

1 **UNIFORM COMMERCIAL CODE**  
2 **ARTICLE 2B**  
3 **LICENSES**  
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9 **NATIONAL CONFERENCE OF COMMISSIONERS**  
10 **ON UNIFORM STATE LAWS**  
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14 **May 5, 1997**  
15 **Draft**  
16

17 **UNIFORM COMMERCIAL CODE**  
18 **ARTICLE 2B**  
19 **LICENSES**  
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21 **With Notes**  
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40

## REPORTER'S NOTES

This Draft contains revisions based on the April Meeting and on-going discussion and communication with consumer and other groups. There are no fundamental changes not contained in prior drafts. However, this Draft presents two important themes that should focus discussion.

The first deals with several issues on which the Committee has not yet taken a position. These are discussed in Part A of these notes. They include ideas presented earlier to which no substantive objection has been made and a new submission regarding scope that should be considered.

The second theme involves maintaining a focus on the entire draft, as contrasted to the details of individual sections and the overall balance of various interests. As the political process unfolds, various positions have been suggested and publicized that, understandably, focus on narrow aspects of the Draft. It is important that a broader perspective also be retained. This is outlined in Part B of these notes.

### PART A

While the Drafting Committee resolved a number of issues at the April Meeting, several broad themes remain to be considered. These include:

#### **1. Treatment of Informational Content Submissions.**

The January Draft proposed a solution to one problem involved in applying Article 2 concepts of tender, rejection and revocation to information industries. Unlike the general rules in common law and the Restatement, the Article 2 model contains a very explicit focus on a particular transactional framework. If applied to entertainment and publishing sectors at the upstream level, this model would introduce new and often undesirable standards in the manuscript, script and other aspects of the information content industries. The proposed solution, which has not been reviewed by the Committee, lies in the concept of "information submissions" that applies to cases involving contracts where the submission is reviewed in terms of aesthetics and market suitability.

The insight that supports separate treatment for these cases is that it is a mistake to assume that submission of a manuscript is equivalent to tender of delivery of a product. It is not. Rather than requiring or anticipating immediate acceptance or rejection, submissions of content initiate a process of review and revision leading to a later decision to accept or reject the submission. Section 2B-602 reflects that reality; it places these transactional situations entirely outside of the tender-acceptance rules, relying heavily on common law themes (as implemented in Article 2B) and trade practice to define the rights of the parties.

One consequence is that, in idea or information submission contexts, acceptance does not occur unless there is an express indication of acceptance (or rejection) by the licensee. This corresponds to commercial practice in this context.

#### **2. Treatment of "Performed on Receipt" Transactions.**

A second setting in which Article 2 concepts of tender, inspection etc. create an uneasy fit with practice in information industries arises with respect to transactions in which, by merely viewing information, the licensee receives all the value of the transaction and because of the nature of the performance, that value cannot be returned in the sense that a defective toaster can be returned. This might involve, for example, a Dun and Bradstreet report on a company, a license of a formula for Coca Cola, a credit report, or a screening at home of a pay per view motion picture. In these cases, the idea of a right to reject is not relevant. What is relevant is ensuring that the recipient can recover if the received performance was not consistent with the contract.

Forcing an Article 2 framework on these transactions creates a dysfunctional change from common law principles, especially in the Article 2 right to inspect before payment. Inspection in such cases in effect

transfers the value and the licensee cannot return (a basic requirement of rejection) the value even if it desires to do so.

Section 2B-608 proposes an treatment of such transactions that exists outside the sale of goods framework on tender, inspection and rejection. It places the transaction under the general rules of 2B-601 which parallel common law; the law currently applicable to such transactions. The common law principle does not describe a right of rejection, but allows one to avoid paying anything for performance that constitutes a material breach or to recover back the full payment previously made and allows recovery of damages for lesser breaches.

### **3. Mass Market License.**

During the December meeting, the Drafting Committee and observers extensively discussed the definition and application of the concept of “mass market” with respect to this Article. Being a new, relatively innovative concept, much of the discussion focused on identifying the basic theme and structure of how the definition should be approached.

As a result of this discussion, the Committee voted to adopt an approach to defining the idea of a mass market in a structure centering on standard forms used in relatively small transactions directed to the general public. In light of the risk allocation issues involved and new nature of the undertaking, the agreed goal was to focus the definition on relatively small transactions in a retail marketplace. This Draft contains a definition implementing that decision. For non-consumer transactions (e.g., transactions between two businesses in a retail market), the definition combines a reference to retail and general public audiences with a monetary cap to achieve the intended focus.

The critical issue in the idea of a mass market license deals with how the concept is applied. As discussed in prior memoranda, the two general approaches to using this concept are: 1) treating the marketplace definition as a surrogate for consumer protection and thereby extending consumer protections to business transactions, or 2) using the concept primarily as a marketplace identifier which keys into various expectations about the nature of transactions in that market. In theory, the differentiation between consumer and mass market constructs as to when they should apply turns on whether the goal is to protect individuals who lack the expertise to understand contract issues (e.g., consumer) and cases where the goal is to identify a marketplace by reflecting presumed assumptions applicable in that marketplace. During the February Meeting, the Committee opted to apply the concept of “mass market” as the operative theme in all but a few sections in which the issue arises. The following applications of the two concepts exist in the current Draft:

#### **“CONSUMER” APPLICATIONS:**

2B-106 (choice of law): default rule

2B-107 (choice of forum): contract choice

2B-303 (limiting effect of no-oral modification clause): contract method

2B-618 (hell and high water clauses): effectiveness of clause

#### **“MASS MARKET” APPLICATIONS:**

2B-105 (opt in to Article 2B): barred in mass market, rather than just consumer

2B-304 (modification of continuing contracts): withdrawal right required in mass market

2B-308 (notice of terms): terms unenforceable in mass market, rather than just consumer

2B-313 (viruses) effect of disclaimer limited in mass market, rather than just consumer

2B-403 (implied warranty of quality): merchantability in mass market

2B-406 (disclaimer of warranty): conspicuous required in mass market

2B-502 (transferability of license): mass market presumed transferable

2B-504 (security interest without consent): allowed in mass market

2B-601 (perfect tender): required in mass market, rather than just consumer

2B-607 (perfect tender): required in mass market, rather than just consumer

2B-610 (refusal for imperfect tender): allowed in mass market rather than just consumer

Perhaps the most important of these applications from the standpoint of causing increased risk to businesses who provide information pursuant to Article 2B are the provisions of Section 2B-308(b). The refusal term concept adopted in that section creates a potentially significant degree of uncertainty about what terms are and are not enforceable in a standard license and the degree of risk is directly associated with the scope of application of that section (e.g., consumer transactions or any business transaction occurring in what the draft defines as a mass market). At the April Meeting, the Committee narrowly voted to not adopt a reconstruction of that section which was suggested by a consumer advocate and would have narrowed the risk element significantly, while still protecting consumer interests.

#### **4. Consumer Issues.**

At several points, questions have been raised about the relationship between consumer law and Article 2B. As a general rule, the approach taken in Article 2B has been to not detract from existing law under Article 2 unless a significant difference exists between Article 2B subject matter and the transactions in goods that have served as the basis for traditional consumer rules. In some cases, this results in transporting Article 2 protections into a previously common law realm to which consumer protection law has not previously extended.

In some situations, such as with respect to the treatment of viruses and the ability to exclude from consumer contracts some terms of a standard form that, while conscionable, have other characteristics that suggest exclusion, Article 2B has enhanced consumer rights as compared to rights under current law in UCC Article 2.

As a general rule, Article 2B leaves unaffected state laws that give consumer protections in reference to the subject matter covered. The sole exception to that occurs in reference to the electronic contracting rules and is outlined in 2B-104(b).

Implicit in this is a judgment that Article 2B is not intended as a consumer protection code, but a commercial code.

**A chart is attached reflecting a comparison between existing Article 2 law and Article 2B provisions.**

#### **5. Scope: The Role of Banks.**

A Commissioner, representing Citibank, has communicated a proposal that the scope of Article 2B be adjusted to exclude, in essence, any transaction involving a bank as the licensor. The argument for this position is stated in the letter from Citibank that was distributed at the last meeting of the Committee. There are at least three issues presented by this proposal.

The first deals with whether Article 2B should cover information transactions where the subject matter (e.g., the information) represents funds or funds transfers regulated by other articles of the U.C.C. and by federal and state banking regulation. This Draft has consistently excluded materials covered by these other articles and contains a clarified exclusion about information representing money or monetary equivalents. Importantly, in implementing this exclusion, the Committee should recognize that modern developments in digital cash and similar systems place many institutions other than banks in this commercial environment. Regulations, such as Regulation E regarding funds transfer, do not apply solely to banks, but to any holder of a depository account and, depending of on-going regulatory activity, non-banks entities ill be included (e.g., a digital account created on a “smart card” for use to purchase a total of \$100 of coffee from a coffee shop, a card containing frequent flier mileage for airline use).

The second issue deals with ho-Z this article deals with compliance with compliance to state or federal regulations about disclosure. The Citibank proposal suggests that a reason for exclusion lies in the inability to conform to both federal regulated disclosures and Article 2B disclosure requirements. This issue has been raised many times in discussion, but has not been resolved by the Committee. One response lies

1 in the definition of “conspicuous” terms, the idea of manifesting assent and the idea of refusal terms. As  
2 redrafted, 2B-308 provides that a term disclosed in compliance with state or federal disclosure regulations  
3 is not a refusal term. A similar approach could be taken in reference to the other mentioned issues.

4 The third issue is fundamental to this Article. It involves drawing a line between regulated and  
5 excluded (if the Committee so chooses) banking activities, and information or access licensing identical to  
6 that engaged in by Netscape, Westlaw, Home Shopping, Microsoft Network, America On-Line, and others.  
7 As the information industries experience convergence where motions pictures and software tend to be  
8 increasingly the same, so too is the banking industry converging into fields identical to that of the  
9 information industries. Banking entry into these fields is regulated - a bank must obtain approval under  
10 Regulation Y to do so. But this is scope regulation, not content regulation. A review of bank websites, for  
11 example, reveals that some deal only with on-line banking, while others do not. The Wells Fargo site, for  
12 example, offers a general shopping mall, a link to purchase software and various other information services.

## 13 14 **PART B**

15 This Draft contains a number of compromises and adjustments designed ultimately to yield a  
16 balanced framework for contracting in the information age. While the Draft remains in flux, the following  
17 indicate some of the areas of trade-off and general benefit, at least as perceived by the Reporter.

### 18 19 **BENEFITS AND POSITIONS IN** 20 **MAY DRAFT OF ARTICLE 2B BY PARTY**

#### 21 22 **GENERAL BENEFITS**

- 23 + creates balanced structure for electronic contracting
- 24 + reduces uncertainty and non-uniformity of software and online contract law
- 25 + provides contract law roadmap for converging industries with differing traditions
- 26 + confirms and reinforces contract freedom in commercial transactions
- 27 + innovates concept of mass market transaction that extends U.C.C. consumer protections to
- 28 some businesses
- 29 + establishes strong protection encouraging dissemination of published informational content in
- 30 contractual relationships
- 31 + expressly recognizes layered contract formation occurring over time
- 32 + clarifies enforceability of standard forms in commercial deals subject to procedural
- 33 requirements
- 34 + proposes solution for battle of forms context
- 35 + applies “material breach” concept corresponding to common law
- 36 + sets standards relating to access and internet contracts
- 37 + establishes contract framework for idea and content submission
- 38 + adjusts statute of frauds to information transactions
- 39 + provides ownership rules for outsourcing and development contracts
- 40 + creates understandable implied warranty for commercial deals
- 41 + outlines relationship between retailer, publisher and customer
- 42 + refines standards for enforcement of liquidated damages rule
- 43 + allows parties to contract for specific performance
- 44 + provides standard interpretations for often litigated grant terms

#### 45 46 **LICENSOR BENEFITS**

- 47 + establishes licensing framework consistent across **converging** industries
- 48 + workable **choice of law** rules for internet
- 49 + fully enforceable choice of **forum** clause in commercial contracts

- + establishes guidance for enforceable **attribution procedure** in electronic contracts
- + validates **mass market license** subject to refusal term concept
- + creates method for contracting in **Internet** and similar contexts
- + establishes guidance on the meaning of **grants**
- + recognizes licensor control of **transferability** of the license
- + deals with effect on warranty of **modification** of code in a copy of a program
- + limits **infringement warranty** to knowledge but expands it to cover use
- + codifies contractual treatment of electronic **limiting or management devices**
- + reconciles inspection concepts with presence of vulnerable **confidential** material
- + establishes guidance on procedures to **modify** on-going contracts
- + defines **exceeding** a license as a breach of contract
- + establishes standard on connection of **remedy** and consequential damages limits
- + excludes **consequential damages** for published informational content

#### LICENSEE BENEFITS

- + creates duty of reasonable care to avoid **viruses** that cannot be waived in mass market
- + broadens **financing** options for licensee interest in a non-exclusive license
- + creates refund right and procedural steps that give a real option to withdraw as a precondition for **creating a contract** in mass market
- + gives courts the right to invalidate undisclosed **refusal terms** in standard form mass market transactions for both consumers and businesses
- + gives licensee a right of **quiet enjoyment** in the license
- + codifies that **advertising** can create an express warranty
- + creates a warranty for **accuracy** of non-published information content
- + creates implied **system integration** warranty
- + extends infringement warranty to a warranty that **use does not infringe**
- + requires that **disclaimers** of implied warranties be in a record (writing)
- + expressly recognizes **implied licenses**
- + creates broad **scope** presumptions
- + makes mass market licenses presumptively **transferable**
- + uses **perfect tender** rule for mass market transactions which does not exist in current law except for goods
- + requires **affirmative acts of assent** to a record
- + creates direct contract with **remote publisher** in mass market
- + increases **class of people** to whom warranty runs for all types of damage
- + creates right to demand a **cure** for accepted imperfect tender in commercial contracts
- + enforceability of **releases** without consideration
- + enforceability of term providing license cannot be **canceled**
- + creates warranties and rights against **retailer** independent of publisher license
- + places substantial limitations on electronic **self-help**
- + presumes **perpetual term** in single payment software license
- + prohibits choice of **forum** that unfairly disadvantages consumer

**PART C.**  
**CONSUMER COMPARISON**  
  
**COMPARISON OF EXISTING**  
**ARTICLE 2 AND PROPOSED ARTICLE 2B**  
  
**(SELECTED ISSUES RELATING TO CONSUMERS)**

	<b>ART 2: RULES RELATING TO CONSUMERS</b>	<b>ART. 2B: RULES RELATING TO CONSUMERS</b>
	<b>GENERAL RULES</b>	
Consumer protections extend to businesses via mass market concept	does not provide for this	implicit in “mass market” for most consumer-related rules
Non-UCC consumer rules; relationship to UCC	no provision	expressly retains and defers to consumer rules outside U.C.C., except for electronic contract formation issues
Mass Market Standard Forms: invalidate some terms even though the terms are <b>not</b> unconscionable	no protection; Restatement adopted in less than 10 states; case law generally sustains enforcement of forms in the absence of special legislation and except in battle of forms which seldom affects consumers	excludes “refusal” terms where there was no knowledge and assent to the term; requires procedures and refund opportunity; applies modified Restatement rule (2B-308)
Standard forms: require affirmative act to be bound	not dealt with; cases often allow enforcement without affirmative act; see Gateway	contract not enforceable unless consumer agrees or affirmatively manifests assent to the form (2B-308)
Refund right: if terms of form contract are not acceptable	no rule; case law does not require a refund right	required if license refused; source of refund may be either the remote publisher or the retailer (2B-113)
Effect of remote manufacturer (publisher) contract terms on obligations of retailer	not dealt with; case law varies, but often makes the two independent	specifies that retailer is not bound by and does not receive the benefits of the remote party’s contractual terms (2B-606)
Parol evidence	no special rule for consumers	<b>same</b> (2B-301)
Modification: bar oral modify	signature makes clause enforceable	manifest assent makes clause enforceable (2B-303)
Unconscionable clause invalid	traditional rule	<b>same</b> (2B-109)
Unconscionable: clause or contract can be invalidated for unconscionable inducement	left to other law	<b>same</b> (2B-109)
	<b>LAW AND FORUM CHOICE</b>	
Choice of forum: enforceability of contract term dealing with the issue	no rule; common law includes Supreme Court decision enforcing against a consumer	contract choice not enforced against consumer unless no “unfair disadvantage;” also subject to common law limits (2B-107)
Choice of law: in the absence of a contract term dealing with the issue	no rule; Art. 1 or common law rules apply	on-line contracts: licensor location; for tangible items involving consumers: delivery place; otherwise Restatement (2d) rules (2B-106)

	<b>ART 2: RULES RELATING TO CONSUMERS</b>	<b>ART. 2B: RULES RELATING TO CONSUMERS</b>
Choice of law: enforceability of contract term dealing with the issue	no rule; Art. 1 requires that the contract choice have a reasonable relationship to the transaction	allows contract choice except where precluded by consumer statute or judicial rule which are not affected by Article 2B
	<b>WARRANTIES</b>	
Warranty: title or authority	good title warranty	authority warranty (2B-401)
Warranty: infringement	warranty that merchant will deliver free of infringement, but warranty does not apply to the use of the information and the premise that use does not infringe; warranty creates liability without knowledge	warranty that merchant will deliver information free of infringement claims and that the use of the information by the licensee does not infringe; warranty is that there is no knowledge (2B-401)
Warranty: quiet enjoyment	no warranty	warranty (2B-401)
Implied Warranty: merchantability of product	given to buyer by merchant seller	<b>same</b> (2B-403)
Implied Warranty: accuracy of informational content	no warranty	warranty except for published informational content (2B-404)
Implied Warranty: fitness	given to buyer for product only	<b>same</b> (2B-405)
Implied Warranty: System components will work in integration	no warranty	warranty (2B-405)
Viruses: Contractual Obligation	no warranty; could be implicit in the disclaimable merchantability warranty, but no current case law on point	obligation to use reasonable care to avoid required and this obligation cannot be disclaimed in mass market with respect to tangible products (2B-313)
Express warranty	any affirmations or promises that become part of basis of bargain; except puffery	<b>same</b> (2B-402)
Express warranties: created by advertising	no specific rule; case law varies	codifies that advertising can create an express warranty (2B-402)
	<b>DISCLAIMERS</b>	
Title & infringement: is the warranty disclaimable?	yes; through specific language or circumstances	<b>same</b> (2B-401)
Express warranties: is the warranty disclaimable?	in most cases cannot be disclaimed; requires that disclaimer and warranty be read as consistent or, if that is not possible, that disclaimer not effective	<b>same</b> (2B-406)
Merchantability warranty: is the warranty disclaimable?	yes	<b>same</b> (2B-406)
>merchantability - how disclaim?	mention merchantability; no record required, but conspicuous if a record is used	plain language disclaimer along the lines provided in text or mention the word merchantability; requires that disclaimer be in a record and conspicuous (2B-406)
Fitness warranty: is the warranty disclaimable?	yes	<b>same</b> (2B-406)
>fitness: how disclaim?	say "no warranties beyond this"	plain language (2B-406)
Disclaimer: "as is"	works for all warranties but the warranty of good title	<b>same</b> (2B-406)



	ART 2: RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS
	THIRD PARTY LIABILITY	
Third party liability majority version: extend to household	yes	same (2B-409)
Third Party majority version: damages that are covered	personal injury only; may disclaim basic warranty	personal injury and economic loss; may disclaim warranty (2B-409)
	ACCEPTANCE AND REJECTION	
Acceptance of tender	can only occur after opportunity to inspect	same; except for services and informational content (2B-609)
Acceptance: time to accept or reject	no specific time period specified	same (2B-612)
Right to reject: single delivery	“perfect tender”	same (2B-610)
Right to reject after defined time from delivery (e.g., 7 days)	not given	same
Right to reject: deliveries made in installments	requires substantial impairment	requires material breach (2B-601)
Revocation of Acceptance	requires substantial impairment	requires material breach (2B-613)
Seller/ Licensor right to cure in consumer cases	allowed in some cases	consumer controls the issue
	DAMAGES AND REMEDIES	
Damages	presumed to include consequential damages unless contract indicates otherwise	same (2B-707, 709)
Consequential include personal injury	yes, if proximate causation exists	same (2B-102)
Damages: Contractual limitation on economic loss recovery	can limit damages if not unconscionable	same (2B-704)
Damages: Contractual limitation on personal injury loss recovery	presumed unconscionable	no specific rule (2B-704)
Modify Remedies	allowed	same (2B-704)
Limiting damages to replace or repair	allowed	same (2B-704)
Effect of failure of limited remedy on contractual limitation of consequential damages	no clear rule; case law splits	the two contract terms are independent unless contract provides otherwise
Minimum adequate remedy: does this over-ride contract terms	not as indicated in statute; comments imply that this is a consideration, but few states apply that theory	not as indicated in statute
Statute of limitations	four years from date of breach in most cases; cannot be reduced below one year	four years from date of breach, extended to maximum of five by discovery rule; cannot be reduced to less than one year (2B-705)

	<b>ART 2: RULES RELATING TO CONSUMERS</b>	<b>ART. 2B: RULES RELATING TO CONSUMERS</b>
> Limitations: when warranty extends to future, from what date does limitation period run?	cause of action for warranty breach accrues when breach was or should have been discovered	accrues when the conduct occurs or should have occurred, but no later than the date the warranty expires (2B-705)
Self Help Repossession	if seller retains title, Art. 9 applies and allows repossession for any default	requires material default and places other restrictions greater than in Art. 9 (2B-716)

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19 [F. Termination]

20 SECTION 2B-626. SURVIVAL OF OBLIGATION AFTER TERMINATION.

21 SECTION 2B-627. NOTICE OF TERMINATION.

22 SECTION 2B-628. TERMINATION: ENFORCEMENT AND ELECTRONICS.

23  
24 PART 7

25 REMEDIES

26 [A. General]

27 SECTION 2B-701. REMEDIES IN GENERAL.

28 SECTION 2B-702. CANCELLATION.

29 SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

30 SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

31 SECTION 2B-705. STATUTE OF LIMITATIONS.

32 SECTION 2B-706. LIABILITY OVER.

33 [B. Damages]

34 SECTION 2B-707. DAMAGES FOR BREACH.

35 SECTION 2B-708. LICENSOR'S DAMAGES.

36 SECTION 2B-709. LICENSEE'S DAMAGES.

37 SECTION 2B-710. RECOUPMENT.

38 [C. Performance Remedies]

39 SECTION 2B-711. SPECIFIC PERFORMANCE.

40 SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE.

41 SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE.

42 SECTION 2B-714. RIGHT TO DISCONTINUE.

43 SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

44 SECTION 2B-716. LICENSOR'S RIGHT TO SELF-HELP.

1 **PART 1**

2 **GENERAL PROVISIONS**

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

4 Code - Licenses.

5 **Uniform Law Source:** UCC 2-102.

6 **Reporter's Note:**

7 The scope of Article 2B is outlined in section 2B-103. While the scope covers more than licenses, the transaction  
8 used to develop this article involves licensing of information. The title follows the approach in Article 2 which is  
9 designated "sales" because that was the primary transaction format used to develop provisions for that Article, but  
10 the actual scope extends to all "transactions" in goods.  
11

12 **SECTION 2B-102. DEFINITIONS.**

13 (a) In this article:

14 (1) "Access contract" means a contract for electronic access to a resource  
15 containing information, resource for processing information, data system, or other similar  
16 facility of a licensor, licensee, or third party.

17 (2) "Authenticate" means to sign, or to execute or adopt a symbol, ~~a digital~~  
18 ~~identifier~~, or encrypt a record in whole or in part with present intent to identify the authenticating  
19 party, or to adopt or accept a record or term, or to establish the authenticity ~~of or signify a party's~~  
20 ~~acceptance~~ of a record or term that contains the authentication or to which a record containing  
21 the authentication refers.

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

24 (4) "Computer program" means a set of statements or instructions to be used  
25 directly or indirectly to operate in an information processing system in order to bring about a  
26 certain result, but does not include any informational content created or communicated as a result  
27 of the operation of the system.

1                   (5) “Consequential damages” includes compensation for losses of a party  
2 resulting from its general or particular requirements and needs which at the time of contracting  
3 the other party had reason to know would probably result from a breach of contract and which  
4 are not unreasonably disproportionate to the risk assumed by the party in breach under the  
5 contract and could not have been prevented by the aggrieved party by reasonable measures. The  
6 term also includes -losses resulting from injury to person or property proximately resulting from  
7 breach of warranty. The term does not include direct or incidental damages.

8                   (6) “Conspicuous” means so displayed or presented that a reasonable individual  
9 against whom or whose principal it operates ought to ~~should~~ have noticed it or, in the case of an  
10 electronic message intended to evoke a response without the need for review by an individual, in  
11 a form that would enable a reasonably configured electronic agent to take it into account or react  
12 to it without review of the message by an individual. A term is conspicuous if it is: ~~terms include:~~

13                               (A) a heading in all capitals (e.g., NON-NEGOTIABLE BILL OF LADING)  
14 equal or greater in size to the surrounding text;

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

17                               (C) a term prominently referenced in the body or text of an electronic  
18 record or display that can be readily accessed from the record or display;

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

22                               (E) language readily distinguishable in another manner.

23                   (7) “Consumer” means an individual who is a licensee of information primarily

1 for personal, family, or household use. The term does not include a person that is a licensee of  
2 information primarily for profit making, professional, or commercial purposes, including  
3 agricultural, business management, and investment management, other than management of an  
4 ordinary person's personal or family assets. Whether or not an individual is a consumer is  
5 determined by the intent of the licensee at the time of contracting.

6 (8) "Contract fee" means the price, fee, or royalty payable under a contract  
7 under this article.

8 (9) "Copy" means information that is fixed on a temporary or permanent basis in  
9 a medium from which the information can be perceived, reproduced, used, or communicated,  
10 either directly or with the aid of an information processing machine or similar device.

11 (9a) "Court" includes an arbitrator or other dispute resolution officer.

12 (10) "Delivery" means the transfer of physical possession, or the communication,  
13 of a copy to a recipient of the copy, to a facility controlled by the recipient or its intermediary, or  
14 to a bailee if the recipient has a right of access to the copy in the bailee's possession.

15 (11) "Direct [general] damages" means compensation for losses of a party  
16 consisting of the difference between the value of the expected performance as measured by the  
17 contract and the value of the performance actually received. The term does not include  
18 consequential damages and incidental damages.

19 (12) "Electronic" means electrical, digital, magnetic, optical, electromagnetic, or  
20 any other form of wave propagation, or by any other technology that entails capabilities similar  
21 to these technologies.

22 (13) "Electronic agent" means a computer program or other electronic or  
23 automated means used, selected, or programmed by a party to initiate or respond to electronic



1 messages or performances in whole or in part without review by an individual.

2 (14) "Electronic message" means a record that, for purposes of communication  
3 to another person, is stored, generated, or transmitted by electronic, optical, or similar means.  
4 The term includes electronic data interchange, electronic or voice mail, facsimile, telex,  
5 telecopying, scanning, and similar communications.

6 (15) "Electronic transaction" means a transaction formed by electronic messages  
7 in which the messages of one or both parties will not be reviewed by an individual as an  
8 expected routine step in forming the contract.

9 (16) "Financier" means a person that pursuant to a security agreement or lease  
10 provides a financial accommodation to a licensor or licensee and obtains an interest in the rights  
11 under a license of the party to which the financial accommodation is provided. ~~The term includes~~  
12 ~~a person that becomes a licensee and then sublicenses or otherwise transfers the license to the~~  
13 ~~financially accommodated party only if, before the licensor provides the information, the licensor~~  
14 ~~receives notice of the intent that the financially accommodated party will be the end user of the~~  
15 ~~information and the financially accommodated party agrees to the terms of the license as a~~  
16 ~~condition to the financial accommodation.~~

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

19 (18) (A) "Incidental damages" includes compensation for any commercially  
20 reasonable charge, expense, and commission incurred after breach by the other party in:

- 21 (i) inspection, receipt, transportation, care, or custody of property;
- 22 (ii) stopping shipment, delivery, or transmission;
- 23 (iii) effecting cover or return of copies or information;

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

2 (v) actions otherwise incidental to the breach.

3 (B) The term does not include compensation for consequential or [direct]

4 [general] damages.

5 (19) “Information” means data, text, images, sounds, computer programs,

6 databases, literary works, audiovisual works, motion pictures, mask works, or the like, and any

7 intellectual property or other rights in information.

8 (20) “Informational content” means information which ~~data, text, images, sounds,~~

9 ~~or similar information~~ is intended to be communicated to or perceived by a person in the ordinary

10 use of the information.

11 (21) “[Intellectual] [Information] property rights” includes all rights in

12 information created under laws governing patents, copyrights, trade secrets, trademarks, publicity

13 rights, or any similar law that permits a party independent of contract to control or preclude

14 another party’s use or disclosure of information because of the rights owner’s interest in the

15 information.

16 (22) “License” means a contract that expressly authorizes, prohibits or controls

17 ~~grants permission to access to or use of information, if the contract expressly conditions,~~

18 ~~withholds, or limits the scope of the rights granted, grants only nonexclusive rights, or~~

19 affirmatively grants less than all rights in the information, whether or not the contract transfers

20 title to a copy of the information. The term includes an access contract and a consignment of

21 copies of information. The term does not include ~~an assignment or other~~ a contract that transfers

22 ownership of intellectual property rights, that reserves or creates a financier’s interest, or that

23 makes a transfer by will or operation of law.

1                   (23) “Licensee” means a transferee or any other person designated in, or  
2 authorized to exercise rights as a licensee in a contract under this article whether or not the  
3 contract constitutes a license.

4                   (24) “Licensor” means a transferor in a contract under this article whether or not  
5 the contract constitutes a license. The term includes a provider of services. In an access contract,  
6 as between a provider of services and a customer, the provider of services is the licensor, and as  
7 between the provider of services and a provider of content for the service, the content provider is  
8 the licensor. If performance consists in whole or in part of an exchange ~~of transfers of~~  
9 information, each party ~~making a transfer~~ is a licensor with respect to the information it  
10 provides~~transfers~~.

11                   (25) “Mass market license” means a standard form that is prepared for and used in  
12 a mass market transaction.

13                   (26) “Mass market transaction” means a transaction in a retail market for  
14 information involving information; directed to the general public as a whole under substantially  
15 the same terms for the same information, and involving an end user licensee that ~~is an end user~~  
16 ~~and~~ acquired the information in a transaction under terms and in a quantity consistent with an  
17 ordinary transaction in the general retail distribution. The term does not include:

18                               (A) a transaction between parties neither of which is a consumer in which  
19 either the total consideration for the particular item of information or the reasonably expected  
20 fees for the first year of an access contract exceeds [     ];

21                               (B) a transaction in which the information is customized or otherwise  
22 specially prepared for the licensee;

23                               (C) a license of the right to publicly perform or publicly display a

1 copyrighted work; or

2 (D) a commercial site license or an access contract between two  
3 businesses ~~parties neither of which is a consumer with respect to the particular transaction.~~

4 (27) “Merchant” means a person that deals in information of the type involved in  
5 the particular transaction, a person that by occupation purports to have knowledge or skill  
6 peculiar to the practices or information involved in the transaction, or a person to which  
7 knowledge or skill may be attributed by the person's employment of an agent or broker or other  
8 intermediary that by its occupation purports to have the knowledge or skill.

9 (28) “Nonexclusive license” means a license in which the licensor or other  
10 person authorized to make a transfer or license is not prohibited from licensing the same rights in  
11 information within the same scope to other licensees or having ~~and has not~~ previously done so in  
12 a license the remains in force at the time of the contract. The term includes a consignment of  
13 copies.

14 (29) “Published informational content” means informational content that is  
15 prepared for, distributed, or made available to all recipients or any class of recipients in  
16 substantially the same form and not provided as customized advice tailored for the particular  
17 licensee by an individual acting on behalf of the licensor using judgment and expertise. The term  
18 does not include informational content provided within a special relationship of reliance between  
19 the provider and the recipient.

20 (30) “Receive” means to take delivery of a copy of information. An electronic  
21 record is received when it enters an information processing system in a form capable of being  
22 processed by a system of that type and the recipient uses or has designated that system for the  
23 purpose of receiving such records or information. “Receipt” has an analogous meaning.

1 (31) “Record” means information that is inscribed on a tangible medium or that is  
2 stored in an electronic or other medium and is retrievable in perceivable form.

3 (32) “Release” means an agreement not to object to, or exercise legal or  
4 equitable remedies against, the use of information if the party granting the release is not required  
5 to act affirmatively enable or support the other party’s use of the information by providing copies  
6 of the information, access, or otherwise. The term includes a waiver of intellectual property  
7 rights or a covenant not to sue.

8 (33) “Sale” means the passing of title to a copy of information for consideration.

9 (34) “Scope”, with respect to a license, means the terms of the license that define  
10 the licensed subject matter or copies, the uses authorized, ~~permitted~~, prohibited, or otherwise  
11 controlled, the geographic area, market, or location in which the license applies, and the duration  
12 of the license.

13 (35) “Software” means a computer program including any informational content  
14 included or to be included as part of a program and any supporting material ~~such as data,~~  
15 ~~program description, media, or documentation~~ provided by a licensor as part of the transaction.

16 (36) “Software contract” means a contract that licenses software or that conveys  
17 ownership of software, including a contract to develop software as a work for hire, whether or  
18 not the contract transfers ownership of a copy of the software.

19 (37) “Standard form” means a record, or a group of linked records presented as a  
20 whole, prepared by one party for general and repeated use and consisting of multiple contractual  
21 terms used in a transaction without negotiation of or changes in most of the terms. Negotiation  
22 or customization of price, quantity, method of payment, standard performance options, or time or  
23 method of delivery does not preclude a record from being a standard form.

(38) “Substantial performance” means performance of an obligation in a manner that does not constitute a material breach of contract.

(39) “Terminate” means to end a contract or a part thereof by an act by a party under a power created by agreement or law, or by operation of the terms of the agreement for a reason other than for breach by the other party .

(40) “[Transfer] [Activation] of rights” means an initial grant of a contractual right or privilege as between the parties for the transferee to have access to, modify, disclose, distribute, purchase, lease, copy, use, process, display, perform, or otherwise take action with respect to information, coupled with any actions initially necessary to enable the transferee to begin to exercise the right or privilege.

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

**Committee Votes:**

1. Adopted the term “authentication” to replace “signed” by a **consensus** without a formal vote.
2. Voted to retain the concept of “mass market” licenses as in prior drafts, subject to revision of the definition of this term and consideration of its use in specific sections as contrasted to use of the term “consumer.” Vote: 13-0 (September, 1996)
3. Voted to adopt a definition of “mass market license” that utilizes a reference to a market involving the general public and that centers on small retail transactions including most consumers and excluding special primarily business transactions. (December, 1996)
4. Voted to move references in definition of consequential damages to the comments except for the personal injury reference. Vote: 8-5 (Feb. 1997)
5. Rejected a motion to delete “intellectual property rights” from the definition of “information.” Vote: 3-5 (Feb. 1997)
6. Voted 10-2 to retain the mass market concept pending consideration of its application in the Article. (Feb. 1997)
7. Voted to delete the language in mass market definition that provided explicit coverage of all consumer transactions. Vote: 8-4 (Feb. 1997)
8. Voted to utilize a dollar limitation to cap the risk factor created under the definition of mass market, Vote: 10-3. (Feb. 1997)

**Reporter's Notes:**

1. **Access contract** includes the relationship that arises when there is a single access to the resource (e.g., web site) if, under ordinary contract law principles, access creates a contract . The relationships include contracts for use of E-Mail systems, EDI services by a provider, as well as web site contracts. The term refers solely to electronic access situations and does not cover attending movie theaters or the like. The term includes situations where a database in the possession of a licensee automatically updates by accessing or being accessed by a remote facility as in the following

1 situation: Lexis provides an integrated environment where the software first queries an on-site copy of a CD-ROM then  
2 checks a local network update and obtains the latest information in a seamless internet or dial-up updating.

3 As outlined in the definition of “licensor”, the model followed in three party access transactions, such as where  
4 the content provider makes content available through a third party access provider, entails two separate agreement and,  
5 in some cases, three separate contracts. The first is between the content provider and the on-line provider. This license  
6 may be an ordinary license to use the information or an access contract in itself. The second is between the on-line  
7 provider and the end user or other client. This is an access contract. The content provider is not necessarily party to or  
8 beneficiary of the contract. The third possible contract occurs when the content provider additionally contracts directly  
9 with or establishes terms with the end user or client.

10 **2. Authenticate.** This article replaces the traditional idea of “signature” or “signed “ with a term that  
11 incorporates modern electronic systems, including **all** forms of encryption or digital symbol systems. Basically, the fact  
12 of authentication can be proved in any manner including proof of a process that necessarily resulted in authentication.  
13 Use of an “attribution procedure” agreed to by the parties per se establishes that a symbol or act constitutes an  
14 authentication.

15 Authentication differs from manifesting assent in this article. Authentication (signing) always constitutes  
16 manifesting assent, but the reverse is not true. For example, tearing open a package or clicking on an icon indicating  
17 assent may manifest assent, but does not constitute a signature.

18 **3. Computer program.** This definition parallels the federal Copyright Act.

19 **4. Consequential damages.** This article follows existing Article 2. Personal injury and property damage are  
20 a form of consequential damages; all other requirements being met. This section makes clear that, as under current law,  
21 property damage and personal injury damages are treated under a standard of proximate causation, rather than simply  
22 foreseeability.

23 The basic premise of consequential loss other than for personal injury and property damage is that it is  
24 attributable to a breaching party only if some level of foreseeability can be proven. Beyond that, the basic test for whether  
25 a type of loss falls within direct or consequential damage as a measure lies in the degree to which the loss is directly  
26 associated with a reduction in the value received through contract performance as contrasted to what was anticipated as  
27 measured by the values assigned to events under the contract itself. Thus, consequential damages include damages in the  
28 form of lost profit or opportunity, damages to reputation, lost value in confidential information because of wrongful  
29 disclosure or misuse, damages for loss of privacy interests associated with the contract, loss of data as a result of the  
30 operational defect, and like damages.

31 Most commercial contracts deal with exclusion or inclusion of consequential loss in practice and that negotiation  
32 process should be supported by a delineation, insofar as possible, of what falls into this category and what does not. The  
33 illustrations suggested above cover many relevant situations providing clarity for negotiation. The theme here is that  
34 consequential losses go outside the principle that the performance itself was less in quality than was agreed to by the  
35 parties.

36 This draft follows draft revisions of Article 2 on disproportionality. Draft Article 2 allows a court to reduce  
37 consequential damages if unreasonably disproportionate to the risk assumed by the breaching party. A motion to delete  
38 that phrase was defeated on the floor of the Conference.

39 **5. Conspicuous.** This definition follows existing law and adds new themes to deal with electronic contracting.  
40 As under current law, under Section 2B-115 whether a term is conspicuous is a question of law.

41 Current law in UCC ' 1-201(10) contains three safe harbors for making a clause conspicuous; these have been  
42 part of law for over fifty years. They serve a critical role in planning and drafting documents. As a general rule, a term  
43 that conforms to a “safe harbor” provision is held to be conspicuous. Many cases hold that failure to conform to a safe  
44 harbor may invalidate any claims to being conspicuous.

45 The idea of being conspicuous in a message to an electronic agent the reference is to whether the agent has the  
46 ability to act on the term; the term must be in a form that can be processed and understood by the computer. It need not  
47 be otherwise separated out. Computers do not respond differently to capital letters or lower case. The electronic message  
48 suffices if it is designed to invoke such a response from a “reasonably configured” electronic agent, a concept that will  
49 be spelled out in the commentary to indicate that it intends an analogous construct that parallels the reasonable man  
50 standard used for the general concept of conspicuous.

51 Revisions of Article 2 propose abolition of the safe harbor concepts present in current law. Article 2B follows  
52 existing law. The theme of conspicuousness blends both a notice function and a planning function giving certainty to

1 the party preparing and using the term. It is equally important to ensure that the recipient of a record receives notice of  
2 the contents and that the party who reasonably desires to rely on the terms of the record can do so. Taking out all safe  
3 harbor language eliminates the second objective and jeopardizes the first.

4 **6. Consumer:** Existing Article 2 does not define “consumer.” Article 9 focuses on persons acquiring property  
5 primarily for personal or household uses. European law uses a different approach and defines a “consumer” as one  
6 entering into a contract outside her business or profession.

7 This Draft focuses on the time of contracting to define the status of a party. The term “consumer” triggers  
8 restrictions on contracting. While most often, intent does not change from the time of contract to the time of delivery,  
9 when changes occur, a time of delivery focus would retroactively change the rules. The issue is important in Article 2B  
10 since many contracts in Article 2B are on-going relationships; a delivery concept might provide different  
11 characterizations of the same transaction at different points in time.

12 The Article 9 definition provides a template for this Draft. The Article 9 definition creates serious  
13 interpretation issues when used for transactions that are not security interests that have been encountered in case law  
14 outside Article 9. This Draft clarifies the focus and resolves some of those problems. Some personal uses are not  
15 consumer uses (see, e.g., a stock broker using database software to “personally” track billion dollar investments).  
16 Distinguishing these personal business uses and truly consumer uses holds great importance in Article 2B because  
17 software and other information can be used “personally” in traditional business contexts. The exclusions in the  
18 definition apply to profit-making, profession, or business use. In the modern economy where individuals can and  
19 often do engage in seriously significant commercial enterprises without the overlay of a large corporation, the  
20 personal use idea needs to respect and reflect the modern practice, especially in this area. The proposed definition  
21 distinguishes between persons using information in profit making and business uses and personal or family uses such  
22 as ordinary asset management for an ordinary family.

23 This issue has been considered in many areas of law that have evolved since the original definition of Article  
24 9. The issues have proven to be difficult and subject to litigation under the Article 9 concept in lending, bankruptcy and  
25 other contexts. For example, a number of reported decisions focus on whether or when a purchase of stocks or limited  
26 partnership assets for investment purposes would be considered a consumer purchase since it might fall within the general  
27 reference to “personal” purposes. See, e.g., Thomas v. Sundance Properties, 726 F.2d 1417 (9<sup>th</sup> Cir. 1984); In re Manning,  
28 126 B.R. 984 (M. D. Tenn. 1991) (UCC definition “not especially helpful on its face”). Some courts emphasize the  
29 difference between acquisition for “consumption (consumer)” and acquisition or use “for profit-making”. This approach  
30 comes in part from the Truth in Lending Act which uses a definition of consumer debt much like the definition in Article  
31 9 of consumer but additionally contains an express exemption for business transactions. The “profit-making” test has  
32 been applied in bankruptcy cases interpreting a Bankruptcy Code provision identical to the standard UCC definition. For  
33 example, the Fifth Circuit commented that “[The] test for determining whether a debt should be classified as a business  
34 debt, rather than a debt acquired for personal, family or household purposes is whether it was incurred with an eye toward  
35 profit.” In re Booth, 858 F.2d 1051 (5<sup>th</sup> Cir. 1988). See also In re Circle Five, Inc., 75 B.R. 686 (Bankr. D. Idaho 1987)  
36 (“The farm operation is a business for the production of income. Debt used to produce income is not consumer debt  
37 “primarily for a personal, family or household purposes.”).

38 **7. Copy:** This definition was designed to correspond to copyright law. In the Copyright Act, cases hold that  
39 a copy does not require permanence, but cannot be purely transitory, such as an image on a screen. Moving information  
40 into a computer memory makes a copy of that information.

41 **8. Court:** This definition extends the power to make choices to officers of non-judicial forums.

42 **9. Direct damages:** The Draft defines “direct damages” to provide guidance on the distinction critical to  
43 commercial practice that differentiates types of damages for disclaimer and other contract language. Direct damages are  
44 losses associated with a reduction of value or loss of value as to the contracted for performance itself, as contrasted to  
45 losses caused by intended uses of the performance or use of the results of the performance by the recipient outside the  
46 contract. Direct damages are measured in the damages formulae in this Article.

47 The definition rejects cases where courts treat as direct damages losses that relate to anticipated advantages  
48 outside the contract that were to flow from the use of the product. These are consequential damages. Thus, one case held  
49 that defects in a system under a contract that disclaimed consequential damages included all the lost benefits that the party  
50 expected from the deal (a total far in excess of the purchase price and incorporating what would ordinarily be  
51 consequential loss). The issue is: if we have software purchased for \$1,000 which, if perfect, would give profits of  
52 \$10,000 and the thing is totally defective, should the “value” of the software be considered to be “\$10,000 or \$1,000 as  
53 “general” damages? The answer here is \$1,000. Similarly, if a virus in a program causes a \$10,000 loss, but the program



otherwise fully performs, should that \$10,000 be direct or consequential loss? The draft adopts the view of most courts and treats this as consequential loss.

**10. Electronic Agent:** An electronic agent is a program designed to act on behalf of the party without the need for human review. As a general rule, a party adopting use of such agents is bound by (attributable for) their performance and messages. The term plays an important role in shaping responsibilities and how parties comply with various conditions, such as an obligation to make terms conspicuous. Courts may ultimately conclude that an electronic agent is equivalent in all respects to a human agent, but this Draft does not go so far, making specific provisions relating to electronic agents when needed. In this respect, the Draft is consistent with Article 4A as well as with modern practice. The accountability of a party for actions of a computer program may hinge on different issues than accountability for a human agent.

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

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

**12. Financier:** This definition provides the basis for the proposed integrated treatment of financing arrangements in this article. The definition covers both security interests and leases. The definition sets out coverage of what in other contexts are described as finance leases where the lessor, for purposes of financial accommodation, acquired a license which it then leases down to a licensee. Qualifying for finance treatment requires, under this definition, both notice to the licensor and actual agreement or assent by the licensee to the licensee. These requirements protect both the licensor and licensee's interests.

The exclusion in the second sentence deals with a circumstance unique to some finance leasing: the case in which the license is given to the financier and then transferred down to the financed party (licensee). This transaction will often violate the terms of transferability in a license. In this case, to qualify for coverage under the financier language, the party must give notice to the licensor of and financier status depends on making the financial accommodation conditional on the licensee's assent to the license terms. This protects both the licensor and the licensee.

**13. Good Faith:** The definition follows current Article 2 law and also extends the duty of good faith and fair dealing to consumers.

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

**15. Intellectual Property Rights:** The definition is to be inclusive and capable of responding to new developments in national and international law, such as possible non-copyright database protections. With each area of law referenced here, the relevant law itself defines what rights are and are not covered. Whether this affects contract limitations pertaining to the information has been debated, but subject to misuse and other regulatory concepts that go beyond this statute, the general approach in courts is that a property right need not exist in order to have an enforceable contractual limitation. The concept covers rights created under any body of law, including federal law, state law, and the law of other countries. The definition of intellectual property rights does not include the right to sue for defamation or similar tort claims.

