. If the exclusive remedy fails, the aggrieved party is entitled to:

(1) specific performance of the agreed remedy if feasible; or

(2) to the extent that the performance failed and subject to subsection (c), other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of terms disclaiming or limiting consequential or incidental damages if the contract expressly makes those terms independent of the performance of the agreed remedy.

(d) Consequential damages and incidental damages may be disclaimed or limited by agreement unless the ~~exclusion~~ disclaimer or limitation is unconscionable. [Limitation of consequential damages for injury to the person in the case of a consumer transaction for a computer program is prima facie unconscionable, but limitation of damages where the loss is commercial is not.]

Uniform Law Source: Section 2-719 (revised).

Committee Actions:

a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

b. Considered in June 1997.

c. Adopted requirement that consequential damages clause be expressly independent of other agreed remedy in order to survive failure of remedy. Vote: 12 – 0. (Nov. 1997)

Reporter's Note:

1. *Agreement Controls.* Subsection (a) recognizes the right of parties to contractually limit remedies. This follows Article 2. The right to control remedies by agreement is a fundamental facet of contract practice and the use of agreements to delimit risks.

2. *Listed Illustrations.* Subsection (a) follows current Article 2 in listing illustrative remedy limitations that are common in commercial practice. The limited remedy of "replacement, repair or refund" is used in some information industries and clearly suffices as an effective limited remedy.

Subsection (a) also lists a remedy (barring cancellation) that is specifically relevant in information transactions where the licensee commits significant resources to the development and exploitation of information licensed to it from the licensor. The ability to waive by agreement the right to cancel for breach is important in that environment.

The illustrations in subsection (a) are not an exclusive list, but give guidance on what options are clearly acceptable, if performed by the party seeking to enforce the limited remedy.

2. *Exclusive Remedies.* A contractual remedy is not an exclusive remedy unless the contract expressly so provides. This follows current Article 2 law and gives a reasonable basis for contract interpretation and a safe harbor for drafters.

The second sentence of subsection (b) and the language in subsection (c) provide a balanced solution to an issue that has split courts which provides that a contractual remedy is not enforced if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential

purpose." This language led to conflicting case law because it does not describe what is at issue in failed remedy cases. The need for clarification was suggested from the floor of the NCCUSL meeting in 1995. There are two issues in such cases.

a. Remedy for Breach of Exclusive Remedy. The first contract law question concerns what remedy exists for failure to perform the exclusive contract remedy as a matter of damages or other contract law. Most reported decisions under Article 2 ignore this question. This Article treats the failure to perform as a breach of contract. The basic principle is that, if a party promises a specific performance as an exclusive remedy, its failure to perform that agreement both vitiates the exclusive nature of the remedy and gives the injured party a right to demand specific performance if that remedy is appropriate under standards set out in this Article.

b. Effect of Failure on a Consequential Damages Term. Subsection (c) deals with a contract interpretation issue. It asks whether one clause (consequential damages) is dependent (or independent) of the other (limited exclusive remedy). Article 2B provides that the clauses are independent if expressly made so by the agreement. Under current Article 2, most cases dealing with failures of the contractual exclusive remedy focus on this independence issue involving whether failure of the limited remedy vitiates the consequential damage limitation. Cases split, but most hold that the failure of one remedy does not exclude enforceability of the other in commercial contracts.

3. *Minimum Adequate Remedy.* Article 2B follows current Article 2 and does not regulate by setting a floor on the ability of parties to define remedies by contract. It does not require that the remedy at least provide a "minimum adequate remedy" to the injured licensor or licensee. Standards of unconscionability and tests for the formation of a binding contract adequately set floors on what agreed terms are binding.

In Article 2, the idea of a minimum adequate remedy rule is noted in the Comments, but not the text of the Article. Few courts have adopted this approach to invalidating agreed on terms.

The Comments to current Article 2-719 tie the idea of a minimum adequate remedy to two legal analyses, both of which are present under this Draft. In one respect, they seem to refer to an idea of a failure of mutuality or consideration and resulting questions about the enforceability of the entire contract. (e.g., "If the parties intend to conclude a contract for sale … they must accept the legal consequence that there be at least a fair quantum of remedy …"). Alternatively, the concept is connected in the comments to the idea of unconscionability, a standard against which all contract clauses are tested in this Article. (e.g., "Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion …").

Since these generally applicable and more widely accepted themes remain present in reference to all contract, the decision to not elevate the commentary to statutory law avoids creating a new and undefined basis for invalidating important contract terms without substantively altering the rights of the parties under current law.

4. *Consequential Damage Limitation: General.* Subsection (d) follows Article 2 and permits exclusion or limitation of consequential damages unless the contract term is unconscionable. The mere fact that damage liability is disclaimed does not cause an unconscionable term.

5. *Consequential Damage Limitations: Personal Injury.* Personal injury caused by breach of contract is potentially a form of consequential damages. Article 2B treats this type of claim as other losses. In the absence of a disclaimer, consequential damages are ordinarily recoverable. Disclaimer or limitation is permitted. In information contracts, modern cases do not use contract breach principles to create liability for personal injury against an information provider. In fact, for informational content, most cases do not allow personal injury recovery even under tort theories. Where the subject matter involves computer software, as compared to informational content, there is a similar lack of case law creating liability for personal injury claims. Additionally, cases where personal injury risk is clearest in reference to computer software (e.g., embedded software operating automobile brake systems) are not within Article 2B (see 2B-103). Under these circumstances, the Article does not adopt the sales law presumption that exclusion of personal injury loss in **consumer** cases is prima facie unconscionable. An assumption of this type is not appropriate since such a remedy is not generally recognized in law with reference to information publishers.

SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages caused by a breach of contract by either party may be liquidated in an amount that is reasonable in light of the actual loss, ~~or of~~ the loss anticipated at the

time of contracting, or ~~of~~ the actual or anticipated difficulties of proving loss in the event of breach. A term fixing unreasonably large liquidated damages is void as a penalty. .