**16. License:** The essence of this definition lies in the conditional or limited nature of the contract rights. At least some conditions must be express, rather than implied. The distinction between an unrestricted sale of a copy and a license revolves around the terms of the contract as expressed, rather than on implied conditions. In an unrestricted sale of a copy, the transferee receives ownership of the copy, but if intellectual property rights apply to the information on the copy, is subject to implicit restrictions on use of the information derived from intellectual property law. In a license,

1 whether or not ownership of the copy is transferred, the transferee is subject to express contract restrictions or receives  
2 a contract grant that expressly gives less than all rights in the information.

3 Some suggest that “implied licenses” should be included. These arise, for example, where a court holds that,  
4 to make the transaction reasonable in light of the parties’ expectations, some rights or limitations not express should be  
5 inferred. Many such transactions are within this Article, including a transaction where some rights are implied in any  
6 otherwise conditional transaction. On the other hand, the Article does not include implied in law licenses such as under  
7 first sale rules in copyright. As noted by the Federal Circuit Court of Appeals, a sale can be made conditional on  
8 intellectual property rights (e.g., patent in that case) and, similarly, while a sale of a copy transfers some copyright rights  
9 under federal law, the licensor retains control of a great deal of the copyright law’s exclusive rights even as to that copy.  
10 A license deals with control of rights of use and the like with reference to the information, while title to the goods deals  
11 simply with that - title to the goods.

12 **17. Licensor and Licensee:** These are generic terms. The terms refer to the transferee and transferor in a  
13 contract covered by this article. Obviously, the transferee in a license is not the employee itself, but the company that  
14 acquired contractual rights under the agreement. In the definition of licensor, several specific illustrations are used to  
15 avoid confusion in cases where more than one party transfers information, that is, where the parties exchange information  
16 or performance.

17 **18. Mass-market transaction.** This definition distinguishes between a mass market transaction and a mass  
18 market license, reflecting the fact that some mass market transactions covered by this Article may not involve a standard  
19 form contract. Since the decision was made to use the mass market concept in lieu of the concept of consumer in a  
20 number of situations where a form may not be involved, the broader term “transaction” was necessary to avoid excluding  
21 these transactions from various consumer protections.

22 **19. Mass-Market License:** This definition and the immediately prior definition distinguish between a mass  
23 market transaction and a mass market license, reflecting the fact that some mass market transactions covered by this  
24 Article may not involve a standard form contract.

25 The definition contemplates a retail marketplace where information is made available in pre-packaged form  
26 under generally similar terms. It applies to information that is aimed at the general public as a whole, including  
27 consumers. It would not cover products directed at a limited subgroup of the general public, such as members of a club  
28 or persons whose income exceeds a specified level. Where the line will be drawn in determining the size of the subgroup  
29 that would qualify for a general public distribution cannot be answered absent judicial consideration of specific cases.  
30 However, the intent is that the products covered here do not include specialty software, information directed to specially  
31 targeted limited audiences, or professional use software, but materials that appeal and intend to appeal to a general public  
32 audience as a whole where the identity and status of the eventual licensee is irrelevant

33 This captures most of a true retail setting, such as transactions in department stores or the like. Article 2B will  
34 be the first UCC article to extend consumer-like protections to business transactions in any form and the first to tailor  
35 at least some default rules based on that concept. The goal is to do this in a limited manner, reflecting the innovative  
36 nature of the concept, while confining the risk created by focusing on small transactions for information oriented toward  
37 the broad general public.

38 The dollar limit should be selected based on empirical evidence relating to the pricing structure of modern  
39 software transactions. In a review of several sources, few items of consumer software exceed \$200. The price curve is  
40 downward, rather than increasing. A \$500 limit would far exceed the average cost of retail business software. As of the  
41 date that this Draft was prepared, the Committee had not voted on the dollar amount.

42 The definition excludes any non-consumer transaction that exceed the dollar limit as to the particular item. In  
43 a situation where items of software are bundled together and with hardware, the dollar limitation applies to each item  
44 separately. In this bundled transaction respect, however, it should be noted that the decision in Article 2 to not utilize  
45 a mass market theory creates a potential anomaly: The items of software will most likely be mass market and subject to  
46 the provisions of 2B-308, while unless the purchaser is a consumer, the hardware would not be subject to the analogous  
47 provision in Article 2.

48 The other business exceptions identify situations involving site licenses, typical performance licenses (e.g.,  
49 ASCAP, Broadcast Music) and situations where the licensor provides customization of the product, rather than  
50 transferring it essentially of the shelf.

51 This Draft proposes a bifurcated treatment of on-line (Internet) transactions. Most consumer transactions on  
52 Internet fall within the definition and a vast number of consumer transactions occur on Internet. It is especially important

1 however, with this new transactional environment, to not regulate business transactions.. The approach in this Draft is  
2 to exclude from the definition of mass market any online transaction not involving a consumer. This gives the online  
3 industry room for expansion and growth not subject to unintentional regulations, while preserving consumer protections  
4 in that environment.

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

13 **21. Sale:** With respect to information, a distinction is made between title to the copy and title to the intellectual  
14 property rights. Title to information essentially means that the transfer is free of any restrictions, express or implied, on  
15 the use, reproduction or modification of the information.

16 **22. Standard form:** Standard forms are a major part of consumer and commercial practice. As to questions  
17 about the enforceability of particular terms and questions of assent to the overall form, standard form issues are expressly  
18 dealt with in the Restatement (Second) and in the UNIDROIT Principles. Existing Article 2 does not contain any express  
19 treatment of forms. In the revision process, initially both Article 2 and 2B contained provisions dealing with when a  
20 party assents to a form. Subsequently, the Article 2 committee deleted the concept. Subsequently, ALI Council  
21 recommended that this decision be reversed. Article 2B has contained provisions dealing with standard forms since the  
22 beginning of the drafting process.

23 The reference in this definition is to forms (e.g., groupings of standard terms) whose use in modern commerce  
24 is not only widespread, but virtually ubiquitous. The idea expressed does not hold that a record that contains language  
25 previously used in other transactions falls within the term and it does not focus on individual "standard terms." The  
26 record, which contains a composite of terms, must have been prepared for repeated use is a standard form whose legal  
27 significance is judged accordingly.

## 28 **SECTION 2B-103. SCOPE.**

29  
30 (a) This article applies to licenses of information and software contracts whether or not  
31 the information exists at the time of the contract or is to be developed or created in accordance  
32 with the contract. The article also applies to any agreement related to a license or software  
33 contract in which a party is to provide support for, maintain, or modify information.

34 (b) Except as otherwise provided in subsections (c) and (d), if another article of this [Act]  
35 applies to a transaction, this article does not apply to the part of the transaction involving the  
36 subject matter governed by the other article except to the extent that this article deals with  
37 financial accommodation contracts.

38 (c) If a transaction involves both information and goods, this article applies to the  
39 information and to the physical medium~~media~~ containing the information, its packaging, and its

documentation, but Article 2 or 2A governs standards of performance of goods other than the copies, packaging, or documentation pertaining to the information. If a transaction includes information covered by this article and services outside this article or transactions excluded from this article under subsection (d)(1) and (2), this article applies to the information, physical medium ~~media~~ containing the information, its packaging and documentation. A transaction excluded from this article by subsection (d)(3) is governed by Article 2 or 2A.

(d) This article does not apply to:

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

(2) a license of a trademark, trade name, or trade dress, or of a patent and know-how related to the patent unless the license is or is part of a software contract, a license of a motion picture ~~license~~, an access contract, or database contract;

[(3) a transaction the subject matter of which is information that represents money or deposit accounts;] or

(3) a sale or lease of a copy of a computer program that was not developed specifically for a particular transaction and that is embedded in goods other than a copy of the program or an information processing machine, if the program was not the subject of a separate license with the buyer or lessee.

**Committee Votes:**

- a. Voted 10-3 to reject a proposal to limit the scope of the article to “coded”, “digital”, “electronic” or similar concept.
- b. After initially rejecting the motion, on reconsideration, the Committee voted 10-0 to limit scope to licenses of all information and software contracts.
- c. Voted 9-3 to reject a motion to include all patent and trademark licenses in the Article.

1           d.       Voted 8-4 to reject a motion to include all patent licenses. (Feb. 1997)

2           e.       Voted 7-4 to reject a motion to delete (d)(2). (Feb. 1997)

3 [This draft contains two changes responding to a letter received from Citibank regarding scope. The first defers on  
4 subject matter, rather than coverage, to the other articles of the UCC. The second is in the bracketed language in  
5 proposed new subsection (d)(3) which excludes coverage of money and deposit accounts. Under this exclusion, if  
6 software is licensed to allow access to bank or other funds on deposit under a depository agreement, the software license  
7 is in Article 2B, but the transactions regarding the funds in the account and the terms of the despoit account itself are  
8 not covered. Under current law, the funds-depositor relationship is regulated, while the software contract is not. The  
9 Committee should also note proposed changes in 2B-308 dealing with the effect of disclosures that conform to state or  
10 federal disclosure rules and allowing that disclosure to exclude application of the refusal term concept in 2B-308(b).]

11 **Reporter's Notes:**

12           1.       This article deals with transactions involving the copyright industries. These industries play a major  
13 role in the modern information age. The article does not cover all contracts in these industries, but focuses on licenses  
14 and emphasizes transactions in those industries whose current or future direction deals with digital products. The article  
15 does not deal with sales of books, newspapers or traditional print media sold over the counter since, except for  
16 transactions involving computer software, the scope of the article is limited to licenses. Article 2B-102 defines a license  
17 as a transaction that expressly conditions or limits the rights conveyed. Implied conditions, which are present because  
18 of copyright law, in any sale of a copyrighted product, are not in themselves adequate to fall within the scope of the  
19 article.

20           2.       As in every context in which digital and other modern information technologies have had significant  
21 impact, they create difficult problems of placing the new technologies and technology products within existing legal and  
22 social categories. That issue affects tax law, communications law, intellectual property law, and many other fields. It  
23 affects the delineation of Article 2B scope. This article reflects extensive discussion by the Committee. The Committee  
24 rejected proposals to limit the scope to digital information. Modern convergence of information technologies makes  
25 reference to digital or a similar term an unworkable scope definition and its linkage to a specific technology makes the  
26 long term viability of such a focus suspect. The Committee opted to focus on licensing and software contracts. Common  
27 to these transactions is that the focus concerns information (rather than goods), even if transferred in a tangible copy (e.g.,  
28 newspaper, diskette, book/manual) and that there are conditions on use or access in the transaction.

29           3.       For transactions in information other than software, this article distinguishes between a license and a  
30 sale of a copy. Exclusion of sales of copies of information leaves undisturbed major segments of the traditional  
31 information industry, such as contracts involving a sale of a copy of a book or a newspaper. The distinction between a  
32 license and a sale of a copy in the information industry is as explicit as the distinction between a sale and a lease in goods.  
33 This section uses a transaction characterization consistent with practices in those industries.

34           For computer software, the more important factor involves the nature of the product. With the exception of some  
35 limited types of software products, all transactions whether licenses or sales are subject to either express or implied  
36 limitations on the use, distribution, modification and copying of the software. These limitations are commercially  
37 important because (unlike in reference to newspapers and books) the technology makes copying, modification and other  
38 uses easy to achieve and essential to even permitted uses of the software. Bringing all transactions involving this subject  
39 matter into Article 2B reflects the functional commercial similarity of the transactions and the need for a responsive and  
40 focused body of law applicable to these types of products. In addition, as a relatively new form of information transaction  
41 involving products with distinctive and unique characteristics, no common law exists on many of the important questions  
42 with reference to publisher and end user contracts regardless of whether a transaction constitutes a license or a sale of  
43 a copy.

44           4.       Subsection (b) discusses interface issues. For transactions governed within the trio of UCC  
45 transactional articles (2, 2A and 2B), the primary rule applies each to its particular subject matter. This is the “gravamin  
46 of the action” test followed in some states under Article 2 in making distinctions between transactions in goods and  
47 transactions in services. It rejects the “predominant purpose” test for this issue. The primary exception occurs in  
48 reference to software embedded as discussed in (d)(3). Subsection (b) allocates coverage for mixed transactions where  
49 the non-covered aspects are not goods. In all cases, this Article covers the information issues within its scope, while other  
50 law governs for other aspects of the transaction. No predominant purpose test is intended even with reference to  
51 transactions part of which fall entirely outside the UCC.

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

1           6.       The exclusion in subsection (d)(1) deals with employment contracts and with services agreements  
2 related to entertainment (e.g., actor, musical group performance, producer, etc.). The excluded cases involve personal  
3 services contracts and require much different default rules than here. The entertainment services exclusion covers both  
4 direct contracts with individuals and the various structures under which a party hires services of an individual or group  
5 through a loan contract with a legal entity with whom the individual or group is employed. This subsection also excludes  
6 professional services to avoid confusion between and the regulatory standards of regulated professions. The exclusion  
7 only pertains to regulated services and not to other contracts or services (e.g., law firm web site where legal advice is  
8 not given is treated the same as any other web site).

9           The motion picture and publishing industries have suggested that the Committee consider exclusion of talent  
10 and author contracts generally (e.g., the upstream portion of the industry).

11           7.       Subsection (d)(2) excludes patent and some other pure intellectual property licenses. The rationale for  
12 exclusion lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law.  
13 Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard  
14 practices that are not contemplated by this draft. The article concentrates on a more focused area of commerce. In  
15 practice, however, one can anticipate that courts will apply by analogy aspects of this Article to other fields of licensing.  
16 The comments will discuss the role of application by analogy of this Article in context of the history of reasoning by  
17 analogy in other contexts. See, e.g., the discussion of applying Article 2A to leases of other personal property.

18           8.       Subsection (d)(3) excludes computer programs such as airplane navigation or operation software,  
19 software that operates automobile brake systems, and the like. Transactional issue relating to this type of software are  
20 governed by the law governing the transaction in the entire product (e.g., Article 2 or Article 2A).

## 21                   **SECTION 2B-104. TRANSACTIONS SUBJECT TO OTHER LAW.**

22  
23           (a) Subject to subsection (b), the conflicting law governs in the case of a conflict between  
24 this article and:

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

27                   (2) a law of this State regulating purchase or license of rights in motion pictures  
28 by exhibitors; or

29                   (3) a consumer protection law of this State.

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

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

34                   (2) A requirement that a record or a contractual term be signed is satisfied by an  
35 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.

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

**Committee Votes:**

- a.** The Committee voted 11-1 to approve the section subject to adjustments of section (b)(4) which have subsequently been made. (September, 1996)

**Reporter's Notes:**

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

Subsection (a)(3) excludes preemption by Article 2B of the various state laws that regulate so-called blind bidding and other practices specifically relevant to the motion picture industry. As with consumer legislation, these statutes were developed through extensive discussion and policy making and they should not be disrupted or affected by Article 2B. This section reflects that, as to consumer law, the preservation of rules covers both statutory and case law. This brings Article 2B into conformity with Article 2A and draft Article 2.

**2.** The Article is also subject to preemptive federal law. Federal intellectual property law contains some contract rules, but does not generally preempt state contract law. Instead, licensing law has traditionally been largely relegated to state law. When this is not true, of course, federal law controls. This draft does not refer to the preemptive effect of federal law for reasons of style, since the principle of preemption is clear.

**3.** Subsection (b) deals with the balance between the modernization themes developed in Article 2B relating to electronic contracting and existing law regulating of contract law in consumer or similar restrictions. The balance must preserve important policies and diversity (thus, the principle of general non-reversal) of these laws, but should extend the effectiveness of innovations in electronic contracting. The approach here sets out a presumption that the other law controls, but identifies aspects of other law where it is appropriate to reverse that presumption as to particular rules based on a legislative judgment that the electronic contract provisions of this Article are appropriate state policy. Digital signature laws adopted in Washington, Utah, and as proposed in other states, adopt a similar reconciliation approach, defining acts that comply with their requirements broadly to comply with writing, signature and similar requirements in **all state laws**. This Draft is more limited in impact, narrowing the changes to center on manageable and identified parameters of existing law without attempting to alter the entire world of signatures, assent and the like.

**4.** The goal is to facilitate electronic commerce and to implement concepts concerning electronic trade. Article 2B expands the idea of a writing and a signature to include, respectively, a record and an authentication. Conspicuous is defined to deal with electronic contexts and expanded by an enhanced concept of manifestation of assent. In these respects, electronic concepts that were not at issue when existing consumer law developed, require adjustments appropriate to promote uniformity and certainty in commerce that is truly national in nature, while preserving the intent of the regulations. There is no effort to alter content terms, such as whether a disclaimer can be made, what language

1 must be used, and like issues.

2       **5.** Subsection (b)(4) does not cover cases where state law requires negotiation of a term. Negotiation  
3 requirements entail a mandate that a party actually dicker over a term with there being an actual and direct exchange  
4 and alteration of positions, the concept of manifesting assent does not meet this.

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

## 8 9       **SECTION 2B-105. APPLICATION TO OTHER TRANSACTIONS.**

10       (a) Except in a mass market transaction, in an agreement represented by a record:

11               (1) Parties to a transaction not governed by this article may elect by agreement to  
12 have all or part of this article apply to the transaction; and

13               (2) ~~if the agreement is in a record that is not a mass-market license.~~ if part of a  
14 transaction is governed by this article and part is governed by other law, the parties may provide  
15 that the transaction is to be governed entirely by this article or by the other law.

16       (b) The agreement is effective to the extent that it deals with issues that the parties could  
17 resolve by agreement.

### 18       **Committee Vote:**

19       a. Voted 7-4 to replace consumer contract with mass market contract.  
20 [Note to this Draft: The section was restructured for clarity. Language in (a)(2) was added to deal with an issue  
21 raised by several observers where transactions involve mixed law and permits an opt in/ opt out option where the  
22 parties may desire to be entirely governed by one or the other body of law. The language in (a)(2) has not yet been  
23 reviewed by the Drafting Committee.]

### 24       **Selected Issue:**

25       a. Should there be provision in an on-line environment to allow opt-in to Article 2B by manifesting  
26 assent to the opt in term based on suggestions by a White House study group that there be an opportunity to elect into  
27 a uniform law tailored to electronic environments?

### 28       **Reporter's Notes:**

29       **1.** This section expresses an approach generally assumed to be current law based on the theory of party  
30 autonomy in contracting. A contractual election to apply this article is analogous to a choice of law term selecting the  
31 law of a particular state. By agreement, parties can determine, for example, that the warranty rules of this article are more  
32 appropriate in a contract involving services than are common law or Article 2 warranties. If there are no fundamental  
33 policy barriers precluding use of these rules, the choice of law made by contract governs.

34       **2.** In addition to validating party autonomy, however, this section exempts out mass market contracts from  
35 the reach of the ability to contract into this UCC section. The exclusion, which was originally restricted to consumer  
36 contracts, assumed that the party to a mass market agreement is not likely to understand differences in law. In most states  
37 under current law, a similar theory does not apply in cases where a consumer contract makes a choice of law unless  
38 fundamental policies of the state are circumvented by the choice. This section thus implements a form of extended  
39 consumer protection and applies it to both consumers and businesses operating in the mass market. Restrictions of this  
40 type, if appropriate for consumers, are not typically expanded to business parties under current U.S. or European law.



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

2           (a) A choice-of-law term in an agreement is enforceable.

3           (b) If an agreement does not have an enforceable choice-of-law term, the following rules  
4 apply:

5                   (1) In an access contract or a contract providing for delivery of a copy by  
6 electronic communication, the contract is governed by the law of the jurisdiction in which the  
7 licensor is located when the contract becomes enforceable between the parties~~[transfer]~~  
8 ~~[activation] of rights occurred or was to have occurred.~~

9                   (2) A consumer contract not governed by subsection (b)(1) which requires  
10 delivery of a copy on a physical medium to the consumer is governed as to the contractual rights  
11 and obligations of the parties by the law of the jurisdiction in which the copy is located when the  
12 licensee receives possession of the copy or, in the event of nondelivery, the jurisdiction in which  
13 receipt was to have occurred.

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

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

20           ~~—————(1) the law of the jurisdiction in the United States or in the country in which the~~  
21 ~~licensor does business and has the most substantial relationship to connection with the~~  
22 ~~transaction.; or~~

23           ~~—————(2) if no such jurisdiction exists, the law of the jurisdiction in the United States in~~

1 ~~which the licensee is located.~~

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

6 **Uniform Law Source:** Restatement (Second) of Conflicts ' 188; Section 1-105; Section 9-103.

7 **Committee Votes:**

- 8 a. Voted 9-1 to use consumer, rather than mass market.  
9 b. Voted 8-5 to adopt alternative A of subsection (a) validating contract choice of law. (Feb. 1997)  
10 c. Voted 11-0 to adopt significant relationship test as back-up rule. (Feb. 1997)

11 [Notes to this Draft: Most of the changes in this Draft involve mere editorial clean-up. Language in (b)(2),  
12 however, was added to clarify that this Draft does not alter or affect the treatment of tax liabilities. In Quill Corp. v.  
13 North Dakota, 504 U.S. 298 (1992) the Supreme Court held that no adequate nexus for tax purposes was  
14 established where the only contact of an entity with a state was advertising and delivery through common carrier.  
15 This Article, of course, deals only with contract issues. An alternative form of avoiding confusion would simply be to  
16 state that this does not relate to tax collection issues.]

17 **Reporter's Notes:**

18 1. There are two questions addressed in this section. The first deals with enforceability of contract  
19 provisions choosing the applicable law for a contract and the second deals with choice of law in the absence of a contract  
20 term dealing with the question.

21 2. Choice of law clauses are routine in commercial licenses. They select what state's law applies.  
22 Subsection (a) validates choice of law agreements, thus adopting a strong, contract choice position. Law outside this  
23 statute might restrict the ability of commercial parties to choose their law if the choice infringes fundamental policy of  
24 the forum state. This Article does not alter that policy or the applicable over-riding law. But few of the cases discussing  
25 this deal with anything other than a consumer transaction. A prior Section of this Article makes clear that those consumer  
26 policies and rules are not disturbed by Article 2B.

27 A rule that validates choice of law agreements states an important policy choice in a context where an increasing  
28 number of modern information transactions occur in cyberspace, rather than in fixed environments. Because many  
29 transactions in this field are not easily related to tangible locations, the ability to fix an appropriate choice of law provides  
30 an important contract drafting premise. The Committee in January, 1996 expressed strong support for this premise and,  
31 indeed, it reflects the clear trend of modern law. The rule enhances certainty of contract on choice of law rules in Article  
32 2B under the principle of freedom of contract. It was strongly supported by ABA representatives.

33 Subsection (a) makes the clause enforceable, subject, implicitly, to concepts of unfair surprise, conscionability,  
34 duress, and other general law theories. Except in Article 2A and cases of consumer regulatory statutes, no current uniform  
35 law in the U.S. precludes enforcement of contract choice of law on issues that a contract could control. Neither the  
36 Restatement, current Article 1 or Article 2, nor revised Article 2 place special restrictions on choice of law.

37 3. Common law generally enforces contractual choice of law in transactions involving intangibles. See  
38 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.  
39 den. 471 U.S. 1049 (1985) (patent license); Medtronic Inc. v. Janss, 729 F.2d 1395 (11th Cir. 1984); Universal Gym  
40 Equipment, Inc. v. Atlantic Health & Fitness Products, 229 U.S.P.Q. 335 (D. Md. 1985); Northeast Data Sys., Inc. v.  
41 McDonnell Douglas Computer Sys. Co., 986 F.2d 607 (1st Cir. 1993). The major exception occurs where the choice  
42 contradicts the basic policy of the state that would otherwise have its law apply, but reported cases outside of consumer  
43 or other regulated contracts often go relatively far to avoid finding such fundamental policies. Shipley Co., Inc. v. Clark,  
44 728 F. Supp. 818, 826 (D. Mass. 1990). The Restatement (Second) allows choice of law terms to govern in any case  
45 (including consumer contract) where the issue could be resolved by contract. In addition, even if contract rules might  
46 not otherwise govern, under the Restatement, the contract choice is presumed to be valid, subject to limited exceptions.

1 Restatement (Second) of Conflict of Laws ' 187 (may be invalid if not resolvable by contract and either there was no  
2 "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to  
3 a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the  
4 particular issue."

5 4. Article 1-105 currently allows a choice of law clause only if the chosen state has a "reasonable  
6 relationship" to the transaction. This rule is more restrictive than the Restatement and the other law of most states outside  
7 Section 1-105. It reflects law that existed when the UCC was adopted five decades ago, but that has little merit in modern  
8 electronic transactions and does not fit with modern scholarship about choice of law as reflected in the Restatement  
9 (Second) and elsewhere. That rule is anomalous applied to transactions involving general commercial behavior. Article  
10 2A provides a limited rule for consumer leases, restricting the choice of law to the jurisdiction in which the lessee resides  
11 on or within thirty days after the contract becomes enforceable. ' 2A-106. That rule is inappropriate for the intangible  
12 property involved in the subject matter of this article. It would create a situation in which an on-line provider would be  
13 subject to the law in all fifty states and unable to resolve this even by contract. That would be true even if no discernible  
14 consumer protection interest justified the contractual choice limitation.

15 The residence rule does not exist under Article 2, Article 1 or the Restatement. As a consumer protection, it  
16 assumes that the domicile is more protective than any other state law. As a matter of logic, that **cannot** be true in all  
17 cases. In an information marketplace and especially in cyberspace transactions, the residence rule harms the consumer  
18 as often as it helps her. I Internet environments, it clearly frustrates goals of providing uniformity and being able to  
19 control the number of divergent laws with which a contract must comply.

20  
21 **Illustration 1:** AOL provides on-line services throughout the United States and has its chief offices in  
22 Virginia. Under the proposed draft, in a contract with a consumer who resides in Oklahoma, the contract  
23 may choose the law of Virginia (licensor location) or Oklahoma (licensee residence). If it purports to  
24 choose Alaska law, that choice of law is enforceable except to the extent that it denies the licensee  
25 fundamental protections that would be available to it under Virginia or Oklahoma law outside this Article.

26  
27 5. The second issue involves choice of law in the **absence of contract terms** and is covered in subsection  
28 (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain for different  
29 terms if they so choose. Under general law, choice of law principles are often driven by litigation concerns and refer to  
30 questions about "reasonable relationship", "most substantial contacts", and "governmental interest." In the online  
31 environment, this does not support commercial development and creates substantial uncertainty.

32 6. The most important rule is in (b)(1). It deals with electronic transactional environments and creates  
33 a presumptive choice of law based on the location of the licensor. This concept has been extensively discussed in  
34 reference to online environments. Where an on-line vendor automatically provides direct marketing to the world through  
35 Internet, any other formulation would require the vendor to comply with the law of fifty states and 170 countries since  
36 it will often not be clear where the information is being sent. Some states or countries mandate such compliance through  
37 local laws, such as for example, recent amendments to California warranty law applicable to the sale of goods. By opting  
38 for a more stable, identifiable source of underlying law is an important step toward facilitating electronic commerce in  
39 digital products. As described in this section, the licensor's location refers to its chief executive office (as in Article 9),  
40 rather than the location of the computer that contains or provides the information.

41 7. Subsections (b)(2) and (b)(3) deal with more traditional environments. Subsection (b)(2) creates a  
42 consumer rule for cases of physical delivery of copies (not involving online contracts). The rule chosen focuses on the  
43 location where the copy is received. In most, but not all cases, of course, this will be the state in which the consumer  
44 resides. That location would typically be chosen under any choice of law regime, but this section makes the choice clear.  
45 Thus, for example, a consumer acquiring software in Chicago will be subject to the law of Illinois in the absence of  
46 contract terms. That rule is consistent with concerns about the "place of performance" and like considerations under  
47 current law. It is also followed in many European consumer protection rules relating to contract choice of law involving  
48 sales of goods and services. This rule deals with situations in which the licensor will know where delivery will occur  
49 because it delivers a physical copy and is not engaged in an electronic communication. This allows electronic transactions  
50 to be governed by a choice of law rule that enables commercial decision-making based on an identifiable body of law  
51 and does not impose costs on the transaction by requiring that the electronic vendor determine what physical location  
52 corresponds to an electronic location.

Subsection (b)(3) states the residual rule, applicable to consumer cases where no copy is delivered and the deal is not an online performance, and to commercial contracts where no choice of law clause was agreed to by the parties. The section adopts the Restatement (Second) test. 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 theme is not the universal rule in choice of law. Many states continue to use principles from the Restatement (First) and theories evolved by academic authors. One text describes the situation as follows: "[C]hoice-of-law theory today is in considerable disarray - and has been for some time. [It] is marked by eclecticism and even eccentricity. No consensus exists among scholars.... [Like] revolutionaries who can unite only to eliminate the existing government, they cannot agree on the establishment of a new one. The disarray in the courts may be worse. Four or five theories are in vogue among the various states, with many decisions using - openly or covertly - more than one theory." William Richman & William Reynolds, *Understanding Conflict of Laws* 241 (2d ed. 1992). The wide-ranging disarray approaches argues for providing guidance in this contractual environment for contract drafting and planning in cyberspace.

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

**SECTION 2B-107. CHOICE OF FORUM.** The parties may choose an exclusive judicial forum. However, [other than in an access contract for informational content or services,] in a consumer contract the choice is not enforceable if the chosen jurisdiction would not otherwise have jurisdiction over the consumer and the choice [unfairly disadvantages] the consumer. A choice of forum in a term of an agreement is not exclusive unless the agreement expressly so provides.

**Uniform Law Source:** Section 2A-106.

**Committee Votes:**

1. Rejected a motion to delete the section. VOTE 4 - 9 (February, 1997).
  2. Voted to adopt the term consumer and not "mass market" VOTE: 8-5 (February, 1997)
  3. Consensus that Draft should deal separately with arbitration clauses if at all. (February, 1997)
- [The bracketed language relating to unfair disadvantage retains an issue that will be addressed over the summer. The intent is to conform to Supreme Court holdings in reference to what type of limits on choice of forum are appropriate. Language from Cruise Lines and other decisions will be examined for what term should be used and for the elements of fairness that are considered. The bracketed language relating to access contracts refines a concept that was discussed without objection by the Committee in February, 1997, but was left out inadvertently in the March Draft.].

**Selected Issue:**

- a. Should the choice of forum be validated in Internet transactions, independent of the consumer or other issue under the rationale in Cruise Lines?

**Reporter's Notes:**

1. 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. Although earlier case law viewed forum choices with some disfavor, the trend of modern case law enforces choice of forum clauses, even if in standard form contracts, so long as enforcement does not unreasonably disadvantage a party. Since 1972, courts have shown an increasing willingness to enforce this type of contract provision, subject to due process restrictions. See Bremen v. Zapata Offshore Co., 407 U.S. 1, 10 (1972) (choice of forum clauses are "prima facie valid"). This case law does not differentiate between standard form and nonstandard contracts. See Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991). However, constitutional concerns about fairness and notice may provide a limiting role. Thus, the US Supreme Court held that a choice of arbitration under New York law in a standard form contract could not be enforced to apply New York law prohibiting punitive damage awards in arbitration where that substantive effect was not highlighted or brought to the affected party's attention. Similarly, some courts hold such clauses to be unenforceable where they impinge on concepts of fundamental unfairness. See also Perkins v. CCH Computax, Inc., 106 N.C. App. 210, 415 S.E.2d 755 (1992); Lauro Lines v. Chasser, 490 U.S. 495 (1989); Sterling Forest Assocs., Ltd. v. Barnett-Range Corp., 840 F.2d 249 (4th Cir. 1988).

2. The importance of choice of forum provisions in transactions in modern cyberspace was highlighted by a series of cases involving jurisdictional issues on Internet and related online environments. See, e.g., CompuServe v. Patterson, 89 F.3d 927 (6<sup>th</sup> Cir. 1996). (allowing jurisdiction of Texas provider in Ohio because of contract contacts with Ohio online provider). 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, a major issue in Article 2B: [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....

3. This section provides separate protection for consumers where the risk of over-reaching is more severe. Protection of this sort may already exist in applicable state consumer protection law. The purpose of the exception is to protect the individual, not to deal with a market place or transactional issue. This is especially important as information commerce goes more and more online. If online transactions in the internet are generally equated to mass market transactions, using that term here would seriously affect the ability of providers to control risk in world wide distribution.

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

5. The term "unfairly disadvantage" is adopted here on a tentative basis, pending further research in applicable case law. The intent is to track modern case law on choice of forum clauses based on due process, unfairness and other grounds.

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

**SECTION 2B-108. BREACH OF CONTRACT.**

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

1 contractual limitation on use of licensed information.

2 (b) A breach of contract is material if the contract so provides. In the absence of express  
3 contractual terms, a breach is material if the circumstances, including the language of the  
4 agreement, reasonable expectations of the parties, the standards and practices of the trade or  
5 industry, and character of the breach, indicate that:

6 (1) the breach caused or may cause substantial harm to the aggrieved party  
7 including imposing costs that significantly exceed the contract value;

8 (2) the injured party will be substantially deprived of the benefit it reasonably  
9 expected under the contract: or

10 (3) the breach meets the conditions of subsection (c).

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

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

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

16 **Committee Votes:**

17 a. Adopted a motion to delete list of events that are material. Vote: 11 - 0 (Feb. 1997)

18 **Reporter's Notes:**

19 1. This Article distinguishes between ordinary (insubstantial) breaches and material breach. The objective  
20 is to correspond the treatment of this issue with the treatment of materiality under current common law, including the  
21 Restatement (Second) of Contracts. In contrast, Article 2 revisions use a reference to "substantial impairment"  
22 presumably to avoid common law concepts about material breach.

23 2. Subsection (a) defines breach. The definition is intended to be inclusive. Breach occurs whenever a  
24 party acts or fails to act in a manner required by the contract. Encompassed within this term are failures to make timely  
25 performance, breach of warranty, late delivery, repudiation, non-delivery, and exceeding contractual limitations, etc.  
26 What is and is not a breach is determined by the contract and, in the absence of contract terms, by this Article.

27 3. Subsection (b) defines material breach. "Material breach" parallels the idea of substantial performance;  
28 the two phrases are interchangeable. (See Section 2B-102 which defines substantial performance as "performance of a  
29 contractual obligation in a manner that does not constitute a material breach of that contract.") The general common law  
30 concept of materiality engages a combination of factors oriented toward determining the significance of the breach in  
31 context of the actual relationship of the parties. The factors listed in subsection (b) are not exclusive. Courts should be  
32 free to draw on common law cases as well as their view of the circumstances in light of the purpose of distinguishing  
33 between material and non-material breach. The concept incorporates questions about the motivation of the breaching  
34 party. A series of minor breaches may constitute a material breach where the motivation for this conduct involves a bad

1 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  
2 forced to relinquish either the entire deal or, through re-negotiation, aspects of the deal that are otherwise important to  
3 it.

4 4. Material breach and substantial performance rules apply under current law to all transactions not  
5 governed by the Article 2. See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Otto Preminger Films, Ltd. v. Quintex  
6 Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) (“a breach of a contract is material if it is so substantial as to defeat  
7 the purpose of the transaction or so severe as to justify the other party's suspension of performance”; this was met where  
8 there was an accounting failure and failure to complete colorization of movies); Compuware Corp. v. J.R. Blank &  
9 Associates, Inc., 1990 WL 208,604 (N.D. Ill. 1990) (Materiality hinges on the cause and the effect of the breach; it  
10 involves the assumption the allegedly injured party performed properly to enable the other's full performance.).

11 5. Common law distinguishes between material and a non-material breach. The basic theme lies in the  
12 fact that, while parties are entitled to the contract performance for which they bargained, some breaches are sufficiently  
13 immaterial that they do not justify forfeiture of the entire bargain. For example, a one day delay in payment may or may  
14 not be material. A reasonable failure to fully meet advertised performance expectations of handling 10,000 files may  
15 not be material where the licensee's needs never exceed 4,000 if the system handles 9,999.

16 6. Materiality does not affect whether a party has a remedy, but what remedies are available. Breach  
17 entitles the injured party to remedies provided in this article or in the contract. What remedies are available depends on  
18 whether the breach is material or nonmaterial. The material breach concept rests on the common law belief that it is better  
19 to preserve a contract relationship in the face of minor performance problems and the related belief that allowing one  
20 party to cancel the contract for minor defects may cause unwarranted forfeiture and unfair opportunism. Materiality  
21 relates to the injured party's perspective and to the value that it expected from performance. Faced with only a  
22 nonmaterial breach, the injured party can recover for damages that arise in the ordinary course as a consequence of the  
23 breach, but cannot cancel the contract or reject the tender of rights unless the contract expressly permits that remedy.  
24 Faced with a material breach, a wider panoply of remedies is available to the injured party, including the right to cancel  
25 the contract. This Article carries the distinction throughout and with respect to both parties to a contract, except that a  
26 different standard applies to mass market transactions involving a refusal of a single delivery of software where the  
27 Article follows existing Article 2 and, rather than inquiring whether the breach is material, in that case asks merely  
28 whether the product conformed to the contract.

29 7. One cannot define materiality in absolute terms any more than one can define concepts such as  
30 negligence, reasonable care, merchantability, or the like. The concept is contextual. The key lies in defining an  
31 appropriate reference point. Subsection (b) emphasizes two elements: the contract terms and the extent to which the  
32 breach causes significant harm to the aggrieved party. The Restatement (Second) of Contracts lists five circumstances  
33 as significant in whether a breach of contract is material: 1) the extent to which the injured party will be deprived of  
34 the benefit he or she reasonably expected; 2) the extent to which the injured party can be adequately compensated for  
35 the benefit of which he will be deprived; 3) the extent to which the party failing to perform or to offer to perform will  
36 suffer forfeiture; 4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into  
37 account all the circumstances, including any reasonable assurances; and 5) the extent to which the behavior of the party  
38 failing to perform or to offer to perform comports with standards of good faith and fair dealing. Restatement (Second)  
39 of Contracts ' 241 (1981).

40 8. Materiality as a standard here parallels international law. Modern international laws use the term  
41 “fundamental breach” to describe the same concept. The Convention on the International Sale of Goods (CISG) states:  
42 “A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he  
43 is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not  
44 have foreseen such a result.” CISG Art. 25. UNIDROIT Principles of International Commercial Law state: “A party may  
45 terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a  
46 fundamental non-performance.” UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand alone in requiring “perfect  
47 tender”, but do so only in reference to a single situation: delivery of goods not part of an installment contract. Outside  
48 that context, use of materiality is unanimous. An ABA Software Contract Task Force recommended that the perfect  
49 tender rule be abolished with respect to software contracts because of the complexity of the software product and the fact  
50 that minor flaws (“bugs”) are common in virtually all software.

51 7. Because of the contextual nature of the problem, some situations arise in commercial practice where  
52 more precise guidance is desirable. One source of greater precision lies in the contract. Subsection (b) acknowledges the

1 right of parties to agree to the remedy caused by certain types of breaches and makes the express contractual terms  
2 binding. The eventual comments to this section will discuss illustrations of breaches relevant to the licensing field to  
3 provide further guidance.

4  
5 **Illustration 1.** The licensee provides specifications that the parties accept as part of the contract for  
6 development of a new word processing program. The standards require a dictionary with no less than  
7 5 million words. The actual dictionary has 4.99 million. The developer fails to meet the standard  
8 within the agreed period of time. The failure to meet the express standards constitutes a material  
9 breach. The licensee need make no payments for any of the work and can refuse the product.

10 **Illustration 2.** A contract requires delivery of a database program. The contract involves a mass  
11 market transaction. The database program meets its own specifications, but because of faulty design,  
12 substantially fails to in a manner comparable to other similar type programs. Whether there is a breach  
13 hinges on what express (description) warranties exist and what implied warranty and whether the  
14 design and performance fall outside of these. If there is a breach, materiality hinges on whether the  
15 defect causes substantial harm to the licensee's interests under subsection (b).

16 **Illustration 3.** In Illustration 1, the software meets all specifications, but is delivered one day after  
17 the scheduled completion date. This raises a question of whether a brief time delay should be treated  
18 as material without looking at the entire context. A similar question arises with late payment of fees.  
19 One view holds that the delay itself is material, even if the context indicates that no harm was caused  
20 to the other party. The other view holds that timing may be material, but that a contextual analysis  
21 should apply before allowing one party to forfeit its entire rights under the contract.

22  
23 The Restatement (Second) of Contracts ' 242 states:

24  
25 In determining the time after which a party's uncured material failure to render performance ...  
26 discharges the other party's remaining duties ... the following ... are significant:

27 \*\*\*\*

28 (c) the extent to which the agreement provides for performance without delay, but a material  
29 failure to perform ... on a stated day does not of itself discharge the other party's remaining duties  
30 unless the circumstances, including the language of the agreement, indicate that performance or an  
31 offer to perform by that day is important.

32  
33 This is designed to deal with boilerplate "time is of the essence" clauses that are not related to the realities of the deal  
34 but might be used to justify a forfeiture even where the day late has no consequence. Restatement (Second) of Contracts  
35 ' 242, comment d.

## 36 37 **SECTION 2B-109. UNCONSCIONABLE CONTRACT OR TERM.**

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

42 (b) Before making a finding of unconscionability under subsection (a), the court, on  
43 motion of a party or on its own motion, shall afford the parties a reasonable opportunity to



1 present evidence as to the setting, purpose, and effect of the contract or term thereof or of the  
2 conduct.

3 **Uniform Law Source:** Section 2-302; 2A-108. Revised.

4 **Committee Votes:**

5 a. In Article 2 at the 1996 Annual Meeting, a motion to delete language allowing invalidation  
6 based on unconscionable inducement of a contract was defeated.

7 b. At the same meeting, a motion to delete the requirement that unconscionable is a matter of  
8 law for the court was defeated.

9 **Reporter's Note:**

10 This draft follows current law in Article 2. Draft Article 2 contains language regarding unconscionable  
11 inducement of a contract. The inducement concept does not exist in current law in any context other than in  
12 Article 2A. In Article 2A, the inducement concept is expressly limited to consumer leases and does not  
13 apply to mass market or other commercial contracts. The argument for extending the scope of any  
14 inducement language beyond consumer contracts is not clear. In this article, many of the situations where  
15 inducement may be an issue are dealt with by the new concepts of manifesting assent, opportunity to review  
16 and statutory creation of a right to exclude surprising terms. An ABA observer group voted that the  
17 inducement provision not be adopted in Article 2B.

18  
19 **SECTION 2B-110. ATTRIBUTION PROCEDURE.**

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

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

the circumstances.

**Uniform Law Source:** Article 4A-201; 202.

**Reporter's Note:**

1. The existence of and compliance with an attribution procedure is relevant to signature requirements and on the question of attributing performance to a party. If an attribution procedure is established and followed, enhanced level of legal reliability is attributed to the message or performance. In signature requirements, following an attribution procedure results in a signature as a matter of law. In other contexts, if there is a question of who sent the message or performance, compliance with an attribution procedure makes the alleged originator of the message attributable as a matter of law. On the other hand, failure to use an authentication procedure does not indicate that there is no signature or that the purported sender is not responsible for the message or performance. It merely places attribution issues under the general attribution sections.

2. An attribution procedure derives from agreement. The procedure must be established by agreement or adopted by both parties. A procedure of which one party is not aware, but which is routinely used by the other would not qualify. On the other hand, agreement or adoption need not precede the transaction involved. Parties dealing for the first time adopt a procedure for verification and authentication of the messages and performances exchanged. That adopted procedure would have the full force of an attribution procedure if it is commercially reasonable.

3. Some have argued that the Draft should eliminate the requirement of commercial reasonableness. That requirement was adapted from Article 4A and provides a buffer against over-reaching and a means of protecting parties who do not have equal knowledge of technology. Viewed as used here as an enhanced assurance of reliability, the requirement of commercial reasonableness serves to encourage the development of reasonable attribution procedures. This section regulates the procedures as in Article 4A. The cost of course, lies in creating a degree of uncertainty that the parties cannot control by agreement. Yet, it may be an important safety valve 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.

4. In subsection (b), the concept of commercially reasonable procedure must take into account the cost relative to value of transactions such as the comments to 4A-203 suggest. This is implicit in the idea of commercial reasonableness, but could be added to the text if appropriate language can be developed. 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 impact of conforming to a procedure that is not reasonable is outlined in the next section.

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

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

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

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

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

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

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

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

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

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

15 (c) If an electronic message was transmitted pursuant to an attribution procedure for the  
16 detection of error and the message contained an error the following rules apply:

17 (1) If the sender complied with the attribution procedure and the error would have  
18 been detected had the receiving party also complied with the attribution procedure, the sender is  
19 not bound if the error relates ~~pertains~~ to a material element of the message or performance.

20 (2) If the sender receives a notice required by the attribution procedure of the  
21 content of the message or performance as received, the sender has a duty to in a commercially  
22 reasonable manner review the notice and report any error detected by it.

23 (d) Except as otherwise provided in subsection (a)(1) and (c), if a loss occurs because a

1 party complies with a procedure for attribution that was not commercially reasonable, the party  
2 that required use of the procedure bears the loss unless it disclosed the nature of the risk to the  
3 other party or offered commercially reasonable alternatives that the party rejected. The party's  
4 liability under this section is limited to losses that could not have been prevented by the exercise  
5 of reasonable care by the other party.

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

7 **Committee Votes:**

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

9 **Reporter's Notes:**

10 [Subsection c(2) was rewritten to clarify that it is a default rule dealing with the obligations of a sender in the context  
11 of an attribution procedure that entails return of notice containing content as received. The section does not provide  
12 a basis for allocating between two parties each of whom is at fault, leaving that issue to courts based on a consideration  
13 of ordinary causation and comparative fault concepts.]

14 1. This section states risk allocation rules pertinent to the potentially anonymous nature of electronic  
15 commerce regarding information assets and applicable to both the creation of an enforceable relationship and acceptance  
16 of or reliance on performance. The policy is to balance interests in making electronic commerce possible in an open  
17 environment (as contrasted to the relatively closed structures of funds transfer and EDI transactions), while reasonably  
18 apportioning risk. It should be noted here that the risk allocation rules do not apply to handling of funds, bank accounts,  
19 or other transactional subject matter that falls outside of the scope of Article 2B.

20 2. Subsection (a) describes three circumstances under which one party is held to be bound by a message.  
21 Subsection (a)(1) relies on general agency rules, but also adds the idea of an electronic agent. "Electronic agent" is a  
22 defined term, covering a computer program programmed to respond or initiate without human review and selected by  
23 the party for that purpose. Some observers have commented that this definition needs to be made more flexible to  
24 accommodate developments in technology. The general approach, however, calls into play a concept that, to be bound  
25 by purely electronic activity, a party must have affirmatively created the agency. That concept then carries through by  
26 virtue of the attribution concept to the offer and acceptance and other electronic contracting provisions of the article.  
27 Having selected and opted to rely on an electronic device or system, the party becomes responsible for its actions. The  
28 idea of an electronic agent does not exist under current law, but has importance in the context of electronic contracting  
29 for information because of the increasing use of preprogrammed software to acquire and conclude agreements for  
30 information assets. The principle here is that the individual or company who created and set out the program undertakes  
31 responsibility for its conduct. That result could be reached by common law courts under agency theory, but the goal is  
32 to eliminate uncertainty on this point. This treatment parallels that adopted in the UNCITRAL Model Law. Article 13  
33 provides that as between the parties, a message is deemed that of the originator if sent "by an information system program  
34 by or on behalf of the originator to operate automatically." That Model Act also separately lists attribution principles  
35 including that the party sent the message and that it was sent by an authorized agent.

36 3. Subsection (a)(2) focuses on agreed procedures for authentication and makes a message attributable  
37 to one party if the other used the procedures and reached that conclusion. This would cover, for example, the case in  
38 which a party obtained a PIN or other identifier and used it without authorization. Liability in the form of being bound  
39 by the message occurs without regard to fault so long as the agreed procedure was used by the recipient party. As defined,  
40 "attribution procedure" deals with a procedure adopted by the parties to verify source or detect errors. In earlier versions  
41 of this section, the substantive treatment here was limited to the verification or attribution of source issue. Bracketed  
42 language in this draft generally follows Article 4A in reference to error detection in messages (not contract performance),  
43 leaving to common law the treatment of other situations under general law of mistake.

44 4. Paragraph (a)(3) deals with a form of fault and attributes the message to one party if the means of  
45 making the identification occurred by way of an intrusion into a source controlled by the "sender" and enabled by the  
46 sender's lack of reasonable care. This form of attribution occurs only if the receiving party reasonably relied. Thus, for

1 example, if the nature of the message or performance clearly indicates or gives reason to doubt the source, reliance that  
2 causes harm may not be protected, but where the reliance is reasonable, the receiving party has a protected right under  
3 this article. The Drafting Committee previously discussed whether liability under (a)(iii) should exist without proof of  
4 negligence or any other fault. This needs to be evaluated in terms of drawing a balance between the interests of senders  
5 and the reliance interests of recipients of messages. In other contexts, it has been argued that use of a new system can  
6 be encouraged by liability limitations. The draft principle was modeled on provisions of the UNCITRAL Model Law.  
7 The UNCITRAL Model Law originally provided that as between the parties, the recipient is entitled to treat the message  
8 as that of the originator if the parties applied a procedure agreed to for this purpose ~~or~~ the message “resulted from the  
9 actions of a person whose relationship with the originator enabled that person to gain access to a method used by the  
10 originator to identify the data message as its own.” Apparently, this latter provision was deleted in the final draft.

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

25 5. New subsection (c) deals with errors in electronic messages, rather than attribution of source. It does  
26 not deal with errors in performance since obligations in that respect are the subject matter of the general contract terms  
27 and default rules in this Article. The approach in subsection (c) follows that used in Article 4A (4A-205). The basic  
28 theme is that a party has a right to rely on an authentication procedure, but that neither party can fail to exercise  
29 reasonable care to protect against loss to the other.

30 6. Subsection (d) provides for allocation of loss caused by the situation in which one party insists on a  
31 procedure for attribution, but that procedure is not commercially reasonable. The loss for use of the procedure falls on the  
32 party insisting on its adoption. The loss encompasses expectation, rather than merely reliance.

33  
34 **Illustration:** Jones insists that, in dealing with its software vendor, the vendor electronically ship software  
35 whenever it receives an E-Mail request using Jones’ name. An impostor places an order for software with  
36 a \$1,000 retail price. The vendor ships. Jones would be responsible for the \$1,000 loss if the procedure  
37 were commercially unreasonable.  
38

39 The alternative would limit loss to reliance damages which, here, might be the actual out of pocket loss (e.g., cost of  
40 the copy).  
41

## 42 **SECTION 2B-112. MANIFESTING ASSENT.**

43 (a) A party or electronic agent manifests assent to a record or term in a record if, with  
44 actual knowledge of the terms or after having an opportunity to review the record or term under  
45 Section 2B-113, it:

46 (1) authenticates the record or term, or engages in other affirmative conduct or

operations that the record conspicuously provides or the circumstances, including the terms of the record, clearly indicate will constitute acceptance of the record or term; and

(2) had an opportunity to decline to authenticate the record or term or engage in the conduct.

(b) Merely retaining information or a record without objection is not a manifestation of assent.

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

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

**Uniform Law Sources:** Restatement (Second) of Contracts ' 211.

**Reporter's Notes:**

1. Sections 2B-112 and 113 create a procedural background for when manifestation of assent occurs that provides protection against inadvertent and unknowing assent. The concept of manifesting assent is used throughout this article. It has three distinct functions, depending on the context.

**First:** In some contexts, it refers to when a party assents to a record. In this sense, the phrase "manifesting assent" is used in the Restatement (Second) and in the UNIDROIT Principles to define when a party is bound to the terms of a standard form contract and, indeed, to any record. Similar themes are found in judicial rulings. See, e.g., Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991) (cruise line ticket containing contract terms). In the Restatement, the term is used, but not defined.

**Second:** in other cases, the concept is utilized with respect to particular terms of a record. In this setting, it provides an enhanced standard in lieu of requiring that a term in a form be conspicuous. Manifesting assent here is the higher standard in that it requires both that the term be called out and that there be affirmative conduct referring to that term itself.

**Third:** in one or two cases in this Draft (e.g., statute of frauds and no oral modification clauses), the concept allows affirmative conduct to supplant a signature. This is especially important in electronic commerce where actual signatures are not always required or feasible.

2. "Manifesting assent" differs substantively from concepts of contract offer and acceptance. Offer and acceptance create a contract. While manifesting assent will also often indicate acceptance of a contract, acceptance is the broader concept. Acceptance does not require satisfying the procedural detail outlined here.

In contrast to accepting an offer, manifesting assent focuses on assent to the terms of a record. It deals with what are the terms of the contract. The concept of manifesting assent creates procedural protections to ensure fairness. The basic theme is that objective manifestations of assent bind a party to a term or to the terms of a record if procedurally there was an opportunity to review the record and the manifestation of assent entails an affirmative act or

1 conduct by the party.

2 3. **Three elements are required for manifestation of assent.**

3 **First**, the party manifesting assent must, of course, be one that can bind the party being charged with  
4 the benefits or limitations of the terms of the record and, where, assent equates with acceptance, the contract itself. This  
5 Article does not deal with questions of agency law. See ' 1-103. If a party proposing a record seeks to bind the other  
6 party, it must of course establish that the party who acted for the corporation had authority to do so. Of course, however,  
7 if the one who acted did not have authority to create the contract, there may be no license and uses of the information  
8 may infringe copyright interest. On the other hand, in appropriate cases, Article 2B rules regarding attribution may also  
9 play a role.

10 **Second**, there must be an affirmative act. A signature, of course, manifests assent to a record; initials  
11 attached to a particular clause manifest assent to that clause. So too, in the electronic world would an affirmative act of  
12 clicking on a displayed button in response to an on-screen description that this act constitutes acceptance of a particular  
13 term or an entire contract. The idea of assent does not require a formal event, although notarization or other formalities  
14 certainly qualify. Mere failure to object is not assent, but affirmative use of the information or access to it can be assent  
15 if that action was clearly defined as sufficient in the circumstances.

16 **Third**, the assent must come after a party had an opportunity to review the record or term. Assent  
17 requires proof that the party actually read the terms to which it assents. "Opportunity to review" is a defined term that  
18 requires that the term or record be called to the party's attention before the actions occur. The terms need not all be in  
19 a single record, so long as the location creates an opportunity to review and the requirement of explicit consent are met.  
20 Thus, a hyper-link reference to a license actually contained in a different record would, all other conditions being met,  
21 satisfy the concept. Of course, it will be necessary for the licensor, if it relies on the terms of the linked text, to show what  
22 was the content of the hyper-linked text at the time of the licensee's assent. One way of attempting to do so is to retain  
23 records of the content at all periods of time. The issues of proof here, while potentially difficult, are primarily matters  
24 of evidence law and reflect ordinary problems encountered in dealing with proof of electronic records.

25  
26 **Illustration 1:** In its pre-registration file, the New York Times on-line provides: "Please read the  
27 license. Click here to read the License. If you agree to the terms of the license, indicate your  
28 agreement by clicking the "I agree" button. If you do not agree to the License, click on the "I decline"  
29 button." The underlined text is a hypertext link which, if selected, displays the license.

30 

31 In this sequence, a party who indicates "I agree" manifests assent to the license. Its conduct, by  
32 moving forward to use the information resource also indicates that it accepted the offer for a  
33 contract and that, therefore, a contract was formed.

34  
35 4. The section makes a distinction between assent to a record and, when required by other provisions of  
36 this article, assent to particular terms. Assent to a record involves meeting the procedures generally with respect to the  
37 record, while assent to a particular term, if such is needed, occurs only if the actions relate to that particular term. One  
38 act, however, may relate both to the record and particular terms if the terms if the record conspicuously so provides:

39  
40 **Illustration 2:** In a shrink wrap license, which license is available and readable on the outside of the  
41 envelope containing the diskette, the license provides:

42 OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR  
43 AGREEMENT TO THE LICENSE WHICH IS CONTAINED ON THE OUTSIDE OF THE  
44 ENVELOPE.

45 WE CALL YOUR ATTENTION SPECIFICALLY TO:

46 **Contract Term No. 5, Precluding Use at Home, and**

47 **Contract Term No. 16, Imposing a \$100 Annual Fee if You Choose to Use the Help**

48 **Line.**

49  
50 In this case, and others where manifestation of assent to a term occurs, manifesting assent is an enhanced form of  
51 conspicuousness in that it requires an affirmative act with respect to a clause or term.

52 5. Manifestation of assent is not the only manner in which the parties define the terms and limits of their

1 deal. For example, clear indications that the product has specific characteristics and limitations become part of a bargain  
2 even if there is no specific, formal manifestation of assent, simply because they in effect define the bargain itself. A party  
3 can license a database of intellectual property attorneys to an end user and rely on the fact that the product need only  
4 contain intellectual property attorneys as a basic term of the deal without obtaining a manifestation of assent in formal  
5 terms to that aspect of the deal. The nature of the product would, in that case, presumably be part of the deal itself. The  
6 comments will make clear that the standard is met if the party has actual notice of the terms, the terms are actually part  
7 of the bargain of the parties, or other methods are used to call attention to the term and the party accepts it.

8  
9 **Illustration 3:** A copyrighted software package states in terms: "THIS PRODUCT IS LICENSED  
10 FOR CONSUMER USE ONLY." It does not go on to specify that opening the product or using it  
11 accepts this term. The circumstances here clearly indicate that the product is licensed solely for  
12 consumer use. The terms are effective as an inherent part of the agreement, not requiring additional  
13 pro forma language in a record or conduct accepting the record.  
14

15 6. Manifestation of assent assumes that the party can be held attributable with the assenting conduct under  
16 agency rules. Additionally, of course, there must be a link between the person who has the opportunity to review the  
17 terms and one who takes the steps that constitute assent. Thus, an email sent to the company at large, or to the company's  
18 computer, does not trigger assent to the terms of that email unless it comes to the attention of one who can and does act  
19 to commit the company to a binding assent to terms under rules of attribution or estoppel. Of course, a party with  
20 authority to act can transfer that authority to another party. Thus, a CEO may implicitly authorize her secretary to agree  
21 to a license when she instructs the secretary to sign up for Westlaw online or to install a newly acquired program that  
22 is subject to a screen license. Questions of this sort lie in the realm of agency law augmented in this Article by provisions  
23 regarding attribution and, in general, produce common sense results.

24 7. Manifesting assent hinges on the opportunity to review the contract or term; the record must be called  
25 to the party's attention before assent is obtained. This excludes devices to create or modify a contract designed to mislead  
26 or conceal, rather than to obtain assent. For example, a notation on the back of a check stating elaborate license terms  
27 and sent to the cashier's office of a company would not create terms when the check is cashed. The cashier lacks  
28 authority and the terms have not been called to the attention of the company.  
29

### 30 . **SECTION 2B-113. OPPORTUNITY TO REVIEW; REFUND.**

31 (a) A party or electronic agent has an opportunity to review a record or term if it is made  
32 available in a manner designed to call it to the attention of the party and to permit review of its  
33 terms or to enable the electronic agent to react to the record or term:-

34 ~~\_\_\_\_\_ (1) before the acquisition of a copy of the information;~~

35 ~~\_\_\_\_\_ (2) before the [transfer] [activation] of rights; or~~

36 ~~\_\_\_\_\_ (3) in the normal course of initial use or preparation to use the information or to~~  
37 ~~receive the [transfer] [activation] of rights. -~~

38 (b) Except for a proposal to modify a contract, if a record is available for review only  
39 after ~~the~~ contract fee is paid, a party has an opportunity to review only if it has a right to a



refund of any contract fees paid or to stop any payment already initiated if it refuses the terms, discontinues use and returns all copies. For multiple products transferred for a single, bundled price:

(1) if the party whose terms are refused~~rejected~~ is the transferor~~supplier~~ of the bundled product, the refund must be the entire bundled price on return of the entire bundled product, unless the licensee agrees to an allocation of the total price attributable to the rejected license; and

(2) if the party whose terms are refused~~rejected~~ was not the transferor~~supplier~~ of the entire bundled product, the refund must be for the contract fee paid for the rejected license or, if not separately stated, a reasonable allocation of the total fee attributable to the license.

**Uniform Law Source:** None

**Selected Issues:**

- a. How should opportunity for review and manifesting assent be coordinated with applicable regulations concerning disclosure under consumer or other law?
- b. How should we deal with restrictive notices (e.g., on a rented video) which are not presented as a matter for review and assent, but rather as defining the terms of use?

**Reporter's Notes:**

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

2. Under this section, the opportunity to review can come at or before payment, or later. If the opportunity follows payment, there is no opportunity to review unless the party can return the product and receive a refund if it declines the terms of the record. **This refund right does not exist in current law.** See Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7<sup>th</sup> Cir. 1997). It provides 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 and rejected prior to payment.

**Illustration:** Sam acquires a copy of the latest James Bond movie from Blockbuster on a three day rental agreement. When Sam 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. Looking around the room at his paying customers, Sam would be bound as a matter of contract by this limitation if he had a right to return the copy for a refund. Under current law, the restriction may also be effective as a matter of direct copyright law.

3. The concept of an opportunity to review contains an inherent element of reasonableness or fairness in that there must be a real opportunity to examine the record. What this requires may differ depending on whether one deals with a paper record or hypertext linked terms. If access to the terms becomes 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 bypass or ignore the opportunity and go forward with the transaction does not mean that there was no opportunity to review. Thus, for example, contract terms presented over the counter or conspicuously made available in a binder as

1 required for some transactions under federal law involve an opportunity for review even if the party does not avail itself  
2 of that opportunity.

3       **4.** In subsection (b) the prefatory language is intended to make clear that the ideas of refund associated  
4 with the opportunity to review are not intended to alter ordinary law relating to the modification of an agreement in which  
5 the parties are already performing, but are only directed to the initial contract formation. In contract modification the  
6 addition of standard form terms would be dealt with under general contract law concepts about adoption of those terms  
7 which, in the UCC, can occur without additional consideration.

8       **5.** While this section does not create an obligation to make a refund, it conditions the creation of terms  
9 of contract between the licensor and the licensee that arise after payment on that opportunity. The failure to provide a  
10 refund is not a breach of contract, but results in failure of the terms to become part of the bargain. Under Section 2B-616,  
11 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  
12 when it occurs, fulfills the refund option stated here.

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

18  
19       **Illustration:** Producer transfers a copy of a copyrighted musical work to User, subject to a license  
20 that restricts use to home use only. The license terms are presented after delivery of the copy. User can  
21 either assent to the license or obtain a refund of the fee. It assents. User later transfers the copy to  
22 Jones. Jones need not have any refund right. If Jones uses the music in a commercial context, the  
23 license is breached. Producer has contract recourse against User. Producer may also have a copyright  
24 claim against Jones for use (performance) that was not authorized. Producer has a contract claim  
25 against Jones only if Jones took an assignment of the license or assented to a license from Producer.

26  
27       **6.** Subsection (b)(1) and (2) deal with bundled products. For the supplier, the refund relates to the entire  
28 bundled package unless the licensee agrees to an allocation of the price based on the proportionality of cost measured  
29 by the vendor's cost for the product bundle or the rejected licensor did not supply the entire bundle. Thus, if the  
30 particular software being refused was attributable for 5% of the total cost of the bundled products for the vendor, the  
31 refund must be of 5% of the price of the bundle to the licensee. The bundled products here can include both goods and  
32 information products, but the principle remains the same. Based on comments by a licensee attorney, several consumer  
33 advocates, and others, this draft does not reduce the refund for "value received." We are dealing here with an up-front  
34 contract creation and deductions would seldom be merited in any event.

35  
36       **SECTION 2B-114. AUTHENTICATION EFFECT AND PROOF; ELECTRONIC**  
37 **AGENT AUTHENTICATION~~PROOF OF AUTHENTICATION.~~**

38       (a)- An authentication is intended to establish the party's identity, its adoption and  
39 acceptance of a record or a term, and the authenticity of the record or term.

40       (b) Operations of ~~Actions by~~ an electronic agent constitute the authentication of a party if  
41 the party designed, programmed, or selected the electronic agent for the purpose of achieving  
42 results of that type.

43       (cb) A record or message is authenticated as a matter of law if party complied with an

1 attribution procedure for authentication. Otherwise, authentication may be proven in any manner  
2 including by showing that a procedure existed by which a party necessarily must have executed  
3 or adopted a symbol in order to proceed further in the use or processing of the information.

4 **Reporter's Notes:**

5 [A new subsection (a) has been added to deal with the multi-purpose effect of an authentication and to state the  
6 presumption that ordinarily applies when a record is authenticated (signed). The presumption is that authentication  
7 serves all three of the primary purposes unless the authenticating party indicates that only one or two of the purposes  
8 are intended. This, it is believed, is the effect of signing under current law.]

9 **1.** Subsection (a) contains a specific application of the general principle that actions of an electronic agent  
10 bind the party that selected and deployed the agent for that purpose.

11 **2.** Subsection (b) states that compliance with an agreed attribution procedure, if followed, removes factual  
12 questions about whether an authentication (signature) occurred. This happens, of course, only if the procedure was  
13 commercially reasonable since commercial reasonableness is part of the statutory definition of an authentication  
14 procedure. The second concept in subsection (b) allows proof of an authentication in any manner, but specifically allows  
15 proof gauged by showing that a process exists that required this result in order to proceed further. This responds to on-line  
16 and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is  
17 sufficient.

18 **3.** This section is neutral as to the nature of the systems adopted for these purposes. Current law in some  
19 states links so-called "digital signatures" to the use of specific types of encryption technology. That is inappropriate in  
20 a general law such as being developed here. Fingerprint, voice recognition, encryption and other technologies as they  
21 evolve are equally acceptable.  
22  
23

24 **SECTION 2B-115. EFFECT OF AGREEMENT.**

25 (a) Whenever this article allocates a risk or imposes a burden as between the parties, an  
26 agreement may shift the allocation and apportion the risk or burden.

27 (b) Except as expressly provided in ~~The effect of~~ this article or in Article 1 of this [Act],  
28 any provision of this article may be varied by agreement of the parties. ~~, but except as expressly~~  
29 ~~provided in this article or Article 1 of this [Act],~~ The agreement may not vary:

30 (1) ~~the obligation of good faith;~~

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

32 (2) the effect of Section 2B-406 on limitation or disclaimer of ~~express~~ warranties;

33 (3) the limits in Section 2B-716 on waiver of self-help protections;

34 (4) the unenforceable terms described in Section 2B-503(b) on contractual transfer

1 restrictions;

2 (5) the limitations on excluding notice in Section 2B-627;

3 (6) the limitation ~~stated~~ in Section 2B-625(e) on excuse by unexpected events;

4 (7) the restrictions ~~stated~~ in Section 2B-705(a) on the statute of limitations;

5 (8) the limits on inclusion of refusal terms in Section 2B-308(b);

6 (9) the limits on choice of forum in consumer contracts in 2B-107; or

7 [other provisions to be added]

8 (c) The absence of a phrase such as “unless otherwise agreed” in a provision of this  
9 article does not ~~by itself~~ preclude the parties from varying the provision by agreement. The fact  
10 that a provision of this article states a precondition for a result does not of itself imply that the  
11 absence of that precondition yields the opposite result.

12 (d) Unless this article requires a term to be conspicuous, or that there be manifest assent  
13 to the term, neither requirement is a prerequisite to enforceability of the term.

14 (e) Whether a term is conspicuous or constitutes an excluded term under Section 2B-  
15 308(b)(1) is a question of law to be determined by the court.

16 [(f) The statement of a rule in this article that is variable by agreement does not imply  
17 that the rule is necessarily suitable or a standard for all transactions in all circumstances. An  
18 agreement that varies such a rule must be interpreted with recognition of this principle and in  
19 light of the ordinary practices of the applicable trade or industry, consistent with the purposes of  
20 this [Act].]

21 **Uniform Law Source:** None.

22 [New language in subsection (c) was added to deal with concerns of several observers about the existence of a so-called  
23 negative pregnant in many of the rules in this article. Thus, for example, if a section indicates that “If the originator  
24 of a message requests acknowledgment, then the following rules apply: ---” does not indicate what rules apply in the  
25 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  
26 a request, but merely states the affirmative proposition. Of course, in many cases, the other and more exclusionary result

1 is intended. This can ordinarily be inferred from the context of the section or the associated policies. Proposed  
2 subsection (f) is provided to suggest the relationship between statutory rules and interpretations of contract terms  
3 varying those rules.]

4 **Reporter's Notes:**

5 **1.** This section implements the basic policy that all of the provisions of this Article are subject to contrary  
6 agreement with the exception of listed sections or rules that are not subject to contractual modification. It deals with an  
7 important issue created by virtue of the drafting approach applied here. As a general rule, sections in Article 2B (and  
8 Article 2) are drafted in apparently mandatory terms as rules of law. This is subject to the over-riding principle, described  
9 in subsection (b), that all of the terms of the article can be altered by agreement. The difficulty rests in the fact that this  
10 general principle is, itself, subject to important limitations. The difficulty thus created is how to provide guidance to  
11 persons drafting or planning a transaction who are not aware of all of the nuances of when or whether a particular  
12 statutory term can be varied and, indeed, even what one means by varying the statutory terms by agreement.

13 **2.** The section reverses decisions such as *Suburban Trust and Savings Bank v. The University of*  
14 *Delaware*, 910 F. Supp. 1009 (D. Del. 1995) which applied the "plain meaning" of an Article 9 provision and held that  
15 the specific terms of Article 9 rule supersede the general terms of UCC ' 1-102 (permitting contractual variation of  
16 statutory rules).

17 **3.** While the feasibility of listing exceptions in a single section has been questioned, it is the only  
18 alternative to the prior practice in UCC articles of stating "unless otherwise agreed" in the sections where the rule can  
19 be modified by agreement. In the absence of one or the other approach specifically in the statute, courts may misread  
20 the mandatory sounding language that arises as a result of the drafting decision to eliminate use of "unless otherwise  
21 agreed."

22 **4.** Subsection (d) holds that conspicuousness is a matter of law. This follows current law.  
23  
24

## 25 **PART 2**

## 26 **FORMATION**

### 27 **SECTION 2B-201. FORMAL REQUIREMENTS.**

28 (a) Except as otherwise provided in this section, a contract is not enforceable by way of  
29 action or defense unless there is a record authenticated by the party against which enforcement is  
30 sought or to which the party manifested assent sufficient to indicate that a contract has been  
31 made between the parties and describing the subject matter or copies. Any description of the  
32 subject matter or copies ~~whether or not it is specific~~, satisfies this subsection if it reasonably  
33 identifies what is described. However, a contract is not enforceable beyond the description of the  
34 subject matter or copies shown in the record.

35 (b) A grant or limitation governed by Section 2B-310 or 2B-502 may not vary the terms  
36 of those sections except by a record authenticated or employed by a party against which  
enforcement ~~of the contractual term~~ is sought.

1           (c) ~~A description of subject matter is sufficient under this section if it reasonably~~  
2 ~~identifies the information or the copy to which the contract pertains. A contract is not enforceable~~  
3 ~~under subsection (a) beyond the subject matter shown in the record.~~

4           ~~——(d) An agreement that does not satisfy the requirements of subsection (a), but which is~~  
5 ~~valid in other respects, is enforceable:~~

6                   (1) if the agreement contemplates no or merely nominal consideration for the  
7 rights acquired, or the total value of any~~the~~ payments to be made and any ~~other~~ affirmative  
8 obligations incurred, excluding payments for options to renew or buy, is less than \$20,000;

9                   (2) ~~the agreement involves a release of intellectual property rights, or permission~~  
10 ~~to use those rights; or~~

11                   ~~——(3) to the extent that a person authorized by the holder of intellectual property~~  
12 ~~rights delivered~~~~transferred~~ copies of the information or access materials to the licensee; or that  
13 performance has been otherwise tendered by one party and accepted by the other; or

14                   (3) to the extent that the party against which enforcement is sought admits in its  
15 pleading, testimony or otherwise in court that a contract was made.:

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

18           (e) For agreements within this article, this section and the remainder of this article state  
19 the only formal requirements for enforceability under the laws of this state.

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

21 **Votes:**

- 22           1. In debate on Article 2 at the Annual Meeting, repeal of the statute of frauds in that Article was sustained  
23 by a relatively narrow vote (65-52). Subsequently, the Article 2 drafting committee has voted to include a  
24 statute of frauds in that article.  
25           2. By a vote of 10-4, the Drafting Committee voted to retain a statute of frauds generally as expressed in  
26 Alternative B of the September Draft. (September, 1996)  
27           3. By a vote of 5-8, the Drafting Committee rejected a motion to remove the dollar limitation in the

exception contained in subsection (e)(1). (September, 1996)

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

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

[Former subsection (c)(3) was moved to the section on releases. New subsection (c)(3) was added at the request of several committee members to restore a principle of judicial admissions recognized under current Article 2. Subsection (e) was added to avoid confusion about the continued applicability of other, non-UCC statutes of frauds.]

#### **Reporter's Notes:**

1. The statute of frauds has been controversial. In sales law, the statute of frauds serves a limited purpose in that it applies only to protecting against fraud in cases involving goods that have not yet been delivered. Reliance on litigation and on evidence rules to regulate fraud there makes sense so long as a statute of frauds causes any significant detriment to modern transaction formats. Neither British contract law nor the Convention on International Sales of Goods (CISG) require a record. Yet, the need for statute of frauds protection is greater in information contracts than in the sale of goods, however. This is true because of the intangible character of the subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights vesting in one party while rights to use or possess a copy of the intangible may vest in another party. These considerations buttress other arguments against repeal which include primarily the idea that the fraudulent practices and unfounded claims that this rule prevents justify the cost **and** that the statute codifies and encourages what might be regarded as desirable business practice.

There has been little or no support outside academic contexts for repeal of the statute of frauds in reference to information transactions. This relates primarily to questions about the intangible nature of the subject matter and the ease of copying as diminishing the reliability of other indicia of agreement to circumvent fraudulent claims. The Drafting Committee voted to adopt a statute of frauds rules with a relative large dollar cut-off. The dollar figure positions the statute in reference to relatively large transactions and excludes most mass market deals. In larger transactions, the risk is sufficiently large and the statutory safeguard is relevant.

2. This Draft opts for a subject matter as the key statutory concept. There are several reasons for this. Chief among these is that, unlike in transactions in goods, questions about quantity are often not a chief consideration in intangibles. Rather, the major focus of a license deals with questions about the scope of the license. As defined in 2B-102, scope refers to five aspects of the contract: subject matter, rights granted, location, duration and the uses allowed. One could argue for a statute that requires that all five elements be in a record, but practices in the industries covered by this article do not support such a position. The subject matter (or information covered) was selected as a reasonable compromise.

3. This section does not require that a record be retained. As in current law, one can prove the prior existence of a 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. In electronic environments, 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. Significant litigation has occurred in copyright law on this question. The cases there do not impose a minimum time period; a "copy" occurs when information is placed in a different part of memory in a computer than the one in which it was stored. Copyright law, on the other hand, does distinguish a copy and a ephemeral manifestation of information. Presumably, an ephemeral copy is not a record in this Article.

4.. Subsection (b) follows the basic principle that use questions are significant and that some basic default principles should not be altered except by a record. Section 2B-310 incorporates the primary default rules on scope in this draft: single user, no right to modifications, and implied right to uses necessary to expressly granted uses. These three facets of the default rule provisions include both licensor and licensee protections.

5. Subsection (c) contains of number of exceptions to the statute of frauds rule. The \$20,000 limit was chosen to exclude coverage the large number of small value transactions that do not require formalities. Focusing on dollar amount is too narrow here; the draft uses a "value" standard instead. The exception covers transactions involving no payment, but which are otherwise enforceable contract because there is other consideration present; these are excluded from the statute if the dollar amount or obligations created are less than \$20,000. Subsection (c)(2) reflects entertainment industry practice.

**Illustration 1:** ABP Corp. licenses movies for one and two week showings by thousands of theaters.

1 For each, it delivers a copy of the motion picture to enable the showing. Regardless of the dollar value  
2 of the license and any renewals, the license is excepted from the requirement of a record because a  
3 copy was delivered to the licensee and subsection (c)(3) applies. The terms of the license are  
4 determined by the actual agreement, the customs of the business, and default rules of this Article.

5 **Illustration 2:** Booker acquires releases from various parties to enable completion and publication  
6 of its books. The releases are often not acquired for any payments to the releasing party. This sSection  
7 ~~2B-207~~ allows enforcement without consideration and this section excludes the application of the  
8 statute of frauds based on both subsection (c)(2) and (c)(1) (the latter being applicable because the total  
9 payments were less than \$20,000, i.e., no payments).

10  
11 **6.** Subsection (d) makes clear that trading partner or similar agreements are enforceable to alter the statute  
12 of frauds issue. The parties can clearly agree to conduct their further business without there being a need for additional,  
13 authenticated writings.

14 **7. Current law:** The common law statute of frauds is contained in statutes in 47 states. Restatement  
15 (Second) of Contracts ch. 5, Statutory Note, at 282 (1979). State law rules differ. In the final version of this draft,  
16 legislative notes must cover the partial revision/ repeal of existing statute of frauds rules to achieve the result noted in  
17 subsection (e) of this Draft.

18 Article 2A employs a statute of frauds for leases based in part on the separation of possession and title in a lease,  
19 the content of which requires documentation that goes beyond the mere transfer of possession of the goods. If the  
20 distinction based on a separation of ownership and possession is accepted as a reason for different treatment in the U.C.C.  
21 for sales and leases, a similar reason for not repealing the statute of frauds exists in intangibles.

22 Copyright law requires a written agreement for an enforceable transfer of a copyright. 17 U.S.C. ' 204. A  
23 similar rule applies for patents. 35 U.S.C. ' 261. A transfer of property rights occurs when there is an "assignment" or  
24 an "exclusive license." The federal rules do not apply to transfers of rights in data. For discussion of the difference  
25 between data and copyright in data compilations, see Feist Publications, Inc. v. Rural Telephone Service Co., 111 S. Ct.  
26 1282 (1991). Federal rules do not apply to nonexclusive licenses since a nonexclusive license is not a "transfer" of  
27 copyright ownership. However, in copyright law, a nonexclusive license that is not in writing may lose priority to a  
28 "subsequent" transfer of the copyright.

## 30 **SECTION 2B-202. FORMATION IN GENERAL.**

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

34 (b) If the parties intended an agreement, an agreement sufficient to constitute a contract  
35 may be found even if the time that the agreement was made cannot be determined, one or more  
36 terms are left open or to be agreed upon, one party reserves the right to modify terms, or the  
37 standard forms of the parties contain varying terms. However, no contract is formed if the parties  
38 disagree about scope. If records exchanged by the parties conflict on the scope of a license, an  
39 agreement exists only if and to the extent that from all the other circumstances it appears that an



1 agreement, including with respect to scope, existed.

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

5 **Uniform Law Source:** Section 2-204, modifies (b).

6 **Committee Votes:**

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

8 **Reporter's Note:**

9 **1.** Subsection (a) generally conforms to current law. Under these standards, courts correctly hold that  
10 preliminary negotiations do not create a contract unless and until the parties manifest an intent to be bound. The clearest  
11 illustration of that, of course, is by executing a contract in record. In addition, in essentially all industries, it is often the  
12 case that performance begins under some form of preliminary understanding or indication of intent to contract (letter of  
13 intent) and this performance creates obligations but not necessarily a commitment to the overall or long term  
14 arrangement. Sorting between cases such as that and the so-called layering situations where terms are layered on over  
15 time even though the parties have clearly agreed to the entire contract with details to be filled in is inevitably a question  
16 of fact for a court or the parties to sort through. Whether a more definitive standard can be provided here or in any other  
17 setting is doubtful.

18 **2.** Parts of subsection (b) were added to deal with the fact that issues about scope go to fundamental  
19 aspects of a license; they in effect define the product being licensed. Disagreement in records (often standard forms)  
20 about this fundamental issue are like an exchange of forms ordering a Corvette and confirming purchase of a  
21 Volkswagon, they indicate potentially fundamental disagreement in respect to the nature of the contract and its subject  
22 matter. This does not disallow the existence of a contract, but requires that a court look elsewhere than in the exchanged  
23 records for indicia of agreement.

24  
25 **SECTION 2B-203. OFFER AND ACCEPTANCE.**

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

30 (b) ~~An order or other offer to buy, license, or acquire information for prompt or current~~  
31 ~~performancetransfer~~ invites acceptance either by a prompt promise to perform~~transfer~~ or by  
32 prompt or current performancetransfer. However, a performancetransfer involving  
33 nonconforming information is not an acceptance if the party who provides the information  
34 ~~transferor~~ seasonably notifies the transferee that the information~~the transfer~~ is offered only as an

1 accommodation.

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

5 (d) Subject to Section 2B-202, a definite expression of acceptance may create a binding  
6 obligation even though it is in a standard form that contains terms that vary from the terms of the  
7 offer. Language in a standard form that makes an offer or acceptance expressly conditional on  
8 assent by the other party to the varying terms is enforceable and precludes a contract in the  
9 absence of agreement to those terms if the party proposing the form acts in a manner consistent  
10 with the stated conditions, such as by refusing to perform until its terms are accepted. The terms  
11 of a contract formed by records with varying terms are determined under Section 2B-309 if  
12 applicable and under general law if that section does not apply.

13 (e) Subject to subsection (f), operations of ~~actions taken by~~ one or more electronic agents  
14 which confirm the existence of an agreement ~~contract~~ are effective to form an agreement ~~contract~~  
15 even if no individual representing either party was aware of or reviewed the action or it results.

16 (f) In an electronic transaction, the following rules apply:

17 (1) An agreement ~~contract~~ is formed by the interaction of two electronic agents if  
18 the interaction results in both agents each engaging in ~~further operations~~ ~~actions~~ that signify  
19 agreement ~~contract~~, such as by engaging in performing the agreement, ordering or instructing  
20 performance, accepting performance, or making a record of the existence of an agreement  
21 ~~contract.~~;

22 (2) ~~a~~An agreement ~~contract~~ may be ~~is~~ formed by the interaction of an electronic  
23 agent and an individual. An agreement is formed if an individual ~~who~~ has reason to know that the

individual is dealing with an electronic agent and performs actions the person ~~who~~ should know will cause the agent to perform or to permit further use, or that are clearly indicated as constituting acceptance regardless of other contemporaneous expressions by the individual to which the electronic agent cannot react.~~;~~~~and~~

(3) The terms of the contract include terms on which the parties have previously agreed, terms which the electronic agents could take into account, and, to the extent not covered by the foregoing, terms provided by this article or other law.

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

**Committee Vote:**

**a.** Approved in principle. (September, 1996).  
[Subsections (a) and (d) were reorganized for clarity without intending substantive changes. Subsection (b) was edited to remove the focus on sale of goods language and make the section generic. Subsection (f) was edited to clarify the general formation rules without substantive change.]

**Reporter's Notes:**

**1.** Article 2B separates the issue of whether an **agreement** exists from the issue of what **terms** govern that agreement. This Section allows formation of a contract through a variety of means, including the exchange of conflicting standard forms if the parties behave as if a contract exists. The materials in subsection (a) through (c) are consistent with current law.

**2.** This general approach leaves open the question of what is the effect of a truly conditional offer. The subsection seeks to deal with one part of the "battle of forms", that is the question of whether a contract exists. The general rule is in (a), which allows acceptance by any means and in the first sentence of subsection (d) which allows for the expression of assent in the form of a standard form that contains varying terms. The second sentence of subsection (d) sets out the idea that terms of condition are enforceable even if in a standard form if the party's behavior is consistent with those terms, insofar as the issue concerns whether the parties have a contract. Subsection (d) coordinates with current law and with the battle of forms treatment in 2B-309. The third sentence of the subsection creates an important reference, clarifying that the creation of the agreement does not necessarily mean that one party's form controls. Determining what terms are included falls to either 2B-309 or to general contract interpretation law in the case where the communications were not in conflicting standard forms.

The approach validates conditional offers if the conditioning language is followed with actual behavior sustaining its conditional nature. Thus, if a party ships pursuant to an allegedly conditional form and its behaviors manifests the existence of a contract, a contract exists despite the language of condition. If, however, a party conditions its form and refuses to ship until the conditions are accepted, that conditioning language and activity preclude the formation of a contract. Section 2B-309 allows the conditional terms of a form to govern if the parties execute an authenticated record containing the terms. In either case, the condition is actual and enforceable.

**Illustration 1.** Purchaser sends a standard order form indicating that its order is conditional on the Licensor's assent to terms contained on the reverse side of the form. Licensor ships pursuant to a standard form invoice conditioning the contract on assent to its terms. Purchaser accepts the shipment. Under these circumstances, neither party acted in a way that was consistent with the language of condition. There exists, however, sufficient indicia to indicate that a contract was formed (e.g., shipment and acceptance). The terms of the contract are governed by 2B-309 and general interpretation law, including the actual terms of any affirmative agreement the parties may have had. If 2B-309 applies, the primary rule is a knock-out rule where conflicting terms in both forms drop out.

**Illustration 2.** In Illustration 1, assume that Licensor does not ship, but telephones Purchaser and informs it of the conditions of shipment. It does not ship until Purchaser agrees to those terms. Until that agreement occurs, there is no contract. If the agreement occurs, the contract exists based, under ordinary contract interpretation rules, on the terms actually agreed to (e.g., the Licensor's terms) since, given that actual agreement, the conflicting forms no longer purport to state the contract of the parties.

**Illustration 3.** In Illustration 1, assume that Licensor ships pursuant to its "conditional" form, but then when the shipment arrives, Purchaser does not accept it because the original conditional offer terms are now changed. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract since the Purchaser acted in a manner consistent with its conditional language. When that agreement occurred, that agreement sets the terms of the contract (e.g., the Purchaser's terms) since, given that actual agreement, the conflicting forms no longer purport to state the contract of the parties.

**3.** Subsection (f) deals with two contexts relevant in the electronic world: 1) interaction between a human and an electronic agent, and 2) an interaction between two electronic agents without human intervention. In both situations, 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 4.** 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 dresses 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 5.** 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.

**4.** As between electronic agents a form of presumed intent within the programming of the electronic agents is sufficient for a contract. The idea here is that, even if the agents "negotiate", they are acting within parameters set by their party's and, if an "agreement" occurs within those parameters signified by performance, ordering performance, or instructing performance to occur, that suffices. The terms of the contract would be 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-204. ELECTRONIC TRANSACTIONS AND MESSAGES:**

### **TIMING OF CONTRACT AND EFFECTIVENESS OF MESSAGE.**

(a) If an electronic message initiated by a party or an electronic agent evokes an electronic message in response and the messages reflect an ~~or can be attributed with the intent to~~ be bound, a contract exists when:

(1) the response signifying acceptance is received; or

(2) ~~if the response consists of electronically furnishing the requested information or notice of access to the information when the information or notice is received and unless the originating message did not prohibited that form of response, or~~

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

(b) Subject to Section 2B-205, an electronic message is effective when received, even if no individual is aware of its receipt.

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

**Committee Vote:**

**a. Approved in principle.**

**Reporter's Notes:**

[Edited for clarity with no substantive change.]

**1.** Subsection (a) deals with timing of a contract when electronic messages are used to complete the transaction. It rejects the mail box rule, and times acceptance or effectiveness of a message to when the message is received. This same approach is followed in Article 4A (" 4A-406, 104(a)). This section adopts the same rule (time of receipt) for all electronic responses. It contrasts to Section 2B-202, which creates a time of performance rule for non-electronic performance.

As in all other sections, questions of attribution of the messages also apply. These are resolved under the section on attribution. If, for example, the "response" purports to be from ABC Corp., but is not, a contract exists as to ABC only if the message can be attributed to it under rules of agency, attribution procedures, or the other attribution concepts contained in this Article or in common law.

**2.** The principal application of this section lies in the growing realm of electronic commerce. Read in combination with Section 2B-203, the principal contribution is that that a contract exists even if no human being reviews or reacts to the electronic message of the other or the information delivered. This represents an adaptation of traditional norms of consent and agreement. In electronic transactions, preprogrammed information processing systems can send and react to messages without human intervention and, when the parties choose to do so, there is no reason not to allow contract formation. A contract principle that requires human assent would inject what might often be an inefficient and error prone element in a modern format. The principle stated here, however, needs further development and coordination with the various other affected sections.

## **SECTION 2B-205. ACKNOWLEDGMENT OF ELECTRONIC MESSAGE.**

(a) If the originator of an electronic message requests or has agreed with the addressee of

the message that receipt of the message must be acknowledged electronically, the following rules apply:

(1) If the originator indicated in the message or otherwise that the message was conditional on receipt of an acknowledgment, the message does not bind the originator until acknowledgment is received and lapses if acknowledgment is not received in a reasonable time.

(2) If the originator requested acknowledgment but did not state that the message was conditional on acknowledgment and acknowledgment has not been received within an reasonable time after the message was sent, on notice to the other party, the originator may either retract the message or specify a further reasonable time within which acknowledgment must be received or the message will be treated as not having binding effect. If acknowledgment is not received within that additional time, the originator may treat the message as not having binding effect.

(3) If the originator requested acknowledgment and specified a time for receipt of acknowledgment, the originator may exercise the options in subsection (a)(2) if receipt does not occur within that time.

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

**Committee Vote and Action:**

a. Motion to delete the section was rejected. Vote: 5-6. (February, 1997)

**Reporter's Note:**

1. This section sets out default rules interpreting the meaning in electronic commerce of requiring or requesting electronic acknowledgment. Under subsection (a), the impact of the request depends on whether the request made the message conditional on acknowledgment or merely requested acknowledge. As a basic principle, the contents

of the section recognize the right of the message sender to control the legal effectiveness and required response to its messages.

2. Acknowledgment, of course, is not necessarily acceptance in cases where the original message was an offer for a contract. Rather, the basic theme is that the acknowledgment gives assurance of receipt. In modern communications systems, this will often occur automatically and immediately on receipt of the electronic message in the recipient's system. See comments to ABA Model Contract; UNCITRAL Model Law.

3. This section deals with functional acknowledgments and, as outlined in subsection (b), 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.

**SECTION 2B-206. 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 of assurance that the offer will be held open that is contained in a standard form supplied by the party receiving the offer ~~offer~~ is ineffective unless the party making the offer ~~offer~~ or manifests assent to that term.

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

**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.

[The third sentence was edited for clarity with no substantive change.]

## **SECTION 2B-207. RELEASES.**

(a) A release ~~or waiver~~ of intellectual property rights ~~in or a permission to use information~~ whole or in part is effective without consideration if it is:

(1) contained in a record to which ~~authenticated by~~ the party giving the release ~~or waiver or to which that party~~ manifested assent, and which identifies the rights released ~~or waived~~; or

(2) enforceable under other law including estoppel, implied license or other rules allowing enforcement of a release.

(b) A release continues for the duration of the rights released if the agreement does not

1 specify its term and does not require:

2 (1) on-going affirmative performance by the party granting the release, or

3 (2) on-going payments or other affirmative performance by the party receiving the

4 release except minor acts such as in complying with any agreement to give acknowledgments or

5 credits in subsequent use of the information or provide copies of any new works.

6 **Selected Issues:**

7 a. Is the definition of a release sufficient distinct from the general idea of a license to permit the two  
8 special rules contained in this section: that is, the absence of an authenticated record requirement and the  
9 presumption of a perpetual term, neither of which rule is appropriate for licenses in general?

10 **Reporter's Note:**

11 ~~[Subsection (a) was moved here from Section 2B-201. Subsection (b) represents a specific application of a rule~~  
12 ~~previously expressed in Section 2B-311, creating a presumption that single payment (or arguably, no-payment)~~  
13 ~~contracts create perpetual rights if no term is specified. The broader rule was abandoned in this draft based on~~  
14 ~~extensive discussion during the April, 1997 meeting, but this specific application was developed to deal with issues~~  
15 ~~common in software, publishing and other industries in cases where parties develop information products based in~~  
16 ~~part on reliance on general releases or waivers that do not contain specific terms as to duration. Leaving those~~  
17 ~~cases to coverage under the general "reasonable time" standard provided in revised Section 2B-311 would create~~  
18 ~~unwarranted and potentially costly uncertainty]~~

19 1. This section provides that ordinarily an authenticated record is not required to enforce a release. This  
20 distinguishes releases from material otherwise covered by 2B-201 on the statute of frauds. While a release is a form of  
21 a license it is characterized by being a simple agreement not to sue, rather than a commercial transaction involving the  
22 variety of elements that are present in a commercial license, including any provision for taking steps by the licensor to  
23 make the information available to the licensee. The term "release" is defined in Section 1-102.

24 2. Subsection (b) relates to practices important in the entertainment and multimedia industries involving  
25 acquisitions of rights clearances relating to properties used in new works. The release or waiver does not relate to claims  
26 based on breach of contract, but refers to releases of intellectual property and similar rights. The section clarifies existing  
27 law concerning the enforceability of releases in fully executed form. This section provides that release of rights in a  
28 certain form is enforceable, but does not alter other existing law with respect to when releases are enforceable.

29  
30 **Illustration 1.** Film Co. is engaged in filming street scenes in New York City for inclusion in its  
31 newest video game. As is common practice, it posts conspicuous signs on the sidewalk informing  
32 people that the filming is occurring and indicating that, if they are filmed, their voluntary participation  
33 constitutes a release of intellectual property rights in the use of the film (e.g., rights of publicity). The  
34 ~~effectiveness of this release is governed by this Section in that the conduct of voluntary participation~~  
35 ~~manifests assent to the record (the sign).~~ As clarified in the text, this section also does not preclude  
36 enforceability under other law such as estoppel or, even, traditional offer and acceptance theory.