(b) If a party justifiably withholds delivery of copies because of the other party's breach of contract, the party in breach ~~of contract~~ is entitled to restitution of any amount by which the sum of the payments it made for ~~such~~ the copies exceeds the amount to which the other party is entitled by virtue of the term liquidating damages in accordance with subsection (a). The right to restitution is subject to offset to the extent that the aggrieved party establishes:

(1) a right to recover damages under the provisions of this article other than subsection (a); and

(2) the amount or value of any benefits received by the party in breach, directly or indirectly, by reason of the contract.

Uniform Law Source: 2-718. Revised.
Committee/ Other votes:

a. At the annual meeting, in reference to Article 2, the Drafting Committee accepted a motion that no after-the-fact determination of excessive or too-minimal damages is intended.

b. The Drafting Committee by consensus agreed to delete a restitution formula in current Article 2, but which has had limited or non-existent use. (June, 1997)

Reporter's Note:

1. *General Standard.* Subsection (a) follows the presumption that contractual choices should be enforced unless a clear contrary reason exists to prevent enforcement. Terms liquidating damages are one method of allocating risk in a contractual relationship. Subsection (a) adopts a standard that enforces any clause liquidating damages if the clause is reasonable based on either the anticipated losses, the actual loss incurred, *or* the difficulties of proof.

If the liquidated damage amount is chosen by the parties based on their assessment of risk at the time of the contract, that choice should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to the enforceability of the term.

2. *Restitution.* Subsection (b) carries forward Article 2 concepts.

SECTION 2B-705. STATUTE OF LIMITATIONS.

(a) An action for breach of contract 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 no longer than five years after the right of action accrues. By agreement, the parties may reduce the period of limitations to not less than

one year after the right of action accrues but may not extend the period of limitations. ~~and may extend it to [a period of not longer than eight years] [an agreed period of time] after the right of action accrues.~~

(b) Except as otherwise provided in subsection (c), a right of action accrues when the act or omission constituting the breach occurs even if the aggrieved party did not know of the breach. A right of action for breach of warranty accrues~~occurs~~ when tender of delivery occurs, but if the warranty explicitly extends to future ~~conduct~~ performance of the information, the right of action accrues ~~breach of warranty occurs~~ when the ~~conduct~~ performance that constitutes the breach of warranty occurs or should have occurred, but not later than the date the warranty expires.

(c) In the following cases, a right ~~cause~~ of action accrues on the later ~~earlier~~ of the date the act or omission constituting the breach occurred or the date on which it was or should have been discovered by the aggrieved party, but in no event earlier than the date for delivery of a copy if the claim relates to information in the copy~~any delivery is required to enable use~~:

(1) A breach of warranty ~~under Section 2B-401 or of an express warranty covering the subject matter of Section 2B-401.~~ ~~(2) A breach of an express warranty~~ against third party claims for

(A) infringement or misappropriation; or

(B) libel, defamation or the like.

(~~3~~2) A breach of contract involving a party's disclosure or misuse of confidential information.

(~~3~~4) A failure to provide an indemnity.

(d) If an action commenced within the time limited by this Section is so terminated as to leave available a remedy by another action for the same breach or

indemnity, the other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(ed) This section does not alter the law on tolling of the statute of limitations and does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; 2-725. Revised.
Committee Vote:
a. Adopted Article 2 rule prohibiting extension of term. Vote: 10 - 0 (March, 1998)
Note to this Section: Subsection (d) added to conform to Article 2 and 2A.
Reporter's Note:
1. *Limitations Period.* Subsection (a) combines a discovery rule with a rule of repose. The primary rule requires the action to be brought within four years of the time that the claim accrues. A limited "discovery rule" applies, however, that allows extension of this statutory time period to a total of no more than five years because the existence of the breach was not discovered. In the absence of contractual modification, the maximum period within which to bring suit is five years.

Subsection (a) follows current Article 2 and precludes contracting for a longer period of limitations than in the statute. This does not preclude the modern practice of allows "tolling agreements" in contract disputes. 2. *Accrual of Cause of Action: Basic Rule.* Article 2B uses two rules for determining when the cause of action accrues. The primary rule is in subsection (b). The cause of action accrues when the conduct constituting a breach occurs or should have occurred. In warranties generally, this occurs on delivery of the information or service, even if the performance problem does not materialize until later.

This section does not adopt the rule that a warranty that expressly relates to future performance automatically changes the basic standard to a "discovery" rule. Rather, for such "future performance" warranties, the standard is that the cause of action arises when the future performance obligation is breached. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

3. *Discovery Rule.* Subsection (c) contains two exceptions to the time of conduct rule. Each exception deals with a case in which, in the ordinary course, the breach may be undiscoverable until after the conduct creating it occurs. One of these involves issues of infringement, whether under a statutory or an express warranty. A second involves disclosure of confidential information. Article 2B rejects the rule in some states that, as to the tort action for misappropriation, no discovery rule applies. See 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).

SECTION 2B-706. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission nor a claim for rescission of the contract nor refusal or return of the information shall bar or be deemed inconsistent with a claim for damages or other remedy.

Reporter's Note: Conforms to Article 2.

SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) If there is a breach of contract, whether or not the breach is material, an aggrieved party may recover direct damages ~~resulting in the ordinary course from the breach as~~ measured in any reasonable manner, together with ~~the present value of~~ any incidental and consequential damages as of the date of judgment, less the ~~present value of~~ expenses avoided as a result of the breach. With respect to damages or expenses considered in the award of damages that relate to events that may occur after the date of judgment, the amount awarded shall be determined at the present value as of the date of judgment.

(b) The remedy for breach of contract relating to disclosure or misuse of information in which the aggrieved party has a right of confidentiality or which it holds as a trade secret may include as consequential damages compensation for the benefit received by the party in breach as a result of the breach.

(c) Except as otherwise expressly provided in the agreement, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(d) ~~Notwithstanding any other provision of this article, n~~Neither party is entitled to recover:

(1) consequential damages associated with the character or quality ~~in the case~~ of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative or otherwise uncertain of proof~~; or~~

~~(3) consequential damages that are unreasonably disproportionate to the~~

~~risk assumed under the contract by the party in breach~~.

Committee Votes:

a. Voted 7-6 to allow consequential damages only if parties agreed to that remedy. March, 1996.

b. Voted 14-0 to return to consequential damages rule of common law, but consider specific circumstances in which consequential damages should be allowed only if agreed to by the parties. September, 1996.

c. Rejected motion to reverse consequential damages presumption in battle of forms. (5-7) December, 1996,

d. Consensus to retain the exception for published informational content. (December, 1996)

e. Reviewed without substantive comment. (June, 1997).