37  
38 **Illustration 2.** Goods operates a website. The first page of the site states that the user can  
39 download and use a copy of the art work by printing it. Wilson charges for access to the website,  
40 but not for downloading. Is the release or grant effective? There would be two analyses that would  
41 yield an enforceable waiver or grant of a right here. One could conclude that the term giving the  
42 right to download was an agreed part of the access contract, although there was no procedure for  
43 manifesting assent to the term. Alternatively, under this section, the release of the right to control  
44 the making of copies is enforceable since the screen is a record to which the provider manifested  
45 assent by making available to other parties, or other law supports enforceability (e.g., estoppel).  
46



3. 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.

4. This section applies to releases that occur in common “chat room” and “list service” activities on the Internet. In these situations, it is common to indicate that participation in the service implicitly 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 the existence of assent to the record containing the release terms.

**Illustration 3.** West operates an on-line chat room. It uses some of the comments placed on line in its monthly newsletter. The first time an individual joins the chat room, the screen displays a legend stating that: “By participating in this on-line conversation, you grant West the right to use your comments as edited in subsequent publications in any media. By joining the conversation, under this section, the participant releases its rights in its copyright comments for the purposes stated. Subsection (b) eliminates the need for consideration if the release is in arecord agreed or manifested assent to by the party. Here, the act of participating constitutes manifesting assent if the release language was prominent and called the the party’s attention.

## PART 3

## CONSTRUCTION

**[A. General]**

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

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

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

**Uniform Law Source: Section 2A-202; Section 2-202.**

**Committee Votes and Action:**

- a. The Committee voted 11-0 to adopt a motion to strike provisions suggesting presumptions in reference to merger clauses and, in effect, return to the Article 2 rule under current law, but not the proposed revision.
- b. Reviewed in April 1997 without substantive comment.

### Reporter's Notes:

1. This Draft generally corresponds to current Article 2.

1           2.       UNIDROIT Principles of International Commercial Contract Law provide that a: “contract in writing  
2 which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed  
3 cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or  
4 agreements may be used to interpret the writing.” Art. 2.17.  
5

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

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

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

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

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

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

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

21 **UNIFORM LAW SOURCE: Section 2A-207; Section 2-208; Section 1-205. Revised.**

22 **Committee Vote:**

- 23           a.       The Committee voted unanimously to adopt this section. (September, 1996)  
24           b.       Reviewed without substantive comment in April, 1997.  
25

26           **SECTION 2B-303. MODIFICATION AND RESCISSION.**

27           (a) An agreement modifying a contract is binding without consideration.

28           (b) An agreement that contains a term that excludes modification or rescission except by

1 a record authenticated by the party to be bound may not otherwise be modified or rescinded.  
2 However, in a ~~consumer contract represented in a~~ standard form supplied by a merchant to a  
3 consumer, a term requiring an authenticated record for modification of the contract is not  
4 enforceable unless the consumer manifests assent to the term.

5 (c) An attempted modification or rescission that does not satisfy the requirements of  
6 subsection (b) may operate as a waiver.

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

8 **Committee Vote:**

- 9 a. The Committee voted 12-1 to approve the section and the use of manifest assent.  
10 b. The Committee voted to retain the reference to consumer, rather than mass market. (11-1) (Feb. 1997).  
11 c. The Committee rejected a motion to make a “no oral modification” clause unenforceable in a consumer  
12 transaction. (1-10) (April, 1997).

13 **Reporter’s Notes:**

- 14 1. The Section generally parallels current law. In subsection (b), Article 2 and Article 2A require no oral  
15 modification terms to be signed by the consumer; that concept appears here in the form of a requirement of manifestation  
16 of assent to the term, rather than signature. This allows the concept to operate in electronic environments where  
17 signatures / authentication is not feasible, while still providing protection in the form of binding the consumer only to  
18 terms where the consumer affirmatively and specifically adopted.  
19 2. This section does not, of course, create a statute of frauds rule. Rather, it confirms that, if the  
20 agreement of the parties limits enforceability to modifications that are in a record, that agreement will be enforced. The  
21 rule is especially important in the on-going relationships that characterize many commercial licenses and development  
22 contracts.

23  
24 **SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.**

25 (a) Terms of an agreement involving repeated performances apply to all later  
26 performances ~~of the parties, their agents, or their designees~~ unless modified pursuant to this  
27 article, even if the terms are not subsequently displayed or otherwise brought to the attention of  
28 the parties or electronic agents in the context of the later performance.

29 (b) ~~A modification in good faith of a continuing contract made pursuant to~~ If a term in a  
30 contract ~~involving repeated performances provides~~ that the contract may be modified as to  
31 future performances by compliance with a described contractual procedure, ~~a modification made~~  
32 ~~in good faith pursuant to that procedure~~ is effective if:

(1) compliance with the procedure reasonably notifies the other party of the change a reasonable time before the change becomes effective; and

(2) in a mass-market license, the procedure permits the licensee to terminate ~~withdraw from~~ the contract if the modified term is material and are in good faith unacceptable and constitute a material change adverse to the licensee.

(c) A contractual term that specifies standards for reasonable notification is enforceable unless the standards are manifestly unreasonable in light of the commercial circumstances.

UNIFORM LAW SOURCE: None

COMMITTEE ACTION:

a. Voted 11-2 to extend protections to the mass market, rather than only to consumers.

b. Voted to delete limitation in former (b)(2) that the change in fact be materially adverse to the mass market licensee and substitute "unacceptable in good faith." (7-5) (April, 1997)

REPORTER'S NOTES:

[Subsection (b)(1) was modified to allow a court to decide what is reasonable timing of notification to accommodate potential emergency or other situations where prior notice is neither necessary nor possible. See 12 CFR 205.8(a)(2) as an example. In mass market transactions, for changes in material terms, there must be an option to withdraw if the party in good faith views the change as unacceptable. On this point, the Committee voted to delete language requiring that the change in fact be materially adverse to the withdrawing party in lieu of a rule focused on good faith.]

1. Subsection (a) deals with a simple principle that contract terms, if enforceable, cover all forms of contractual performance. In the language of the section, they are continuing in nature and need not be repeated on each use of a system. This does not refer solely to cases where the agreement requires future performances. The principle stated here is applicable in any case where the subsequent performances are covered by the prior agreement. Thus, for example, a purchase of an item of information pursuant to an agreement at one time would not mean that the terms flow to subsequent performances. However, if the first agreement specifies that it applies to the first and to all or any subsequent purchases, this rule applies and that provision is effective.

2. Subsection (b) addresses a common practice in online or other continuing service contracts in which changes in service conditions occur by posting on the service from time to time. Subsection (b) provides one method for contractual modification procedures. It serves as a safe harbor, indicating that methods that comply with this are enforceable, without indicating that other methods are not available. See Section 2B-115 (c). The general idea of modification of a contract is noted in Section 2B-303 and the related common law and U.C.C. developments with respect to modifications. For example, under 2B-303, consideration is not required to modify an existing contract. What constitutes an effective modification may generally hinge on concepts of agreement and assent. Thus, for example, a signed modification would be effective. Similarly, some types of changes may not require even the procedural protections indicated here. For example, even in a fixed term loan and mortgage that are not subject to termination federal law allows unilateral changes in consumer contracts if the changes meet any of several criteria, including that they unequivocally benefit the consumer or make an "insignificant change" to the contract terms. 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. The safe harbor in subsection (b) requires a contractual authorization of a modification procedure and that the procedure entail notification of the other party. In addition, in mass market transactions, for changes in material terms, there must be an option to withdraw if the party in good faith views the change as unacceptable. On this point, the Committee voted to delete a concept of requiring that the change in fact be materially adverse to the withdrawing party in lieu of a rule focused on good faith.

1           **4.**       This subsection deals with changes in contract terms and does not cover changes in the content made  
2 available under an access contract, such as a multifaceted database. Under subsection 2B-614(a), an access contract grants  
3 rights of access to materials **as changed and modified** by the licensor over time. Thus, unless an express contract term  
4 provides otherwise, a decision to add, modify, or delete an element of the databases made available does not modify the  
5 contract, but merely constitutes performance by the licensor and is not within this subsection.

6           **5.**       What constitutes notification varies depending on the circumstances. In many cases, reasonable  
7 notification requires notification before the change is effect, but in some emergency situations, notice that coincides with  
8 the change or follows the change would be sufficient (e.g., a block of access to a virus infected site, or a change in the  
9 length or nature of the access codes required for access). The standard requires that the part be notified of the change.  
10 A procedure for the posting of changes in an accessible location of which the other party is aware will ordinarily satisfy  
11 the terms of this section. In consumer contracts, a further protection involves the requirement that the consumer be  
12 allowed to withdraw from the contract (e.g., terminate it) if it in good faith disagrees with the changed terms. Withdrawal  
13 is without penalty, but the mass market licensee must, of course, perform the contract to the date of withdrawal (e.g., pay  
14 all sums due at that time).

## 15 16           **SECTION 2B-305. OPEN TERMS.**

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

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

23           (c) If a term of an agreement is to be specified by a party, the following rules apply:

24                   (1) Specification must be made in good faith.

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

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

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

30           (d) An agreement that provides that the performance of one party be to the satisfaction or  
31 approval of the other requires performance sufficient to satisfy a reasonable person in the

position of the party who must be satisfied~~whose satisfaction must be met~~. However, the agreement requires performance to the subjective satisfaction of the other party to the extent:

(1) the performance is the creation or delivery of informational content in a context in which content is evaluated in reference to aesthetics, marketability, appeal, suitability to taste, or similar characteristics; or

(2) the agreement expressly provides that the performance is to be judged in the “sole discretion” of the party, or words of similar import.

(e) If a term is to be fixed by agreement and the parties intend not to be bound unless the term is fixed or agreed to, a contract is not formed if the term is not fixed or agreed to. In that case, each party shall return or, with the consent of the other party, destroy all copies of information and other materials already received or, if unable to do so, pay the to the other party compensation for the benefit received from information that cannot be returned or destroyed. The licensor shall return any portion of the contract fee paid ~~on account~~ for which performance has not been received and retained by the licensee. The parties remain bound with respect to any obligation of confidentiality, or similar obligations, to which the parties have agreed.

**Uniform Law Source: Section 2-305; Section 2-311. Revised.**

**Reporter’s Notes:**

1. Subsection (a) through (c) bring together several rules relating to open terms under current law.
2. Subsection (d) pulls out cases where performance is to be to the satisfaction of the other party. Here, two different approaches reflect different traditions and case law in the industries affected by Article 2B and differences in qualitative standards that are appropriate to the commercial relationships. The factor that distinguishes these industries is that many of the information products that they obtain entail judgments about aesthetics and marketability, leaving it important that the judgment of the licensee be unfettered. 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.
4. 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 (d) attempts to provide guidance for determining when the subjective standard is appropriate for informational content performances.
5. Subsection (d) provides safe harbor language.
6. Subsection (e) deals with situations in which the parties agreement contains an element requiring

1 further agreement to a term. This section derives from 2-305. The relevant policy is that, in the case of a failed  
2 agreement, the parties must be placed into the same position as that would have been without the tentative steps toward  
3 agreement having occurred and that no party should retain a benefit for which it has not paid. Subsection (e) permits  
4 destruction of copies of the information and other materials in lieu of returning them. In the context of goods, return of  
5 the tangible items is essential to place the parties back into the position that they were before the tentative agreement.  
6 In reference to information, in most cases at least, the party having transferred the information retains copies of it. The  
7 option of destroying the copies is subject to the consent of the other party to cover the case in which recovery of the  
8 information by the original transferor would be difficult or costly.  
9

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

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

17 (b) An agreement for exclusive dealing imposes an obligation on a licensor that is the  
18 exclusive supplier to use good faith ~~reasonable commercial~~ efforts to supply, and on a licensee  
19 that is the exclusive distributor to use good faith ~~reasonable commercial~~ efforts to promote, the  
20 information or product commercially.

21 **Uniform Statutory Source: Section 2-306.**

### 22 **Committee Vote:**

23 1. Voted unanimously to approve the section in principle, but to consider changes in the idea of best  
24 efforts, either in definition or by shifting to a “reasonable commercial efforts” standard. (Oct. 1996)

### 25 **Reporter's Notes:**

26 [After extended discussion of the standard to be used in subsection (b), no clear resolution was reached combining the  
27 various industry approaches. The basic choice was between reasonable commercial efforts and good faith. As indicated  
28 during the April meeting, the Reporter reviewed the possibility of employing a business judgment standard, but that was  
29 rejected for several reasons, including questions about with reference to which business and about how corporate law  
30 decisions deal with conflicting interests arising from having two products of similar type. The approach suggested here  
31 relies on a good faith standard - honesty in fact and adherence to commercial standards of fair dealing.]

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

38 2. Subsection (b) accommodates the various bodies of law that pertain to exclusive dealing relationships

1 in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for  
2 resale by the other party. Article 2 and case law dealing with patent licensing create a best efforts default rule. That rule,  
3 however, is not the law in other fields governed by Article 2B and, in any event, uses a standard that has been difficult  
4 if not impossible to define with reliability. The standard here is more consistent with publishing and similar industries:  
5 it allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context  
6 in the atypical case where the contract is silent on the issue.

## 8 [B. Forms]

### 9 SECTION 2B-307. ADOPTING TERMS OF RECORDS.

10 (a) ~~Except as otherwise provided in Sections 2B-308 and 2B-309,~~ If a party adopts the  
11 terms of a record, including a record that is a standard form, the terms of the record become  
12 terms of the contract.

13 (b) Except as otherwise provided in Sections 2B-308 and 2B-309, a party adopts the  
14 terms of a record if the party agrees, including by manifesting ~~to or manifests~~ assent, to the  
15 record before or in connection with the initial performance, use of or access to the information. ~~If~~  
16 ~~agreement or assent does not occur by that time but~~ If the parties commence performance or use  
17 the information with the expectation that their agreement will be represented in whole or in part  
18 by a record that the party has not yet had an opportunity to review or that has not yet been  
19 completed, a party adopts the terms of the later record if the party agrees to or manifests assent to  
20 that record.

21 (cb) A term adopted under subsection (ba) becomes part of the contract without regard to  
22 the knowledge or understanding of the individual term by the party adopting the record and  
23 whether or not the party read the record.

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

27 **Uniform Law Sources:** Restatement (Second) of Contracts 211.



1 **Committee Votes:**

- 2       **a.**       Rejected a motion to add retention of benefits as manifesting assent.  
3       **b.**       Rejected a motion to make specific reference to excluding terms that are unconscionable in addition  
4 to general exclusion under section 2B-109. (September, 1996)  
5       **c.**       Consensus to expand the section to cover all records, rather than merely standard forms, provided that  
6 it be made clear that standard forms are covered. (September, 1996)

7 **Reporter's Notes:**

8 [Rewritten for clarity on the distinction between adopting a record and creating a contract, but no substantive changes  
9 have been made.]

10       **1.**       Article 2B deals with standard form records in three separate sections. This Section and 2B-308 deal  
11 with standard forms in “single form” cases. Section 2B-309 deals with cases involving an exchange of conflicting forms.  
12 These sections do not address whether a contract exists. If no contract is formed under other provisions of this Article,  
13 the sections are not applicable. What is addressed here is, given an agreement, what are the relevant terms.

14       **2.**       In single form cases, a balance is implemented involving two elements. The **first**, contained in this  
15 section, solidifies the enforceability of standard forms in commercial deals. This confirms an important aspect of  
16 commercial law. The principle, already followed in the vast majority of modern commercial case law, flows from the  
17 belief that in the absence of fraud, unconscionable or similar conduct, commercial parties are bound by the writings to  
18 which they assent, without being able to later claim surprise or a failure to read the language presented to them. Assent  
19 is not conditional on the party actually reading the terms. The **second** is that, in consumer or mass market transactions,  
20 protections can be created altering the idea that a party is bound by the entire form to which it assents in a way the  
21 accommodates the possibility of unfair surprise. This counterbalance arises in 2B-308 with reference to mass market  
22 contracts. That Section adopts the approach of the Restatement (Second) of Contracts’ 211, which creates a limited basis  
23 to argue that a term in a record to which the party assents may have been so surprising that it should not be enforced  
24 unless called to that person’s attention. The Restatement rule is seldom applied to commercial contracts not involving  
25 insurance policies, and has been adopted fewer than ten states. Other states use concepts of fraud, unconscionability,  
26 bad faith and similar devices to police, in a limited way to preclude serious cases of abuse.

27       **3.**       This section applies the principle of enforceability to all commercial records. A party is bound by a  
28 record if it agrees to the record or if it manifests assent to the record. Given the definition of manifesting assent, this  
29 gives three ways of establishing that a record is binding. The most restrictive is “manifested assent.” This concept focuses  
30 on objective manifestations of assent and adopts procedural safeguards allowing the party bound by the standard form  
31 an opportunity to review terms and to reject the contract if the terms are not acceptable. The two safeguards are in the  
32 concept of “opportunity to review” (see 2B-114) and “manifests assent” (see 2B-113). A party cannot manifest assent  
33 to a form or a provision of a form unless it has had an opportunity to review that form before being asked to react. Except  
34 in contract modifications, an opportunity to review does not occur unless the party has a right to return the subject matter,  
35 refuse the contract, and obtain a refund of fees already paid (if any). The second theme involves signing the record  
36 (authentication). Historically, this has been sufficient to show assent. Third, there is the possibility of “agreement to the  
37 record.” This is more subjective and deals with the entire context. A party in a context covered by this section would  
38 generally prefer to construct its transaction to fall within the either of the other provisions.

39       **4.**       Subsection (b) rejects the idea that a contract and all of its terms must be formed at a single point in  
40 time. Case law adopts a more fluid conception of the process of contracting, where parties define the agreement over a  
41 period of time that is not constrained to an instantaneous “closing” in most cases. See, e.g., Carnival Cruise Lines, Inc.  
42 v. Shute, 111 S.Ct. 1522 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7<sup>th</sup> Cir. 1997). As a consequence, terms  
43 can be created by agreement or assent after beginning performance. Thus, in the entertainment industry and in many  
44 development contracts, contract terms are developed and drafted **while** performance occurs, not before performance  
45 begins. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until  
46 one is fully drafted. This section accommodates that process.

47       **5.**       Subsection (d) simply clarifies that assent or agreement do not over-ride statutory requirements that  
48 a term be conspicuous or that there be assent to the particular term.

49  
50 **SECTION 2B-308. MASS-MARKET LICENSES.**

51 (a) Except as otherwise provided in this section and Section 2B-309, a party adopts the

1 terms of a mass-market license if the party agrees, including by manifesting ~~or manifests~~ assent,  
2 to the mass-market license before or in connection with the initial performance, use of or access  
3 to the information.

4 (b) Terms adopted under subsection (a) include all of the terms of the license without  
5 regard to the knowledge or understanding of individual terms by the party assenting to the form.  
6 However, except as otherwise provided in this section, a term [for which there was no  
7 opportunity to review before payment of the contract fee is not adopted and] does not become  
8 part of the contract if the term creates an obligation or imposes a limitation that:

9 (1) the party proposing the form should know would cause an ordinary reasonable  
10 person acquiring this type of information in the mass market to refuse the license if that party  
11 knew that the license contained the particular term; or

12 (2) conflicts with the negotiated terms of agreement.

13 (c) A term described under subsection (b) is part of the contract if the party that did not  
14 prepare the form manifests assent to the term.

15 (d) Subsection (b)(1) does not apply to a term that:

16 (1) states a limit on the licensee's use of the information that would exist under  
17 intellectual property law in the absence of the contractual term;

18 (2) was disclosed in compliance with any federal or state regulation; or

19 (3) becomes part of the contract under other provisions of this article.

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

23 (f) In a mass-market transaction, unless otherwise agreed, an obligation or limitation that

was reasonably disclosed; on the product packaging or otherwise, before payment of the license fee, or that was part of the product description, becomes part of the contract without manifestation of assent to a license or to a term containing the obligation or limitation.

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

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

**Votes:**

- a. During Article 2 discussion at the annual meeting in 1996, a motion to delete special treatment there for consumer was defeated based in part on Article 2 Drafting Committee assurances that Article 2 would use an **objective** test.
- b. The Drafting Committee adopted by a vote of 10-1 a motion to delete the reference to terms consistent with "customary industry practice."
- c. The Drafting Committee adopted by a vote of 12-0 a motion to delete a safe harbor for terms giving no less rights than under a first sale.
- d. The Drafting Committee voted 12-0 to support an approach (b) that focuses on the perspective of the party proposing the form.
- e. The Committee rejected a motion to adopt ABA proposal to substitute refusal term concept with an affirmative, expanded refund right that covers cost of return and return of system to original state. Vote: 2- 6 (April, 1997)
- f. The Committee failed to adopt a motion to add the expanded refund right and restrict the refusal term concept to consumer transactions. Vote: 5 - 5 (April, 1997)
- g. The Committee rejected a motion to limit the section to consumer licenses. Vote: 2 - 8 (April, 1997).

**Selected Issue:**

- a. Should the Committee reconsider the question of restricting the refusal term concept to consumers with a refund provision for others where contract reached after payment?

**Reporter's Notes:**

[Subsection (d)(2) was added to respond to an issue raised by the letter from Citibank regarding scope. It provides that compliance with applicable state or federal regulation is adequate to avoid treatment as a refusal term under (b)(1). Where a specific decision is made by regulators to mandate and enable particular disclosure rules, the general standards of this section should not create an entirely separate compliance regime.]

**1.** This Section deals with mass market licenses and states an exception to the general rule of validation found in Section 2B-307. The exception, described primarily in subsection (b), invalidates some terms in a mass market form if there was no manifestation of assent to the form or if the terms are such that the party proposing the form should know would cause a refusal of the license by the licensee.

In modern practice, mass market licenses occur in several different formats which differ in part based on the extent to which the licensor (typically the publisher of the software) deals directly with the licensee (end user). In some cases, there is direct contact and the license represents no more than a particular application of general standard form practice. In other cases, the license arise on-line in an access contract where the initial screens presented to the licensee request assent to the license before use of the resource. Again, except for the automated nature of the contracting, this up-front use of a form is analogous to ordinary contracting. An additional framework involves forms presented after the licensee obtains the software from a retailer. In that case, the form establishes a relationship between the publisher and the end user. That relationship, which may be central to the licensee's right to use the software, did not arise in the retail transaction. Under this Article, the post-payment terms cannot be made enforceable unless the licensee has a right to a refund if it rejects the proposed agreement. This format include so-called "shrink-wrap" licenses.

1 This section will typically not apply to transactions involving information provided in separate units pursuant  
2 to an overall agreement between the licensor and the licensee. Such agreements are not part of a retail marketplace and,  
3 thus, would not fall within the definition of mass market transaction. They would be governed under the general rules  
4 of this Article.

5 2. Subsection (a) states the principle announced in the Restatement (Second) and followed in 2B-307 that  
6 by authenticating or manifesting assent to a standard form record, a party adopts the terms of that record. Unlike  
7 common law which leaves the idea of assent undefined, this Article places significant restrictions procedurally on the  
8 idea of manifesting assent. These restrictions ensure that the record be available for review and that the assenting party  
9 make some affirmative indication of assent. Compare Hill v. Gateway 2000, Inc., 1997 WL 2809 (7<sup>th</sup> Cir. 1997) (assent  
10 to a form based on failure to object within thirty days sufficient to allow enforcement of arbitration clause contained in  
11 that form). See also Proposed Revisions of Article 2, 2-404 (remote party warranties and disclaimers are enforceable  
12 if included in package or on label). In light of the nature of mass market transactions, the timing in which the form can  
13 be made effective is limited to no later than the initial use of the information.

14 3. Subsection (a) requires manifestation of assent to the form. Its impact is limited by subsection (b). It  
15 is also shaped by the existence of other mechanisms that create terms in an agreement. One of these is described in  
16 subsection (g). That subsection clarifies that information about a product disclosed on packaging or otherwise or part  
17 of the product description itself, become part of the deal in a mass market transaction without there being a need to obtain  
18 manifested assent to a standard form. This clarifies the point that the standard form and the manifesting assent  
19 requirements are not the exclusive methods of defining the agreement in this marketplace, or indeed, in any other market.

20 3. This section deals with single-form cases. In that situation, case law generally affirms the  
21 enforceability of forms. With respect to single form cases, no appellate case law rejects the contract-based enforceability  
22 of the forms and recent cases support it. See Hill v. Gateway 2000, Inc., 1997 WL 2809 (7<sup>th</sup> Cir. 1997); ProCD, Inc. v.  
23 Zeidenberg, 86 F.3d 1447 (7<sup>th</sup> Cir. 1996); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz.  
24 1993). Compare Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5<sup>th</sup> 1988) (applying a preemption analysis to statute  
25 validating a particular term after the lower court held otherwise the contract was invalid as a contract of adhesion; the  
26 appellate court did not address the contractual enforceability issue). Case law is less clear in the conflicting forms setting  
27 where, as in Section 2B-309 of this article, the presence of differing terms creates questions about assent to either form.  
28 See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir.1991); Arizona Retail Systems, Inc. v.  
29 Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). These cases do not contest the underlying enforceability of standard  
30 forms, but deal with conflicting terms. See Douglas G. Baird & Robert Weisberg, Rules, Standards, and the Battle of the  
31 Forms: A Reassessment of '2-207, 68 Va. L.Rev. 1217, 1227-31 (1982).

32 4. Subsection (b) places two general restrictions on the enforceability of terms in the mass market license.  
33 These are, of course, in addition to the generally applicable UCC rules regarding unconscionable contracts and the  
34 requirement of good faith. Both statutory restrictions aim at preventing the creation of terms that contradict the basics  
35 of the agreement without giving the licensee fair notice of their inclusion. The bracketed language in (b) raises a question  
36 about whether the exclusionary terms should be limited to cases where the form was not made available to the licensee  
37 until after it paid the purchase price. This would be the “classic” shrink wrap case where, unlike in the case of forms  
38 assented to at the outset of the transaction, some arguments can be made about the equities in allowing terms to arise after  
39 the initial retail acquisition. In most shrink wrap cases, of course, the license is not an amendment of the agreement  
40 between the retailer and the end user, but the creation of a relationship between the end user and the publisher or  
41 copyright owner. In this Article, under Section 2B-616, the retailer’s contract is independent of the terms of the  
42 publisher’s contract with the end user (including disclaimers and the like). Article 2 revisions deal with this third party  
43 relationship by validating so-called “warranties in a box” regardless of assent by the consumer and independent of  
44 exclusion of refusal terms.

45 5. Subsection (b)(2) disallows terms in the license that conflict with prior, negotiated terms of the  
46 agreement.

47 6. Subsection (b)(1) invalidates “refusal” terms unless, pursuant to subsection (c), those terms are called  
48 out to the attention of the end user and assented to by that party. “Refusal terms” are terms that the proposing party has  
49 reason to know would cause a refusal of the license if the licensee were aware of the terms. This subsection creates what,  
50 in most states, is a significant expansion of protection for consumers and, for businesses who make contracts in the “mass  
51 market.” The section in part adopts principles of the Restatement (Second) of Contracts ' 211. Since the Restatement  
52 test has been adopted in relatively few states for transactions that do not involve insurance agreements, this substantially

1 expands licensee protection as contrasted to current law.

2       7. Subsection (b) parallels the Restatement, but does not adopt the broad interpretation that some courts  
3 have placed on that rule. Some courts have confused the Restatement approach with a general authorization to review  
4 the terms of a standard form to determine whether, in the view of the court, the contract term was within the reasonable  
5 expectations of the recipient of the form and, ultimately, whether the term was appropriate in the context of the deal as  
6 viewed by the court. This, in effect, allows a court to rewrite the deal of the parties by excluding terms it thinks are not  
7 reasonable. This broad approach reflects case law in a number of states dealing with insurance contracts, but is neither  
8 appropriate in this commercial context, nor consistent with the language of the Restatement, the apparent intent of the  
9 developers of the Restatement, or the language of this section. As applied outside of the arena of insurance contracts and  
10 divorced from the insurance law concepts that influence the test in that setting, a broad “reasonable expectations” test  
11 finds little support and is rejected here.

12       The Restatement comments indicate that a recipient of a form does not adhere to terms if the form provider had  
13 reason to believe that the recipient would not accept the agreement if it knew the term was present. While this monitors  
14 against unexpected terms that are outside reasonable expectations, it only does so from the perspective of the proposing  
15 party. The comments also say that:

16               Reason to believe may be inferred from the fact that the term is bizarre or oppressive, from the fact that it  
17 eviscerates the nonstandard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose  
18 of the transaction. The inference is reinforced if the adhering party never had a opportunity to read the term,  
19 or if it is illegible or otherwise hidden from view. Comment f.

20  
21  
22 In addition to these themes, some cases emphasize that a term hidden in a form can be invalidated if it takes away or  
23 contradicts affirmative expectations created by the vendor in a deal that are basic to the value of the bargain for the other  
24 party.

25       It is in the more narrow, refusal term sense that the test is meant.

26       8. Subsection (b) (1) modifies the Restatement approach in several ways. A major difference is that, in  
27 light of the mass market context, this Draft focuses on the perspective of the party proposing the form with respect to  
28 an **ordinary** user of the information. The Restatement permits a reference to the perception of the party proposing the  
29 form as to the reactions of the **recipient**, and courts applying the test conflict in their treatment of this issue. In the mass  
30 market, the assumption of a one to one relationship creating an individualized perception would be unrealistic.

31       Subsection (b)(1) expressly connects the nature of the term to the refusal of the entire deal. The issue presented  
32 is not whether a term would fall within general expectation, but whether the vendor has reason to know that the term  
33 would be a “deal breaker” in that it would so contradict the terms of the transaction or create oppressive conditions that  
34 would cause refusal of the proposed deal itself and in full.

35       As in the Restatement, subsection (b)(1) refers to the perspective of the party proposing the form, not to whether  
36 the form is within the expectations of the individual recipient. A review of reported cases on this point under the  
37 Restatement indicates that the insurance law concepts have affected judicial treatment of the Restatement and that not  
38 all courts concentrate on the form provider’s reason to know. The test as proposed here does not adopt the reasoning of  
39 those cases.

40       9. Subsection (c) allows terms that would otherwise be excluded to become part of the contract if the party  
41 manifests assent to the term. At the heart of the Restatement test and of the approach adopted here is the idea that  
42 unknown terms require some closer monitoring to avoid surprising and oppressive terms. If the party is made aware of  
43 and assents to the term, there is no room for argument about whether the term was unknown to it. This does not create  
44 a mere formality, but rebuts a basic element of the exclusionary standard. By disallowing “refusal terms” the intent is  
45 not to invalidate terms known and assented to by the licensee. Subsection (c) allows the proposing party to call the terms  
46 to the licensee’s attention explicitly and, thereby, eliminate the argument that a term was an unknown refusal term.  
47 Basically, if a party desires to use terms in its mass market forms that are possibly within the exclusion, and does not wish  
48 to risk unenforceability, that licensor must structure the transaction to obtain assent by the licensee to the particular term.  
49 This requires that the term be called to the licensee’s attention and assent obtained by signing or an action related to that  
50 term. The structure adopted here not only attempts to balance the interests of licensor and licensee, it also attempts to  
51 create a structure in which transactions can occur. This is not a litigation standard, but an approach that says to the  
52 licensor: if you wish to impose a bizarre term, the only safe procedure you can adopt entails one in which that term is

brought to the licensee's attention and assented to by the licensee.

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

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

**Illustration 3:** In the foregoing transaction, assume that the license provides that the licensee indemnifies the licensor for any claims based on the licensor's infringement of third party copyrights. Is this clause included in the agreement for the word processing program? No. This indemnity would be unusual and most likely a refusal condition in the mass market although, in some commercial markets, it may be an ordinary clause.

**10.** Subsection (d) describes situations in which the exclusionary test of subsection (b) does not apply. The first states that a term stating limits that would exist under intellectual property law are not refusal terms and do not fall within the provisions of subsection (b)(1). The section does not validate specific terms or go outside the scope of what rights the licensor would have under copyright and patent (including any limitations on those rights under federal law or policy). The intent is to validate contract terms that merely implement a copyright owner's exclusive rights and reflect conditions already established by federal property law. The second exception is also present in some drafts of revised Article 2 and applies to a term which comes into the contract under other provisions of the Article. The primary application of this lies in use of conspicuous terms. A conspicuous disclaimer that conforms to rules on disclaimers cannot be avoided under this section as a refusal term, nor could a conspicuous term limiting damages. The more specific treatment governs. Disclaimers and ordinary remedy limitations, of course, would not be refusal terms pursuant to the standards of this section in any event.

**11.** Subsection (e) states the obvious corollary to the fact that terms conforming to this article are not to be excluded under (b). It indicates that terms that do not comply with other provisions of this article are not part of the terms adopted by the assenting party.

## **SECTION 2B-309. CONFLICTING TERMS.**

(a) If an ~~the parties to an~~ agreement is formed, and the parties exchange standard forms before or after the agreement that purport to contain terms of the agreement and the forms contain varying standard terms, the following rules apply:

1 (1) If a party proposes a standard form containing language that conditions assent  
2 on agreement to its terms and ~~states that the party does not intend to be bound unless the other~~  
3 ~~party agrees to the terms in its form and the conduct of the party proposing the conditions are at~~  
4 ~~form is enforceable under Section 2B-205, consistent with the stated conditions,~~ the terms of that  
5 form govern if the other party by language or conduct agrees to the form.

6 (2) In all other cases, terms on which the forms coincide~~agree~~ become part of the  
7 contract, but conflicting standard terms are not part of the contract unless the party claiming  
8 inclusion establishes that the other party manifested assent to the term or the records of both  
9 parties agree in substance with respect to the term.

10 (3) If a standard form of one party deals with a term, silence of the other standard  
11 form on the subject is not a conflicting term. If the standard forms of the parties agree in part, but  
12 disagree in part on a subject matter [the terms are in conflict as to the entire subject] [the terms  
13 are in conflict only as to the point of disagreement].

14 (b) Subject to subsections (c) and (d), in cases governed by subsection (a)(2), the terms  
15 of the contract are:

16 (1) terms agreed to by the parties;

17 (2) terms included under subsection (a)(2);

18 (3) terms of the licensor's standard form governing scope of a license; and

19 (4) supplementary terms included under this article.

20 (c) In the case of a conflict between terms included under subsection (b):

21 (1) terms under subsection (b)(1) govern as to all other terms;

22 (2) terms included under subsection (b)(2) govern terms under subsection (b)(3)

23 or (b)(4); and

(3) terms under subsection (b)(3) govern terms under (b)(4).

(d) ~~Contractual~~ Terms in a record authenticated by the party to be bound supersede the inclusion or exclusion of terms under subsection (a) or (b).

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

**Committee Votes:**

a. Consensus to strike or rewrite former subsection (c) (rewritten as subsection (b)(2)) to deal more effectively with terms that are basic to defining the product and, thus, not subject to the knock out rule.

b. Failed to adopt a motion that in the battle of forms the presumption should be no consequential damages apply. (4 - 4) (April, 1997)

**Reporter's Note:**

[Subsection (a)(1) was redrafted for clarity and for coordination with Section 2B-202 on contract formation. Note that, if behavior is consistent with the conditional form, the condition is enforceable and there may be no contract formed. Subsection (a)(2), which has not yet been reviewed by the Committee, proposes solutions for two problems involved in the idea of conflicting terms. The first sentence holds that silence in one form is not a conflict that triggers the knock out rule. The second proposes alternatives to solve cases of partial conflict. It would apply, for example, where one form provides "no consequential damages for either party" and the second form provides "no consequential damages for either party, except with respect to breach of confidentiality provisions." In one view, this is a complete conflict and both terms drop out (creating the unique result that both parties fail to exclude consequential damages for most risks. The other approach allows the point of agreement to be part of the contract, but creates a knock out rule with respect to confidentiality damages in that hypothetical.)]

1. This section deals with a limited, but significant problem: the limited case of two or more conflicting standard forms exchanged by the parties, the problem with which current UCC ' 2-207 deals. Broader interpretation problems involving exchanges of letters, E-mails and other communications are left to general contract law. This Draft assumes that a knock-out rule of interpretation is appropriate for an exchange of forms. This leaves those complex situations to ordinary contract interpretation rules.

2. The battle of forms deals with a situation where the parties exchange forms, but undertake a contract regardless of whether the forms agree. Where this is true, the section states simply that, if the parties did not negotiate or limit their conduct to reflect the form, law will not retroactively create a rule in which the standard form terms have greater significance for either party than was suggested by their behavior. In that respect, the section applies a "knock-out" rule; the parties are governed by the supplementary principles of this Act to the extent that their forms disagree. Discussing current 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.

3. This Section adopts a "knock out" rule which essentially excludes conflicting terms in the forms, regardless of which form was the first received or sent. The sole question here deals with what are the terms of the contract in the battle of forms. The creation of the contract comes under 2B-202 and 203.

**Illustration 1:** In response to a standard order form from DuPont, Developer ships software subject to a form. The two forms disagree on warranty terms. Under this rule, both warranty terms drop out. If Developer sends an E-mail or a letter objecting to the warranty terms, but goes ahead and ships without obtaining assent from DuPont to any change, determining what terms govern the contract poses a difficult, but ordinary contract interpretation issue inquiring into the intent of the parties, rather than an automatic knock-out rule. If Developer states its refusal to ship unless DuPont agrees to its warranty terms **and** in fact refuses to do so until DuPont agrees, the provisions of (a)(1) apply. If Developer sends a form conditioning shipment on acceptance of its terms, but nevertheless ships, subsection (a)(2) governs; the conflicting terms drop out.



1  
2       **4.**       In cases of two conflicting records, this section controls over the prior two sections on standard forms  
3 and mass market licenses which deal with cases involving only one standard form. Varying or conflicting terms are  
4 excluded unless a party manifests assent to a particular **term**. A party does not manifest assent by mere silence or  
5 retention of a record. Assent requires an affirmative act that reflects agreement to terms that the party had an opportunity  
6 to review and reject.  
7

8       **Illustration 2:** Licensor and licensee exchange standard forms relating to an acquisition of software.  
9 The terms conflict with respect to warranty. The conflicting terms drop out. The licensee does not  
10 obtain its term (full warranties) unless the other party assents to that term. Suppose that the Licensee  
11 form states that, by shipping this package, you consent to all of my terms and specifically to term 12  
12 on warranties. Does shipping the package assent to the term? No. The conduct does not relate to that  
13 term. The licensee would have to require initials on the term, telephone assent to the term, or other act  
14 clearly connected to the fact that the licensor knew of and assented to the term itself.  
15

16       **5.**       This section identifies three cases where a knock-out rule would be inappropriate even though the  
17 parties exchanged standard forms. The **first** involves a case (subsection (a)(1) where one party, by conduct **and** by its  
18 form, conditions its agreement to a contract on the other party's assent to its forms. Although a naked exchange of forms  
19 gives neither party priority, conditional offers or acceptances must be recognized and enforced when appropriate, even  
20 if made by a standard form. By matching the form with the behavior as required in subsection (a)(1), a party expressly  
21 takes the transaction outside the battle of forms by actually conditioning participation in the contract on agreement to the  
22 terms of its form. Often, when this occurs, there is no agreement between the parties unless the other party assents to the  
23 conditional offer. See 2B-202.  
24

25       **6.**       A **second** situation that takes the case out of the knock-out rule occurs when the parties execute an  
26 authenticated record. Authentication (signature) of a record supersedes the standard forms issue. The authenticated  
27 record can come before or after the exchange of forms. The basic theme is that an executed agreement better indicates  
28 intent and throws the case outside the knock out rule. Clearly, it would be a major change in law to regard a signed  
29 writing as being no different in substance that unsigned and conflicting forms. Consistent with this section courts should  
30 use general concepts of contract interpretation to discern the meaning of the contract incorporated in a signed record.  
31

32       **7.**       The **third** situation occurs when the **forms conflict about the scope of the license**. Scope is a defined  
33 term in 2B-102 that refers to terms restricting field of use, duration and similar terms that in effect define the nature of  
34 the information product being licensed. The mere fact that one form disagrees with the licensor's form on issues of scope  
35 cannot be held to throw the case back on general default rules. A vendor who provides a consumer version of software  
36 cannot be forced to have given an unlimited, license in the software for development and other use simply because a  
37 competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms  
38 define the product being sold (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware  
39 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  
40 basic points, the true issue is whether a contract exists (that is, was there agreement). A knock-out rule would expose  
41 intellectual property to the vagaries of conflicting forms.  
42

43       Taken together with the provisions on contract formation, the rule contemplated here involves inquiry about  
44 three issues in cases of conflicts on scope:  
45

46       (1) Did the parties actually reach an agreement or was one purchasing a Corvette while the other was  
47 selling a Ford? Under the general formation rules, disagreement about scope means that there is no contract. Thus, in this  
48 section, the reference to the licensor's scope provisions becomes an issue only if there was no disagreement about scope.  
49

50       (2) If an agreement exists, did the parties agree on scope and, if so, what agreement was reached? If  
51 there is an affirmative agreement on scope terms, that affirmative agreement governs and, pursuant to this section, the  
52 agreed terms take precedence over any terms in the forms of either party.  
53

54       (3) If a specific scope was not agreed to by the parties, what terms on scope are contained in the  
55 licensor's form? As this indicates, rather than giving dominance to the licensor's form per se, this treats the issue of  
56 scope as a central aspect of the relationship and uses the licensor's terms only after concluding that an agreement exists  
57 and that there was no specific understanding about scope. If the parties agreed on scope, that agreement prevails over  
58 the forms of either party.  
59

**Illustration 4.** Vendor offers two versions of its copyrighted directory and commentary relating to restaurants. One is a license for consumer use only at a price of \$50.00. The second, containing the same data and software is for commercial use, including the right to make commentary available in commercial publications. It is priced at \$10,000. Licensee sends a standard form which contains the provision that the software must be available for **all** uses, including commercial use. It orders one copy of the restaurant software. Vendor ships, using a standard form limiting use to **consumer** purposes. The vendor's scope limitation controls since there was no contrary negotiated term.

Disagreement on scope of the license often indicates a lack of agreement on what is being purchased. In this section, terms of a form that conflict with a negotiated agreement on scope do not control; the licensor's terms only control as against other non-negotiated terms.

### [C. Interpretation]

#### SECTION 2B-310. INTERPRETATION OF GRANT.

(a) A license grants all rights expressly described and all rights within the licensor's control during the duration of the license which are necessary to use the rights expressly granted in the ordinary course in the manner anticipated by the parties at the time of the agreement. A license contains an implied limitation that the licensee will not exceed the scope of the grant. Use of the information in a manner that was not expressly granted or ~~expressly withheld~~ exceeds this implied limitation unless ~~if~~ the use was ~~not~~ necessary to the granted uses ~~or~~ and would ~~not~~ otherwise be legally permitted in the absence of the implied limitation.

(b) A license ~~concerning digital information~~ which does not specify the number of simultaneous users permitted only authorizes ~~grants a right for~~ use by one party at any one time. However, if the license authorizes display or performance of the information, it permits ~~participation in or~~ viewing by any number of persons, but only ~~offer~~ for a single display or performance ~~or display~~ at any one time.

(c) Neither the licensor nor the licensee is entitled to any rights in improvements or modifications made by the other party after the license becomes enforceable~~[transfer]~~~~[activation]~~ of rights, or to receive source code, object code, schematics, master copy, or other design material, or other information used by the other party in creating, developing, or implementing

1 the information.- A licensor's agreement to provide updates to or new versions of information  
2 requires that the licensor provide only such updates or new versions that are developed by the  
3 licensor from time to time for use by third parties and made generally available unless the  
4 agreement otherwise expressly provides.

5 (d) In interpreting language of a license grant, the following rules apply:

6 (1) A grant ~~without qualification~~ of "all possible rights and media" in information,  
7 "all rights and media now known or later devised", or ~~a grant in~~ similar terms, includes all rights  
8 then existing or created by law in the future and all uses, media, modes of transmission, and  
9 methods of distribution or exhibition in all technologies or applications then existing or  
10 developed in the future, whether or not anticipated at the time of the grant.

11 (2) A grant of "all possible rights", "all rights now known or later devised", or  
12 similar terms, includes all rights then existing or created by law in the future, whether or not  
13 anticipated at the time of the grant.

14 (3) A grant of "all possible media", "all media now known or later devised", or  
15 similar terms, includes use in all media, modes of transmission, and methods of distribution in all  
16 technologies or applications then existing or developed in the future, whether or not anticipated  
17 at the time of the grant.

18 (42) In a contract between merchants, a grant of a "quitclaim" of rights, or a grant  
19 in similar terms, is a contract without implied warranties as to infringement or the rights actually  
20 possessed and transferred by the grantor.

21 (53) A grant that states that it is ~~of~~ an "exclusive license", or uses ~~a grant in~~ similar  
22 terms, conveys to the licensee exclusive rights in the information as against the licensor and all other  
23 persons to exercise the rights granted within the scope of the license and affirms that the licensor will

not grant rights in the same information within the same scope to any other party and has not previously done so in a license that is in force at the time of the contract.

**Reporter's Notes:**

1. This section reflects a significant reduction of the default rules contained in prior drafts.

2. The first sentence in subsection (a) covers a classic implied license dealing with rights necessary to achieve the purposes of the grant and with rights that may not have been expressly granted. For example, a license to use a film clip in a CD ROM product impliedly conveys the right to crop or modify the size of the clip to fit the media unless that is expressly excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to 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. Additionally, express contract terms precluding this treatment are effective.

4. The second and third sentences in subsection (a) deal with a highly important interpretation issue that is accentuated as information transactions become more common outside areas expert in intellectual property rules. Unless dealt with here, the interpretation issue creates a trap for unwary draftsmen. 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 "this use only" or otherwise expressly precludes the use. If the word "only" does not appear, the cases are less clear and some case law suggests that the omission of the word in formal grant language vitiates the contract claim. This concept is not universally followed and some federal policy holds that the proper interpretation is that any use not expressly granted is withheld.

Under the second and third sentences of (a), an affirmative grant of less than all rights impliedly excludes other uses that exceed the grant. The implied limitation, however, is not as strong as an express limitation. The implied limitation does not preclude acts that are necessary to achieve the uses contemplated in the express grant. Additionally, the implied limitation is not exceeded if the use would have been permitted by law in the absence of the implied limitation. Thus, a consumer (personal) use of a commercial license might be permitted if it would be a fair use (if it does not adversely impact the market for the work) and was not expressly precluded by the contract. However, if a grant is for use of a motion picture in one location but did not use the magic word "only" and the licensee uses the motion picture copy to make and distribute multiple copies for sale to home uses, that activity would violate the copyright (as a non-fair use) and breach the contract. The position that no implied limits are present creates a trap for the unwary licensor in that it contradicts normal contract interpretation ideals of viewing a contract in light of its commercial purpose. A grant to use software or a motion picture in Peoria implies the lack of a contract right to do so in Detroit.

**Illustration 1:** Disney licenses to Acme Theater the right "to show the movie 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 infringes the copyright. Whether it breaches the contract depends on whether the grant creates an implied limitation that precludes other uses of the work and derivative copies. Under section (b), the implied limitation exists unless the use was a fair use without that limitation or was necessary to the primary grant. Neither condition is met here. The fact that Disney forgot to add the word "only" to its grant language does not create a different result than would be explicit in the presence of that language.

**Illustration 2:** Licensor grants the "right to use its software in motion pictures." The licensee uses the software to develop and distribute an animated movie. Later, it uses the software to develop and distribute a television series. Assume that a television program is not within the idea of a motion picture. When sued for breach, if the rule is that uses outside the grant are not breaches of contract, the grant terms are inadequate to give the licensor rights in this case. If there is an implied limitation as proposed here, the issue is whether television use "exceeds" the grant. It should, under an appropriate test.

**Illustration 3:** Same as illustration 2, except that the license grant states that it grants "the right to use its software solely in motion pictures." Under this framework, use in television violates and express condition of the license 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-

1 counseled parties.

2 **Illustration 4:** Same as illustration 2, except that the license provides in addition to the grant that “all  
3 uses not expressly granted are expressly reserved to the licensor.” This is the same as Illustration 3.

4 **Illustration 5.** EXL licenses software to Dangerfield. The license is silent regarding reverse  
5 engineering and consumer use, but expressly gives Dangerfield the right to use the software in the  
6 1000 person network Dangerfield operates for its employees. Dangerfield reverse engineers the  
7 software to discover its interface with Digital Computer systems for purposes of making a new system.  
8 Also, a Dangerfield employee uses the software for personal (consumer) purposes. Under subsection  
9 (b), the consumer use is clearly authorized since it would be a fair use if the implied limitation were  
10 not present. The reverse engineering would also most likely be authorized under case law allowing  
11 reverse engineering if necessary to discover interoperability requirements.  
12

13 **4.** Subsection (b) states the presumption that, for copyrighted or patented material, an agreement restricts  
14 the licensee to a single simultaneous use. This is consistent with a basic principle that allows retention by a copyright  
15 owner of rights not expressly granted; it also covers practices in the general mass market context. While many  
16 commercial licenses involve site or multiple user licenses, this entails an express agreement that over-rides the default  
17 rule. The second sentence, however, recognizes that contracts for or involving display or performance rights center on  
18 the simultaneous number of performances, rather than on the number of users. Thus, for example, a transfer of a  
19 Nintendo computer game does not allow the making and simultaneous copying of multiple copies, but implicitly allows  
20 involvement by more than one person in reference to the performance.

21 **5.** The first clause of subsection (c) comes from prior 2B-311(d) which the Committee approved. The  
22 second clause comes from prior 2B-316 which was also approved. The basic principle is that no right to subsequent  
23 modifications made by the other party is presumed., nor is access to typically confidential material. Arrangements for  
24 improvements and source code or designs constitute a separate valuable part of the relationship handled by express  
25 contract terms, rather than presumed away from their owner by the simple fact of creating a contract.  
26

27 **Illustration 6:** Word Company licenses B to use Word's robotics software. The license is a four-  
28 year contract. Three months after the license is granted, Word develops an improved version of the  
29 software. Party B has no right to receive rights in this improved version unless the agreement  
30 expressly so provides.

31 **Illustration 7:** In the Word license, two years after the license is established, Party B's software  
32 engineers discover several modifications that greatly enhance its performance. Word is not entitled  
33 to rights in these modifications unless the license expressly so provides. However, the modifications  
34 may create a derivative work under copyright law and a question also exists about whether the license  
35 granted the right to make such a derivative work.  
36

37 The second sentence of subsection (c) is from former 2B-613 and provides a standard interpretation of an update agreement.

38 **6.** Subsection (d) (1) provides guidance for whether (when) a license grants rights only in existing media  
39 or methods of use of an intangible or whether it extends to future uses. The draft adopts the majority approach in a  
40 number of recent cases. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a  
41 fact sensitive interpretation issue. But the intent of the parties may not be ascertainable. In such cases, use of language  
42 that implies a broad scope for the grant without qualification should be sufficient to cover any and all future uses. This  
43 is subject to the other default rules in this chapter, including for example, the premise that the licensee does not receive  
44 any rights in enhancements made by the licensor unless the contract expressly so provides.

45 **7.** Subsection (d)(2) deals with how, in a commercial context, parties can transfer information without  
46 giving assurances about rights. The concept of a quitclaim of rights is most common in entertainment contexts, but like  
47 the idea of a quitclaim in real estate, it is essentially a grant only of whatever rights the grantor holds.

48 **8.** Subsection (d)(3) deals with the effect of language of exclusivity in a grant. The case law and treatises  
49 on this issue are in conflict. The issue focuses on two distinct elements: **a looking forward and looking backward issue**  
50 **about exclusivity as to other persons, and the issue of whether the exclusivity also applies to actions of the**  
51 **licensor. The Committee has not yet discussed this provision.**  
52

1  
2 **SECTION 2B-311. DURATION OF CONTRACT.** If an agreement is indefinite in

3 duration, the following rules apply:

4 (1) Except as provided in subsection (2), the duration is a reasonable time  
5 determined in light of the commercial circumstances unless this article or other law provides for  
6 a different term.

7 (2) If the agreement provides for the sale or physical delivery of a tangible copy  
8 and neither party is required to render on-going affirmative performances to the other party after  
9 delivery, the duration of a license as to that copy is perpetual subject to cancellation for breach.

10 (3) In an agreement governed by paragraph (1) in which a party is required to  
11 render on-going affirmative performances to the other party, the agreement may be terminated at  
12 will on reasonable notice by either party.

13 **Uniform Law Source: Section 2-309(1)(2).**

14 **Committee Votes:**

15 1. The Committee voted to approve this section in principle.

16 **Reporter's Note:**

17 [This section was substantially redrafted in light of extensive discussion during the April Meeting. The redrafting  
18 returns the section toward current law under Article 2 and the common law, and returns to the general approach  
19 approved by the Committee at a prior meeting. It avoids the attempt in the March Draft to accommodate the various  
20 special rules on termination and duration that exist in different branches of intellectual property law. The reference in  
21 subsection (1) to other law incorporates and carries that disparate law forward and some of the major non-UCC themes  
22 will be discussed in comments. The language has also been clarified to indicate what is meant by “successive  
23 performances” under current Article 2 as applied in the context of licensing.]

24 1. Subsection (1) follows current law and provides that in the absence of provisions in the agreement  
25 referring to the duration of the contract, the term is presumed to be a “reasonable” time. This rule follows both existing  
26 Article 2 and general common law. It makes explicit, however, that what is to be considered a reasonable time is gauged  
27 by reference to the commercial context.

28 In applying this and the remainder of the Section, it must be understood what type of contract comes  
29 within the section. The reference is to an agreement that does not specify its duration. This requires that there be an  
30 agreement. In some cases, a failure to agree on duration will, like failure to agree on any other scope provision in a  
31 license, indicate that no contract exists. This principle is implicit in the provisions of this Article on offer and acceptance,  
32 formation.

33 In addition, the precondition for this section is not met simply because the record that documents  
34 the agreement is silent. An agreement refers to the entire bargain of the parties. This includes oral agreements,  
35 trade use considerations, and the entire commercial setting. This section applies only if the total of all of the  
36 circumstances defining the bargain yield no understanding about duration of the contract. Thus, for example, a license  
37 reached in an industry setting where, for the particular information, licenses are typically for hourly, daily, weekly, or  
38 monthly terms, would typically not fall within this section because the ordinary term for licenses of the type would supply

1 the unstated duration.

2 The Section does not deal with contracts that contain provisions defining their term. Thus, for example,  
3 a contract providing that a license continues for “the life of the edition” or “for so long as the work remains in print”  
4 defines the term of the license in the same manner as does a contract term of, for example, ten years. These contract  
5 provisions control.

6 On the other hand, decisions interpreting the analogous Article 2 rule for cases where there are  
7 commitments to “lifetime” service or “perpetual” maintenance, would provide guidance on whether language of that sort  
8 provides a definite term that takes the contract out of this section. The basic policy in such cases is that the person making  
9 an open-ended commitment should be held to performance over a time that is reasonable in light of the payment and the  
10 type of commercial setting, but would typically not be placed in a position of perpetual servitude without a very clear  
11 indication that should be the case.

12 2. Subsection (1) refers to other law as providing other terms for a contract. In this field, there are various  
13 federal policy considerations that impinge on the duration of licenses and which may have an impact here. An effort in  
14 the prior Draft to capture some or all of these in the black letter of Article 2B revealed the complexity of the enterprise  
15 and counsels against continuing that effort. Instead, these other law principles are allowed to govern. This can occur  
16 either through direct application of the other law or by its influence on determining what is a reasonable time. Thus, for  
17 example, a patent license that does not state its term can reasonably be presumed (at least in many cases) as extending  
18 for the life and validity of the patent. A similar premise exists with reference to an indefinite copyright license term. This  
19 interpretation would also allow a court to take into account the patent law premise that invalidity of a patent invalidates  
20 royalty obligations as to that patent.

21 3. Subsection (2) differs from existing Article 2 and general common law in presuming a perpetual term  
22 for a license associated with the sale or delivery of a tangible copy. This rule corresponds to licensing practice in general.  
23 It applies, as redrafted, to cases where neither party has an obligation to deliver on-going affirmative performances to  
24 the other party. This language is intended to clarify what, under current Article 2 is a reference to a contract that does  
25 (does not) entail “successive performances.”

26 A rule analogous to that in Subsection (2) is applied to intellectual property releases, but is stated in  
27 Section 2B-207 on releases.

28 4. Subsection (3) restates and limits the rule in Article 2 and common law on termination of indefinite  
29 contracts. See Zimco Restaurants, Inc. v. Bartenders & Culinary Workers' Union, Local 340, 165 Cal. App. 2d 235, 331  
30 P.2d 789 (1958); Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92 C 0911, 1993 WESTLAW 214164 (ND Ill. June  
31 17, 1993); Soderholm v. Chicago Nat'l League Ball Club, 587 N.E.2d 517 (Ill. Ct. App. 1992). This assumes a contract  
32 of indefinite duration.

33 This rule is limited to cases where a party has on-going, affirmative performance obligations to be  
34 rendered to the other party. These obligations may include payment obligations (e.g., royalties) or affirmative conduct  
35 (e.g., repair or maintenance). The premise here is identical to that in current Article 2.

## 36 37 **SECTION 2B-312. INFORMATION RIGHTS IN ORIGINATING PARTY.**

38 (a) If an agreement requires one party to deliver commercial, technical, or scientific  
39 information to the other for its use in performing its obligations under the contract or obligates  
40 one party to handle or process proprietary commercial data, including customer accounts and  
41 lists, and the receiving party has reason to know that the information is confidential and not  
42 intended for republication, the following rules apply:

43 (1) As between the parties, the information and any summaries or tabulations

1 based on the information remain the property of the party delivering the information, or in the  
2 case of commercial data the party to whose commercial activities the information relates, and  
3 may be used by the other party only in a manner and for the purposes authorized by the  
4 agreement.

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

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

11 (1) If information is developed jointly by the parties, rights in the information are  
12 held jointly by both parties subject to the obligation of each to handle the information in a  
13 manner consistent with protection of the reasonable expectations of the other respecting  
14 confidentiality.

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

17 (c) This section does not apply to transactional data or to information intended by the  
18 parties to be published by the licensee.

19 **Uniform Law Source:** None.

20 **Committee Votes:**

21 1. Voted unanimously to approve the section in principle.

22 **Reporter's Note:**

23 1. Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person  
24 about whose business the commercial data relates maintains ownership of the data. This deals with an important issue  
25 in modern commerce relating to cases in which one party transfers data to another in the course of the transaction. The  
26 default rule applies to cases involving information that has not been released to the public and that the recipient knows  
27 is unlikely to be released. The default presumption is that the information is received in a confidential manner and  
28 remains the property of the party who delivers it to the transferee. In effect, the circumstances themselves establish a



1 presumption of retained ownership.

2  
3 **Illustration 1:** Staten Hospital contracts to have Computer Company provide a computer program  
4 and data processing for Staten's records relating to treatment and billing services. Staten data are  
5 transferred electronically to Computer and processed in Computer's system. This section provides that  
6 Staten remains the owner of its data. Data held by Computer are owned by Staten because the records  
7 are not released to the public. There is an obligation to return the data at the end of the contract.  
8

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

12 2. The remedies for breach of the obligations described in this section are for breach of contract and  
13 ordinary contract remedies apply. So also do ordinary contract remedies limitations.  
14

## 15 [E. Electronics]

### 16 SECTION 2B-313. ELECTRONIC VIRUSES.

17 (a) In this section "virus" means computer instructions intended to disrupt, damage,  
18 destroy, or interfere with use of a communications facility or a computer without the consent or  
19 permission of the owner.

20 (b) Unless the circumstances clearly indicate that a duty of care could not be expected, a  
21 party shall exercise reasonable care to ensure that its performance or message when completed by  
22 it does not contain an undisclosed virus ~~that may be reasonably expected to damage or interfere~~  
23 ~~with the use of data, software, systems, or operations of the other party.~~

24 (c) The duty described in subsection (b) is owed solely to the other party to the contract  
25 and is satisfied if:

26 (1) the party exercised reasonable care; or

27 (2) except with respect to a mass-market license involving delivery of a copy of  
28 information on a physical medium by a merchant dealing in information of the kind, language in  
29 a contract stating that no action was taken to ensure exclusion of a virus or that a risk exists  
30 that viruses have not been excluded.

31 (d) A party is not liable ~~under this section~~ if the virus was introduced by a third party

1 after the party completed its performance or if the party injured by the virus failed to exercise  
2 reasonable care to prevent or avoid loss.

3 (e) In determining whether reasonable care has been exercised ~~under this section~~, the  
4 court shall consider the nature of the party, type and value of the transaction, consideration  
5 exchanged, circumstances of the transaction, language on packaging or in a display, and general  
6 standards of practice prevailing among persons of a similar type for similar transactions at the  
7 time of the performance or message. A party is deemed to have exercised reasonable care if it or  
8 its agent searches for known viruses using any commercially reasonable virus checking software  
9 at or before the time the licensor completes its performance or, as to the licensee, the time the  
10 licensee first uses the information.

11 (fe) A party's obligations with respect to the existence of a virus are determined by this  
12 section and the express terms of the contract and not implied warranty.

13 **Uniform Law Source:** None.

14 **Committee votes:**

- 15 a. Voted to delete former (e) giving language of disclaimer 10-0.
- 16 b. Consensus that across the board general disclaimer is not appropriate.
- 17 c. Motion to delete former (b)(2) allowing obligation to be satisfied by language and circumstances giving  
18 reason to know of risk, rejected: 5-6.
- 19 d. Voted to use "mass market" rather than consumer in this section. Vote: 11-0 (Feb. 1997).
- 20 e. Rejected a motion to delete the section. Vote: 4 -6 (April, 1997)
- 21 f. Rejected a motion to adopt a duty of reasonable care with a statutory safe harbor provision. Vote: 4 - 6  
22 (April, 1997)
- 23 g. Rejected a motion to adopt a disclaimable warranty specific to viruses in what had been alternative (b).  
24 Vote: 4 - 7 (April, 1997)
- 25 h. Rejected a motion to adopt in the mass market a duty of care that cannot be disclaimed in a standard form.  
26 Vote: 4 - 6 (April, 1997).

27  
28 **REPORTER'S NOTES:**

29 1. This section describes a default rule that apportions contractual obligations for excluding electronic  
30 viruses. Under current law, the contractual basis for liability pertaining to viruses, if any, is unclear. In cases of delivered  
31 diskettes or computers, virus claims against a vendor would fall within the implied warranty of merchantability. The  
32 warranty of merchantability requires that a court ask two questions. The first deals with whether the "extraneous code"  
33 falls within normal expectations regarding the particular type of software or performance. If it does not, there may be  
34 a breach of warranty. Perhaps, courts faced with the issue would refer by analogy to cases dealing with food products  
35 for standards. The second issue would ask whether the implied warranty was disclaimed. In most transactions,  
36 merchantability is disclaimed. Disclaimers are effective in both the mass market and the commercial marketplace. While

1 a disclaimer would be required to mention merchantability, it need not refer specifically to a virus risk.

2 In cases outside Article 2 (e.g., on-line systems), the basic standards would be under common law. In some (but  
3 not all) states, that obligation engages a duty to exercise reasonable and workmanlike care in performance. That standard  
4 has never been litigated with respect to a virus.

5 This Article does not deal with criminal law risks. In most states, criminal law proscribes “knowing”  
6 introduction of viruses that damage the computer system of another person. Article 2B does not alter the criminal and  
7 related civil liability issues there, but merely sets out contract risk allocation.

8 2. This Section creates a mutual obligation to exercise reasonable care to exclude viruses in all electronic  
9 performances and messages. The obligation is not a warranty, but a contractual obligation. The obligation applies to both  
10 the licensee and the licensor. Indeed, virus problems in a contractual relationship as often result from acts of the licensee  
11 as from acts of the licensor. The section expands the obligation of the performing party as compared to current law  
12 where the contractual obligation is entirely disclaimable. Subsection (a) provides a definition of the core concept for this  
13 section. The intent is not to cover elements of a program that are poorly designed, but to deal with instructions that are  
14 intended to cause damage.

15 3. Reasonable care does not create absolute liability. It creates a flexible standard that gauges the party’s  
16 conduct against a variety of contextual considerations. No requirement exists that a party take extraordinary steps to  
17 preclude viruses in all cases. Thus, for example, in a situation where the rate of new virus discovered is large and  
18 exceeds any reasonable testing or preventative developments, compliance with reasonable activities suffices even if it  
19 fails to discover all viruses. What the section requires is reasonable care, not superhuman effort. Similarly, the standard  
20 varies depending on the party to whom it applies. A producer that makes no effort to screen a virus from its packaged  
21 products would not be acting in a reasonable manner. A retailer that receives pre-packaged software for distribution  
22 cannot be expected to examine the diskettes in the boxes and, while it has a duty of care, that duty does not require the  
23 impossible. It may simply require warnings if the retailer becomes aware that viruses are contained in products it is  
24 providing. On the other hand, a private individual with no expertise may be acting reasonably even though it takes  
25 protective steps that are far below what would be reasonable for a publisher.

26 4. Under subsection (c), in the mass market the reasonable care obligation cannot be satisfied by a  
27 merchant in the particular type of information merely by inclusion of language in a contract or in packaging. That  
28 language may have an effect on determining the nature of the obligation in context, but cannot be a complete disclaimer.  
29 This covers all mass market transactions and many other commercial deals. It does not, however, apply to transactions  
30 on the Internet or in other on-line media (access contracts) where it was thought that the need to satisfy the obligation  
31 by conspicuous warnings was important to allow for multi-layered development of this new distribution methodology.  
32 A party who is not a merchant can satisfy the obligation by conspicuous warnings as can an Internet provider.

33  
34 **Illustration 1:** Jane is a licensee in an access contract with AL. Jane posts data to an AL bulletin board, but the  
35 data contains a virus. A DuPont employee downloads the data and the virus. Damage is caused to the AL system  
36 and DuPont system. Jane is liable to AL if she failed to exercise reasonable care to exclude the virus. AL might  
37 be liable on the same basis to DuPont. The degree of care required varies based on the nature of the parties and  
38 the like.

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

43 **Illustration 3:** James, a college student, sets up a web site to distribute information for a fee about policies at  
44 Union. He does not concern himself about viruses. When the national political party downloads data from the  
45 site and pays its fee, the data includes a virus placed there by a user of the system. Whether James is liable for  
46 the resulting damages depends on the standard of care for a person such as James. James could avoid liability  
47 by providing on his initial screens that he has made no effort to exclude viruses.

48 **Illustration 4:** Vendor distributes an art database in a retail market through the licensing diskettes to the general  
49 public. Arthur obtains a copy of the database which has a virus. Vendor’s license disclaimed any duty of care  
50 and any liability for viruses. The disclaimer is ineffective; Vendor’s liability hinges on whether the virus came  
51 from or before its performance and whether it exercised what would be a relatively high standard of care for the  
52 retail market. For the retailer, the fact that the product was packaged and inaccessible indicates that the duty of  
53 care that it may have could not include actively searching for viruses in the software and that, therefore, it has

1 no liability unless the facts indicate awareness of the risk and a failure to warn the purchaser.

2  
3 5. Subsection (d) limits the obligation to reasonable care in the party's performance and not to control  
4 of subsequent activities. The following illustration captures the issue:

5  
6 **Illustration 5:** Novell transfers software to Distributor who is licensed to integrate the software into  
7 a system with other software and hardware and then distribute the system on the retail market. During  
8 the integration, a virus is introduced by an employee of Distributor. The system is acquired by  
9 Thomas Inc. and the virus causes damage to Thomas. Novell is not liable under this section since the  
10 virus was not a result of its performance and came after it completed its role. Distributor is liable if  
11 it failed to exercise reasonable care.  
12

13 Subsection (d) also states a concept of fault based on exercise of care to avoid loss. As with the primary obligation, the  
14 nature of the reasonable care duty varies with the party and the type of transaction. IBM may have a high duty to screen  
15 viruses in major software licenses it acquires, while a consumer may have no obligation in acquiring software in a retail  
16 package over the counter.

17 6. Subsection (e) has two functions. The first clarifies that the duty of care must be assessed against  
18 various background variables relating to the parties and the context. The last sentence of the subsection attempts to  
19 provide a more specific, safe harbor guidance for both parties. It indicates that commercially reasonable software  
20 employed by a party or its agent satisfies the obligation if applied on or before a particular point in time. The timing  
21 variable benefits both parties by giving guidance in when actions are to be taken. In the world of virus protection, new  
22 viruses are discovered continuously and this should not be taken as creating a continuous, never capable of being satisfied  
23 obligation for either party.

24 7. Subsection (f) clarifies that liability for a virus is to be determined by this section and the express  
25 contract terms, indicating that the issue does not come within implied warranty theory. The rationale is that this is the  
26 more specific section and sets out the balanced deemed appropriate in contrast to the absolute liability risk that exists in  
27 an implied warranty.  
28

## 29 **SECTION 2B-314. ELECTRONIC REGULATION OF PERFORMANCE.**

30 (a) A party entitled to enforce a limitation or restriction may include in the information  
31 and utilize a program, code, or device that restricts use in a manner consistent with the agreement  
32 if:

33 (1) a term in the contract authorizes use of the program, code, or a device;

34 (2) the program, code, or device merely prevents uses of the information that are  
35 not other than in a manner consistent with the agreement license but does not destroy or alter the  
36 information; or

37 (3) the program, code, or device merely prevents uses of the information that  
38 are not in a manner inconsistent with a licensor's rights under copyright or patent law and that  
39 were not granted to the licensee but does not destroy or alter the information.

(4) the information is obtained for a stated period of time not more than 30 days or for a stated number of uses and the program, code, or device merely enforces that time or use limitation; or

(5) the program, code, or device prevents further use at the expiration of the term of the license and the program, code or device or the licensor gives~~provides~~ reasonable notice to the licensee before ~~preventing~~ further use is prevented.

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

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

(d) A program, code or device included in information pursuant to this section or as authorized under other law does not constitute a virus for purposes of Section 2B-313.

**Uniform Law Source:** None

**Reporter's Notes:**

[The subsections were reorganized and partially rewritten for clarity.]

1. 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 and enforce contract terms; they limit use consistent with contract terms or terminate a license at its natural end. 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 controversial use of restrictive devices not associated with enforcing claims of breach of contract.

2. 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. 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.

3. Subsection (a) distinguishes between active and passive electronic devices. An active device terminates

1 the ability to make any further use of the information. Since this section deals only with cases where no breach of contract  
2 occurs, the contractual right to do this arises only in the event of termination pursuant to contractual terms. Subsections  
3 (a)(4) and (a)(5) state the basic principle in such cases. Creation and use of the electronic means to terminate a contract  
4 (end it other than for breach) requires either a contractual term that permits the action (a)(1), or reasonable notice before  
5 termination which notice subsection (a)(5) which can come from the program, code or device itself or directly from the  
6 licensor.

7 The exception to the notice rule focuses on short term agreements, such as shareware or trial copies,  
8 or the new Java-based software modules whose use is limited to a brief period of time or to a stated number of uses. The  
9 argument for requiring consent or notice in longer term agreements deals with avoiding problems due to stale  
10 information. In the brief contracts, that is not an issue. The subsection dealing with this issue employs thirty days as the  
11 cut-off based on the fact that this is a common period in so-called shareware or limited use demonstration systems. This  
12 provision would also apply to various pay per view and similar systems, since it reflects the ability to enforce short term  
13 limitations on service or use through electronic devices without specific or special notice other than that inherent in the  
14 contract itself.

15 Some argue that enforcing a contractual right not associated with breach should not require notice in  
16 any case. Ending the ability to use after the term merely enforces the agreement. Although that position has strength, the  
17 choice here establishes additional licensee protection and limits the right to enforce contract termination on the argument  
18 that a licensee might be disadvantaged by being forced to strictly stay within contract limits in the absence of a contract  
19 term indicating the enforcement tool was present. Notice may occur either in the terms of the contract itself or in actions  
20 of the licensor or the electronic system giving notice to the licensee before precluding further use. Code that precludes  
21 further use of a program after one year would be effective under this section if either the contract provides for electronic  
22 enforcement of the one year term or the code itself displays notice of the impending termination a reasonable time before  
23 implementing it (e.g., five days before the end of the term).

24  
25 **Illustration 1.** A software license requires monthly payments of \$1,000 due on the first of the month  
26 and covers a one year term with a right to renew based on written notice before the expiration of the  
27 term. Licensee makes a payment five days late because of accounting problems. Licensor uses an  
28 electronic device to turn off the software. That action is not authorized under this section since it  
29 enforces a breach of contract. The section on self-help applies and the action may be appropriate if the  
30 breach was material.

31 **Illustration 2.** In Illustration 1, there was no late payment, but the licensee fails to give notice of  
32 renewal within the contractual time period. Licensor turns off the software. This action is covered by  
33 this section. The termination electronically is valid if either the contract contained a term authorizing  
34 that action, or the licensor or the device gave prior, reasonable notice of termination to the licensee.

35  
36 **4.** Special notice is not required if the electronics merely restrict use without otherwise disabling the  
37 information. This authorizes use of passive electronic devices to enforce use limitations under subsection (a)(2) and  
38 subsection (a)(3). This is especially important for smaller suppliers whose ability to enforce contracts against often larger  
39 licensees is limited by costs of monitoring and judicial enforcement. The limitations, for example, might entail a counter  
40 which can be used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice  
41 is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation  
42 inconsistent with the agreement constitutes a breach of contract and that it has contracted for the substantive limitation  
43 itself, while the device merely prevents breach.

44  
45 **Illustration 3:** The license provides that no more than five users may employ the word processing  
46 software at any one time. An electronic counter is embedded in the software and, if a sixth user  
47 attempt to sign on for simultaneous use, that sixth user is denied access until another user discontinues  
48 use. This limiting device is effective without prior notice or contractual authorization.

49 **Illustration 4:** The same situation as in Illustration 3, except that the limiting device permanently  
50 disables the software if a sixth user attempts access. This device is not authorized by the this section  
51 since it involves a cancellation for breach. Section 2B-711 applies.

52 **Illustration 5.** ABC Publishing includes an anti-copying device in a CD-ROM version of its novel,  
53 "Gone with the Sea" which it licenses subject to express terms precluding making additional copies

1 of the work. The device allows normal loading into memory and use relating to a computer system,  
2 but prevents making an additional copy. No separate contract term is required to authorize the device  
3 since it merely enforces a limitation in the contract and does not otherwise disable the data.  
4

5 5. Subsection (a)(3) allows use of passive devices that merely preclude going beyond the contract to make or  
6 distribute copies or take other actions that are not within the transferee's prerogatives under the agreement and involve intellectual  
7 property rights reserved to the licensor. Merely preventing the act does not require contract or other notice.

8 6. Subsection (b) states the obvious premise that actions consistent with a contract are not a breach and do not give  
9 rise to liability under this Article or the contract.  
10

## 11 **PART 4**

### 12 **WARRANTIES**

#### 13 **SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING** 14 **AUTHORITY AND NONINFRINGEMENT.**

15 (a) A licensor warrants that:

16 (1) the licensor has authority to make the transfer;

17 (2) the licensor and any person holding a claim or interest created by an act of the  
18 licensor or to which the licensor is subject will not interfere with the licensee's enjoyment of its  
19 rights under the contract, except that this warranty does not relate to claims by way of  
20 infringement;

21 (3) ~~in if the information is transferred under an exclusive license for redistribution~~  
22 ~~by the licensee~~, the intellectual property rights that are the subject of the license are valid and  
23 exclusive to the licensor within the scope of the license for the information delivered as a whole;  
24 and

#### 25 **[Alternative A]**

26 (4) if the licensor is a merchant regularly dealing in information of the kind, the  
27 licensor at the time of the transfer, ~~the licensor~~ has no reason to know that the transfer, any  
28 copies transferred by the licensor, or the information, when used in any authorized use, infringes

1 an existing intellectual property right of a third party except as disclosed to or known by the  
2 licensee.

3 **[Alternative B (to be added as new subsection)]**

4 (f) A licensor that is a merchant regularly dealing in information of the kind  
5 indemnifies and holds the licensee harmless against any final judgment rendered in favor of a  
6 third party for infringement against the licensee with reference to the information and any copies  
7 thereof transferred by the licensor to the licensee to the extent that the infringement pertains to an  
8 intellectual property right in existence at the time of the [transfer] [activation] of rights.  
9 Performance of this indemnity excludes any other liability to the licensee for the infringement.

10 **[end of alternatives]**

11 (b) The warranties in this section are subject to the following:

12 (1) The warranty under subsection (a)(4) does not apply to a license of a patent  
13 accomplished without any agreement by the licensor to provide to the licensee property or  
14 services to enable the licensee to use the patented ~~exercise the rights~~.

15 (2) If intellectual property rights are subject to a right of public use, collective  
16 administration, or compulsory licensing, the warranty is subject to those rights. ~~transferred or to a~~  
17 ~~compulsory or other license required by law or collective management arrangement.~~

18 (3) If the license includes territories outside this country, the warranties under  
19 (a)(4) and (a)(5) extend only to countries that, at the time of the contract, have entered into a  
20 treaty or other binding international obligation granting foreign nationals protection under the  
21 applicable intellectual property law.

22 (c) A licensee that furnishes specifications to a licensor or a financier shall indemnify and  
23 hold the licensor and the financier harmless against any claim by way of infringement which the



licensee had reason to know would arise out of compliance with the specifications.

(d) A warranty under this section may be disclaimed or modified only by express language or by circumstances giving the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to transfer only the rights that it has. In an electronic transaction that does not involve review of the record by an individual, language is sufficient if conspicuous. Otherwise, language in a record is sufficient if it states “There is no warranty of title or authority” or “There is no warranty that the [information] [computer program] does not infringe the rights of others”, or words of similar import.

**UNIFORM LAW SOURCE: Section 2A-211; Section 2-312. Revised.**

**COMMITTEE VOTES:**

**a.** Voted to adopt a “reason to know” standard in lieu of “knowledge.”

**b.** Rejected a motion to bar disclaimer in “mass market” contracts.

**SELECTED ISSUE:**

**a.** Should the warranty of authority also be made by the licensee outside the mass market as suggested by the motion picture industry?

**REPORTER'S NOTES:**

[The new language added to (a)(2) corresponds this draft to Article 2A. The infringement claims are dealt with in subsection (a)(4). Language was added to (b) to reflect suggestions of entertainment lawyers regarding international scope licenses.]

1. This section creates a warranty of quiet enjoyment and right to continue in possession of property over the term of a contract; this extends the warranty rights creates under Article 2 in current law, which center solely on the initial delivery of the property.

2. Subsection (a) contains the affirmative warranties. Subsections (a)(1) and (a)(2) deal with issues other than intellectual property infringement. First, the licensor represents it has authority to make the transfer. Authority here would refer to possible defects in the chain of title or authorization. For example, if a licensee holds information under a non-transferable license, a transfer to another licensee occurs without authority and, thus, breaches this warranty. Second, the licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. The combination of these two subsections takes language from Article 2 (authority) and 2A (interference and enjoyment), making the resulting warranty broader than either of the other two articles. Authority and 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).

3. Subsections (a)(3) and (a)(4) deal with intellectual property risks. In current law, the idea of title has several different connotations. The issues can be broken down into three parts:

public domain risk: Whether enforceable rights exist in the technology that is transferred. In essence, this asks whether 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 transfer the technology or whether that right is also held by third parties by way of prior assignment, joint invention or coauthorship.

infringement risk: Whether the transferor can convey the rights defined in the contract in a way that enables the

transferee to exercise those rights without infringing third party rights in the technology.

4. Subsection (a)(3) deals with the first two of these. Subsection (a)(3) refers to validity and exclusivity and limits those warranties to situations in which the transfer purports to convey exclusive rights in the information. If the transferee relies on the rights transferred to create a product for third parties, affirmations about validity define an important aspect of the deal since the converse of validity is that the information is in the public domain. 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 (including public domain) is typically not relevant to the ordinary end user license. The subsection also deals with exclusivity. The title risk includes that a portion of the rights may be vested in another person. Coequal rights exist where co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In either case, while a transfer may convey rights, it may be no more than equal to rights vested in and available for conveyance by the third party co-author. Depending on the underlying deal, the existence of coequal rights in other parties may have no relevance to the transferee or it may be a critical limit on the licensee's ability to recoup investment. Subsection (a)(3) reflects practice in motion picture and publishing industries and states what may be an appropriate warranty for those settings. Exclusivity is an important issue where a licensee undertakes significant investment on the assumption that its rights are exclusive as to other competitors. As to **end users and non-exclusive licenses**, the question of whether intellectual property rights are **exclusive** in the licensor is seldom significant because exclusivity does not alter the end user's ability to continue to use the licensed rights without challenge from third parties.

5. The subsection (a)(4) warranty relating to infringement risk goes beyond the substantive scope of current Article 2 and 2A in terms of what is warranted, but uses a reason to know standard of liability, rather than an absolute liability standard. Current UCC ' 2-312 provides that every sale contains an implied warranty that the seller has "good title" to the property conveyed. This does not establish a warranty that **use** will not violate a patent held by a third party. Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N.D. Tex. 1986). The warranty applies to the condition of the goods when delivered, not the use of the product. Section 2A-211 speaks not in terms of good title, but of an implied warranty that for lessors who are merchants in the particular type of property, "the goods are delivered free of the rightful claim of any person by way of infringement or the like." In Article 2B, the warranty of noninfringement covers not only the information as delivered, but the information as used. The expansion gives the licensee greater protection against process patents and against the fact that "copies" made during ordinary use of software in a machine may infringe a copyright. Neither of these assurances exists in current law.

Balancing against this, the warranty establishes a "no reason to know" standard. This does not impose a duty of inquiry, but relates only to facts actually known to the party. The choice between a "reason to know" and an absolute liability warranty requires a balancing of the interests of the licensor and licensee in an ordinary case where infringement claims may arise without fault of either party. Both in copyright and patent infringement claims, the complexity of the technology, the diverse sources from which it arises and character of modern infringement claims that do not admit of good faith purchase and do not require knowledge of infringement all create significant risk in the modern commercial environment. The choice made here places knowing misconduct risk on the licensor, but in cases where neither party had knowledge that an infringement would ensue, to allows loss to stay with the licensee if it is the party sued unless the contract reverses that allocation. No knowledge warranties are common in modern licensing. Note that this does not alter current intellectual property law which recognizes neither a concept of bona fide purchaser defense to infringement, nor a lack of knowledge defense. Thus, in the case of a merchant who does not know about the infringement, either the licensee or the licensor may have infringement liability and this warranty will not redistribute the loss. Redistribution if it occurs, requires an express warranty.

Part of the difficulty involves the fact that patents are not knowable or readily checked by the myriad of small producers in this market place and that, therefore, an absolute warranty would place liability exposure on them without an effective means of protection.

**Illustration 1:** Sunspot Software develops a multi-terminal operating system for Citibank. After installation of the system, a patent issues to Lansing which patent reads on the process created by the Sunspot program. If the warranty refers to "reason to know", Citibank bears the loss since an unissued patent could not be known. If the warranty applies without knowledge, Sunspot bears the loss so long as the warranty extends to uses of the software.

1           7.       The issue is especially important in on-line systems where the licensor may be providing a service that  
2 includes allowing the posting and subsequent downloading of material from third parties. Case law under copyright  
3 indicate that, in some cases, the vendor may be liable for infringement, but that this liability does not exist in all cases.  
4 The issue here is whether a reason to know standard best serves in our context.

5  
6           **Illustration 2:** Adam opens an Internet website providing access for a fee to photographs of football players  
7 for three cents a piece, not restricting the use of the photographs by its licensees. The photographs are supplied  
8 by third parties in digital form to Adam. Alumni Magazine acquires a photograph of Jones and uses it in its May  
9 issue, distributed to 10,000 subscribers. Jones and the photographer, who never consented to Adam's use, sue  
10 Magazine which in return sues Adam for \$100,000. Should Adam be liable for breach of contract and  
11 consequential damages in addition to any liability for copyright infringement?  
12

13           8.       Alternative B to the warranty of infringement was included at the suggestion of various observers  
14 indicating that the warranty in practice is often converted to an indemnity obligation. The difference lies in the scope  
15 of the obligation and in the consequences of there being an infringement. The indemnity requires coverage of losses  
16 caused by the infringement, but the mere fact of infringement itself does not breach the license under this Alternative.  
17 Breach would occur only if the indemnity were not performed.  
18

## 19           **SECTION 2B-402. EXPRESS WARRANTIES.**

20           (a) Except with respect to published informational content, a licensor creates an express  
21 warranty as follows:

22                   (1) An affirmation of fact, promise, or description of information made by the  
23 licensor to its licensee [in any manner, including in a medium for communication to the public  
24 such as advertising,] which relates to the information and becomes part of the basis of the  
25 bargain creates an express warranty that the information and any services required under the  
26 agreement will conform to the affirmation, promise, or description.

27                   (2) A sample, model, or demonstration of a final product which is made part of  
28 the basis of the bargain creates an express warranty that the performance of the information will  
29 reasonably conform to the performance illustrated by the model, sample, or demonstration,  
30 taking into account such differences between the sample, model, or demonstration and the  
31 information as it would be used as would be apparent to a reasonable person in the position of the  
32 licensee.

33           (b) The licensor need not use formal words, such as "warrant" or "guarantee", or state a

specific intention to make a warranty. However, a mere affirmation or prediction of the value of the information, a display of a portion of the information to illustrate the aesthetics or market appeal of informational content, or a statement purporting to be the licensor's opinion or commendation of the information does not create a warranty.

**Uniform Law Source: Section 2A-210. Section 2-313.**

**Committee Votes:**

- a. Deleted former subsection (b) that warranties are limited to the time of transfer based on the argument that this merely restates current law.
- b. Motion to limit this section to the immediate parties, allow other parties to be included if courts decide to do so. Rejected: 4-5
- c. Motion to amend by adding “except for published informational content” with the comments or the section to make it clear that it’s neutral on the law development here. Adopted 7-3.

**Reporter's Note:**

1. This section adopts existing law in two crucial respects. It follows current Article 2 regarding express warranties in general and preserves current law relating to express warranty obligations in reference to published information content.

2. The introductory clause to subsection (a) preserves existing law for published informational content. While there are many reported cases dealing with express warranties in the context of goods and using the standards outlined here, no such case law exists with respect to warranties in reference to published information. This subject matter entails significant First Amendment interests and courts that deal with liability risk pertaining to that subject matter must balance contract themes with more general social policies. By excluding this type of information content from the coverage of this section, 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 may, if inclined to find liability for published information, do so under any general contract law theory. Merely adopting Article 2 concepts from sales of goods to this much different context would risk a large, and substantially uncontrollable over-reaching of liability in this sensitive area. The result does not to make information providers immune from liability, but allows first amendment case law to evolve.

3. The term, “published information content” focuses on information **content** not customized to particular end users. (see Section 2B-102) That concept adopts case law under the Restatement which does not impose liability on providers of information outside special relationships. 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 theory.

3. A second use of current law involves retention of the “basis of the bargain” standard in current Article 2 and Article 2A. This allows courts to draw on an extensive body of prior case law for distinguishing express warranties from puffing and other, non-enforceable statements made during bargaining. See, e.g., Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. 1977); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495 (E.D.N.Y. 1984), rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986); Management Sys. Assocs. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985); Consolidated Data Terminal v. Applied Digital Systems Inc., 708 F.2d 385 (9th Cir. 1983) (“the express statements warranting that the Regent 100's would perform at a 19,200 baud rate prevail over the general disclaimer.”); Cricket Alley Corp. v. Data Terminal Systems, Inc., 240 Kan. 661, 732 P.2d 719 (Kan. 1987) (court enforced an express warranty that computerized cash registers would communicate with a remote computer; “capability to communicate with plaintiff's Wang computer was the prime consideration in selecting new cash registers.”). By retaining current Article 2, Article 2B allows courts to use the full panoply of doctrines that they have evolved.

In Article 2 revisions, debate has focused on express warranties through advertising. The bracketed language

1 in subsection (a) makes clear that advertising may create an express warranty. Even without that language, however,  
2 in appropriate cases, advertising would create a warranty. Article 2B does not change existing law on this point. Some  
3 cases acknowledge advertising warranties under Article 2; no conceptual barrier exists to a published statement becoming  
4 part of the bargain sufficient to constitute a warranty. Unless the bracketed language were adopted, however, this section  
5 does not adopt an express advertising warranty rule. In an area such as information contracts where the development  
6 of liability and warranty theory is less fully established than in goods and encounters first amendment and related  
7 restrictions, the draft adopts a cautious, rather than aggressive approach toward creating new forms of liability. Either  
8 advertising liability exists under current law and is carried forward, or it does not exist under current law and is not  
9 created.

10 4. Subsection (a)(2) deals with samples and the use of beta models. These are employed in testing  
11 developmental, not yet completed products. A beta model may include elements that are not carried into the final product  
12 and may include defects that are not cured in the final product. In either event, the parties both expect that the product  
13 being demonstrated or used is not representative of what will eventually be the product and the exclusion here is designed  
14 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  
15 elects to delete an element in the test model when it produces the eventual product).

## 16 17 **SECTION 2B-403. IMPLIED WARRANTY: QUALITY OF COMPUTER** 18 **PROGRAM.**

19 In a mass market transaction a ~~A~~licensor that is a merchant that provides a computer  
20 program to a licensee ~~with respect to a mass-market transaction providing a computer program~~  
21 warrants that the computer program and media are merchantable. To be merchantable, the  
22 computer program and any physical medium ~~tangible media~~ containing the program must:

- 23 (1) pass without objection in the trade under the contract description;  
24 (2) be fit for the ordinary purposes for which it is distributed;  
25 (3) substantially conform to promises or affirmations of fact made on the  
26 container, documentation, or label, if any;  
27 (4) in the case of multiple copies, consist of copies that are, within the variations  
28 permitted by the agreement, of even kind, quality, and quantity, within each unit and among all  
29 units involved; and  
30 (5) be adequately packaged and labeled as the agreement or circumstances may  
31 require.

32 (b) In cases not governed by subsection (a), a licensor that is a merchant with respect to

1 computer programs of that kind and that delivers a program to a licensee warrants that any  
2 physical medium ~~media~~ on which the program is transferred ~~is~~ are merchantable and that the  
3 computer program will perform in substantial conformance with any promises or affirmations of  
4 fact contained in the documentation or specifications provided by the licensor at or before the  
5 delivery of the program. A mere affirmation of the value of the program or a statement of  
6 opinion or commendation does not create a warranty.

7 (c) A warranty under this section does not pertain to informational content in software, or  
8 to the quality, aesthetic appeal, marketability, accuracy, or other characteristics of the  
9 informational content.

10 **Uniform Law Source: Section 2-314. Revised.**

11 **Selected Issues:**

12 **1. Should content and aesthetic appeal be subject to this warranty?**

13 **Committee Votes:**

14 a. Rejected a motion to add language warranting that the program will not damage ordinary  
15 configured systems because no "ordinary system" exists in modern licensing and the general premise is  
16 covered under the language of existing Article 2 as brought forward here.

17 b. Voted 10-2 to use "mass market" in this section, rather than "consumer." (Feb. 1997)

18 **Reporter's Notes:**

19 1. Article 2B warranties blend three different legal traditions. One tradition stems from the UCC and  
20 focuses on obligations about the quality of the product. This tradition centers on the result delivered to the transferee:  
21 a product that meets ordinary standards of performance. The alternate tradition stems from common law, including case  
22 law relating to licenses, services contracts and information contracts. This tradition focuses on the manner in which a  
23 contract is performed, the process rather than the result. It assumes that the obligations of the transferor are to perform  
24 in a reasonably careful and workmanlike manner unless it expressly agrees to a greater burden. The third tradition comes  
25 from the area of contracts dealing with informational content and essentially disallows implied obligations of accuracy  
26 or otherwise in reference to information transferred outside of a special relationship of reliance. Under current law, these  
27 two traditions apply or not depending on characterizations about whether a transaction involves goods or not. That  
28 distinction is not reliable in information contracting, especially in light of the ability to transfer intangibles electronically  
29 without the use of any tangible property to carry the intangibles.

30 2. This section and the next following section seek to define the basis on which the different traditions  
31 apply, focusing on a distinction between "computer programs" and services or informational content. This expands the  
32 scope of the quality warranty here by including at least some cases where a court would otherwise conclude that the  
33 transaction is actually a services contract. See, e.g., Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97  
34 (Wisc. App. 1988); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Snyder  
35 v. ISC Alloys, Ltd., 772 F.Supp. 244 (W.D. Pa. 1991) (license of manufacturing process described as "services").  
36 Compare Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992); The Colonial Life  
37 Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993)

38 3. The two implied warranties are not mutually exclusive and, in many cases, both will apply to the same  
39 transaction and the same digital product (e.g., an encyclopedia). In the final comments to the statute, notes will be  
40 developed containing illustrations indicating the manner in which the warranties work together.

1 **Illustration 1:** Party A contracts to transfer software to Party B that will allow B to process its  
2 accounts receivable. Whether the transfer is by diskette or by electronic conveyance into B's  
3 computer, the implied warranty in this section applies. Under current law, this would be a transaction  
4 in goods with an implied warranty attached to the performance of the product.

5 **Illustration 2:** Party A licenses Party B to use a copy of the Marvel Encyclopedia. This warranty  
6 applies to the computer program and diskette, while Section 2B-404 applies to the content of the  
7 encyclopedia. Under current law, this would be an information contract most likely involving no  
8 warranty about the accuracy of the information.