Notes to this Draft: Based on discussion at the last meeting, the reference to disproportionate damages is proposed for deletion. The phrase does not follow existing law and raises serious issues in information contracting. The Restatement (Second) 351(3) states: "A court may limit damages for foreseeable loss…if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation." That rule differs from our prior proposal and is not universally adopted. Also, it is a permissive, rather than mandatory limitation.

Reporter's Notes:

1. *General Rule.* Subsection (a) defines a broad approach to damages. Unlike in Article 2, in many Article 2B cases, formula-driven damage computation is often inappropriate. Article 2B covers a range of performances and this section allows a party to resort to general, common sense approaches to damage computation. The language comes from the Restatement (Second) of Contracts § 347, with clarifications to include restitution and reliance losses when appropriate. See also Article 2A, § 2A-523(2); UNIDROIT Principles of International Commercial Law art. 7.4.2.

Subsection (a) maintains the distinction between general or direct damages and consequential damages. The first portion of the subsection relates to direct loss. The definition in 2B-102 should be consulted in limiting this concept. Direct damages ordinarily refer to the value of the performance received or expected as measured by contract terms, while consequential loss refers to foreseeable losses resulting from the inability to use the performance.

Illustration 1: OnLine provides access to stock market quotes for $1,000 per hour. It fails to have the system available during ten minutes critical for Meri-Lynch, a client. Assume that this is a breach. Meri-Lynch recovers the value of the performance (e.g., difference in value if perfect and as delivered) as measured in any reasonable manner. Losses from not being able to make investments during the ten minutes are consequential damages, if recoverable at all.

Illustration 2: Sizemore licenses database software to General, restricting licensed use to no more than twenty simultaneous users. General used the system with an average of twenty two simultaneous users for a two month period. Sizemore recovers the difference in value of a twenty-two person license and the twenty person license as measured in any reasonable manner.

Subsection (a), as with other damage formulations in this Article, provides that consequential and incidental damages are to be awarded based on present value as of the date of judgment. "Present value" is a defined term. It provides for discounting the value of future payments or losses as measured at a particular point in time. As applied to this damages issue here, this requires that, *as to damages awarded for eventualities that are in the future as of the date of judgment*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does not require discounting or enhancement of the amounts. No change in the applicable law on pre-judgment interest is made under this standard.

2. *Party Choice.* A party may elect to use the measure of damages in (a) in the case of either material or non-material breach. This is subject to general limitations on double recovery and the ability of a court to exclude recovery that substantially over-compensates. The principle is that the aggrieved party controls the choice, while the court (or jury) controls the computation.

3. *Confidential Information.* Subsection (b) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party has an expectation of the information not being misused and that expectation is entitle to protection. Lost value in the sense described here, however, does not easily fit into the idea of damages resulting from breach. Yet, compensation for such results is important to maintaining the integrity of the relationship.

5. *Mitigation.* Subsection (c) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. The idea that an injured party must mitigate its damages permeates contract law jurisprudence, but has not previously been made explicit in the UCC. The basic principle flows from the idea that remedies are not punitive but compensatory and that the injured party cannot act in a manner that enhances the loss

6. *Published Content.* Subsection (d) excludes consequential damages for "published informational **content**." As noted elsewhere, published informational content 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 opposition 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.

As indicated in the definition of published informational 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. Information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the liability limit even under tort law; the exclusion here merely declines to change the law. 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 3:** Dow distributes general stock market information through newspapers and on-line for $5 per hour or $1 per copy. Dupond, reviews the on-line information and relies on it to trade 1 million shares of Acme at a price that caused a $10 million loss because the data were incorrect. If Dupond was in a relationship of special reliance on Dow, consequential loss would be recoverable. In this published content, Dupond cannot recover the consequential loss.
>
> **Illustration 4:** Disney licenses a motion picture to Vision. Vision shows the movie through an on-line access contract. One viewer who pays five dollars is shocked by the violence and spends a sleepless week. That 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 since this is published content. If liability exists, it exists only under tort law.

7. *Speculative Damages.* The Article does not require proof with absolute certainty or mathematical precision. Consistent with the underlying principle of Article 1 that there be a liberal administration of the remedies of this Act, the remedies must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See Restatement (Second) of Contracts 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see Freund v. Washington Square Press, Inc., 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) ("[Plaintiff's] expectancy interest in the royalties … was speculative. [He] provided no stable foundation for a reasonable estimate of royalties he would have earned had defendant not breached his promise to publish. [The] claim for royalties fails for uncertainty.").

SECTION 2B-708. LICENSOR'S DAMAGES.

(a) Subject to subsection (b), on 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 damages, the value of accrued and unpaid contract fees and

other consideration earned but not received for any performance rendered by the licensor, plus:

(A) ~~the present value of~~ unaccrued contract fees and other consideration required for the remaining duration of the contract~~, less the present value of expenses saved as a result of the licensee's breach~~;

(B) ~~the present value of the~~ profit, including general overhead, that the licensor would have received on acceptance and full payment for performance that was to be delivered to the licensee but was not because of a wrongful refusal or repudiation of the contract; or

(C) direct damages calculated in any manner that is reasonable~~pursuant to Section 2B-707~~; and

(2) ~~the present value of~~ any consequential and incidental damages ~~as of the date of entry of the judgment~~.

(b) The recovery in (a) must be reduced by the expenses saved as a result of the licensee's breach.

(~~b~~c) If the breach of contract makes possible a substitute transaction concerning the same information or informational property rights that would not have been possible in the absence of breach, the damages in subsection~~s~~ (a)(1)(A) and ~~(a)(1)~~(B) must be reduced by due allowance for:

(1) the net proceeds of any actual substitute transaction; or

(2) the market value of a substitute transaction made possible because of the breach, less costs of the substitute transaction.

(d~~e~~) The same date shall be used for determining present value of unaccrued contract fees, consideration, or profit, and ~~the date~~ for determining the sum of accrued contract fees or value of earned consideration under subsection (a). With respect to

damages or expenses considered in the award of damages that relate to events that may occur after the date of judgment, the amount awarded shall be determined at the present value as of the date of judgment. ~~That date is determined as follows:~~

~~(1) if the initial enabling of use never occurred, 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 the actual ability to use the information or the informational property rights; or~~

~~(3) if the licensee's contractual rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.~~

(e~~d~~) To the extent necessary to obtain a full recovery, a licensor may use any combination of damages provided in subsection (a).

Uniform Law Source: Section 2A-528; Section 2-708.
Definitional Cross References: "Information": Section 2B-102; "Licensee": Section 2B-102; "Licensor": Section 2B-102; "Present value": Section 2B-102;
Reporter's Note:

1. *General Approach.* This section gives the licensor a right to elect damages under three measures described in (a). Each formula is subject to subsection (b) and (c) which reduces the recovery by the amount realized through a substitute transaction made possible by the breach. The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables double recovery. No order of preference is stated for the three options.

Subsection (d~~e~~), as with other damage formulations in this Article, provides that consequential and incidental damages are to be awarded based on present value as of the date of judgment. "Present value" is a defined term. It provides for discounting the value of future payments or losses as measured at a particular point in time. As applied to this damages issue here, this requires that, *as to damages awarded for eventualities that are in the future as of the date of judgment*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does not require discounting or enhancement of the amounts. No change in the applicable law on pre-judgment interest is made under this standard.

2. *Effect of Intangible Character of Subject Matter.* Licensor remedies are formulated in a manner that differs from those made available for sellers under Article 2. The most significant difference lies in recognition of the intangible character of information and value. Article 2 focuses damages formula on an assumption that the seller's loss deals with the disposition of the particular item (goods) and measures recovery by either: 1) contract price compared to resale price, or 2) contract price compared to market price (e.g., hypothetical resale). It provides a lost volume remedy as a background rule if the others fail to compensate adequately.

For information assets, the particular copy (item) is not the focus of the deal. Given their ability to be recreated easily and rapidly, with little cost, information assets are prime candidates for damage assessment focusing on net return or profit lost to the licensor and, under the Article 2 framework, this would be the most likely result. Article 2B recognizes the difference in goods and information and gauges the formula for determining loss in a manner that reflects this fact. Instead of the rigid contract-resale or contract-market focus, this Section centers on the contract fee and lost benefits of the licensor and

provides that if substitute transactions are made possible by the breach, they shall be given consideration in reducing the damages. This is consistent with common law approaches and explicitly recognizes that the nature of information and information-related services means that breach often does not make an additional transaction possible, since in effect, the information assets are available in relatively infinite supply.

3. *Computation Approaches.* The basic damages formulae require consideration of ~~both~~ subsection (a) and subsections (b) and (c). They yield the following results:

a. Accrued Fees and Consideration. Subsection (a)(1) recognizes the obvious principle that the aggrieved licensor is entitled to recover any accrued and unpaid fees or the value of other consideration owed for information or services actually delivered. This element of recovery applies to all of the three computational formats. The fees relate to direct (general) damages. The consideration referred to is the agreed compensation, not to the possible gains that the party expected from using the information (a form of consequential damages).

b. Measuring other Direct Damages. This Section outlines three approaches to determining direct damages in addition to unpaid fees.

A. Recovery Measured by Contract Fee. Subsection (a)(1)(A) describes a recovery measured by the *present* value of unaccrued (e.g., future) contract fees and other consideration. This contract standard parallels the contract price approach in Article 2, but also requires that the contract fee be reduced by the amount of expenses saved by virtue of the breach. Subsection (d) indicates the time at which the present value is determined.

i. Certainty. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. See Section 2B-707. This Article retains the general law concept that speculative damages are not recoverable. This is especially important in information transactions and licenses generally, many of which reflect a future payment stream based on royalties chargeable against future sales, use, or market response. If these cannot be adequately predicted and proven, no recovery should be allowed. Similarly, many transactions involve "floating royalty" fees. If the rates are proven and not speculative, recovery is appropriate under this or any other damage standard. If they cannot be proven, then recovery is not appropriate. The reasonable certainty principle is recognized in the Restatement and throughout common law. Restatement (Second) of Contracts § 352.

ii. Substitute Transaction. The contract fee recovery must be reduced by the proceeds of a substitute transaction consistent with subsection (c). The theory here represents a specific application of the general concept of mitigation. This due allowance approach is appropriate in this setting because of the nature of the subject matter and the variety of circumstances covered. Similar language is in the Restatement.

The substitute transaction must have been made possible by the breach. Thus, for example, in a breach of an access contract by the licensee, the substitute transaction concept would not reduce recovery if the licensor had essentially unlimited capability to make access available to others. While a new access contract may occur after breach, it was not made possible by the breach – the new license would have occurred with or without the breach. On the other hand, breach and cancellation of a license giving the exclusive right to show a digital work in a particular geographic area may enable a new license for that area, which could apply to reduce the recovery.

If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery would be reduced under the general duty to mitigate. However, in the case of a failure to mitigate by conducting a substitute transaction made possible by the breach, it is appropriate to reduce the recovery by the proven market value of the substitute that could have occurred. As with the actual transaction standard, market value of a hypothetical substitute will only be considered in reduction of the recovery if the substitute was made possible by the breach. It is not sufficient simply to show that a second transaction occurred or could have occurred.

B. Recovery Measured by Lost Profits. Subsection (a)(1)(B) provides as an alternative that losses may be measured by lost profits caused by a failure to accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts in dealing with computation of loss under this standard should refer to common law cases involving license recovery and to cases under the lost profit concept in Article 2. Unlike in Article 2, however, applying this standard does not require proof that the alternative standards are inadequate to compensate the licensor. The injured party can choose the method of computation.

As in the contract fee standard, lost profits must be proven with reasonable certainty and not merely speculative. No change in law is intended and this Article adopts the general common law and UCC concept on proof with reasonable certainty. Restatement (Second) of Contracts §

352.

Similarly, recovery is subject to both the limiting effects of the substitute transaction concept and the general duty to mitigate. See, e.g., Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996) (discussing of the application of the substitute transaction concept in lost profits claim relating to a license).