9 **Illustration 3:** Party A reaches a license with Party B. Party A will transfer its data to B's computer  
10 for processing there. B agrees to return various reports and summaries to A. The 2B-403 warranty  
11 does not apply since the contract did not deliver a computer program to A, but use of B's facility.  
12 Under current law, most cases hold that this is a services contract containing at most a warranty of  
13 workmanlike conduct; it is governed here under general standards of contract and by the implied  
14 warranty in Section 2B-404.

15  
16 4. Merchantability sets the standard for computer programs in the mass market, where the idea of  
17 comparing a particular program to other mass market programs of similar type. This draft uses a substantial conformance  
18 to documentation standard for non-mass market software. That warranty is common in commercial licenses. The  
19 prevalence in commercial cases of disclaiming merchantability is such that virtually no software cases dealing with that  
20 warranty. The reliance on conformance to documentation reflects the wide range of variations involved in the non-mass  
21 market. The two standards both give assurances of quality, but focus on different reference points. Merchantability asks  
22 what are normal characteristics of ordinary products of this type, while the documentation warranty focuses on the  
23 manuals and contours of the particular product. Beside conforming to ordinary commercial practice (e.g., disclaim  
24 merchantability and give substantial conformance warranty), the substantive question here deals with whether  
25 merchantability is a relevant standard and at all protective in cases where software is often relatively unique. For  
26 example, assume a commercial computer program that provides data compression functions on an ABC computer with  
27 an XYZ operating system. Merchantability would ask whether that product passes without objection among all data  
28 compression products of all types (e.g., mass market, Windows-based, Apple systems, etc.) even though the particular  
29 environment, approach and capabilities of this product may be unique. How that standard protects the licensee is not clear  
30 and in fact it may set out standards well below what the documentation provides.

31 5. Most agreements disclaim merchantability; there are few reported commercial cases involving  
32 merchantability in any industry. Most licenses substitute a warranty of conformance to documentation. The section treats  
33 this as the presumed warranty, conforming to a commercial norm. This warranty measures performance by reference  
34 to what is said about the particular product. The argument in favor of retaining a merchantability warranty for  
35 transactions is that it would maintain a congruence between this article and Article 2 and 2A. This may be ephemeral  
36 and could be reversed: those articles should adapt to commercial practice. Merchantability measures performance  
37 obligations by reference to other like products, while the documentation warranty measures performance by what the  
38 licensor says about its product.

## 39 **SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT**

### 40 **AND SERVICES.**

41 (a) Subject to subsections (b) and (c), a merchant that provides informational content in a  
42 special relationship of reliance or services in collecting, compiling, transcribing, processing or  
43 transmitting informational content, ~~data processing, or the like, or informational content in a~~  
44 ~~special relationship of reliance,~~ warrants to its licensee that there is no inaccuracy, ~~flaw, or other~~

~~error~~ in the informational content; caused by its failure to exercise reasonable care and workmanlike effort in its performance. ~~in creating, collecting, compiling, or transcribing the information.~~ The warranty is not breached merely because the performance does not yield a result consistent with the objectives of the licensee or because the informational content is not accurate or is incomplete.

(b) A warranty does not arise under subsection (a) for:

(1) the aesthetic value, commercial success, or market appeal of the content;

(2) published informational content;

(3) informational content in manuals, documentation, or the like, that is merely incidental to a [transfer] [activation] of rights and does not constitute a material portion of the value in the transaction; or

(4) informational content prepared or created by a third party, if the party distributing the information, acting as a conduit, provided only editorial services with respect to the content and made the informational content available in a form that identified it as being the work of the third party, except to the extent that the lack of care or workmanlike effort that caused the loss occurred in the party's performance in providing the content.

(c) The liability of a third party that provides the informational content ~~under this section~~ is not excluded by the use of a conduit described in subsection (b)(4) or by the fact that the conduit is not liable for errors under that subsection.

**Uniform Law Source:** Restatement (Second) of Torts ' 552.

**Reporter's Notes:**

1. This section creates a warranty applicable to consulting, data processing, information content, and similar contracts involving an information provider or processor dealing directly with a client and, with respect to content, where the provider tailors or customizes its information for the client's purposes or being in a special relationship of reliance with that client. The warranty reflects case law on information contracts. In Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (NY 1977), for example, the New York Court of Appeals rejected a UCC warranty of fitness for a purpose in a contract for the design and installation of a sprinkler



1 system. “[Those] who hire experts for the predominant purpose of rendering services, relying on their special skills,  
2 cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be  
3 ensured under a traditional negligence standard of conduct ... unless the parties have contractually bound themselves to  
4 a higher standard of performance...”

5 2. Restatement (Second) of Torts § 552 regarding negligent misrepresentation provides a framework.  
6 It states that: “One who, in the cause of his business, profession or employment, or in any other transaction in which he  
7 has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject  
8 to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise  
9 reasonable care or competence in obtaining or communicating the information.”

10 In most states, this liability does not exist in the absence of a “special relationship” between the parties justifying  
11 a duty of reasonable care. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news  
12 service not liable to customer; distribution was more like a newspaper than consulting relationship); A.T. Kearney v.  
13 IBM, -- F.3d -- (9<sup>th</sup> Cir. 1997). The obligation consists of a commitment that the content provided will not be wrong due  
14 to a failure by the provider to exercise reasonable care. Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill.  
15 App. May 26, 1993) (license of index; liability for inaccurate number tested under Restatement concepts in light of  
16 contractual disclaimer; information, although handled in commercial deals is not a product taking it outside this  
17 Restatement approach). Under Restatement case law, the obligation is limited to cases involving a special or fiduciary  
18 relationship. Under subsection (a) the obligation does not center on delivering a correct result, but on care and effort in  
19 performing. A contracting party that provides inaccurate information does not breach unless the inaccuracy is attributable  
20 to fault on its part. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368  
21 N.E.2d 1247 (N.Y. 1977); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988).  
22 Liability under the Restatement for inaccurate information exists only if the information was intended or designed to  
23 guide the business decisions of the other party. This section is not limited to cases involving business guidance.

24 3. The cases largely exclude liability for information distributed to the public. This concept is captured  
25 by the term “published informational content” in subsection (b)(2). “Published informational content” refers to  
26 information made available without being customized for a particular business situation of a particular licensee and where  
27 no “special relationship” of reliance exists between the parties. It is material made available in a standardized form to  
28 a public defined by the nature of the material involved. The information is not tailored to the client’s needs. This  
29 definition and the liability exclusion reflects the vast majority of case law under the Restatement and modern values of  
30 not inhibiting the flow of content. The policy values supporting this stem in part from First Amendment considerations,  
31 but also from ingrained social norms about the value of information and of encouraging its distribution.

32  
33 **Illustration 1:** Sam opens a website making available information on restaurants for a small monthly  
34 fee for subscribers. One item of information concerning Restaurant A is incorrect and a subscriber has  
35 a bad experience because of the error. Sam’s website contains published informational content and  
36 creates no warranty or resulting liability. The same would be true of a restaurant review in the New  
37 York Times.

38 **Illustration 2:** Sam, an expert on restaurants, contracts with Able to provide advice about which  
39 restaurants should be included in Able’s book on the “most profitable” Chicago restaurants. Sam  
40 makes a negligent error in providing a list of restaurants. Sam has liability under this warranty as to  
41 Able since the information is not “published informational content” but was tailored to the specific  
42 purposes of the specific client. When the book is published, however, no warranty exists for either  
43 provider since the book is published informational content.

44  
45 4. Subsection (b) lists situations in which the warranty does not arise under current law. Subsection (b)(1)  
46 clarifies that this is not a warranty of aesthetic quality, but accuracy, an element present in current U.S. law and important  
47 in the publishing and entertainment industries affected by this Article. This point, although it could be inferred from the  
48 affirmative terms of the warranty, has substantial importance and language was added to this subsection based on  
49 suggestions from a licensee representative involved with entertainment issues.

50 5. Subsection (b)(4) states as a contract law principle case law that holds the publisher harmless from  
51 claims based on inaccuracies in third party materials that are merely distributed by it. In part, this case law stems from  
52 concerns about free speech and leaving commerce in information free from the encumbrance of liability where third

1 parties develop the information. In cases of egregious conduct, ordinary principles of negligence apply. As a contractual  
2 matter, however, merely providing a conduit for third party data should not create an obligation to ensure the care  
3 exercised in reference to that data by the third party. See Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991);  
4 Walter v. Bauer, 109 Misc 2d 189, 439 N.Y.S.2d 821 (S. Ct. 1981). Compare: Brockelsby v. United States, 767 F.2d 1288  
5 (9th Cir. 1985) (liability for technical air charts where publisher designed product) (query whether this is a publicly  
6 distributed product).

7 6. The issue is important for information systems analogous to newspapers and are treated as such here  
8 for purposes of contract law. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic  
9 news service not liable to customer; distribution was more like a newspaper than consulting relationship). The District  
10 Court in Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "Technology  
11 is rapidly transforming the information industry. A computerized database is the functional equivalent of a more  
12 traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news  
13 distributor ... than that which is applied to a public library, book store, or newsstand would impose an undue burden on  
14 the free flow of information."  
15

#### 16 **SECTION 2B-405. IMPLIED WARRANTY: EFFORT TO ACHIEVE PURPOSE.**

17 (a) Except with respect to the aesthetic value, commercial success, or market appeal of  
18 informational content, if a licensor at the time of contracting has reason to know of any particular  
19 purpose for which [a computer program] [the information] is required and that the licensee is  
20 relying on the expertise of the licensor to select, develop, or furnish a suitable [program]  
21 [information]:

22 (1) if, from all the circumstances, it appears that the contract is for a price for  
23 performance that will not be paid if the end product is not suitable for the particular purpose,  
24 there is an implied warranty that the information will be fit for such purpose; but

25 (2) if, from all the circumstances, it appears that the licensor was to be paid for  
26 the amount of its time or effort regardless of the suitability of the end product, there is an implied  
27 warranty that the licensor will make a workmanlike effort to achieve the licensee's purpose.

28 (b) If an agreement requires a licensor to provide or select a single or integrated system  
29 consisting of components, and the licensor has reason to know that the licensee is relying on the  
30 expertise of the licensor to select the components, there is an implied warranty that the  
31 components selected will function together as a system.

1 **Uniform Law Source: Section 2-315; 2A-213. Substantially revised.**

2 **Reporter's Note:**

3 1. The section deals with development and design contracts. This section balances between the two  
4 results. This section incorporates the differences between results and efforts, but makes the distinction depend on  
5 judgments about payment expectations. The test here gives a better measure for courts to use to determine which implied  
6 obligation fits than does the current test involving whether the contract involves goods (article 2 fitness) or services.

7 2. Design contracts involving software are a setting in which litigation is common over whether the  
8 contract involves goods or services under current law. Those cases choose between a warranty of result and a warranty  
9 of effort based on whether the court viewed the transaction as involving goods (result) or services (effort). The reported  
10 cases split on this issue, often turning on the subjective view of the court, rather than on any differences in the actual  
11 transactions. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 108, 546 N.E.2d 888 (1989) (goods);  
12 Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987) (goods) with Micro-  
13 Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988) (services); Wharton Management Group  
14 v. Sigma Consultants, Inc., 1990 WESTLAW 18360, aff'd 582 A.2d 936 (Del. 1990) (services contract); Data Processing  
15 Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) (services).

16 2. Software development contracts are covered under Article 2B without regard to classification of the  
17 contract as involving services or goods. This is important in eliminating uncertainty and arbitrary factors determining  
18 outcome. Under current law, the distinction between goods and services affects the applicability of the implied warranty  
19 of fitness. Services contracts involving custom design do not call into play a warranty that the result of the services fits  
20 the licensee's purposes. This is because the focus is on the process of performance, rather than the outcome. See Micro-  
21 Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Milau Associates v. North Avenue  
22 Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977) (An implied warranty is  
23 inconsistent with the nature of the contract. Fitness of outcome can be contracted for only as an express warranty.). In  
24 contrast, custom contracts treated as sales of goods may create implied warranties of fitness pursuant to UCC 2-315 if  
25 the vendor's expertise is relied on by the vendee. See USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 108,  
26 546 N.E.2d 888 (1989).

27 3. Subsection (b) provides an implied warranty of system integration. This differs from the fitness  
28 concept, but is closely related to that concept. The obligation is that the selected components will actually function as  
29 a system. That is an additional step beyond the obvious fact that the components themselves must be separately  
30 functional in a manner consistent with the contract.

31  
32 **SECTION 2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.**

33 (a) Language or conduct relevant to the creation of an express warranty and language or  
34 conduct tending to disclaim or modify an express ~~the~~ warranty must be construed wherever  
35 reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or  
36 extrinsic evidence, language or conduct disclaiming or modifying an express warranty is  
37 ~~ineffective and inoperative~~ to the extent that such a construction is unreasonable.

38 (b) Subject to subsection (c), to disclaim or to modify an implied warranty, the following  
39 rules apply:

40 (1) Except as otherwise provided in paragraphs (5) and (6), language of disclaimer

or modification must be in a record.

(2) To disclaim or modify an implied warranty under Section 2B-403 or 2B-404, language that mentions “warranty of quality”, “warranty of merchantability”, “warranty of accuracy”, or words of similar import, is sufficient. Language sufficient to disclaim one of the warranties is sufficient to disclaim the other. Language sufficient to disclaim the warranty of merchantability in a transaction governed by Article 2 is sufficient to disclaim the warranties under Sections 2B-403 and 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 the subject of this transaction will fulfill any of your particular purposes or needs,” or words of similar import. Language sufficient to disclaim a warranty of fitness under Article 2 is sufficient to disclaim the warranty under Section 2B-405.

(4) All implied warranties may be disclaimed or modified only by specific language complying with paragraphs (1) through (3) or other language that in common understanding calls the licensee's attention to the exclusion of all warranties. Language stating that the information is provided “as is” or “with all faults”, or words of similar import excludes warranties under Sections 2B-403 and 2B-404 [and 2B-405].

(5) An implied warranty may be disclaimed or modified by course of performance or course of dealing.

(6) There is no implied warranty with respect to a defect that was known by, discovered by, or disclosed to the licensee before entering into the contract, or which would have been revealed to the licensee if it had not refused to make ~~reasonable~~ use of a reasonable n opportunity ~~reasonably provided to it~~ to examine, inspect, or test the information or a sample thereof made available before entering into the contract, unless the licensee was not aware of the

1 defect after examination and the licensor knew that it existed at that time.

2 (c) In a mass-market license, language that disclaims or modifies an implied warranty  
3 must comply with subsection (b) and be conspicuous. To disclaim all implied warranties in a  
4 mass-market license, other than the warranty under Section 2B-401, language in a record is  
5 sufficient if it states: “Except for express warranties stated in this contract, if any, this  
6 [information] [computer program] is being provided with all faults, and the entire risk as to  
7 satisfactory quality, performance, accuracy, and effort is with the user,” or words of similar  
8 import.

9 (d) If a contract requires ongoing performance or a series of performances by the  
10 licensor, language of disclaimer that complies with this section is effective with respect to all  
11 performance that occurs after the contract is formed.

12 (e) A contractual term disclaiming implied warranties which complies with this section is  
13 not subject to exclusion under Section 2B-308(b)(1).

14 (f) Remedies for breach of warranty may be limited in accordance with the provisions of  
15 this article on liquidation or limitation of damages and contractual modification of remedy.

16 **Uniform Law Source: Section 2A-214. Revised.**

17 **Selected Issue:**

18 1. Should (b)(6) be modified to conform to current law and revised Article 2 which provides: “If a buyer  
19 before entering into a contract has examined the goods, sample, or model as fully as desired or has declined to examine  
20 them, there is no implied warranty with regard to conditions that an examination in the circumstances would have  
21 revealed to it.”

22 **Committee Votes:**

- 23 a. Voted to delete requirement of conspicuousness for non-mass market disclaimers.  
24 b. Rejected a motion to delete conspicuousness for mass market contracts.  
25 c. Rejected a motion to delete (b)(5) by a vote of 3 - 6.  
26 d. Accepted a motion to delete (b)(6) by a vote of 6 -4 with the ability to rewrite to focus and clarify  
27 effects, perhaps in reference to known defects.  
28 e. Adopted a motion to delete the reference to use of trade in (b)(5) by a vote of 8 - 2.  
29 f. Adopted a motion to restrict the impact of the “as is” language to exclude coverage of 2B-405  
30 because it deals with services like obligations. Vote was 6- 3.  
31 g. Motion to adopt the idea of mass market, rather than the idea of consumer on disclaimers.  
32 Adopted 8-2 (Dec. 1996)

1       **h.**       Motion to adopt language from Article 2 precluding disclaimer of consequential damages relating  
2       to personal injury, rejected by a vote of 2-8.

3       **i.**       Motion to delete subsection (e) and replace that section with provision indicating that a term that is  
4       conspicuous is not a refusal term under 2B-308. Accepted 9-1

5       **j.**       Voted 7-6 to use mass market, rather than consumer in this section. (Feb. 1997).

6       **Reporter's Note:**

7       1.       Subsection (a) restates current law.

8       2.       Subsection (b) brings together provisions dealing with commercial disclaimers. Subsection (b)(1)  
9       requires that the disclaimer be in a record, thus not following the possibility in drafts of Article 2 that an oral disclaimer  
10       suffices Subsection (b)(2) sets out a safe harbor for the merchantability warranties and also allows an Article 2 disclaimer  
11       to be effective in reference to the two merchantability like warranties in Article 2B. The purpose of this latter rule is to  
12       avoid requiring that the guess about coverage of the two articles. Importantly, as in existing and revised Article 2, the  
13       specified language is not mandatory, but merely sets out a safe harbor. This language works, but other language may  
14       also work. (b)(3) provides a more common language disclaimer treatment than in current law.

15       3.       Subsection (b)(6) deals with concerns expressed during the November meeting which deleted prior  
16       language taken directly from existing Article 2. The revised language emphasizes knowledge or opportunity to know  
17       of the defect and also expressly disallows a licensor's failure to disclose defects that it knows to be present. Equally  
18       important, by focusing on reasonable use and resulting disclosure, the redraft avoids the potential problem in which might  
19       disallow any implied warranty where inspection was as fully as the licensee "desired". In complex systems often provided  
20       through retail outlets, that standard is not workable.

21       3.       Subsection (c) deals with mass market disclaimers. The subsection adds two requirements applicable  
22       to mass market transactions that do not apply for other transactions. First, the disclaimer must be conspicuous. That  
23       requirement does not apply to commercial transactions in Article 2B. Second, if the intent is to disclaim all warranties  
24       in a single sentence, the subsection sets out a common language disclaimer based on proposals by the software industry  
25       as a means of giving more disclosure to the consumer of what is disclaimed. That language is a safe harbor, rather than  
26       a required statement.

27       5.       Subsection (e) exempts disclaimers that qualify under this section from further consideration under  
28       the "refusal terms" concepts outlined in Section 2B-308.

29       6.       Subsection (f) was added to conform to current law and revised Article 2.

32       **SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM.** Modification

33       of a computer program by a licensee voids any warranties, express or implied, regarding the

34       performance of the modified copy of the program unless the licensor ~~previously~~ agreed that the

35       modification would not void the warranty or the modification was made using capabilities of the

36       program intended for that purpose in the ordinary course of operation of the program. A

37       modification occurs if a licensee alters, deletes, or adds code to the computer program.

38       **Uniform Law Source:** None

39       **Reporter's Notes:**

40       1.       This method of losing warranty protection applies only to warranties related to the performance or  
41       results of the software. It does not apply to title and non-infringement warranties. More importantly, the voiding of  
42       performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications  
43       have no effect.

44       2.       The basis for the provision lies in the fact that because of the complexity of software systems changes

1 may cause unanticipated and uncertain results. This language follows common practice. It voids the warranties whether  
2 the modification is authorized or not unless the contract, or an agreement, indicates that modification does not alter  
3 performance warranties. The section covers cases where the licensee makes changes in the program that are not part of  
4 the program structure or options itself. Thus, if a user employs the built-in capacity of a word processing program to  
5 tailor a menu of options suited to the end user's use of the program, this section does not apply. If, on the other hand,  
6 the end user modifies code in a way not made available in the program options, that modification voids all performance  
7 warranties as to the altered copy.

#### 8 9 **SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.**

10 Warranties, whether express or implied, must be construed as consistent with each other and as  
11 cumulative. However, if that construction is unreasonable, the intent of the parties determines  
12 which warranty prevails. In ascertaining this intent, the following rules apply:

13 (1) Exact or technical specifications prevail over an inconsistent sample, model,  
14 demonstration, or general language of description.

15 (2) A sample, model, or demonstration prevails over inconsistent general language of  
16 description.

17 (3) An express warranty prevails over an inconsistent implied warranty other than the  
18 implied warranty of effort to achieve a purpose.

19 **Uniform Law Source:** ' 2-317.

20 **Committee Action:**

21 Approved in principle.

22 **Reporter's Note:**

23 This Section generally follows existing Article 2. A substantive difference exists between this Draft and the proposed  
24 revisions to Article 2 which indicate that an express warranty does not prevail over inconsistent implied warranties in  
25 a consumer contract. The apparent intent of this is to eliminate the ability to replace implied merchantability warranties  
26 with express warranty concepts.

#### 27 28 **SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.**

29 (a) Except for information made available as published information content, a warranty  
30 made to a licensee extends to persons for whose benefit the licensor intends to supply the  
31 information, directly or indirectly, and that use the information in a transaction or application in  
32 which the licensor intends the information to be used.

(b) For purposes of this section, a licensor that provides the information to an individual as a licensee is deemed to have intended to supply the information to any other individual who is in the immediate family or household of the licensee if it was reasonable to expect that such individual would rightfully use the copy of the information delivered to the licensee.

(c) A disclaimer or modification of a warranty, or of rights and remedies, which is effective against the licensee is also effective against a beneficiary under this section. An expressed intent that limits or excludes third-party beneficiaries excludes any obligation or liability under the contract with respect to third parties excluded by the contract other than persons described in subsection (b).

**Uniform Law Source:** 2-318.

**Committee Action:**

- a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

**Reporter's Notes:**

1. This section defines third party beneficiary concepts. It neither expands nor restricts tort concepts that might apply with reference to third party risks in reference to information. The field of products liability remains outside this Article; governed by tort law in each jurisdiction. In the absence of prior law creating product or other tort liability for the subject matter covered by this Article, Article 2B allows the development of that theme to common law courts.

2. The section deals with when a beneficiary status exists. For a discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994). For a discussion of information liability to third parties, see Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts Restatement test; "By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information receive notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.").

3. 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, for information, contract-based liability is restricted to intended third parties and those in a special relationship with the information provider. The scope of liability extends to transactions that the provider of information intended to influence. This Section incorporates those 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:** Clancey contracts for publication of his text on chemical interactions. Publisher obtains an express warranty that Clancey exercised reasonable care in researching the material. Publisher distribute the text to the general public. Some data is incorrect. Neither Publisher (which make to warranty on published information content), nor Clancey (excluded under (a) makes a warranty to a general buyer of the book.

4. Unlike in goods, the willingness of courts and legislatures to avoid privity and impose third party liability under tort or contract theory has been limited in information products. 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 imposing products liability on information products all involve air craft charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided one of the air chart cases, but later commented that public policy accepts the idea that information content once placed in public moves freely and that the originator of the data does not own obligations to those remote parties who obtain it. See Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991). See also Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817, 824 (3rd Cir. 1951); Berkert v. Petrol Plus of Naugatuck, 216 Conn. 65, 579 A.2d 26 (Conn. 1990) ("[The] imposition of liability against a trademark licensor under [tort law] is appropriate only when the licensor is significantly involved in the manufacturing, marketing or distribution of the defective product...."); Porter v. LSB Industries, Inc., 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993) (product liability cannot be imposed on a party that is outside the manufacturing, selling, or distribution chain); E.H. Harmon v. National Automotive Parts, 720 F. Supp. 79 (N. D. Miss. 1989) (strict liability cannot be imposed on one who neither manufactures nor sells the product); Snyder v. ISC Alloys, Ltd, 772 F Supp. 244 (W. D. Pa. 1991) (16 UCC Rep. Serv.2d 38); Jones v. Clark, 36 N. C. App. 327, 24 UCC Rep. Serv. 605, 244 S.E.2d 183 (N. C. App. 1978) (implied warranty cannot be imputed to one who simply allows its seal of inspection to be placed on a product manufactured by another; if some type of implied warranty were arguably applicable such a warranty could not meet privity requirements since sellers purchased unit from manufacturer and it was only the manufacturer which dealt directly with the laboratory).

While there may be a different policy dealing with software embedded in products, this Article does not deal with embedded products. Tort issues regarding, for example, the software that operates the brakes in an automobile falls within Article 2. No reported cases place products liability on software products that are not embedded in hardware products.

5. Restatement (Second) of Torts \* 552 establishes a limited third party liability structure for persons who provide information to guide others in business decisions. This Section is consistent with that Restatement which 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 of action unless there is a "special relationship" between the information provider and the injured party. Modern case law is increasingly oriented toward the terms of the Restatement. See Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992). This is a contract law statute. To the extent that greater liability is desired, that should come from tort law development, rather than from an expanding notion of contract liability.

6. If the subject matter involves informational content, constitutional considerations and general considerations of policy often limit liability at least in respect of the liability of the publisher. See, e.g., Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991) (publisher of encyclopedia of mushrooms has no duty of care respecting accuracy); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer). Compare Brockelsby v. United States, 767 F.2d 1288 (9th Cir 1985); Saloomey v. Jeppeson & Co., 707 F.2d 671 (2d Cir 1983); Aetna Casualty & Surety Co. v. Jeppeson & Co., 642 F.2d 339 (9th Cir. 1981). Both of the latter cases deal with highly technical and highly specialized information products and impose liability on the author-publisher running to persons with no privity. They have not been followed with respect to any other information liability case.

7. 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.

8. Subsection (c) recognizes and flows from the fact that the basis of this section lies in beneficiary status, rather than product liability concepts. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. Thus, in Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993), for example, the court treated a license agreement involving Standard and Poors (SP), which provided data and index figures for daily closing of options based on the SP index, as an information contract. When SP provided an inaccurate number because of an error in the price of one stock, the court applied concepts of negligence and effort, rather than UCC warranty rules to gauge potential liability. The court held that concepts of negligent misrepresentation applied to this form of information service. The third parties were barred from recovery, however, based on a disclaimer in the original license agreement.

1 **PART 5**

2 **TRANSFER OF INTERESTS AND RIGHTS**

3 **SECTION 2B-501. OWNERSHIP OF ~~TITLE TO~~ RIGHTS AND TITLE TO**  
4 **COPIES.**

5 (a) If an agreement transfers ownership of ~~title to~~ intellectual property rights and does not  
6 specify when ownership ~~title~~ is to pass, ownership ~~title~~ passes to the transferee:

7 (1) when the agreement becomes enforceable between the parties if the  
8 information is in existence at that time; and

9 (2) if the information is not in existence when the agreement becomes  
10 enforceable, when the information has been so far identified to the contract as to be  
11 distinguishable in fact from similar property even if it has not been fully completed and any  
12 required delivery has not yet occurred.

13 (b) Transfer of title to or possession of a copy of information does not transfer ownership  
14 of intellectual property rights in the information.

15 (c) In a license, the following rules apply to copies of information:

16 (1) Title to a copy is determined by the agreement.

17 (2) A licensee's right to possession or control of a copy is governed by the  
18 contract and does not depend on title to the copy.

19 ~~———— (2) Title to a copy is determined by the contract.~~

20 (3) In a ~~If a~~ license, ~~includes a license of intellectual property rights of the~~  
21 ~~licensor~~, reservation of title to a copy reserves title in that copy and any copies made by the  
22 licensee unless the license contemplates that the licensee will make and sell copies of the  
23 information to other parties, in which case reservation of title reserves title only to copies

1 delivered to the licensee by the licensor.

2 (d) If the parties intend to transfer title to a copy and the contract does not specify when  
3 title transfers:

4 (1) physical delivery ~~transfer of a tangible copy from the licensor~~ transfers title to  
5 the copy on delivery to and acceptance by the licensee; and

6 (2) electronic delivery of a copy ~~by electronic means~~ to the licensee transfers title  
7 of the copy when ~~if the transfer constitutes~~ a first sale occurs under federal copyright law.

8 **Uniform Law Source:** Section 2-401; section 2A-302. Revised.

9 **Committee Vote:**

10 a. Voted 11-0 to delete a sentence restricting exercise of rights until it pays according to the terms of  
11 the contract. That concept can be transferred to comments in a form that also accommodates in kind and  
12 other value.

13 **Reporter's Notes:**

14 1. This section distinguishes title to the copy from ownership of the intellectual property rights, a point  
15 that is made explicit in subsection (b). This distinction flows from the Copyright Act and other law. It means that, while  
16 ownership of a copy may carry with it some rights with respect to that copy, it does not convey ownership of the  
17 underlying rights to the work of authorship or the patented technology. This represents a basic theme in differentiating  
18 intangibles and tangible objects. The media here is not the message, but the conduit.

19 2. Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a  
20 matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as  
21 compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that  
22 limit. The subsection solves the problem in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article  
23 2 theories of title transfer to goods to hold that title to an intangible (a computer program) being developed for a client  
24 could not pass until the program was fully completed and delivered.) The transfer of title hinges on completion to a  
25 sufficient level that separates the transferred property from other property of the transferor. See In re Bedford Computer,  
26 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallows transfer of title in software where “new” code could not be separately  
27 identified from old or pre-existing code.).

28 3. Under subsection (c), in a license, the right to the copy of information depends on the terms of the  
29 contract and not on the label one applies to handling underlying media. This is a default rule that applies regardless of  
30 the terms of the license contract. As in Article 2A, this draft does not spell out title transfer rules with reference to  
31 licenses. The question of whether title to a copy in fact transfers in a license may depend on the terms of the license and  
32 the marketplace in which the license transaction occurs. Especially in many commercial licenses, it is inappropriate to  
33 presume that title does pass to the licensee in the absence of contractual reservation. The typical presumption is that the  
34 transfer there is conditional as reflected in the license terms, rather than presumptively a sale of the copy. See United  
35 States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (licenses transferred rights for exhibition or distribution and did not  
36 constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license not a sale). The  
37 circumstances may be different in the mass market even where purchasers are aware that a license agreement will be  
38 involved. As drafted, the section takes no position on that issue or how one distinguishes these cases. The mass market  
39 licensee receives protections under applicable default rules that are not based on title issues. If the issue were to become  
40 important in litigation and were not dealt with by contract, a court would presumably inquire about the intent of the  
41 parties as to title to the copy.

42 4. Subsection (d) deals with cases involving an intent to sell a copy and states various presumptions  
43 relating to when title passes to copies. The basic theme is that the contract controls. Absent contract terms, the draft

distinguishes between tangible and electronic transfers. The rule for tangible transfers of a copy parallels Article 2 in current law. The electronic transfer approach defers to federal law on a potentially controversial issue. The White Paper on copyright in the Internet suggests and legislation is being considered to implement that the electronic delivery of a copy of a copyrighted work is not a first sale because it does not involve transfer of a copy from the licensor to the licensee. While state law could control questions of title to personal property, this draft suggests that the issue be left to federal policy.

## **SECTION 2B-502. TRANSFER OF PARTY'S INTEREST.**

(a) Except as ~~otherwise~~ provided in subsection (b) ~~this section~~, a party's rights under a contract may be transferred, including by an assignment or 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, ~~cause~~~~create~~ a delegation of material performance, 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.

~~Except as otherwise provided in Section 2B-504 with respect to the creation of a financier's interest, a~~ transfer of a licensee's ~~may not transfer, voluntarily or involuntarily,~~ contractual rights under a nonexclusive license that would be effective under subsection (a) without the consent of the licensor ~~party that holds intellectual property rights in the information~~ is ineffective unless the transfer is subject to the terms of the license and:

(1) the contract is a mass-market license, the licensee received delivery of a copy of the information, and transfers the original copy and all other copies made by it; or

(2) the licensee received title to the copy of the information by a transfer authorized by ~~from~~ the party that holds intellectual property rights in the information, the license did not preclude transfer of the licensee's rights, and the transfer of the licensee's rights complies with applicable provisions of federal law for the owner of a copy to make the transfer.

(c) Subject to subsection (a), either party may transfer the right to receive payment from the other party.

(d) A transfer made in violation of this section is ineffective.

**Uniform Law Source: Section 2A-303. Substantially revised.**

**Committee Vote:**

- a. Voted 7-1 to add a provision to allow transfer when the licensee owns the copy of the information.
- b. Voted unanimously to use mass market, rather than consumer in this section.

**Reporter's Notes:**

1. The provisions of this Section apply in the absence of contractual restrictions. The effect of contract restrictions on alienation are treated elsewhere as is the enforceability of a security interest. "Transfer" is used in the sense of a conveyance of rights and duties under a contract and contrasts to the idea of merely delegating or sub-licensing performance where the delegator remains primarily responsible and in control of the contract performance. It contrasts to the idea of delegation or sublicense which involve a shift of the performance to a third party without transferring the contractual rights.

2. Subsection (a) states a general principle of transferability subject to that being disallowed in cases where the transfer jeopardizes significant interests of the other party to the license contract. This is consistent with general UCC themes, except that the subsections spell out additional protected interests that block transfer and that are important here, but not in reference to sales of goods. Included among those interests are transfers that create and actual disclosure or threaten a disclosure of confidential material. Whether this occurs must be viewed in context of the original transaction. The application of this concept would be limited to cases where actual trade secret or confidentiality relationships had been established with respect to some of the information that forms the subject matter of the contract.

3. Subsection (a) expressly refers to transfers that disclose or threaten to disclose trade secret or confidential material of the other party. Whether particular information is confidential or not will ordinarily be determined by other law, including common law contract and trade secret law. Application of this limitation on transfer hinges on the existence of such an interest. The restriction on transfer that results occurs only if the transfer increases the risk of confidentiality disclosure juxtaposed to the original transaction itself. Thus, for example, if arguable trade secrets are embedded in object code of a computer program, but the contract does not place confidentiality restrictions on the licensee, merely transferring the copy to another party, if that is otherwise permitted, does not jeopardize the secrets for purposes of subsection (b). With reference to both the transferor and transferee, in the absence of enforceable confidentiality restrictions in the contract or otherwise in law, discovery of the secret information may be appropriate and the degree of risk does not change for the secret owner. On the other hand, where confidential material is subject to restrictions or is directly disclosed as a result of the transfer, the limitation in (a) applies. Of course, even if the limitation grounded in confidentiality concepts does not apply, a non-exclusive license may be otherwise non-transferable under the other provisions of this section.

4. Subsection (b) follows current law which holds that a licensee cannot assign its rights in a nonexclusive license. For patents and copyrights, this represents federal policy. The fact that this federal policy overrides state law was restated and accepted by the Ninth Circuit in 1996. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9<sup>th</sup> Cir. 1996); Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7<sup>th</sup> Cir. 1972). The non-transferability premise flows from the fact that a nonexclusive license is a personal, non-assignable contractual privilege, representing less than a property interest. See Harris v. Emus Records Corp., 734 F.2d 1329 (9<sup>th</sup> Cir. 1984) (copyright); In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W. D. Tenn. 1987).

5. The Ninth Circuit explained the policy basis for this federal law rule in reference to patent licenses in the following terms:

Allowing free assignability - or, more accurately, allowing states to allow free assignability - of nonexclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute number of licenses in existence under a free-assignability regime, it would lose the very important ability to control the identity of its licensees. Thus, any license a patent holder granted—even to the smallest firm in the product market most remote from its own—would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be

absolutely unwilling to license. As a practical matter, free assignability of patent licenses might spell the end to paid-up licenses such as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for per-use royalties, if the license could be assigned to a completely different company which might make far greater use of the patented invention than could the original licensee. Thus federal law governs the assignability of patent licenses because of the conflict between federal patent policy and state laws, such as California's, that would allow assignability.

Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9<sup>th</sup> Cir. 1996). The approach to non-exclusive copyright licenses in federal law is the same. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984).

6. The two exceptions in subsection (b) to the non-transferability concept attempt to define situations in which the basis of this policy are not present or offended by a general rule allowing assignment. The first, mass market licenses, indicates the fact that in a mass market environment the licensor has essentially chosen not to be concerned about the identity of the particular licensee, but rather places the information out to the general public. In the second exception, federal law rules relating to first sales apply and allow the owner of a copy to distribute that copy, presumably along with the right to use/ copy that work in the case of computer software. See 17 USC ' 117.

7. Subsection (d) states a rule on the effectiveness or ineffectiveness of transfers of non-exclusive license rights by a licensee that makes the transfer ineffective unless authorized by this section. Given the carve outs for mass market and owned-copy transactions in subsection (b), this rule carries forward the federal policy and the underlying personal nature of the non-exclusive licensee's rights. Cases such as Everex indicate not only that the attempted assignment violates contract provisions, but that it is invalid without the licensor's consent. The Ninth Circuit in Everex indicated that federal law sets out a bright line test invalidating the transfer without consent and entirely independent of whether there was (or was not) actual impact on the licensor's interests. The predominant interest here focuses on the licensor's intellectual property rights and control of to whom the intellectual property is given. Article 2A, dealing with tangible property, makes the contrary assumption in 2A-303(5), but would generally enable a lessor to cancel the lease because of the transfer. Under the intellectual property regime that governs here, that additional step is not warranted and may be barred by existing case law. It is important to recognize, however, that the net effect of this section and the parallel rule in Section 2B-503 is to increase significantly the transferability of licensee rights.

## **SECTION 2B-503. CONTRACTUAL RESTRICTIONS ON TRANSFER.**

(a) Except as otherwise provided in subsection (b), a contractual restriction or prohibition on transfer of an interest of a party to a contract or of a licensor's ownership of intellectual property rights in information that is the subject of a license is enforceable. A transfer made in breach of an enforceable contractual term that prohibits transfer is ineffective.

(b) With respect to a financier's interest, ~~the~~ the following contractual restrictions are not effective to prevent creation of the interest, but a transfer or creation of an interest made in violation of the restriction constitutes a ~~breach~~enforceable:

(1) a term that prohibits a party's transfer of its interest or creation or enforcement of a security interest in an account or in a general intangible for money due or to become due or which requires the other party's consent to such a transfer; and

(2) a term that prohibits a party's transfer of its interest or creation or enforcement of a financier's interest except to the extent that creation of the financier's interest or enforcement would be precluded in the absence of the term under Section 2B-502 or 2B-504.

~~—— (c) A transfer made in breach of an enforceable contractual term that prohibits transfer is ineffective.~~

**Uniform Law Source:** Section 2A-303(2)(3)(4)(6)(8).

**Committee Vote:**

a. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license.

**Reporter's Note:**

This Section generally validates contractual restrictions on the transfer of a contractual interest. The primary exceptions to this policy relate to financing arrangements, the transfer of interests in a cash flow from a license and the creation of a financier's interest under this Article.

## **SECTION 2B-504. FINANCIER'S INTEREST IN A LICENSE.**

(a) The creation, ~~perfection, or enforcement~~ of a financier's interest in a party's rights under a license without the consent of the other party to the license is effective if the creation ~~a transfer~~ of the interest would be effective under Section 2B-502 and 2B-503, but enforcement of a financier's interest thus created is effective only if enforcement would also be effective under Section 2B-502 and Section 2B-503 ~~or if the other party to the license consents.~~

(b) If the creation, ~~perfection,~~ or enforcement of a financier's interest in a licensee's rights under a nonexclusive license is not effective under subsection (a):

(1) ~~Subject to paragraph (b)(2), the creation , perfection,~~ or enforcement is effective only to the extent that it does not result in an actual transfer or change of the use or possession of, or access to, the information, or a result not consistent with the limitations of Section 2B-502(a) ~~delegation of a material performance or obligation of the licensee other than as to the obligation to make payments to the licensor; and~~

(2) in the event of a breach ~~of contract~~ by the licensee, as between the financier

1 and the licensee, the financier has a right -under Section 2B-715 to prohibit the licensee from  
2 using the information covered by the financier's interest and the financier may take possession of  
3 copies of the information or related materials covered by its interest only if the licensor consents  
4 or the conditions of Section 2B-502(a)~~subsection (a)~~ are met.

5 (c) A financier that creates or enforces an interest and any transferee of the financier is  
6 subject to the terms and limitations of the license and to the licensor's intellectual property  
7 rights. The financier ~~and~~ may not use, sell, or otherwise transfer rights in the license or copies  
8 of the information or access to the information unless the conditions of subsection (a) are met  
9 as to enforcement of the interest.

10 (d) The creation or enforcement of a financier's interest imposes no obligations or duties  
11 on the licensor with respect to the financier.

12 **Committee Action:**

- 13 a. Consensus that Article 2B should allow creation of limited rights in licensee side of non-exclusive  
14 licenses, but not permit sale and the like without consent of the licensor.

15 **Reporter's Notes:**

16 [Changes were made to avoid a number of drafting problems that produced either unintelligible or inappropriate results  
17 based on prior Committee discussion. Changes here correspond to changes in 2B-502 and 2B-503. In subsection (a),  
18 for example, the changes avoid the apparent interpretation that "enforcement" (in any manner) would be allowed if  
19 "creation" would not violate the restrictions of 502 and 503. Enforcement, such as through sale, of course, involves  
20 very different considerations and, while creation might not improperly delegate rights, repossession and sale may very  
21 well do so. As redrafted, the creation and the attempted enforcement must each pass under the standards outlined in  
22 this Article.]

23 1. This section reflects the general approach of Article 2B of combined treatment of security interests  
24 and financing leases in an integrated treatment. The definition of "financier" covers both secured parties and lessors. See  
25 2B-102.

26 2. As redrafted, subsection (a) makes clear that, in general, a financier's interest can be created in any  
27 contractual right that can be transferred and that, in all other cases, consent by the other party to the contract makes  
28 transfer possible, but that the act of creating a security interest and the act of enforcing that interest are separable events.  
29 Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property  
30 and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's rights  
31 are dominant. Thus, a critical limit on enforcement and, except for non-possessory interests, creation of a financier's  
32 interest lies in 2B-502(a) which disallows transfers that impinge on licensor interests of the type described therein.

33 3. For non-exclusive licenses, the transferability of a licensee's rights is even further constrained in law  
34 by federal policy limitations that presume non-transferability without licensor consent. See 2B-502(b). This Article  
35 pushes the scope of secured lending in the absence of licensor consent as far as possible in light of that strong contrary  
36 and preemptive federal policy. It assumes that the license is non-assignable and personal for reasons noted in the cases  
37 cited in Section 2B-502 notes, but tailors a right to **create** a security interest without the licensor's consent in a manner  
38 that avoids preemption by satisfying the policy interests that underlie the basic non-assignability principle. Thus, while



1 an interest can be created, it cannot, without the licensor's consent, result in an actual change of control, access or use  
2 or any sale. This preserves the licensor's protected interest under federal law in controlling the resale market and the  
3 identity of the licensee to whom it transfers rights in its intellectual property. See Everex Systems, Inc. v. Cadtrak Corp.,  
4 89 F.3d 673 (9<sup>th</sup> Cir. 1996).

5 4. The approach is modeled after Article 2A-303(3) which limits the enforceability of lease provisions  
6 restricting security interests in the lessee's interests. It applies here to both a contract clause and to a non-exclusive  
7 license that contains no such clause because, unlike in leases, the underlying law does not routinely allow assignment  
8 of the licensee's interest. The comments to Article 2A-303 state: "[The] lessor is entitled to protect its residual interest  
9 in the goods by prohibiting anyone other than the lessee from possessing or using them." Article 2A-303, Comment 3.  
10 As in Article 2A, the licensor (lessor) has a right to control who is in effective possession (including use and access) of  
11 the subject matter of the license. In many cases, this will preclude repossession or sale without the licensor's consent.  
12 It does not prevent repossession and sale if the licensed rights would be transferable under 2B-502 and 2B-503.

13 5. The provisions here allow creation of a security interest in many cases because mere creation does not  
14 make an actual change of possession, use, or access, nor does it delegate obligations. The argument against preemption  
15 is that "creating" a security interest does not "transfer" or assign the interest under the license. The **Everex** case indicated  
16 that one aspect of the federal policy was that the intellectual property rights holder has a protected interest in restricting  
17 the use of its intellectual property by persons other than those it specifically authorizes. The approach in this draft draws  
18 a balance that allows full pursuit of that federal policy, but gives substantial scope to the state law policy of allowing  
19 creation of security interests. The same would not be true, for example, with a rule that allows all assignment of rights  
20 under the other section of transferability, a rule that would be specifically subject to preemption.

21 6. The draft also parallels Article 2A in providing that the secured lender and any transferee take subject  
22 to the terms of the original license. The license is the dominant document in that it defines the licensee's rights. A lender  
23 does not have the ability to abrogate those rights and the limitations that are attached to the rights.

24 7. The result of the financing provisions allow creation of a security interest in any case where creation,  
25 in itself, alters none of the actual interests of the parties. When it comes to enforcement of the interest, however, the  
26 lender's rights are subordinate to actual interests of either party and to federal policies about transferability. The effect  
27 of the provisions is illustrated in the following examples.

#### 28 **Illustration 1. Financing a Licensor's Interest.**

29  
30 Creditor desires to finance the licensor's interest in a commercial license. To determine whether  
31 it can do this, the creditor must make the following determinations: a) under 2B-502(a) would  
32 creation of the interest make a change that impinges one or more of the interests listed there; b) if  
33 not, under Section 2B-503 is there an enforceable no transfer provision that precludes creation of  
34 the interest without consent; c) if not, then the interest can be created under 2B-504(a). However,  
35 if the transfer is precluded by either of the above, no security interest can be created.

36 If an interest can be created, the lender would make the same analysis in reference to  
37 enforcement (e.g., repossession or sale). The issues are different, of course, since repossession or  
38 sale precludes some further uses and changes the party in control in a way that may adversely  
39 impact the licensee. The result of the analysis would depend on the licensor's personal role in the  
40 on-going license. In cases of fully paid up, [perpetual licenses, enforcement would not be barred  
41 unless, for example, it threatens trade secret rights of the licensee.

#### 42 **Illustration 2. Financing the Licensee in a Commercial License.**

43  
44 Assume creditor desires to finance the licensee's interest in a commercial, non-exclusive license.  
45 It would ask the following questions: a) is the creation of the interest blocked by 2B-502(a) in that  
46 it would cause an inappropriate delegation, deny the return expected by the licensor, or otherwise  
47 adversely impact the interests listed there; b) if the interest is **permitted** under 2B-502(a), it is still  
48 prohibited under 2B-502(b) unless it falls into one of the exceptions there (mass market, or title  
49 without contract restriction); c) if it is not within an exception, the Creditor would not need to  
50 consult 2B-503, if it did so, however, and there was a contractual limitation on creation of an  
51 interest or on transfer, that contract terms is effective since creation of an interest is barred under  
52 2B-502; d) if creation is barred under either 2B-502 or 2B-503, 2B-504(b)(1) still permits creation

of an interest if this does not violate 2B-502(a) or change possession, use or control of the information.