C. Measurement in the Ordinary Course. Subsection (a)(1)(C) recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases.

c. Consequential and Incidental Damages. The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The right to recover consequential loss is established in common law for breach of a license. See Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) ("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."); United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) (premature publication entitled licensor to lost profits). See also Restatement (Second) of Contracts § 347; UN Convention on International Sales of Goods art. 74.

For consequential damages, present values are measured as of the date of entry of the judgment. The section distinguishes between contract 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 (de) provide guidance on this issue, making computation of accrued and unaccrued fees occur on the same date.

4. *Illustrative Situations.*

Illustration 1: Chambers agrees to supply a master disk of its software to Wilson and to allow Wilson to make and distribute 10,000 copies in a wholesale market. This is a nonexclusive license. The license fee is $1 million. The cost of the master disk is $5. Wilson refuses the disk and repudiates the contract. Under (a)(1)(A), Chambers recovers $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach, and (2) by any failure to mitigate. The creation of another 10,000 copy license may or may not constitute a substitute under subsection (c) depending on whether this license was made possible by the breach or was simply anther transaction that would occur in any event. Recovery under subsection (a)(1)(B) is determined by assessing what portion of the contract price constitutes lost profit in the transaction.

Illustration 2: Same as in Illustration 1, except that the contract requires Chambers to deliver manuals, boxes and other materials for Wilson to distribute the copies. The cost of these materials is approximately $800,000. The $800,000 savings is deducted from the $1 million. In making "due allowance" for any substitute transaction, a court should take into account that this expense adjustment reflects some accommodation to the alternative transaction.

Illustration 3: Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, Chambers makes an identical license with Second for a fee of $900,000. This transaction was possible because the first was canceled. Chambers recovery is $100,000 less any net cost savings not accounted for in the second transaction.

Illustration 4: Parkins grants an exclusive U.S. license to Telemart to distribute copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches and Parkins cancels. Its recovery is the present value of the remaining contract fees with due allowance for substitute transactions (if any) made available by virtue of the breach and subject to a duty to mitigate. Since the license was exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution of the encyclopedia.

Illustration 5. Producer receives a promise to be paid $10,000 for information that cost $1,000 and a commitment of 3% royalties for any sales of copies. The licensee repudiates the contract. As direct damages, Producer receives $10,000 less any expenses saved. The possible future royalty can be recovered only if proven with reasonable certainty.

5. *Remedies under Other Law.* The licensor may have remedies under other law. The primary alternative is intellectual property law. Breach introduces the possibility of an infringement claim

if (a) the breach results in cancellation (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the breach consists of acting outside the scope of the license and in violation of the intellectual property right. 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); 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).

Licensors often opt for intellectual property remedies, rather than contract remedies because the recovery is often greater. Federal intellectual property remedies do not preempt or displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general 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); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992).

SECTION 2B-709. 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, or if appropriate, as to the entire contract, the sum of the following:

(1) as direct damages, the value of any payments made and other consideration provided 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 of performance not provided, minus the contract fee and the value of other contractual consideration for that performance;

(B) the present value, as of the date of breach, of the difference between the cost of a substitute transaction entered into by the licensee for identical information under the same contractual use restrictions, minus the contract fee for the performance that was not provided; or

(CB) direct damages calculated in any manner that is reasonable;~~computed pursuant to Section 2B-707; or~~

~~(C) if the licensee has accepted performance from the licensor and has not revoked acceptance, 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 if there had there been no non-conformity, which shall not exceed the~~

~~agreed contract fee or other contractual consideration required for the performance;~~ and

(2) the present value of incidental and consequential damages as of the date of the entry of judgment.

(b) The amount of damages calculated under subsection (a) must be reduced by:

(1) expenses avoided as a result of the breach of contract; and

(2) any unpaid contract fees for performance by the licensor which has been received by the licensee.

(c) Market value in this section is determined as of the time and place for performance. In determining market value, ~~D~~due weight must be given to any substitute transaction entered into by the licensee taking into account the extent to which the transaction involved contractual terms, performance, information, and informational property rights similar in terms, quality, and character to the agreed performance.

(d) With respect to damages or expenses considered in the award of damages that relate to events that may occur after the date of judgment, the amount awarded shall be determined at the present value as of the date of judgment.

(e~~d~~) To the extent necessary to obtain a full recovery, a licensee may use any combination of the measures of damages provided in subsection (a).

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2). Revised.
Definitional Cross References: "Consequential damages": Section 2B-102. "Contract fee": Section 2B-102. "Direct damages": Section 2B-102. "Incidental damages": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Material breach": Section 2B-109. "Present value": Section 2B-102.
Reporter's Notes:

1. *General Structure.* As with licensor remedies, this section allows the licensee to choose among alternatives to fit its circumstances. The choice is subject only to the prohibition on double recovery and to the court's right of overview to prevent excessive recovery under Section 2B-701. Because of the diverse issues that might be involved in breach of a license, the narrower structure of Article 2 remedies for a licensee (buyer) is not appropriate. Article 2B makes the choice of remedy broader and eliminates the hierarchy used in current Article 2. It nevertheless retains much of the conceptual framework present in Article 2, preserving both market value and cover approaches to computing damages.

Subsection (d), as with other damage formulations in this Article, provides that consequential and incidental damages are to be awarded based on present value as of the date of judgment. "Present value" is a defined term. It provides for discounting the value of future payments or losses as measured at a particular point in time. As applied to damages, this requires that, *as to damages awarded for eventualities that are in the future as of the date of judgment*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does not require discounting or enhancement of the amounts. No change in the law on pre-judgment

interest is intended.

2. *Computational Approaches.*

a. Recovery of Fees. Subsection (a)(1) confirms the simple premise that, in the event of breach, the licensee is entitled to recover any fees paid for which performance was not received. This right applies to all of the optional methods of proving loss. Performance has not been provided if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled.

b. Computation Formulae. Subsection (a) provides three alternative methods for computing other direct damages. These are optional at the choice of the licensee, subject to concepts of mitigation and to the ability of a court to limit a remedy to the extent it causes substantial over-compensation. Section 2B-701.