In most cases, the net of these provisions allows **creation** of an interest in a non-exclusive license, but this does not permit the full panoply of enforcement. The analysis must be repeated for any effort to enforce the interest. Enforcement will involve different issues because it changes possession or use. The first stages of analysis are the same. If repossession or sale is barred under 2B-502 or 2B-503, which it will ordinarily be, 2B-504(b) may not alter that result as to enforcement. Under (b)(1) enforcement is not permitted if it changes possession or use. Section (b)(2) is an over-ride that allows taking possession (but not sale) and barring use, **but only if these acts do not violate the rules of 2B-502(a)**. In effect, enforcement without licensor consent cannot occur if it adversely affects the licensor's interest, including an adverse effect by making the licensor's return less likely to be received. In end user software, this will often allow a court order to prevent use under (b)(1), but may will not allow repossession. Section (b)(2) does not authorize enforcement by sale in a licensee situation in any case without the licensor's consent.

#### **Illustration 3. Financing an Entertainment Licensee Interest.**

Assume that the commercial license in Illustration 2 involves a distribution license for a motion picture. Under 2B-502(a), while creation of an interest in the licensee rights may not be barred, any enforcement of those rights without consent would typically be barred because it would change (increase) the risk of the licensor not receiving a return expected from the contract. This is true regardless of the presence or absence of contract provision. Under Section 2B-504, creation of the interest may be permitted under (b)(1), but typically, no enforcement would be permitted because enforcement (barring use, taking possession) would adversely effect the return and other interests of the licensor.

#### **Illustration 4. Financing a Mass Market Licensee Interest.**

The treatment of a mass market license parallels other non-exclusive licenses, except that the exception stated in 2B-502(b) shifts the presumptions and, at least if the definition of mass market focuses on anonymous, true retail transactions where the licensee identity is not relevant, the nature of the product will often eliminate a major limitation on transfer. Section 2B-504(a) requires analysis under 502 and 503. Under 2B-502 and 2B-503, a lender can create an interest in a mass market license if the creation of the interest does not result in a 502(a) injury to the licensor. Under these same sections, a lender can enforce the interest if a) enforcement does not violate 2B-502(a) and b) enforcement is not barred by a contract provision against enforcement or transfer. If either of these conditions preclude enforcement, the focus shifts to 2B-504(b). This section does not allow sale, but does allow creating an interest and enforcement that does not violate 502(a). In effect, in the **true** mass market the lender can create and enforce its interest unless the licensor contractually bars transfer, in which case, creation is still allowed. This solution works so long as the idea of mass market does not encroach too strongly into commercial transactions.

### **SECTION 2B-505. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.**

(a) A transfer of a party's rights under a contract is a transfer of contractual rights subject to the restrictions on use of the information contained in the contract ~~agreement on the exercise of those rights~~ and, unless the language or the circumstances indicate to the contrary, such as in a transfer limited to creating an financier's interest, the transfer is a delegation of duties by the transferor. Acceptance of the transfer constitutes a promise by the transferee to perform the

1 duties of the transferor. The promise is enforceable by the transferor or any other party to the  
2 contract.

3 (b) A transfer of contractual rights does not relieve the transferor of any duty under the  
4 contract to pay or perform, or of liability for breach of contract, except to the extent the other  
5 party to the original contract agrees.

6 **Uniform Law Source:** 2-210; 2A-303.

7 **Committee Action:** Discussed in November, 1996, without substantial comment.

8 **Reporter's Note:**

9 1. This section implements a policy in current Article 2 and Article 2A. The recipient of a transfer is  
10 bound to the terms of the original contract and that obligation can be enforced either by the transferor or the other  
11 party to the original contract.

12 2. This section clarifies that an effective transfer (assignment or otherwise) of rights under a contract  
13 constitutes a transfer of those contract rights and, a delegation of duties if accepted by the transferee. This language  
14 follows Article 2 (which uses the word assignment) and Article 2A (which refers to transfers).

15 3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's  
16 obligations to the original contracting party in the absence of a consent to the novation.

17  
18 **SECTION 2B-506. DELEGATION OF PERFORMANCE; SUBCONTRACT.**

19 (a) A party may delegate or subcontract to ~~another person~~ performance of its contractual  
20 obligations unless:

21 (1) transfer would be prohibited under Section 2B-503,

22 (2) the other party otherwise has a substantial interest in having the original  
23 promisor perform or directly supervise or control the performance, or

24 (3) the contract prohibits delegation or subcontracting.

25 (b) Delegation or subcontracting does not relieve the delegator or subcontractor of any  
26 duty under the contract to pay or perform, or of liability for breach of contract, except to the  
27 extent the other party to original contract agrees.

28 **Committee Action:**

29 Reviewed in November, 1996, without substantial comment except that adjustments should be made to clarify  
30 that the section is subject to restrictions on transfer.

31 **Uniform Law Source:** Section 2-210; Section 2A-303.

32 **Reporter's Notes:**

1           1.       Delegation or subcontracting of performance refers to a party's ability to use a third party in making  
2 an affirmative performance under an information contract. It does not refer to authorization or other allowance of third  
3 party exercise of rights in licensed information. pursuant to in a contract is generally allowed. In both cases, while the  
4 performance may be made by the delegee, the original; party remains bound by the contract and responsible for any  
5 breach thereof. The ability to delegate performance must be read in contrast to the general limitations on transferability  
6 of non-exclusive licenses under in 2B-502. A delegation or subcontract works a transfer equivalent in substance to a  
7 transfer or assignment of

8           2.       The ability to delegate is subject to contrary agreement. Thus, a contract that permits use of licensed  
9 information only by a named person or entity controls and precludes delegation. The result in such cases is determined  
10 by both the general principle that contract terms control and the more specific principle that the other party has, by the  
11 contract, expressed an interest limiting performance to the designated party.

12           3.       In the absence of a contractual limitation, delegation can occur unless the circumstances come within  
13 one of three conditions are met. The first condition that prevents delegation arises if the transfer of an interest would be  
14 precluded under 2B-503. That section disallows transfers in cases where the contract prohibits such action. The second  
15 condition, arises if the contract is silent but the other party has a substantial interest in having performance rendered by  
16 the person with whom it contracted. Obviously, a party has a substantial interest in having the original party perform if  
17 the delegation triggers the restrictions outlined in 2B-502(a). On the other hand, neither of these provisions would deny  
18 a right to delegate or subcontract performance in a mass market transaction where, under Section 502, can be freely  
19 transferred by the licensee.  
20  
21

## 22           **SECTION 2B-507. PRIORITY OF TRANSFER BY LICENSOR.**

23           (a) A licensor's transfer of ownership of intellectual property rights,~~other than by the~~  
24 ~~creation of a financier's interest,~~ is subject to a previous nonexclusive license if that license was  
25 in a record authenticated ~~and executed~~ by the licensor before the transfer of ownership.

26           (b) A financier's ~~security~~ interest created by a licensor or a transfer of ownership of  
27 intellectual property rights under a financier's ~~security~~ interest in information or in copies of the  
28 information is subordinate to a nonexclusive license which was:

29                   (1) authorized by the secured party;

30                   (2) documented in a record authenticated ~~executed~~ by the licensor before the  
31 security interest was perfected; or

32                   (3) transferred in the ordinary course of the licensor's business to a licensee that  
33 acquired the license in good faith and without knowledge that it was in violation of the security  
34 interest.

35           (c) For purposes of this section, a transfer of ownership or of a financier's ~~security~~

1 interest occurs when the transfer is effective between the parties, but, if applicable intellectual  
2 property law requires filing or a similar act to obtain priority against other transfers, the transfer  
3 does not occur until the date on which priority begins under that law after the filing or similar act  
4 occurs.

5 **UNIFORM LAW SOURCE: Section 2A-304. Revised.**

6 **Selected Issues:**

7 **a.** Should the Article provide a rule about transfer of intellectual property ownership that is subject to  
8 contrary federal intellectual property law when applicable as has been suggested?

9 **REPORTER'S NOTE:**

10 1. This is an area heavily influenced by federal copyright law as to copyright interests and the provisions  
11 here attempt to trace that influence while providing maximum state law recognition for traditional UCC priorities. As  
12 to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal  
13 intellectual property rights. There is no such preemption in reference to data, trade secrets and other non-federal rights.  
14 For security interests and their relationship in terms of priority to the rights created under an intangibles contract, the  
15 priority questions might be dealt with in this article as was done in Article 2A or they may be dealt with in Article 9.  
16 Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with  
17 a non-exclusive license.

18 2. Under the Copyright Act, a prior non-exclusive license is subordinate to a later transfer of copyright  
19 ownership unless the license is in a signed writing. This rule, while awkward and somewhat inconsistent with modern  
20 trends, was made part of the Copyright Act in 1976; there are no indications of probable repeal. The restatement of that  
21 rule here alerts persons who engage in commercial transactions about a priority rule that may not otherwise be expected.  
22 This avoids traps for unwary licensees. Note, however, that by using the new terms “record” and “authentication” this  
23 section are not yet explicitly adopted in federal law.

24  
25 **Illustration 1:** Computer Associates sells the copyright in its data compression program to Major  
26 Holdings Corp. Five days before that sale, Computer Associates entered a non-exclusive license with  
27 Boeing Corp. for a 100 user site license, which license was in an unsigned form. Three days after the  
28 sale, Computer Associates entered a non-exclusive site license with Standard Corp. Under subsection  
29 (b) **and** under federal law, the licensees’ rights to copy (e.g., use) the software are subordinate to the  
30 copyright ownership of Major.

31 **Illustration 2:** Lotus enters into a non-exclusive distribution license with Distributor, allowing  
32 Distributor to make and distribute copies of 1-2-3 Spreadsheet in the mass market subject to a standard  
33 form license for end users. Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale,  
34 Distributor provides a copy of 1-2-3 to Smith, who assents to the license. If the distribution license was  
35 a signed writing, the distribution was authorized by the license which has seniority over Taylor. Smith  
36 has priority over Taylor because it took through the valid license. If the distribution license was not  
37 a signed writing, Taylor’s purchase is senior to that license and Smith is not an authorized user.

38  
39 3. Subsection (b) also presents a preemption problem under federal copyright law, but the case for  
40 preemption is less clear since the UCC generally controls priorities and other aspects of law relating to security interests  
41 and the federal concerns in the priority statute are more focused on title transfers. This section does not take a position  
42 on whether a security interest should be filed in federal or state records systems; it simply refers to perfection of the  
43 interest. It adopts priority rules for a security interest in conflict with a nonexclusive license that parallel priority  
44 positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions  
45 that enable the licensor whose intangibles are encumbered to continue to do business in ordinary ways.

46 4. Article 2A deals with the priority conflicts that arise when the licensor or owner transfers to a third  
47 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

1 to the rights of the lessee in the particular item. That situation does not arise in intangibles involving two nonexclusive  
2 licenses since intangibles can be licensed an infinite number of times and each licensee receives the same rights. In  
3 contrast, if there is a transfer of ownership of the information there may be a conflict between the transferee and the  
4 licensee. There are two types of priority conflicts in such cases and modern law lacks clear guidance or commercially  
5 viable solutions. One conflict is between two transferees of ownership. The other is dealt with in this section: conflicting  
6 claims of a nonexclusive licensee as against a transferee of ownership rights, including a secured party.

7 5. For rights not created by federal law, the priority issue raised is a question of state law. The same is  
8 apparently true for rights that arise under federal patent law. The Patent Act contains provisions that deal with the  
9 respective priority of transfers of patent ownership. A nonexclusive license is not a transfer of ownership and the  
10 relationship between the nonexclusive licensee and a transferee of a patent is not dealt with in current federal law. The  
11 situation is different in copyright law. Section 205(f) of the Copyright Act provides:

12  
13 A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright  
14 ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed  
15 or such owner's duly authorized agent, and if:

- 16 (1) the license was taken before execution of the transfer; or  
17 (2) the license was taken in good faith before recordation of the transfer and  
18 without notice of it.  
19

20 17 U.S.C. ' 205(f). There is no case law under this provision. Significantly, however, the provision does not allow a  
21 license made after recordation of the ownership transfer to attain priority under any conditions. Also, an unwritten  
22 license will lose even to a subsequent transfer of ownership if this section is regarded as a comprehensive priority rule.  
23

24 6. Copyright Act ' 205(f) can be viewed as a comprehensive rule of priority (e.g., an unwritten license  
25 never superior to a transfer of ownership and the priority status of a written license entirely controlled by Section 205(f)).  
26 Alternatively, one might view it as a minimum condition for a particular result (e.g., that a written nonexclusive license  
27 has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true).  
28 This draft adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus,  
29 as a matter of enacted federal policy, a nonexclusive license prevails in the listed situations, but a nonexclusive license  
30 in cases not covered by Section 205 is not controlled by federal law. A contrary interpretation would mean that all mass  
31 market licenses currently are subject to being overridden by any subsequent transfer of the underlying copyright since  
32 many of these transactions may not qualify as involving a writing signed by the owner of the copyright. Clearly, an  
33 assignee of the copyright to Word Perfect software should not be able to sue pre-existing Word Perfect licensees for  
34 continued use of the program without a license from the current owner. Even if this position is not correct, the priority  
35 rules here would apply to all intangibles other than copyrights, leaving a wide variety of important situations to be  
36 addressed here.  
37  
38

## 39 **SECTION 2B-508. PRIORITY OF TRANSFERS BY LICENSEE.**

40 (a) In a license, a creditor or other transferee of a licensee acquires no interest in  
41 information, copies, or rights held by the licensee unless the conditions for an effective transfer  
42 under this article and the license are satisfied, and if the transfer is effective, the creditor or other  
43 transferee takes subject to the terms of the license.

44 (b) Except for rights under trade secret law, a person that acquires information that is

subject to the intellectual property rights of another person acquires only the rights that its transferor was authorized to transfer by the owner of the intellectual property rights or its agent as such rights were limited under the license.

**Uniform Law Source: Section 2A-305**

**Committee Action:** This section was considered in November, 1996, without substantial comment.

**Reporter's Notes:**

1. A license, previously created, governs rights in the information and in copies thereof. A transferee acquires only the rights that the license allows. As a general principle, a license does not create vested rights and is not generally susceptible to free transfer in the stream of commerce. Subsection (a) is generally consistent with Article 2A.

2. Subsection (b) states an important principle, mandated under current intellectual property law. The idea of entrustment, which plays a major role in dealing with goods, has less role in intangibles covered by patent or copyright law, since the value involved resides in the intangibles and the concept of possession being entrusted in a manner that creates the appearance of being able to reconvey the valuable property is not ordinarily a relevant concern. Intellectual property law does not recognize a buyer in the ordinary course (or other good faith purchaser) as taking greater rights than the information or copy than were authorized to be transferred. While copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, the first sale must be by a party authorized to make the sale under the terms provided to the buyer.

**Illustration 1:** Correll transfers copies of its software to DAC a distributor. DAC is licensed to transfer the software for educational uses only. DAC transfers a copy to Mobil Oil for use in a business application. Mobil has no knowledge of the Correll license restriction. DAC breached its contract and its distribution also constitutes copyright infringement. Mobil's copying (use) of the software is not authorized under copyright law since it did not receive an authorized distribution. The remaining question is whether Mobil should be subject to a contract action for violating the license in the DAC contract. This section takes no position on the issue.

3. Transfers in a chain of distribution that exceed a license or that otherwise are unlicensed and unauthorized by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase, but its use is likely to constitute infringement. As to software, this established principle was enforced by the court in Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). A retailer that obtained copies of software from third parties argued that the distribution was not a violation of copyright because it in good faith believed that it obtained the copies of the software through a first sale from an authorized party. The court held that there is no concept of good faith purchaser under copyright law and that the buyer cannot obtain any greater rights than the seller had. In the case where the seller is neither an owner of a copy or a person acting with authorization to sell copies to third parties, no first sale occurs and the "buyer" is subject to the license restrictions created under any license to the third party seller. In one instance, the defendant had purchased from a licensee who was authorized to transfer the Microsoft product in sales of its machines. In fact, however, it purported to sell the product as a stand alone. This clearly exceeded the license to it and the mere fact that the alleged buyer acted in good faith did not insulate it from copyright liability. "Entering a license agreement is not a "sale" for purposes of the first sale doctrine. Moreover, the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products." See also Major League Baseball Promotion v. Colour-Tex, 729 F. Supp. 1035 (D. N.J. 1990); Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077 (D. Md. 1995); Marshall v. New Kids on the Block, 780 F. Supp. 1005 (S.D.N.Y. 1991).

4. This section does, however, allow for a bona fide purchaser in reference to trade secret claims. The essential feature of a trade secret resides in enforcing confidentiality obligations. Where a party takes without notice of such restrictions, it is not bound by them and, in effect, is a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

5. Article 2A provides that a buyer from a lessee generally acquires only the "leasehold interest in the goods that the lessee had or had power to transfer, and ... takes subject to the existing lease." Section 2A-305(1). The

1 exception to these principles in Article 2A occurs in the case of a buyer (or sublessee) from who acquires in the “ordinary  
2 course” of the lessor-seller’s business. The buyer here takes free of the lease under theories of entrustment. For a buyer  
3 to acquire these rights, however, it must purchase from a “person in the business of selling goods of the kind.” In effect,  
4 the goods were entrusted to a sales business. Also, the buyer must be in good faith and without knowledge that the sale  
5 violates the lease or ownership rights of the lessor.

6 -

## 7 **PART 6** 8 **PERFORMANCE**

### 9 **[A. General]**

#### 10 **SECTION 2B-601. PERFORMANCE OF CONTRACT.**

11 (a) A party shall perform in a manner that conforms to the contract and, in the absence of  
12 contractual terms, in a manner and with a quality that is reasonable in light of the circumstances  
13 including the ordinary standards of the relevant business, trade or industry.

14 (b) A party’s duty to perform, other than with respect to contractual use restrictions, is  
15 contingent on the absence of an uncured material breach by the other party of obligations or  
16 duties that precede in time the party’s performance.

17 (c) In a mass-market transaction, if the performance consists of delivery of a copy ~~on a~~  
18 ~~physical medium~~ which constitutes the initial ~~[transfer]~~[activation] of rights, the licensee may  
19 refuse the performance if the performance does not conform to the contract.

20 (d) If a party is subject to contractual use restrictions or required to render ~~other~~ future or  
21 on-going performance, the party’s rights ~~to exercise its rights~~ under the contract ~~are~~ contingent  
22 on the absence of an uncured material breach of the obligations or duties of that party.

23 (e) If a party breaches its obligations or duties, including by failure to comply with a  
24 contractual use restrictions, the aggrieved party may:

25 (1) suspend its performance, other than compliance with contractual use  
26 restrictions, and demand assurance of future performance pursuant to Section 2B-621; or

27 (2) exercise its rights on breach of contract under this article or the terms of the



1 agreement, but the aggrieved party must continue to comply with contractual use restrictions and  
2 may cancel only if the agreement so provides or the breach is material and has not been cured.

3 (f) “Contractual use restrictions” include obligations of nondisclosure and confidentiality  
4 and limitations on scope, manner, method, or location of use to the extent that those obligations  
5 or duties are created by the contract.

6 **Uniform Law Source: Restatement (Second) of Contracts ' 237. Substantially revised.**

7 **Committee Vote:**

8 a. **Motion to make an exception to the material breach rule for mass market contracts on the issue**  
9 **covered by Article 2 (the right to reject a transfer of rights). Adopted 12-0**

10 b. **Voted 10-3 to use mass market license, rather than consumer in this section.**

11 **Reporter's Notes:**

12 1. Subsection (a) states a generalized default rule which basically requires a court to look to reasonable  
13 commercial standards in any case not otherwise governed by the contract or by provisions of this Article as to default  
14 terms.

15 2. Subsection (b) adopts the theme of material breach (or substantial performance) as the measure of the  
16 right to cancel or refuse a performance except in reference to certain mass market transactions. As is described in the  
17 Restatement, that rule holds that a duty to perform is contingent on the prior performance by the other party without a  
18 material failure of performance. Restatement, Restatement (Second) of Contracts ' 237 states: “[It] is a condition of each  
19 party's remaining duties to render performances ... under an exchange of promises that there be no uncured material  
20 failure by the other party to render any such performance due at an earlier time.” This is also the common law rule. In  
21 subsection (b), it is made clear that the contingent relationship does not refer to situations involving contractual use  
22 restrictions. A breach of a license by the licensor does not give the licensee unfettered rights to act in derogation of the  
23 licensor's ownership rights in the intellectual property and the use restrictions that these support.

24 This section sets out basic default rules. The model treats the performance of the parties as being mutually  
25 conditional on the substantial performance of the other party. Other sections dealing with specific types of contract  
26 supplement these with more specific provisions that enhance and amplify the general rules, but displace them only if there  
27 is a conflict.

28 3. The decision to adopt a material breach concept places Article 2B parallel with common law and the  
29 modern international law of sales (except in the mass market which is kept in line with current Article 2 rules). The  
30 Convention on the International Sale of Goods (CISG) refers to “fundamental breach,” which it defines as: “A breach  
31 ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled  
32 to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen  
33 such a result.” CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: “A party may terminate  
34 the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental  
35 non-performance.” UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional  
36 law in requiring so-called “perfect tender.” Even then, these statutes do so in reference to a single fact situation only: a  
37 single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a  
38 performance standard for when the reciprocal performance is not required is virtually unanimous.

39  
40 **Illustration 1:** Tom Jones has agreed to develop systems software for DNY. DNY promises to pay  
41 the purchase price of \$300,000 in three installments once every three months. Jones fails to complete  
42 stage 1 in month 2 and this failure is material. When the first payment is due, if the failure remains  
43 uncured, DNY is not required to pay. It can cancel the contract or seek assurances of performance.  
44 To alter this result would require an express agreement severing the obligation to pay from the  
45 performance of the deliveries.  
46

1           5.       The concept is simple: A minor defect in the transfer does not warrant rejection of performance or  
2 cancellation of a contract. Minor problems constitutes a breach of contract, but the remedy is compensation for the value  
3 lost. The objective is to avoid forfeiture based on small errors and to recognize that, especially if performance involves  
4 ongoing activity, fully perfect performance cannot be the expected norm. This is especially true in information contracts.  
5 Software often contains “bugs” or imperfections. Information services often entail small errors and incompleteness. The  
6 policy choice here adopts general law and allows a party whose performance has minor errors to expect performance by  
7 the other party; subject, in appropriate cases, to offsets and compensation for the problems.

8           6.       The substantial performance rule does not hold that substantial (but imperfect) performance of a  
9 contract is not a breach. Substantial (but imperfect) performance is a breach of contract. The significance of substantial  
10 performance lies in the remedy for the injured party. Substantial performance is sufficient to trigger the injured party's  
11 obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract  
12 obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject the initial  
13 tender or cancel the contract on that account, but it can obtain financial satisfaction for the less than complete  
14 performance.

15          7.       This section creates a carve out of perfect tender in mass market transactions with respect to tender  
16 of deliver of a copy other than in an installment contract setting. This tender rule does not mean that the tendered  
17 information is in fact perfect, but that it meet the general contract description in light of ordinary expectations and trade  
18 use. As in Article 2, this rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender  
19 that is the single performance in the transaction (e.g., delivery of a television set, delivery of the diskette containing the  
20 software). As under current law, however, substantial performance rules apply in reference to on-going performance for  
21 both parties, services such as continuous access, and deliveries of a series of copies in an installment contract.

22          8.       Article 2 applies a "perfect tender" rule to only one setting: the initial tender (transfer) of goods in a  
23 contract that does not involve installment sales. Article 2 does not allow the buyer to assert a failure of perfect tender  
24 in an installment contract (that is, a contract characterized by an ongoing relationship). Even in a single delivery context,  
25 the theory of perfect tender is hemmed in by a myriad of countervailing considerations. As a matter of practice, a  
26 commercial buyer cannot safely reject a tendered delivery for a minor defect without considering the rights of the vendor  
27 to cure the defect under the statute or under commercial trade use. White and Summers state: “[we found no case that]  
28 actually grants rejection on what could fairly be called an insubstantial non-conformity . . .” Indeed, in one case involving  
29 software, a court applied a substantial performance test to a UCC sales transaction. See D.P. Technology Corp. v.  
30 Sherwood Tool, Inc., 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven  
31 economic loss).

32          9.       Definitions in Section 2B-102 make "substantial performance" and "material breach" mirror image  
33 concepts. Material breach is defined in Section 2B-108 and is discussed in the Reporter's Notes to that Section. The  
34 definition largely adopts the definition in the Restatement (Second) of Contracts ' 241, adding some specificity related  
35 to this commercial context. This article rejects the less fully explored language used in Article 2A (and some parts of  
36 Article 2) which refers to breaches that "substantially impair" the value of a contract to the injured party. A material  
37 breach is a breach that significantly damages the injured party's receipt of the value it expected from the contract, but  
38 reliance on language that is common in general law and legal tradition enables this article to fall back on themes that  
39 courts are familiar with, rather than on language in other UCC articles that has not been well explored in case law.

## 40                   **SECTION 2B-602. SUBMISSIONS OF INFORMATIONAL CONTENT.**

41  
42           (a) If a party submits informational content to a licensee under an agreement that requires  
43 that the information be to the subjective satisfaction of the licensee, the following rules apply:

44                   (1) Sections 2B-607 through 2B-613 and 2B-619 do not apply.

45                   (2) If the informational content is not ~~immediately~~ satisfactory to the licensee, the  
46 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.

(3) Neither refusal nor acceptance ~~of the submitted informational content~~ occurs unless the licensee makes an express, affirmative indication of refusal or acceptance of the submission to the licensor.

(4) Refusal ~~of the submitted informational content~~ terminates the agreement and does not constitute a breach of contract.

(b) If a person submits informational content or an idea other than pursuant to an agreement, the following rules apply:

(1) No contract or obligation arises or is implied from the mere receipt of an unsolicited disclosure of an idea for the creation, development or enhancement of information. 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.

(2) If ~~and~~ the recipient notifies the person making the submission that it maintains a procedure to receive and review such submissions, no contract is created unless the information or idea is submitted and accepted pursuant to that procedure or the recipient expressly agrees to contractual terms concerning the submission.

(c) Unless a term in the agreement expressly provides otherwise, an agreement to disclose an idea for the creation, development or enhancement of information does not create and enforceable if the idea is not confidential, concrete or novel to the trade or industry.

**Prior Uniform Law: None.**

**Reporter's Notes:**

Subsection (b) and (c) have been added to and expanded to deal with an issue of importance to all of the industries involved in this article. They set out standards for the formation of an enforceable agreement associated with the submission of ideas to a potential licensee. These sections will be moved to the 200 series of sections, but are left here to enable the Committee to review them prior to annual meeting. Subsection (b) adopts procedures to determine the

1 basic creation of obligations around the submission of information and ideas. Subsection (c) resolves a national split  
2 of case law about when an idea disclosed creates an enforceable obligation. In the cases identified, the contract in  
3 essence fails for lack of consideration under the body of case law adopted here.]

4 1. This section deals with a problem that was raised recurrently during the discussion of the Committee  
5 concerning the carrying forward of Article 2 rules concerning tender, acceptance and rejection into situations involving  
6 the informational content industries where practices are much different than in traditional sales of goods. The Section  
7 solves that conflict by carving out content submissions from the circumstances involved in reference to tender of a  
8 required performance in other respects.

9 2. For transactions involving traditional book and publishing upstream agreements, the solution lies  
10 simply in recognizing that the submission of a manuscript, even pursuant to an agreement, does not represent a tender  
11 of performance analogous to that involving a delivery of goods that requires immediate acceptance or rejection. Rather,  
12 the delivery of informational content in this context triggers a process that typically centers around the fact that the  
13 licensee has the right to refuse if the content does not satisfy its expectations. Once that fact is recognized, the  
14 inapplicability of the various rules on acceptance and the like becomes apparent. The provisions of subsection (a) attempt  
15 to capture basic principles of content submission in such case, but need to be reviewed by members of the industry for  
16 relevance and desirability.

17 3. An important aspect of the difference in the two circumstances lies in subsection (a)(3) where it is  
18 made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since, by  
19 presumption, the circumstances are keyed to the subjective satisfaction of the receiving party.

20 4. Subsection (b) deals in a limited way with a problem that exists in all of the industries to which this  
21 Article applies: submission of informational content not pursuant to an agreement. It provides that, if a procedure exists  
22 for receipt and review of such submissions to which the submitting party is referred, no contract exists unless the  
23 submission was pursuant to that procedure or compliance with the procedure was waived by the licensee. This leaves  
24 undisturbed a vast array of doctrines dealing with adequacy of consideration, equitable remedies, and the like, but  
25 clarifies the legal effect of the submission in contractual doctrine.

26  
27 **SECTION 2B-603. ~~TRANSFER~~ ~~ACTIVATION~~ OF RIGHTS; LICENSOR'S**  
28 **OBLIGATIONS.**

29 (a) Subject to Section 2B-601, the ~~The~~ licensor shall complete the initial ~~activation~~ of  
30 rights.]~~[transfer of rights]~~ The licensor completes its obligations with respect to the initial  
31 activation of rights when it completes the activation of rights and gives its direct licensee  
32 licensee any notice reasonably necessary to make it aware of that occurrence in a commercially  
33 reasonable manner. ~~[A transfer of rights] [An activation of rights] occurs when, pursuant to a~~  
34 ~~contract, a licensor completes the acts required to make information available to a licensee and~~  
35 ~~gives the licensee any notice reasonably necessary to make it aware of that occurrence.~~

36 (1) If applicable intellectual property law requires or allows the filing of a record  
37 to establish the priority of a transfer of ownership of intellectual property rights and a transfer of

ownership is contemplated by the agreement, then on request by the licensee, the licensor shall deliver a record sufficient for such purpose.

(2) If no act is required to make information available, the ~~[transfer of rights]~~ ~~[activation of rights]~~ occurs when the contract becomes enforceable between the parties.

(b) If information is made available by delivery of a copy, the following rules apply:

(1) If the contract is silent as to delivery:

(A) except as provided in subsections (2) and (3), in a physical ~~delivery~~ ~~transfer~~ of a tangible copy ~~on a physical medium~~, the licensor shall make the copy available to the licensee at the licensor's place of business or, if it has none, its residence, but, if the copy is identified at the time of contracting and located elsewhere, the licensor shall make the copy available at that place; and

(B) in a ~~delivery~~ ~~transfer~~ of a copy by electronic means, the licensor shall make the information available in an information processing system designated by the licensor and shall provide the licensee with authorization codes, addresses, acknowledgments, or any other materials necessary to obtain the information.

(2) If the contract requires or authorizes delivery of a copy held by a third party to be delivered without being moved, the licensor shall deliver any documents, authorizations, addresses, access codes, or other materials necessary for the licensee to obtain the copies.

(3) If the contract requires or authorizes the licensor to send a copy of the information to the licensee or a third party but does not expressly require the licensor to deliver it to a destination:

(A) in a physical ~~delivery~~ ~~transfer~~ of a tangible copy on a physical medium, the licensor shall put the copy in the possession of a carrier, make such arrangements as

are reasonable for transportation to the licensee or the third party with the expenses of the shipment to be borne by the licensee, and deliver any documents necessary to obtain the copies from the carrier; and

(B) in a delivery~~transfer~~ of a copy by electronic means, the licensor shall initiate an appropriate transmission of the information to the licensee or a third party.

(c) If ~~[a transfer of rights]~~ ~~[an activation of rights]~~ is to occur by making access available to a licensee or providing the licensee with access to a facility containing the information, the licensor shall complete such acts as are necessary to make access available, including providing the licensee with any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for the licensee to obtain access.

(d) In an electronic transmission or delivery, information provided~~must be made available~~ in a manner consistent with the technological capabilities of the receiving party known to the licensor or the ordinary methods in the business, trade or industry for transfers of the particular kind.

**Uniform Law Sources:** 2-401, 509(a), 308

**Reporter's Notes:**

[Subsection (a) was edited to reflect the changed language reference to "activation" as contrasted to "transfer" of rights and to indicate that this is a timing issues. Language in (a)(1) was added at the suggestion of the motion picture industry to coordinate with federal intellectual property recording rules.]

1. This section brings together various rules defining the obligations of the licensor relating to completion of its obligation to activate the rights provided for under the contract. The section corresponds to Section 2B-606 which deals with tender of performance

2. The section corresponds to the treatment of title and delivery in Article 2. While title itself is not a key concept in article 2, the seller's obligations for delivery correlate to obligations relating to title transfer and risk of loss. In article 2B, title and delivery are less significant. The keys are transfers of rights which involve making information available to the transferee. The default rules here correspond to standards in Article 2 relating to delivery and title transfer, but they account for transactions involving access and electronic transfers.

3. These are default rules and are thus subject to contrary terms of agreement.

4. Subsection (b)(1) distinguishes between physical delivery and electronic delivery of a copy. In both cases, consistent with current law in Article 2, the obligation consists of making the copy or access to making a copy available to the transferee. In development or similar contexts, contrary agreement often occurs (e.g., by requiring installation or testing on site). Under Article 2, despite similar fact settings, current law chose an approach that effectively corresponds to so-called shipment contracts. Absent contrary agreement, the assumption is that the licensor (or seller in Article 2) is not obligated to transport without charge the material to the licensee's location.

1  
2       **SECTION 2B-604. PERFORMANCE AT SINGLE TIME.** If it is commercially

3 reasonable to render all of one party's performance at one time, the performance is due at one  
4 time and the other party's reciprocal performance is due only on tender of the entire  
5 performance.

6       **Uniform Law Source:** Section 2-307.

7       **Committee Action:** This section was reviewed in November without substantive comment.

8       **Reporter's Note:**

9       The section adopts an approach found in both ' 2-307 and common law as described in the Restatement (Second) with  
10 reference to the relationship between performance and payment in cases where performance can be rendered at a single  
11 time. It adds the qualification that the ability to so perform must be gauged against standards of commercial  
12 reasonableness. The section does not affect the treatment of contracts calling for delivery of systems in modular form  
13 or for contracts that extend performance out over time, such as in data processing arrangements. In each of these cases,  
14 the performance of the one party cannot be completed at one time.  
15  
16

17       **SECTION 2B-605. WHEN PAYMENT DUE.**

18       (a) If a party has the right to make or demand performance in part or over a period of  
19 time, payment, if it can be apportioned, may be demanded for each part performance.

20       (b) If payment cannot be apportioned or the agreement or circumstances indicate that  
21 payment may not be demanded for part performance, payment is due only on tender of  
22 completion of the entire performance.

23       **Uniform Law Source:** Restatement (Second) Contracts; Section 2-310.

24       **Committee Action:** Considered in November, 1996, without substantive comment.

25       **Reporter's Note:**

26       This Section follows current law in Article 2 and in the Restatement.  
27

28                       **[B. Tender of Performance; Acceptance]**

29       **SECTION 2B-606. ACCEPTANCE: EFFECT.**

30       (a) A party shall pay or render other performance required according to the contractual  
31 terms for any performance it accepts.

32       (b) The burden is on the party that accepted the performance to establish any breach of

contract with respect to the performance accepted.

**Uniform Law Source: Section 2-507.**

**Committee Action:**

Considered in November, 1996, without substantive comment.

**Reporter's Notes:**

1. This section should be read in context of the right to revoke, the licensor's obligation to cure immaterial breaches, and the licensee's right to recoup from future payments even in the case of an immaterial breach where the amounts to be recouped are liquidated amounts. The additional language in new (b) is taken from current Article 2-607(4).

2. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received. Buyer remedies arise when the seller "fails to perform any of his obligations," Art. 45(1), and are preserved if proper notice is given. Art. 39(1). There is no rejection remedy in general and the buyer is obligated to pay the purchase price unless the contract can be avoided for "fundamental breach." Art. 25. This model more closely resembles the Restatement. The Article 2 Drafting Committee has considered and rejected use of this in lieu of the acceptance-rejection model on several occasions.

3. In cases of rejection, proposed Article 2 reflects this model in part by providing that "If the use of the goods is reasonable ... and is not an acceptance, the buyer on returning or disposing of the goods, shall pay the seller the reasonable value of the use to the buyer. This value must be deducted from the sum of the price paid to the seller ... and any damages ..." 2-605 (b)(2).

## **SECTION 2B-607. TENDER OF PERFORMANCE; RIGHT TO ACCEPTANCE.**

(a) A tender of performance occurs when a party, with manifest present ability to do so, offers to complete the performance. If a performance by the other party is due before the tendered performance, the other party's performance is a condition to the first party's duty to complete the tendered performance.

(b) Tender of performance that substantially conforms to the contract entitles the party to acceptance of that performance. However, in a mass-market transaction, if the performance consists of the delivery of a copy which constitutes the initial activation~~transfer of rights~~, the licensee may refuse the performance if it does not conform to the contract.

(c) If performance entails delivery of a copy, is ~~a transfer of rights~~ ~~[an activation of rights]~~, a licensor shall tender first but need not complete the performance until the licensee pays



and tenders other performance required at that time. Tender must be at a reasonable hour and requires that the licensor:

(1) notify the licensee that the information or copies of the information are available or have been shipped;

(2) tender any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for the licensee to obtain access to, control over, or possession of the information; and

(3) hold the information, copies, and materials at the licensee's disposal for a period reasonably necessary to enable the licensee to obtain such access, control, or possession.

(d) Tender of payment is sufficient if made by any means or in any manner acceptable in the ordinary course of business unless the other party demands payment in money and gives any extension of time reasonably necessary to procure it.

**Uniform Law Source:** ' 2-510, 511(a)(b). Restatement (Second) of Contracts ' 238.

**Committee Action:**

a. Approved substantial performance rule in (b). (September, 1996)

**Selected Issues:**

a. Should full conformance to express performance standards or conditions by both parties be an exception to the substantial performance standard in (b)?

**Reporter's Notes:**

1. This section brings together various rules from existing Article 2.

2. Subsection (a) states a general principle of what constitutes tender. It is drawn from the Restatement. Unlike in Article 2, the performances here are not always actions relating to an offer to delivery goods and to pay for them. As a result, general language in (a) provides an important baseline.

3. Subsection (b) states the substantial performance rule and the mass-market exception. In contracts where the information must be to the satisfaction of the licensee, performance that is not satisfactory does not satisfy the condition stated in subsection (b) and creates no obligation to accept.

4. Subsection (c) chooses who goes first. Current law (2-511(1)) states that tender of payment is a precondition for the duty to tender or complete delivery. In this draft, the licensor, must tender first. The basic model is that tender of a performance means to offer to perform, and typically precedes actual performance. In reference to transfers of rights, Article 2B follows Article 2 by requiring tender, then payment, then completion. For tender, the circumstances must clearly indicate that performance is immediately forthcoming. This is the function of the references to shipment, tender of materials and the like.

5. As in the case of Article 2, the licensee's duty to accept typically hinges on its right to inspect the tendered copy as outlined in 2B-609 and elsewhere. In the case of development contracts, the common practice typically expands on the inspection right, creating a period of testing before acceptance. at the end of the contract. In such cases, the tender itself implies an opportunity to test and inspect the copy. The duty to accept conforming property comes afterwards.

1       **Illustration 1.** Jones contracts for the development of a system by Smith. Smith completes what it  
2 anticipates to be the full system and tenders a disk containing the software to Jones. Jones has a right  
3 to inspect the information before paying pursuant to an interaction of this section and the section on  
4 inspection. If the parties agreed to acceptance tests, those tests define the scope of the inspection right.  
5 If not, a reasonable inspection is required. Payment follows satisfactory inspection.  
6

7       6.       Subsection (d) is drawn from Article 2.

## 8       **SECTION 2B-608. COMPLETED PERFORMANCES.**

9       (a) If performance involves delivery of informational content, entertainment, or related  
10 artistic, personal or professional ~~other~~ services that because of their nature provide the licensee  
11 substantially with the value of the information and that value cannot be returned once delivery or  
12 performance is received by the licensee, Sections 2B-609 through 2B-613 and Section 2B-619 do  
13 not apply and the rights of the parties are determined under Section 2B-601 and the ordinary  
14 practices of the applicable trade or industry.

15       (b) In a contract governed by subsection (a), before payment, a party may inspect the  
16 media and label or packaging of a performance, but may not view or receive the performance  
17 unless the contract provides otherwise.

### 18       **REPORTER'S NOTES:**

19       This section deals with a problem arising from the nature of the subject matter covered in this article. Some  
20 subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection,  
21 rejection and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an  
22 entertainment event or other information. It is also the case where the subject matter of the contract involves  
23 informational content that, once seen, has in effect communicated its entire value. The parties should be left to general,  
24 common law remedies as described in section 2B-601. If the delivered performance constitutes a material breach, the  
25 receiving party can obtain its money back or sue for damages, but it cannot demand full performance prior to payment  
26 as would be the case with anything other than the limited inspection right described in subsection (b).  
27

## 28       **SECTION 2B-609. LICENSEE'S RIGHT TO INSPECT; PAYMENT BEFORE** 29 **INSPECTION.**

30       (a) If performance requires delivery of a copy, the following rules apply:

31               (1) Except as provided in this section, a licensee has a right before payment or

1 acceptance to inspect the physical medium and the performance of the information and to obtain  
2 any related documentation at a reasonable place and time and in a reasonable manner in order to  
3 determine conformance to the agreement.

4 (2) Expenses of inspection must be borne by the licensee, but reasonable expenses  
5 may be recovered from the licensor if the performance is rightfully refused.

6 (3) A place, ~~or method or standard of inspection, or a standard for inspection~~  
7 fixed by the parties, is presumed to be exclusive. However, unless otherwise expressly agreed,  
8 the fixing of a place, ~~or method or standard of inspection~~ does not postpone identification or shift  
9 the place for delivery or for passing the risk of loss. If compliance with the place or method  
10 becomes impossible, inspection must be made as provided in this section unless the place,  
11 method, or ~~standard~~ fixed by the parties was intended as an indispensable condition the failure  
12 of which avoids the contract.

13 (4) A licensee's right to inspect is subject to the confidentiality of the  
14 information. Unless the licensor otherwise agrees, the licensee may not inspect before payment  
15 in a manner that would disclose or jeopardize information designated by the licensor as a trade  
16 secret or confidential.

17 [(5) If inspection would provide the licensee substantially with the value of the  
18 information, access or performance before payment, the licensee does not have a right to inspect  
19 before payment.]

20 (b) If a right to inspect exists under subsection (a) and the ~~agreed procedures for payment~~  
21 ~~or the terms of the agreement~~ are inconsistent with an opportunity to inspect before making  
22 payment, the licensee does not have a right to inspect before payment. Nonconformity in the  
23 tender does not excuse the licensee from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-610; or

(2) in a documentary transaction, despite tender of the required documents, the circumstances would justify injunction against honor.

(c) Payment pursuant to subsection (b) is not an acceptance of performance and does not impair a licensee's right to inspect or preclude other remedies of the licensee.

**Uniform Law Source: Section 2-513; CISG art. 58(3); Section 2-508. Substantially revised.**

**Reporter's Note:**

1. This section combines former 2B-607 and 2B-608 with new material relevant to the information industries.

2. 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.

3. Subsection (a)(5) concerns situations in which the nature of the information is such that inspection would effectively convey substantially all of the value to the licensee before payment. Thus, for example, in a transaction where the essence of the deal is to reveal discrete information known to one party (e.g., the profit record of a company for the past year), inspection would communicate the subject matter of the deal and that communication cannot effectively be taken back if payment does not follow. The parties can agree to this result if they so choose, but it is not appropriate for law to presume it. This rule would not apply, however, where merely inspecting information conveys it. Thus, an author's submission of a manuscript to a publisher would not trigger this rule since the publisher's does not obtain the value by merely examining the manuscript.

4. Subsection (b) follows the rules stated in current UCC ' 2-512.

**SECTION 2B-610. REFUSAL OF DEFECTIVE TENDER.**

(a) Subject to subsection (b), if a tender of performance or the tendering party's previous performance constitutes a material breach of contract, as to the particular tendered performance, the party to which it is tendered may:

(1) refuse the ~~entire~~ performance;

(2) accept the ~~entire~~ performance;

(3) accept any commercially reasonable units and refuse the rest; or

(4) permit an opportunity to cure the nonconformity.

(b) In a mass-market license, a licensee may refuse a performance that consists of the delivery of a copy which constitutes the initial activation~~transfer~~ of rights if the performance does not conform to the contract.

(c) Refusal is ineffective unless ~~it is~~ made within a reasonable time after the tender and the completion of any permitted effort to cure and before acceptance and the party whose performance is refused is notified within a reasonable time after the breach of contract was or should have been discovered.

**Uniform Law Source: Combines ' 2-601, 2-602, 2A-509. Substantially revised.**

**Votes:**

1. The Committee adopted a "perfect tender" carve out for cases involving the tender of delivery of a copy in circumstances equivalent to those where the perfect tender rule applies in Article 2.

**Reporter's Note:**

1. This section deals with refusal of tendered performance. The word "refuse" is used in lieu of the Article 2 term "reject" because the intent is to cover more broadly the circumstances under which a party can decline to accept a performance of any type, rather than merely to concentrate on cases of a refused (rejected) tender of delivery as the phrase is used in Article 2. Thus, for example, a party might refuse proffered services under a maintenance contract because of prior breach or of their failure to substantially conform to the contract. The right to refuse tendered performance hinges either on the substantial nonconformity of the particular performance or on the existence of an uncured, prior material breach by the tendering party.

2. This section and the section on cure give control of the situation to the licensee to whom improper performance is provided. In this Article, other than in the mass market, refusal or cancellation can occur only in the event of a material breach. This is unlike in Article 2 where even minor defects may allow rejection of a tender. Given the greater impact of the breach, the equities shift more clearly to the injured party and it is given a right to close out the transaction without waiting for cure. Cure cannot come after cancellation.

3. Subsection (b) implements the carve out for mass market transactions which are governed in this Article under standards that are consistent with Article 2 in the sale of goods.

**SECTION 2B-611. DUTIES FOLLOWING RIGHTFUL REFUSAL.** After refusal or revocation, the following rules apply:

(1) Any use ~~or exercise of rights by a licensee with respect to~~ of the information or copies, ~~involved in the performance,~~ or any disclosure of a trade secret or confidential information ~~of the other party~~ inconsistent with the agreement, constitutes a breach of contract. However, use ~~or exercise of rights~~ for a limited time solely to avoid or mitigate loss is not prohibited if the use is not inconsistent with the licensee's refusal of the performance or the terms

1 of the agreement.

2 (2) A licensee in ~~that takes possession of copies or documentation or that has made~~  
3 additional copies, shall return all copies and documentation to the licensor or hold them ~~with~~  
4 ~~reasonable care~~ for disposal at the licensor's instructions for a reasonable time. If the licensee  
5 holds the materials ~~in this case~~, the following additional rules apply:

6 (A) ~~If the licensee elects to hold the documentation or copies for the licensor's~~  
7 ~~disposal,~~ The licensee shall follow any reasonable instructions received from the licensor.  
8 However, instructions are not reasonable if the licensor does not arrange for payment of or  
9 reimbursement for the reasonable expenses of complying with the instructions.