A. Market and Cover. Subsection (a)(1)(A), when read in connection with subsection (b) and (c) parallels the Article 2 concepts of computing damages by comparing contract price to the market value of performance not received or to the cost of cover replacing that performance with a substitute. It is predicated on the assumption that the breaching party will also return any contract fees already received for that performance.

The subsection enables recovery based on the difference between the contract cost and "market value" of the performance, less expenses saved by virtue of breach (subsection (b)). Because of the variations in terms and content encountered in information transactions and the fact that many information products are by definition unique, this does not state a specific "cover" remedy. Subsection (c) recognizes the right to cover and provides that the "market value" of the performance is determined by giving due weight to information or other performance obtained as cover for the promised, but not delivered performance. If the cover involves a copy of the same information under the same license terms, the cost of that cover identifies the market value of the undelivered performance. Where there are differences in license terms of information content or performance, the court shall account for the differences in either increasing or decreasing the dollar value against which the contract fee is compared. A failure to effect an alternative transaction does not bar recovery unless it affects concepts of mitigation. This overall approach builds on the remedy structure in Article 2A.

New subsection (1)(B) provides for the unusual situation in which the licensee is able to obtain a substitute involving identical information under identical contract use terms. When this happens and the licensee so elects, damages are computed by reference to the specific cover.

B. Measured in any Reasonable Manner. Subsection (a)(1)(C) authorizes the licensee to compute damages in manner that is reasonable. The intent is to provide a response to the many situations that cannot be fully predicted in advance and to instruct the parties and the courts to rely on reasonable standards of computer loss when appropriate.

C. Value of Delivered Performance. Former subsection (a)(1)(C) was deleted because it merely restated the general standard for direct damages and, given the ability in new subsection (1)(C) to use any reasonable calculation approach, was not needed. Under the general definition of direct damages, the damages are the difference between the value of the performance received and the value of the performance promised as measured by contract or market value. This standard would apply directly, for example, where the licensee accepts the information or other performance despite the breach. This parallels current Article 2-714 but expressly caps direct damages by the contract fee for the performance. Recovery of losses in excess of that amount is in the nature of consequential damage recovery.

As a general rule, the value of the performance as it would be in the absence of a defect, focuses on the market value of the property which most often equals the agreed price. This Article rejects the approach of the few courts that compute direct damages accounting for perceived potential benefits from use, a concept more appropriately entailed in computation of consequential damages. See Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3rd Cir. 1980). This section, however, 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.).

c. Consequential and Incidental Damages. The licensee may also recover incidental and consequential damages in an appropriate case. If proven with reasonable certainty, damages can include lost profits in this context. See Western Geographic Co. of America v. Bolt Associates, 584 F.2d 1164 (2d Cir. 1978); Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984); Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir. 1989); Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir. 1989). Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

3. *Illustrative Cases.*

Illustration 1: Amoco contracts for a 1,000 person site license for database software from Meed. The contract fee is $500,000 in initial payment and $10,000 for each month of use. The contract term is two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and obtains a substitute database system under a three year contract for $400,000 and $9,000 per month. Under subsection (a)(1)(A), it is entitled to return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court must consider to what extent this second transaction 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 2: Same facts as in Illustration 1, but Amoco obtains a license for Meed software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the Meed contract. The new license is given due weight in the (a)(1)(A) computation and, under (1)(B, since the contract terms and information are identical, it controls The issue of similarity is the same, but giving due weight to this alternative transaction will use this license to define the market value, giving Amoco recovery of its initial payment, the $100,000 difference, and any incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While Amoco could reject the software, it elects to accept the software license and begins to perform. It sues for damages. Direct damages are computed under either subsection (a)(1) (C). Under (C), the issue is establishing the difference in value between a proper system and the one delivered. Assume that the difference is measured at $150,000. Amoco recovers that amount as direct damages, along with any incidental or consequential damages.

SECTION 2B-710. RECOUPMENT.

(a) Except as otherwise provided in subsection (b), an aggrieved party, on notifying the party in breach of contract of its intention to do so, may deduct all or any part of the damages resulting from the breach from any part of payments still due under the same contract.

(b) If a breach of contract is not material, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Section 2-717. Revised.

Committee Action

a. Discussed in June, 1997.

Reporter's Note:

1. *Basic Standard.* Subsection (a) follows language from Article 2 and Article 2A, allowing recoupment to either party in light of the fact that payment streams from which losses can be recouped can flow in either direction in an Article 2B transaction. This is a form of self-help. The injured party can employ self-help by diminishing the amount that it pays under the contract.

2. *Non-material Breaches.* Subsection (b) limits the recoupment rule in cases of nonmaterial breach involving ongoing performance contracts. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach.

[C. Performance Remedies]

SECTION 2B-711. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance ~~of any obligation, other than the obligation to pay for information or services already received~~, if:

(1) the agreement expressly provides for that remedy~~-~~, other than for an obligation to pay for information or services received, and an order for specific performance will not cause an undue administrative burden for the court; or

(2) the contract was not for personal services, but the agreed performance is unique or in other proper circumstances~~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 informational property rights of the party ordered to perform.

Uniform Law Source: 2A-521. Section 2-716. Revised.
Committee Action:
a. Discussed without substantive changes in June, 1997.
Reporter's Notes:
1. *Contracted For Remedy.* Subsection (a) allows the parties to contract for specific performance, so long as a court can administer that remedy. This is consistent with the overall approach in this Article to 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.
2. *Judicial Remedy.* Subsection (a)(2) states the substantive standard for specific performance based on the unique nature of the particular performance. 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.
Specific performance cannot be order for to a "personal services contract" in light of concerns about imposing judicial mandates requiring work or services by an individual. 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.
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 courts 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, most often holding that adequate substitutes are available or that differences can be compensated for by damages. Article 2A has a similar

rule. § 2A-521.

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.

3. *Conditioning the Order.* 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 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.

SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, an aggrieved licensor, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, may complete the information and identify the information to the contract, cease work on the information, relicense or dispose of it, or proceed in any other reasonable manner. The licensor remains bound by all ~~of the terms of the agreement~~ otherwise enforceable contract ~~concerning~~ restrictions on disclosure of confidential information of the licensee ~~to the extent~~. In any case, the licensor may recover damages or pursue other remedies.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.

Reporter's Notes:

1. *Basic Policy.* This section adopts a policy from both Article 2 and Article 2A. A licensor faced with a material breach by the licensor while work 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 licensor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails. See Article 2A-524(2).

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 general theme in this section. 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. Resale as a way of relieving loss is often inappropriate.

SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, the licensee that has not canceled may continue to use the information and informational property rights under the contract. If the licensee elects to continue to use the information or rights, the following rules apply:

(1) Except as otherwise provided in paragraphs (2) and (3), the licensee is bound by all of the terms of the agreement, including contractual use restrictions or noncompetition obligations to the extent they are enforceable under other law, and any obligations to pay contract fees.

(2) Unless waived ~~pursuant~~ under to Section 2B-606, the licensee may pursue remedies for any breach of contract.

(3) The licensor's rights remain in effect as if the licensor had not been in breach but are subject to the licensee's remedy for breach of contract.

Reporter's Note:

1. *General Rights.* This section establishes the licensee's right to continue use and sue for breach. This flows from the decision to accept flawed performance and pursue remedies that do not involve a cancellation of the contract.

2. *Contract Terms.* If the licensee elects to continue use, it remains bound by the contract terms as if no breach occurred, except, of course, for its right to a remedy for breach.

SECTION 2B-714. RIGHT TO DISCONTINUE. Notwithstanding Section 2B-715 and 716, in an access contract, in the event of a material breach of contract or if the agreement so provides, a party may discontinue all contractual rights of access of the breaching party ~~in breach~~ and direct any ~~third~~ other person that is assisting the performance of the contract to discontinue its performance.

Reporter's Notes:

1. *Right to Deny Access.* This section deals with the right of a party in an access contract to stop performance under two significant circumstances. The ability to act quickly in an access contract is potentially critical to party's ability to avoid continuing liability risk, as might occur where the basis of the breach includes use of the access system to distribute infringing, libelous, or otherwise damaging material. It corresponds to current common law principles regarding access to facilities – treating these as arrangements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides. The right to discontinue 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 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). This right is independent of Sections 2B-715 and 716.

In cases where the information available for access is information of the breaching party, the breaching party's rights to recover the information are protected under other provisions of this Article.

2. *Not Related to Retaking Transfers.* This section does not create a right to retake transfers already made, but merely to stop future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This subsection derives in part from Section 2A-525(1). It 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 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.

SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) On cancellation of a license because of breach by the licensee, the licensor has the right:

(1) to possession of all copies of the licensed information ~~provided by it to the licensee and all copies~~ in the possession or control of the licensee ~~whether delivered to or made by it,~~ and any other materials pertaining to that information that by contract were to be returned or delivered by the licensee to the licensor; and

(2) to prevent the continued exercise of informational property and other rights in the licensed information ~~and informational property rights provided to the licensee pursuant to the agreement~~.

(b) A licensor may exercise its rights under subsection (a) without judicial process only if this can be done:

(1) without a breach of the peace;

(2) without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information; and

(3) when applicable, in compliance with Section 2B-716.

(c~~b~~) In a judicial proceeding, a court may enjoin a licensee in breach of contract from continued use of the information and the informational property rights and may order that the licensor or an officer of the court take the steps described in Section 2B-627. If the ~~agreement~~ license so provides, the court may require the licensee ~~party in breach~~ to assemble all copies of the information and any other materials relating thereto and make them available to the licensor at a place designated by the licensor ~~that party~~ which is reasonably convenient to both parties.

(d~~c~~) A party has a right to an expedited judicial hearing on prejudgment relief to enforce or protect its rights under this section.

(ed) The right to possession under this section ~~subsections (a) and (b)~~ is not available to the extent that the information, before breach of the license ~~contract~~ and in the ordinary course of performance under the license, was so altered or commingled that the information is no longer identifiable or separable.

(fe) A licensee that provides information to a licensor subject to contractual restrictions on the use of that information has the rights and is subject to the limitations of a licensor under this section and Section 2B-716 with respect to the information it provides~~d~~.

Uniform Law Source: Section 2A-525, 526; Section 9-503.

Reporter's Notes:

1. *Scope and Policy of the Section.* This section only applies to licenses and only if the license was canceled for breach. It authorizes judicial action to assert the rights stated in subsection (a). The right to possession and to control use of information in the hands of the other party in commercial practice may run either to the benefit of the licensor or the licensee. This is true because in many commercial settings, the licensee provides information to the licensor. The principle which gives the injured party a right to recover and control use of its information should not be restricted to a licensor.

Within this structure, this section recognizes the injured party's right to recover the information and prevent further use by the other party. This reflects the conditional nature of the license relationship, which makes it more analogous to a lease of goods, than to a sale. The remedies here are, in an intangibles context, analogous to the remedies recognized in Article 2A.

2. *Rights Recognized.* Subsection (a) recognizes two distinct rights for the injured party. It can obtain possession of all copies of the information and, when appropriate, obtain an injunction against further use of the information. This combination is necessary to fully implement the intent that, on cancellation of the license, the injured party has a full right to preclude further benefits to the breaching party resulting from the licensed information. In many cases involving informational content, merely returning all copies does not achieve that result.

3. *Self-help.* A license is a conditional transfer. Subsection (b) reflects that fact and provides for a right of self-help consistent with remedies under current Article 2A and Article 9. The self-help right is constrained by 1) there being a breach sufficient to cancel the license and 2) the ability to exercise self-help without causing a "breach of the peace" or a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

Subsection places more restrictions on general self-help than exist in reference to leases under Article 2A or security interests under Article 9. While the "breach of peace" limitation exists under Article 2A and Article 9, the further "foreseeable risk" standard is adopted here.

4. *Expedited Hearing.* To reduce the need for self-help, subsection (d) provides for a right to an expedited hearing to enforce rights or possession and restriction of use. No effort has been made to define the contours of what that hearing timing may entail. This is left to state procedural law.

5. *Identifiability.* The rights under 2B-715 arise only in the case of a license and only in the event of cancellation. Furthermore, as indicated in subsection (e), there must be something with reference to which the rights can be applied. The right to possession of copies obviously cannot exist to the extent the copies of the information cannot be identified because they have been commingled. This deals, for example, with cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible because of the expected performance of the parties under the contract.

This does not necessarily apply to the right to prevent use. For example, if trade secret information was provided to the licensee under use restrictions, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is incorporated and inseparable from other property of the party in

breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license of the "Mickey Mouse" character which results in placing that image in a video game produced by the party in breach does not prevent the other party from barring continued use of the image on the hats in commerce.

SECTION 2B-716. ~~LICENSOR'S~~ ELECTRONIC SELF-HELP.

~~(a) A licensor may exercise its rights under Section 2B-715(a) without judicial process only if this can be done:~~

~~(1) without a breach of the peace;~~

~~(2) without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information; and~~

~~(3) when applicable, in compliance with subsection (b).~~

(a) A licensor may not use electronic means to exercise its rights under Section 2B-715 unless:

(1) the licensor obtains physical possession of a copy without a breach of the peace and the electronic means are used solely with respect to that copy;

(2) the licensed information is information content licensed for display or performance for entertainment or educational purposes;

(3) the licensed information is not material to the licensee's business or is not licensed for use in that business; or

(4) the following conditions are met:

(A) the licensee manifests assent to a term in the license that authorizes use of electronic means; and

(B) the licensor gives notice in a record of the nature of the breach and of its intent to exercise the remedy:

(i) to a person designated by the agreement of the parties for this purpose or, in the absence of a designation, to a senior information officer, managing partner, or managing agent of the licensee; and

(ii) within the time and manner specified in the agreement or, in the absence of agreement, not less than 10 business days before utilizing the electronic means.

(b) The parties by agreement may specify the timing, method, and manner of giving notice under subsection (b) unless the terms are manifestly unreasonable.

(c) A party has a right to an expedited hearing to contest or affirm the licensor's right to proceed under subsection (a).

(d) An act that violates this section is a breach of contract unless it is authorized by other law.

(e) The licensee cannot waive the protections of this section

Uniform Law Source: Section 9-503. Revised.

Committee Action:

a. Considered and substantially revised in January 1996.

b. Motion to delete the section and adopt alternative B was withdrawn. Sept. 1997

d. Motion to endorse alternative A approach, passed 10-1 (Nov. 1997)

e. Motion to make personal injury risk applicable to all self-help, withdrawn.

f. Rejected a motion to delete the right to an expedited hearing. Vote: 4-7 (Nov. 1997)

g. Adopted a motion to indicate that the time of notice is as specified in the agreement or, in the absence of specific terms, a time no less than ten days prior to exercise of the right. Vote: 10-0

h. Adopted a motion that the person to be given notice is as specified in the agreement and, in the absence of contract terms, one of the listed persons. Vote: 12 –1 (Nov. 1997)

i. Rejected a motion that consequential damages under this section cannot be waived by contract. Vote 5-7 (Nov. 1997)

j. Rejected a motion giving the state jurisdiction over a foreign party who exercises this right against a resident of the state. Vote: 5 –7 (Nov. 1997)

Reporter's Notes:

1. *Scope of the Section.* This section deals with "electronic self-help." It does not deal with discontinuation of an access contract. See Section 2B-714. Electronic self-help exists as a potential remedy because digital technology enables a licensor to use remote means to disable a copy of digital information in the event of breach. provisions are controversial. This Section recognizes the availability of this remedy, but places severe restrictions on its exercise.

These licensee protections are far in excess of those provided for under Article 2A (leases) or Article 9 (security interests), both of which allow the injured party to repossess by rendering the goods "unusable" without taking possession if the goods are used in a trade or business. That can be done physically or electronically in the digital world. It is already being done electronically with automobile rentals and other limited term or limited use contracts.

The limited case law on electronic self-help enforces the remedy if advance notice or prior agreement allows it. See *American Computer Trust Leasing v. Jack Farrell Implement Co.*, 763 F. Supp. 1473 (D Minn. 1991) (court held that remote deactivation was permitted for a breach of payment obligations on a software license). Several cases disallow use of this procedure if no prior authorization or notice was given. See *Franks & Son, Inc. v. Information Solutions*, Computer Industry Litigation Rep. 8927-25 (N.D. Okla. 1988) (Jan. 23, 1989); *Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc.*, 157 App. Div. 2d 689, 549 N.Y.S.2d 789 (1990).

2. *Basic approach.* The basic principle is that self-help remedies are appropriate, but that there are important concerns about restraining the leverage this form of repossession creates in settings in

which the information is critical to the business licensee. The prefatory language in (b) limits the additional protections to these circumstances. Of course, the use of electronic self-help is also restricted by the provisions of Section 2B-715(b) on breach of the peace and risk of personal or property damage.

a. Physical Possession. Subsection (a)(1) makes clear that ordinary methods currently used to enforce rights through physical repossession are not invalidated simply because electronics may eventually be involved. Thus, for example, an access card that is repossessed by an ATM or similar device refusing to return the card is subject to the general rule of breach of the peace, rather than to the more elaborate protections established for electronic self-help.

b. Agreement and Notice. Subsection (a)(4) outlines a series of restrictions on electronic means in all other cases of operation software where the licensee's risk is high. Electronic self-help remedy is restricted by contractual consent and prior notice. The required notice is important because the licensee is given a right to an expedited hearing to contest the electronic disabling of the licensed information.

c. Expedited Hearing. Subsection (c) gives the licensee a right to an expedited hearing to context the licensor's right to electronic disabling of the licensed information. Thus, given the required notice, most issues about this remedy will devolve into questions about judicial remedies, rather than self-help, unless the licensee chooses to not context the repossession.

d. Damages. Subsection (d) makes clear that actions that fail to conform to this Section constitute a breach, entitling the licensee to damages, including, when appropriate, damages for personal injury or property damage. This follows Article 2A. Improper use may also be conversion, trespass or another tort under applicable law.

e. Non-Waiver. Subsection (f) provides that rights under this Section cannot be waived prior to breach.

PART 8
TRANSITION PROVISIONS

SECTION 2B-801. EFFECTIVE DATE OF THE ARTICLE. This Act takes effect on [ ].

SECTION 2B-802. TRANSACTIONS COVERED BY THIS ARTICLE. This Article applies to all contracts within its scope that are formed after its effective date.