10 (B) If the licensor does not give instructions within a reasonable time after being  
11 notified of refusal, the licensee may in a reasonable manner to avoid or mitigate loss store the  
12 documentation and copies for the licensor's account or ship them to the licensor with a right of  
13 reimbursement for reasonable costs of storage, shipment, and handling.

14 (3) A licensee has no further obligations with respect to information or ~~related~~ copies and  
15 documentation ~~refused~~. However, both parties remain bound by any obligations of nondisclosure  
16 or confidentiality and any scope or other limitations ~~or restrictions~~ on use ~~which would have~~  
17 been enforceable had the performance not been refused.

18 (4) In complying with this section, a licensee is held only to good faith and a standard of  
19 care that is reasonable in the circumstances. Conduct in good faith under this section does not  
20 constitute acceptance or conversion and is not the basis for an action for damages or equitable  
21 relief.

22 **Uniform Law Source: Section 2-602(2), 2-603, 2-604.**

23 **Reporter's Note:**

24 1. This section does not give the licensee a right to sell goods, documentation or copies related to the

1 intangibles under any circumstance. The materials may be confidential and may be subject to the overriding influence  
2 of the proprietary rights held and retained by the licensor in the intangibles. As Comment 2 to current ' 2-603 states:  
3 "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in  
4 respect of information. The licensor's interests are focused on protection of confidentiality or control, not on optimal  
5 disposition of the goods that may contain a copy of the information.

6 2. Subsection (1) limits the revoking person's right to use the information in its possession. Uses  
7 inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse. The  
8 section does permit, however, limited uses for purposes of minimizing loss. That use does not extend to disclosure of  
9 confidential information or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to  
10 reach the balance discussed in *Can-Key Industries v. Industrial Leasing Corp.*, 593 P.2d 1125 (Or. 1979) and *Harrington*  
11 *v. Holiday Rambler Corp.*, 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of  
12 any intellectual property rights that may be involved here.

13 3. Subsection (3) makes clear that, following refusal or revocation, both parties remain bound by  
14 confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon  
15 that each party have some such information of the other and a mutual, continuing restriction is appropriate.

16 4. The eventual comments to the Section will make clear that a wrongful refusal is not a refusal for  
17 purposes of this and other sections, but simply a breach of contract. That breach may or may not be material, but in either  
18 event, it triggers the sequence of remedies contained in the contract and this article, rather than the duties stated here.  
19

## 20 **SECTION 2B-612. WHAT CONSTITUTES ACCEPTANCE.**

21 (a) Subject to subsections (b) and (c), acceptance of a performance occurs when the party  
22 receiving the performance:

23 (1) substantially obtains the value or access expected from the performance and,  
24 without objecting, retains the value or utilizes the access beyond a reasonable time to refuse the  
25 performance;

26 (2) signifies or acts with respect to the information in a manner that signifies to  
27 the other party that the performance was conforming or that the party will take or retain the  
28 performance in spite of the nonconformity;

29 (3) fails effectively to refuse performance under the terms of the agreement or  
30 Section 2B-610;

31 (4) acts in a manner that makes compliance with the licensee's duties on refusal  
32 impossible because of commingling[; or

33 (5) receives a substantial benefit or knowledge of valuable informational content

1 from the performance and the benefit or knowledge cannot be returned.]

2 (b) Except in cases governed by subsection (a)(4) and (5), if a right to inspect exists  
3 under Section 2B-609 or the agreement, acceptance of performance that involves delivery of a  
4 copy occurs only when the party has a reasonable opportunity to inspect the copy and any  
5 document.

6 (c) If an agreement requires performance in stages to deliver a contracted for whole  
7 information product ~~with respect to portions of the information or with respect to its capacity to~~  
8 ~~perform~~, this section applies separately to each stage. Where the agreement contemplates  
9 delivery of a product in stages, rather than repeated separate performances pursuant to an overall  
10 agreement, ~~Acceptance of any stage is conditional until acceptance completion of the [transfer~~  
11 ~~of rights] [activation of rights] in the completed information or all stages required under the~~  
12 ~~agreement.~~

13 **Uniform Law Source: Section 2A-515. Revised.**

14 **Reporter's Note:**

15 Subsection (c) was edited to clarify the scope of application of the conditional acceptance concept. If does not apply,  
16 for example, in an access contract where there are a series of exercised accesses to information over a period of time.  
17 The application intends to focus on the case of, for example, the development of software or a manuscript which is  
18 delivered in parts in the expectation of the eventual delivery of the entire product.]

19 1. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general  
20 remedies sections.

21 2. Subsections (a)(2) and (3) conform to the language of Article 2A, clarifying as in Article 2A, that  
22 actions as well as communications can signify acceptance. This section does not adopt existing Article 2 provisions  
23 relating to actions inconsistent with the party's ownership since, as in Article 2A, there is a split between performance  
24 and retention of ownership in many cases. That split indicates that, as in 2A, the ownership standard is not relevant to  
25 use of information assets and other performance relevant here.

26 3. Subsection (a)(4) and (5) focus on two circumstances significant in reference to information and that  
27 raises issues different from cases involving goods. In (a)(4), the key fact is that it would be inequitable or impossible  
28 to reject the data or information having received and commingled the material. The receiving party can exercise rights  
29 in the event of breach, but rejection is simply not a helpful paradigm. Recall that a rejecting licensee must return or to  
30 keep the digital information available for return to the licensor. Commingling does not refer only to placing the  
31 information into a common mass from which they are indistinguishable; it also includes cases in which software is  
32 integrated into a complex system in a way that renders removal and return impossible or where they are integrated into  
33 a database or knowledge base that they cannot be separated from. Commingling is significant because it precludes return  
34 of the rejected property.

35 4. The second situation (a)(5) involves use or exploitation of the value of the material by the licensee.  
36 In information transactions, it is the case that in many instances merely being exposed to the factual or other material  
37 transfers the significant value. Also, often, use of the information does the same. Again, rejection is not a useful



1 paradigm. The recipient of the information can sue for damages for breach and, when breach is material, either collect  
2 back its paid up price or avoid paying a price that would otherwise be due.  
3

4 **Illustration 1:** Licensee receives a right to use a mailing list of names of customers of Macey's store.  
5 It notices that the list contains no names from a particular zip code, but goes ahead with an initial  
6 mailing. It then seeks to reject the performance. While this would not fit within subsection (a)(5), the  
7 section provides that the acceptance already occurred if substantial value was received. Licensee can  
8 collect damages for the error and, if the breach was material, avoid obligation for the price. But it  
9 cannot reject because of (a)(1).

10 **Illustration 2:** A contracts with B to obtain the formula to Coca Cola and information from B about  
11 how to mix the formula. B delivers the formula, but the mixing information is entirely inadequate. If  
12 the mixing information is not significant to the entire deal, A cannot reject because it received  
13 substantial performance. If the mixing information is significant, a right to reject may arise because  
14 of a material breach. However, subsection (a)(5) bars rejection if A received substantial value by  
15 obtaining knowledge of the formula and cannot return that knowledge. Even though it can return  
16 copies of the formula, knowledge would remain. A can sue for damages, but cannot reject after the  
17 formula is made known to it.

18 **Illustration 3:** Intel contracts with John for a right to use John's list of the ten largest users of  
19 Motorola chips in the Southwest. The price is \$1 million. John supplies the list, but there are two  
20 names that, through negligence, are not correct. After reading the list, Intel desires to reject the  
21 performance and cancel the contract. Subsection (a)(5) would ask whether Intel received substantial  
22 valuable knowledge and, thus, cannot reject. If so, its remedies are for breach under applicable  
23 sections involving a recovery for the difference in promised and received value. If it can reject, it can  
24 recover the part of the price already paid, plus any relevant and provable loss under the methods  
25 described in this Article.  
26

27 Subsection (a)(5) may be deleted if the Drafting Committee adopts the proposed section 2B-608 on performances  
28 complete when delivered.

29 5. This section must be read in relationship to the reduced importance of acceptance. Refusal and  
30 revocation both require material breach in order to avoid the obligation to pay according to the contract. This is unlike  
31 Article 2 which follows a perfect tender rule for rejection, but conditions revocation on substantial impairment.  
32 Acceptance does not waive a right to recover for deficiencies in the performance.  
33

## 34 **SECTION 2B-613. REVOCATION OF ACCEPTANCE.**

35 (a) ~~Subject to subsections (b) and (c),~~ A licensee may revoke acceptance of a  
36 commercial unit that is part of a performance by the licensor if the nonconformity of the  
37 commercial unit is a material breach of the contract and the party accepted the performance:

38 (1) on the reasonable assumption that the breach would be cured, and it has not  
39 been seasonably cured;

40 (2) during a period of continuing efforts at adjustment and cure, and the breach  
41 has not been seasonably cured; or

42 (3) without discovery of the breach and the acceptance was reasonably induced by

1 the other party's assurances or by the difficulty of discovery before acceptance.

2 (b) Revocation is not effective until the revoking party sends notice of it to the other party  
3 and is barred if:

4 (1) the revocation does not occur within a reasonable time after the licensee  
5 discovers or should have discovered the ground for it;

6 (2) the revocation does not occur before any substantial change in condition or  
7 identifiability of the information not caused by the breach of contract; or

8 (3) the party attempting to revoke acceptance received a substantial benefit or  
9 knowledge of valuable informational content from the performance or access, and the benefit or  
10 knowledge cannot be returned.

11 (c) A party that justifiably revokes acceptance:

12 (1) has the same duties and is under the same restrictions with regard to the  
13 information and any documentation or copies as if the party had refused the performance; and

14 (2) is not obligated to pay the contract price for the performance as to which  
15 revocation occurred.

16 **Uniform Law Source: Section 2A-516; 2-608.**

17 **Reporter's Note:**

18 2. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase  
19 price. Often, of course, other performance will have already occurred. This section deals with revocation of acceptance  
20 as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention  
21 of article 2.

22 3. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. It  
23 reduces the importance of when or whether acceptance occurs. In cases of continuing efforts to modify and adjust the  
24 intangibles to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both  
25 parties know that problems exist. The question is whether or not the licensee is obligated for the contract price, less a  
26 right to damages for breach by the licensor.

27 There has been substantial litigation in Article 2 on questions of whether or not an acceptance occurred (or can  
28 be revoked) in a situation in which the licensee participates with the licensor in an effort to modify, correct and make  
29 functional the software that is being provided. The issue has importance because acceptance obligates the licensee to the  
30 purchase price unless that acceptance can be revoked due to a substantial defect, while prior to acceptance the licensee  
31 can reject for a failure to provide "perfect" quality. National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785,  
32 787 (Mich. App. 1975) ("Here, the malfunctioning was continuous. Whether the plaintiffs could have made it functional

1 is not the issue. The machine's malfunctions continued after the plaintiff was given a reasonable opportunity to correct  
2 its defects. [The] warranty was breached."); Integrated Title Data Systems v. Dulaney, 800 S.W.2d 336 (Tex. App. 1990);  
3 Eaton Corp. v. Magnovox Co., 581 F. Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may  
4 constitute a waiver); St. Louis Home Insulators v. Burroughs Corp., 793 F.2d 954 (8th Cir. 1986) (limitations bar); The  
5 Drier Co. v. Unitronix Corp., 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); Computerized  
6 Radiological Service v. Syntex, 595 F. Supp. 1495, rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use  
7 precludes rejection); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573 (8th Cir. 1982); Aubrey's R.V. Center, Inc. v.  
8 Tandy Corp., 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App. 1987) (nine month delay did not foreclose revocation);  
9 Triad Systems Corp. v. Alsip, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years after the initial  
10 delivery of software and hardware system); Money Mortgage & Inv. Corp. v. CPT of South Fla., 537 So.2d 1015 (Fla.  
11 Dist. Ct. App. 1988) (18 month delay permitted); Softa Group v. Scarsdale Development, No. 1-91-1723, 1993 WL  
12 94672 (Ill. App. March 31, 1993); David Cooper, Inc. v. Contemporary Computer Systems, Inc., 846 S.W.2d 777 (Mo  
13 App 1993); Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

14 4. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully  
15 understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party  
16 who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must  
17 pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee  
18 essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation does  
19 not, however, serve as a precondition to suing for damages. In the context of information transactions, revocation is not  
20 appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection  
21 (b)(3).

22 5. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not  
23 or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model  
24 would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying  
25 further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared  
26 to benefit received.

## 28 [C. Special Types of Contracts]

### 29 SECTION 2B-614. ACCESS CONTRACT.

30 (a) An access contract grants rights of access to the information as ~~is~~ modified from time  
31 to time and made generally available by the licensor over the duration of the period of under the  
32 license. Changes in the content of the information to which access is provided do not constitute a  
33 breach unless they conflict with an express term of the agreement.

34 (b) Unless ~~it is obtained~~ subject to a license or other use restrictions relating to the  
35 information contained in the access contract or a record to which the licensee agreed, including  
36 by manifesting assent to the record, information obtained by a licensee in an access contract is  
37 free of any restriction by the licensor except restrictions resulting from the intellectual property  
38 rights of a licensor or other applicable law. The licensee may make a transitory copy for purposes

of viewing or other agreed use ~~the information~~ only but may make a permanent copy of the information accessed only if authorized by the agreement.-

(c) In an access contract, access must be available at times and in a manner consistent with:

(1) express terms of the agreement; and

(2) to the extent not dealt with by the terms of the agreement, in a manner and with a quality that is reasonable consistent with ordinary standards of the trade or industry for the particular type of agreement.

(d) In an access contract which, during agreed periods of time, affords the licensee a right of access at times substantially of its own choosing, intermittent and occasional failures to have access available do not constitute a breach of contract if they are consistent with:

(1) the express terms of the agreement;

(2) standards of the 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:**

[Subsections (a) and (b) have been modified based on consultation with various groups to reflect the variety of transactions encompassed by the idea of an access contract and the need for a capability to make continuing changes in the content and composition of the information provided for access. The language about restrictions in subsection (b) incorporates the possibility that the access contract is with a general information provider, but the content provider for a particular element of the overall spectrum of resources made available, places restrictions on use of its information.]

**1.** This section applies to a "access" transactions. In concept, access contracts are of two types. In one, the access and the contract creation or performance occur essentially at the same time and there is no on-going relationship between the parties. In the other, which some describe as a continuous access contract, the license contemplates that the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This latter type of relationship is characterized by on-line services such as Westlaw and Lexis. Access contracts of this latter type constitute an important application of an ongoing relationship rules involving information services. The transaction is not only that the transferee receives the functionality or the information made

1 available , but that the subject matter be accessible to the transferee on a consistent or predictable basis. The transferee  
2 contracts for continuing availability of processing capacity or information and compliance with that contract expectation  
3 hinges not on any specific (installment), but on continuing rights and ability to access the system. The continuous access  
4 contract is unlike installment contracts under Article 2 which have more regimented tender-acceptance sequences. Often,  
5 the licensor here merely keeps the processing system on-line and available for the transferee to access when it chooses.

6 As outlined in the definition of “licensor”, the model followed in three party access transactions, such  
7 as where the content provider makes content available through a third party access provider, entails two separate  
8 agreement and, in some cases, three separate contracts. The first is between the content provider and the on-line provider.  
9 This license may be an ordinary license to use the information or an access contract in itself. The second is between the  
10 on-line provider and the end user or other client. This is an access contract. The content provider is not necessarily party  
11 to or beneficiary of the contract. The third possible contract occurs when the content provider additionally contracts  
12 directly with or establishes terms with the end user or client.

13 **2.** Subsection (b) outlines two important default rules with respect to the treatment of information  
14 obtained through an access contract. The first is that, unless there are license terms dealing with the information obtained  
15 through access, information obtained by access is received on an unrestricted basis, subject only to whatever intellectual  
16 property rights apply. Thus, for example, if an access contract merely enables access to news articles, but does not  
17 further limit their use by the licensee, no limitation exists other than as applied under copyright law. In contrast, if the  
18 agreement contains license restrictions on use of the articles obtained by the access, those license terms would be  
19 governed under Article 2B and other law.

20 **3.** The second issue considered in subsection (b) concerns the making of copies. The default position here  
21 recognizes that access contracts will involve a wide variety of contexts, many of which do not contemplate that the  
22 license make and retain a copy of the information accessed (e.g., video on demand). The default rule assumes that  
23 transitory copies to enable viewing of the information are implicitly authorized. If, however, the agreement allows  
24 making a permanent copy, then a back up is authorized unless expressly excluded.

25 **4.** Access contracts are a form of license in the pure common law sense that they entail a grant of a right  
26 to have use of a facility or resource owned or controlled by the licensor. This involves less of a traditional intellectual  
27 property license and more of a modern application of traditional concepts of licensed use of physical resources. See  
28 *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993);  
29 *Soderholm v. Chicago Nat'l League Ball Club*, 587 NE2d 517 (Ill. App. Ct. 1992) (license revocable at will). For a  
30 discussion of how one potential vendor handles these problems, see Proposed Rule Regarding Postal Electronic  
31 Commerce Service (39 C.F.R. ' 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed regulations and terms  
32 of use for Postal Service electronic commerce systems).

33 **5.** Under current law, these contracts are services or information contracts. The fault based warranties  
34 noted in the warranty sections apply insofar as one deals with the accuracy of content or processing. The contract  
35 obligation deals with an obligation to make and keep the system available. Obviously, availability standards are subject  
36 to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the  
37 industry involving the particular type of transaction. Thus, a database contract involving access to a news and  
38 information service would have different accessibility expectations than would a contract to provide remote access to  
39 systems for processing air traffic control data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v.*  
40 *Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

41 **6.** In continuous access contracts, the transferee may receive substantial value before or despite problems  
42 in the overall transaction. The remedies provide for a concept of partial performance. For example, the fact that a  
43 company continues to use a remote access database processing system for several years while encountering problems  
44 and seeking a replacement system, may allow it to reject the future terms of the contract, but leaves the transferee  
45 responsible for the past value received. *Hospital Computer Systems, Inc. v. Staten Island Hospital*, 788 F. Supp. 1351  
46 (D.N.J. 1992).

## 48 **SECTION 2B-615. CORRECTION AND SUPPORT CONTRACTS.**

49 (a) If a party agrees to correct errors or provide similar services, the following rules

50 apply:

(1) If the services cover a limited time and are part of a limited remedy in a contract between the parties, the party undertakes that its performance will provide the licensee with information of a quality that conforms to that contract.

(2) In cases not covered by paragraph (1), the party shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the express terms of the agreement, in a workmanlike manner and with a quality that is reasonably consistent with ordinary standards of the trade or industry for similar contracts.

~~(3) In cases governed by paragraph (2),~~ The party providing the services does not warrant that its services will correct all defects or errors unless the agreement expressly so provides.

(b) A licensor is not required to provide support or instruction for the licensee's use of information or licensed access after completion of the ~~[transfer of rights]~~ [activation of rights]. If a person agrees to provide support for the licensee's use of information, 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 reasonably consistent with ordinary standards of the trade or industry for the particular type of agreement.

**Uniform Law Source:** Restatement (Second) of Torts § 299A.

**Reporter's Notes:**

1. The section deals with obligations to correct errors and obligations to provide support.

2. Obligations to correct errors are different from an obligation to provide updates or enhanced versions. In modern practice, contracts to provide updates, generally described as maintenance contracts, are a valuable source of revenue for software providers. Under Section 2B-310, no implied obligation exists to provide updates or new versions. A licensor may have an obligation to make an effort to correct errors in some cases even independent of a separate contract to do so.

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. Contracts to provide corrections are services contracts. As in any other services contract, the services provider must provide a reasonable and workmanlike effort to correct identified problems. Subsection (a) sets out this

1 basic principle, but (a)(1) recognizes an important, alternative obligation that is presumed when the obligation to correct  
2 errors arises in lieu of a remedy under a contract.

3       **4.** Subsection (a)(1) deals with situations in which the circumstances indicate that promisor agrees to  
4 a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort.  
5 The obligation stated in subsection (a)(1) arises in any case where the repair/ correction obligation is set out as a form  
6 of remedy for any breach of the contract. The focus is on the classic “replace or repair” warranty. When the obligation  
7 to correct errors arises in that context, the promisor’s obligation is to complete a product that conforms to the contract.

8       **5.** Subsection (a)(2) deals with the broader case of the general repair obligation outside of the limited  
9 remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise  
10 reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a  
11 perfect result.

12       **6.** Subsection (b) provides a default rule regarding the time, place and quality of the services in a support  
13 agreement in the absence of contrary agreement. The standard reflects a theme of "ordinariness" that provides default  
14 performance rule throughout the chapter. It measures a party's performance commitment by reference to standards of  
15 the relevant trade or industry.

16  
17       **Example:** Software Vendor agrees to provide a help line available for telephone calls from its mass  
18 market customers. If this agreement constitutes a contractual obligation, the availability and  
19 performance of that help line is measured by reference to similar services or by express terms of a  
20 contract.

## 21 22       **SECTION 2B-616. PUBLISHERS, DISTRIBUTORS AND RETAILERS.**

23       **(a)** In this section:

24               (1) “retailer” means a merchant licensee that receives information from a  
25 licensor for sale or license in tangible copies to end users.

26               (2) “publisher” means a licensor other than a retailer that enters into an  
27 agreement with an end user with respect to the information.

28               (3) “end user” means a licensee that acquires a tangible of the information for its  
29 own use and not for the purpose of distributing to third parties by sale, license, or other means.

30       **(b)** In a contract between a retailer and an end user, if the parties understand that the end  
31 user’s right to use the information is to be subject to a license from the publisher, the following  
32 rules apply:

33               (1) The contract between the end user and the retailer is conditional on the end  
34 user’s assent to the publisher’s license.

35               (2) If the end user refuses the terms of the license with the publisher, the end user

1 may return the information to the retailer and receive from it a refund of any contract fee already  
2 paid in an amount consistent with Section 2B-113(b) and avoid any obligation for performance  
3 of future payments to the retailer ~~for regarding the information. Refund by the retailer under this~~  
4 paragraph ~~also~~ constitutes a refund under Section 2B-113.

5 (3) The retailer is not bound by the terms of, and does not receive the benefits of,  
6 an agreement between the publisher and the end user unless the retailer and end user adopt those  
7 terms as part of their agreement.

8 (c) If a refund is made in good faith pursuant to this Section or Section 2B-113:

9 (1) a retailer that makes the refund to its end user because the end user refused the  
10 publisher's license is entitled to reimbursement from the authorized party from which it obtained  
11 the copy of the amount paid for the copy ~~paid~~ by the retailer on return of the copy and  
12 documentation to that person; and

13 (2) a publisher ~~that~~ makes the refund to the end user is entitled to reimbursement  
14 from the retailer of the difference between the amount refunded and the price paid by the retailer  
15 to the publisher for the ~~refunded~~ product.

16 (d) If an agreement contemplates physical distribution of tangible copies ~~of information~~  
17 ~~in the ordinary course of business~~ provided by the publisher, a retailer or other distributor shall  
18 distribute such copies and documentation as received from the publisher and subject to any  
19 contractual terms provided for end users.

20 (e) A retailer that enters into an agreement with an end user is a licensor of ~~in its~~  
21 ~~transaction with the end user for all purposes~~ under this article.

22 **Uniform Law Source:** None

23 **Reporter's Note:**

24 [The modification in the definition of retailer is a first step to establish that this section does not apply to access



1 contracts. While the three-party model used here may be applicable to such contracts at least in some cases, further  
2 review is needed to determine the extent and nature of the analogy.]

3       **1.** This section deals with the three party relationship common in modern information transactions,  
4 especially in reference to digital products. The three party transaction involves a publisher, retailer, and end user. While  
5 the end user acquires the copy of information from a retailer, the retailer often lacks authority to convey a right to use  
6 a copyrighted work to the end user or, even, the right to transfer title to the copy. The right to “use” (e.g., copy) arises  
7 by agreement between the end user and the producer (party with ownership or control of the copyright). Often, in retail  
8 markets, this latter agreement is a screen license or a shrink wrap license. The enforceability of the terms of that license  
9 with respect to the licensee and publisher are dealt with elsewhere.

10       **2.** While there are three parties involved in separate relationships, it is clear that the relationships are  
11 linked. Subsection (b) deals with the relationship from the perspective of the **retailer’s** contract with the **end user**. The  
12 basic principle in (b)(3) is that a retailer is not bound by nor does it benefit from any contract created by the producer  
13 with the end user. This mirrors modern law and limited case law dealing with sales of goods where manufacturer  
14 warranties and warranty limitations do not bind the retailer, but also do not benefit that retailer. A prior draft of this  
15 section stated the opposite position, but that met strong dissent. This means, of course, that the retailer does not have the  
16 benefit of warranty disclaimers made in a mass market publisher’s license. That result can be changed by contract, of  
17 course. However, it gives the end user two different points of recourse - retailer and publisher.

18       Subsection (e) confirms that warranties exist on the part of the retailer by stating that the retailer is a licensor  
19 with respect to its licensee.

20       **3.** Subsection (b)(1) and (b)(2) deal with the reality that performance of the retailer’s relationship with  
21 the end user hinges on the end user’s ability to make actual use of the information supplied by the retailer and that this  
22 depends on the license between the producer and the end user. The net effect is to give the end user who declines a  
23 license a right to refund, and to not being forced to pay the purchase price to the retailer. This refund concept creates  
24 a refund right, rather than an option on the part of the retailer. It reflects the conditional nature of the transaction with  
25 the end user. It differs from the publisher’s option to provide a refund opportunity as a means of enabling the effective  
26 assent to the publisher’s license terms. While they are distinct, however, a refund made by the retailer under the  
27 conditions of subsection (b) satisfies the refund opportunity required under 2B-113 for creating an opportunity to review.

28       **4.** There are several ways to view the retailer-end user relationship in reference to the publisher’s license.  
29 One is to treat the publisher’s license in full as an element of the retailer contract, understood as present by both the  
30 retailer and the end user from the outset, even if the precise terms are not yet known. See *ProCD v. Zeidenberg*, 86 F.3d  
31 1447 (7th Cir. 1996). An alternative treats the retailer’s commitment as being to deliver the copy and to convey the right  
32 to use (e.g., copy into a machine). It cannot do the latter unless or until the end user assents to the publisher’s license  
33 since, in most cases, the retailer’s contract with the publisher authorizes only distributions subject to end user licenses  
34 and distributions that go outside this restriction constitute copyright infringement in cases where the information consists  
35 of copyrightable material. The end user’s assent to the producer’s license is then, as to its situation with the retailer, either  
36 a condition precedent (there being no final agreement until the end user can review and assent to or reject the license)  
37 or a condition subsequent (the agreement being subject to rescission if the terms of the license are unacceptable). In either  
38 case, if the end user declines the license, it can return the product to the retailer and obtain a refund or, if it has not  
39 already paid, avoid being forced to pay the contract fee. Subsection (b)(1) and (b)(2) create this result. The contract  
40 between the retailer and end user is a license in that the end user’s use rights are subject to assent to and the terms of the  
41 publisher’s license. When the end user assents to the license, the publisher’s license in effect replaces the retailer-end  
42 user license except as to obligations expressly created and earmarked as continuing on the part of the retailer (such as  
43 a services or support obligation). Of course, in addition, if the information breaches a warranty, the right to recover from  
44 the retailer remains present unless it was disclaimed by the retailer’s contract.

45       **5.** In a recent European case, *Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd.*, the court  
46 gave the end user a right to return the software and not pay the purchase price as to the retailer when the contract terms  
47 were unacceptable. The analysis was that the retailer’s contract with the end user must have contemplated that the end  
48 user would have a right to copy/use the software, but that right could be obtained only through license or other agreement  
49 from the copyright owner. When the end user declined the license, in effect the conditions of the retailer’s obligation  
50 were not met. The court did not treat this as a breach of contract, but as a failure to conclude the contract between the  
51 parties. No final agreement was present until the end user could review and accept or reject the license terms. In effect,  
52 the contract was concluded (or to be concluded) over a period of time, as opposed to at a single point in time over the

counter.

**Illustration 1:** User acquires three different software programs from Retailer for a price of \$1,000 each to be used in its commercial design studio. User is aware that each software comes subject to a publisher license. When it reviews one license, however, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the retailer did not provide a useable package and the end user did not pay simply for a diskette. Because the failed sale occurred due to the license terms, the refund under this section is from the retailer. 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. In most cases, of course, the publisher will establish this alternative refund process as at least initially coming through the retailer.

6. In most cases where an end user license is contemplated, the publisher's arrangements with distributors are licenses that retain ownership of all copies in the publisher and permit distribution only subject to a 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, 94<sup>th</sup> Cong., 2d Sess. 79 (1976).

7. To the extent that the retailer performs the producer's warranty obligations, the presumption is that it has a right of reimbursement from the producer. The provisions regarding refunds coordinate this section with the obligations incurred in creating an opportunity to review the terms of a license, which opportunity requires that there be a refund if the terms of the contract are refused. The consumer is entitled to refund of the retail price of the refused product and may obtain that either from the retailer or the producer. However, as between the producer and the retailer, the retailer can only receive reimbursement for what it paid to the producer. Thus, for example:

**Illustration 2:** Consumer refuses a program because it dislikes the license. It obtains a refund of the price paid to retailer (\$100). Retailer is entitled to reimbursement from Producer of the \$75 price that Retailer paid Producer for the product (if it returns the product). On the other hand, if Consumer obtains the \$100 from Producer, Producer is reimbursed \$25 from Retailer.

8. 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-617. DEVELOPMENT CONTRACT.**

(a) In this section, "developer" means a person hired or commissioned to create, modify, or develop a computer program, and "client" means a person that hires a developer.

(b) If an agreement requires the development of a computer program, as between the developer and the client, the following rules apply.

(1) Unless an authenticated record provides for different result~~treatment of~~  
~~ownership of the intellectual property rights:~~

(A) the developer retains ownership of the intellectual property rights in

1 ~~the program~~ except to the extent that the program includes intellectual property of the client or  
2 the client would be considered a co-owner under other law; and

3 (B) the client receives a nonexclusive ~~but~~ irrevocable license to use the  
4 information in any manner consistent with the agreement. ~~within this country [which is~~  
5 ~~unrestricted as to the types of use] [which is limited to the uses contemplated by the agreement].~~

6 (2) If the client requests response ~~On request of the client~~ in a record, the  
7 developer ~~must~~ shall notify the client if it ~~the developer~~ used independent contractors or  
8 information provided by other third parties and ~~must~~ shall provide the client with a statement that  
9 either confirms that all applicable intellectual property rights have been obtained or will be  
10 obtained, or that it makes no representation about those rights beyond any stated in the  
11 agreement. The response must be made within 30 days after the request is received unless ~~—If~~  
12 the time for performance is less than 30 days, in which case the ~~the request must be made at or~~  
13 ~~before the time of contracting, and~~ the response must be ~~made~~ before the [transfer] [activation] of  
14 rights.

15 (3) If an authenticated record or applicable intellectual property law provides that  
16 ownership of the intellectual property rights in the ~~completed~~ program ~~will~~ passes to the client,  
17 but does not otherwise deal with the following issues, ~~unless the agreement provides otherwise,~~  
18 the following rules apply:

19 (A) Ownership of ~~in the~~ program passes under ~~in accordance with~~ Section  
20 2B-501.

21 (B) The client receives the program free of ~~any~~ restrictions on use ~~on the~~  
22 ~~part of the developer~~ and its rights in the program may not be canceled by the developer after  
23 ownership vests in the client. ~~pursuant to Section 2B-501 [payment of the contract price].~~

1 (C) The developer retains ownership of ~~intellectual property rights in~~  
2 components or code developed before or independent of the contract, but the client has an  
3 irrevocable license to use ~~these~~ such components or code as were delivered to the client consistent  
4 with the agreement. ~~in any manner in connection with its use of the program or any modifications~~  
5 thereof.

6 (D) The client receives ownership of generally applicable components or  
7 code, including development tools or the like, developed in performance of the contract, but the  
8 developer has an irrevocable nonexclusive right to use generally applicable components or code  
9 in other contracts if the use does not disclose confidential information of the client.

10 (4) Language in an authenticated record is sufficient to provide that ownership of  
11 all intellectual property rights will pass to the client or be retained by the developer if it states  
12 “All rights, title, and interest in the completed program will be owned by [named party]”, or  
13 words of similar import.

14 **Uniform Law Source:** None

15 **Reporter's Notes:**

16 1. This section deals with an important area of software contracting. It is an area affected by federal  
17 intellectual property law rules and also characterized by both, extensively negotiated contracts as well as very informal  
18 relationships. In many cases, the licensor-developer is a smaller firm dealing with larger companies. The section is  
19 specifically limited to development contracts relating to computer programs.

20 2. Federal copyright law provides that, unless there is an express transfer of the copyright in a writing,  
21 copyright ownership remains in the developer, rather than the client for whom the developer worked. The copyright rule  
22 was adopted after substantial deliberation and placed in the 1976 Copyright Act. It sets the background for default rules  
23 in this section. In addition, the default rules seek to balance the interests of the developer in continuing in business with  
24 the interests of the client in obtaining a right to use the information developed for it. In many cases, retention of rights  
25 in elements of a developed program is critical for the developer who will reuse program components and routines in  
26 subsequent projects.

27 3. Subsection (b)(1)(A) states a default rule that corresponds to copyright law rules about ownership. In  
28 the absence of an employment relationship, ownership remains in the creative individual or company unless the contract  
29 expressly provides for a transfer of that ownership to the client (licensee). This rule states an important premise relating  
30 to the rights of the individual or other small developer to retain the primary rights in its intellectual work product unless  
31 it specifically and clearly transfers those rights. This policy reflect federal intellectual property law and protects small  
32 developers. Subsection (b)(1)(B), however, ameliorates the possibility of an adverse impact due to a misunderstanding  
33 by providing what amounts to an implied license for the client. The license is non-exclusive. A critical issue needs to  
34 be resolved about the scope of the license, with the two alternatives being to make the rights unrestricted or to limit the  
35 implied license to uses consistent with the developmental purposes.

1 The implied license approach is consistent with case law dealing with this type of case. In the reported cases,  
2 the implied license tends to be limited to uses consistent with the purposes of development.

3 4. Subsection (b)(2) provides important protection for a licensee not found in current law. The section  
4 stems from a problem created under federal intellectual property law, especially as to copyright ownership. Copyright  
5 law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The  
6 licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate  
7 good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the  
8 licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to potentially  
9 avoid those problems.

10 5. Subsection (b)(3) deals with cases where the contract gives ownership of the intellectual property in  
11 the program to the client. The default rule is intended to provide protection for small developers and small licensees who  
12 may not address the basic questions presented. The theme is that ownership transfers in all code developed for and  
13 included in the program and that no conditions limit the licensee's use. However, two interests are balanced in the event  
14 that the contract does not deal with them: 1) the developer's right to continue to use general applicability code and tools  
15 and 2) the licensee's rights in code developed outside the project which are not clearly transferred to it. In each case,  
16 a split between ownership and a non-revocable license is used to give each party rights in the materials as a default rule.  
17 The developer retains ownership of previously developed materials, but the licensee has an irrevocable license to use  
18 them. In reference to included general tools, on the other, the licensee has ownership, but the developer has a license  
19 to continue to use.

20 6. Subsection (4) provides safe harbor transfer language for effectuating a transfer. The terminology is  
21 designed to clearly indicate that more than a transfer of a copy was contemplated.  
22  
23

## 24 **SECTION 2B-618. FINANCIAL ACCOMMODATION CONTRACTS.**

25 (a) A financier is subject to the terms and limitations of the license and to the intellectual  
26 property rights of the licensor. Except as provided under subsection (c)(1), ~~The creation;~~  
27 ~~perfection;~~ and enforcement of a financier's interests in a license is subject to Section 2B-504.

28 (b) If a financier is not a licensee that transfers ~~or sublicenses~~ rights under the license to a  
29 licensee receiving financial accommodation, the following rules apply:

30 (1) The financier is not required to perform the obligations owed to the licensee  
31 under the license and does not receive the benefits of the license.

32 (2) The licensee's rights and obligations with respect to the information are  
33 governed by the license and any rights of the licensor under other law and, to the extent not  
34 inconsistent with the license or other law, the terms of the financial accommodation agreement.

35 (c) If a financier is a licensee that ~~sublicenses or otherwise~~ transfers the license to a  
36 licensee receiving the financial accommodation, the following rules apply:

1                   (1) The ~~sublicense or~~ transfer to the licensee is not effective unless:

2                               (i) the ~~transferor is a financier under this article or~~ transfer meets the  
3 conditions for ~~effective~~ transfer under Section 2B-502 and 2B-503, or

4                               (ii) the accomodated party agrees to the license and the financier becomes  
5 a licensee solely to make the financial accommodation and before the licensor provides the  
6 information, the financier delivered notice to the licensor giving the name and location of the  
7 accommodated party and indicating that the accommodated party will be the only end user of the  
8 information. However, the financier may make only the single transfer contemplated by the  
9 notice financial accommodation unless the licensor consents to a subsequent transfer or the  
10 subsequent transfer is effective under Section 2B-504.

11                   (2) After transfer to the licensee, the licensee becomes a party to the license and  
12 the licensee's rights and obligations with respect to the information are governed by the license  
13 and any rights of the licensor under other law and, to the extent not inconsistent with the license  
14 or other law, the terms of the financial accommodation agreement.

15                   (3) With respect to the licensee, on completion of an effective transfer to the  
16 licensee, the financier is no longer a licensor and, except for the warranty under Section 2B-401  
17 concerning authority and quiet enjoyment, makes no warranties to the licensee other than any  
18 express warranties in the agreement.

19                   (d) Unless the licensee is a consumer, if the financial accommodation agreement so  
20 provides, as between the financier and the licensee and any transferee of either party, the  
21 licensee's promises under the financial accommodation and any related agreements become  
22 irrevocable and independent of the license on:

23                               (1) the licensee's acceptance of the license and [commitment to pay] [payment] by

the financier unless the information was selected, created or supplied by the financier, the financier provides support, modifications, or maintenance for the information, or the financier holds intellectual property rights in the information; or

(2) transfer of the contract by the financier to a third party.

(e5) As between the financier and the licensee, if the financial accommodation agreement so provides, the financier is entitled to possession of any copies, upgrades, new versions, or other modifications of the information provided by the licensor pursuant to the license, but the financier's rights with respect to the licensor are determined under Section 2B-504.

(fd) On breach of a financial accommodation agreement by the licensee, the financier may cancel that agreement, but may not cancel the license. The rights of the financier to further enforce the agreement are subject to Section 2B-504.

(ge) The licensor's rights and obligations with respect to the licensee are governed by the terms of the license and any rights of the licensor under this article or other law.

#### **Committee Action:**

a. In December, 1996, the Committee concluded, by a consensus, that treatment of financing arrangements was appropriate, but that it should be limited and generic. The over-riding concept would allow creation of an interest, but not sale and reflect important differences in the license arrangement as contrasted to lease and security interests in goods.

b. The Committee did not adopt a motion that the "hell and high water" rules in subsection (d) should be applicable even though the contract does not so provide. Vote: 5 - 5 (April, 1997).

#### **Reporter's Notes:**

[The subsection was amended to move substantive material from the definition sections into this section regarding the financier's ability to transfer the license to the accommodated licensee. Comments to d(1) will indicate that selecting involves actual choices, rather than merely following orders. Should there be a safe harbor language for the notice to the licensor.]

1. This section is one of two sections that implement the integrated treatment of security interests and finance leases. This section deals with the relative rights among the parties, while Section 2B-504 on financier's rights deals with the creation of the interest. The term "financier" includes both a secured creditor and a lessor. The critical distinction, implemented here and in the definition of the term, 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 traditional true party leasing where the lessor (financier) acquires the property (license) and transfers this down to the licensee.

2. An important licensee protection makes the financial accommodation 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. The definition of "financier" incorporates this concept, requiring that

1 the licensee's assent be a condition to the creation of the lease. This transaction is different from the ordinary  
2 equipment lease because of the central importance of this license agreement and the provisions here recognize that  
3 importance. (see also the treatment of when promises become irrevocable).

4 3. Subsections (b) and (c) outline some attributes of the two scenarios. Subsection (b) involves a  
5 situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also  
6 have a contract relationship with the licensee. The key factor here is that the lessor is not bound by the obligations of  
7 the license, but is bound by the limitations of the license. The licensee's rights are governed first by the license and  
8 secondly by the financial accommodation agreement. In subsection (c) we deal with the less common situation  
9 where the license is actually provided to the lessor and then passed down through to the licensee. Here, when the  
10 licensee takes on the license, the lessor is taken out of the transaction as between the licensee and financier for  
11 purposes of qualitative and other issues except for quiet enjoyment and authority to transfer consideration. The  
12 licensee becomes a direct party to the license.

13 4. Subsection (d) provides rules pertaining to hell and high water clauses. Promises become  
14 irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule  
15 is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party  
16 context. Additionally, the provisions have been modified to reflect a problem not present in ordinary equipment  
17 leasing. Article 2A-407 provides that the promises become irrevocable on the lessee's acceptance of the goods. In  
18 the stereotypical transaction under that article, the goods are sold to the lessor and sent to the lessee. If there is non-  
19 payment by the lessor, the seller's remedies are against the lessor (not the lessee). In a license transaction, however,  
20 there are two different factors. First, in many cases, the licensee contracts directly with the licensor. Non-payment  
21 then may give a contractual right of action for the price against the licensee even though its lease called for payment  
22 by the lessor. Second, in a license, payment is typically a condition on the licensee's rights to continue to use the  
23 information. Thus, although the lessor was to pay, the licensee may be placed in a position of paying twice if the  
24 lessor fails to do so. To avoid this type of problem, the irrevocability concept is limited here not only to acceptance  
25 of the transfer, but also payment to the licensor.

26 5. Subsection (e) deals with a common area of litigation in the leasing industry, focusing on the  
27 relationship between the three parties in reference to update and the like made available during the license term. As  
28 between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement.  
29 As between the licensor, however, the general provisions of Section 2B-504 control.

30 6. Subsection (f) states a primary right of the financier in the event of breach. Since the financier is  
31 not a party to the license, it cannot cancel that contract.

## 32 [D. Performance Problems; Cure]

### 33 SECTION 2B-619. CURE.

34 (a) A party in breach of a contract, at its own expense, may cure the breach if the party:

35 (1) without undue delay notifies the other party of its intent to cure; and

36 (2) effects cure promptly ~~and~~ before cancellation or refusal of a performance by  
37 the other party.

38 (b) If a licensor, other than in a mass-market license, receives timely notice of a specified  
39 nonconformity and a demand for cure from a licensee that was required to accept a performance  
40 because a nonconformity was not material, the licensor promptly and in good faith shall make an  
41  
42



effort to cure unless the cost of the effort would be disproportionate to the adverse effect of the nonconformity on the licensee.

(c) A breach of contract which has been cured may not be used to cancel a contract, but mere notice of intent to cure does not preclude cancellation or refusal.

**Uniform Law Source: Sections 2-508; 2A-513**

**Reporter's Note:**

1. The idea of cure applies in both directions. Unlike in Article 2 transactions, it affects performance obligations of both the licensee and the licensor. In Article 2 the sole emphasis is on the seller's right to cure. For licensees' cure often relates to missed payments, failures to give required accounting or other reports, and misuse of information. For licensors, depending on the context, the issues often focus on timeliness of performance, adequacy of delivered product, breach of warranty and the like.

2. In this Article, unlike in Article 2, except in mass market licenses, breaches that trigger cure typically do not occur unless there was a material breach of the relevant performance obligation. This shifts the equities in reference to the extent to which a right to cure exists. This Section does not create a "right" to cure. The basic policy is that, when there exists a material breach, the aggrieved party's interests prevail over the vendor's interests.

3. The idea that a breaching party may, if it acts promptly and effectively, alleviate the adverse effects of its breach and preserve the contractual relationship is embedded in modern law. Restatement (Second) of Contracts § 237 provides that a condition to one party's performance duty in a contract is that there be no uncured material breach by the other party.

4. Although the idea of cure is embedded in modern law, there is significant disagreement in pertinent statutes and statements of contract law as to the scope and balance applied to the operation of a cure.

a. The UNIDROIT Principles go the furthest in establishing a **right** to cure indicating that a cure is not precluded even by notice of termination for breach and by not limiting the opportunity to cure in any manner related to the timing of the performance. That is, cure is neither more nor less possible as a right if it occurs during the agreed time for performance than if it occurs afterwards. The UNIDROIT Principles, of course are not enacted law in any state. They condition cure on "prompt" action and allow it if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing the cure. UNIDROIT art. 7.1.4

b. Article 2, in contrast, distinguishes between cure made within the original time for performance (essentially allowing a right to cure) and cure occurring afterwards (which it restricts to cases where the vendor expected the tender to be acceptable). Draft revisions of Article 2 are in flux, apparently attempting to blend the existing Article 2 concept with the Unidroit concept.

c. The UN Sales Convention does not distinguish between cures occurring 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" (e.g., canceled) if the breach was a fundamental breach of contract.

5. This section is consistent with the Sales Convention. That approach is used because this Article employs the standard of materiality of breach as a precondition for cancellation or refusal of a performance. This Section allows cure if it is prompt, but does not create a right to cure. The cure is subject to prior cancellation or refusal by the other party. This places control in the aggrieved party who has suffered a material breach by the other person. In a mass market setting, it enables a clearly delineated right to end the transaction which many from the consumer context have viewed as significant.

6. 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 consistent with comments to other sections, this will be pointed out in comments, rather than in the statute. One might ask whether this obligation should be mutual and apply to situations where the licensor has been required to accept nonmaterial breaches.

7. The final comments will discuss aspects of the substantive elements of cure. The elements that would

1 be discussed include: fully perform the obligation that was breached, compensate for loss, timely perform on all  
2 assurances of cure, and provide assurance of future performance.

3  
4 **SECTION 2B-620. WAIVER.**

5 (a) Any claim or right arising out of an alleged breach of contract may be discharged in  
6 whole or in part without consideration by a waiver contained in a record [to which the party  
7 making the waiver manifests assent] [authenticated by the party making the waiver].

8 (b) A party that accepts a performance, knowing or with reason to know that the  
9 performance constitutes a breach of contract:

10 (1) waives its right to revoke acceptance or cancel because of the breach unless  
11 the acceptance was on the reasonable assumption that the breach would be seasonably cured, but  
12 acceptance does not in itself preclude any other remedy provided by this article; and

13 (2) waives any remedy for the breach if the party fails within a reasonable time to  
14 object to the breach.

15 (c) Except with respect to a failure to meet a contractual requirement that performance be  
16 to the subjective satisfaction of a party, a party that refuses a performance and fails to state in  
17 connection with its refusal a particular defect that is ascertainable by reasonable inspection  
18 waives the right to rely on the unstated defect to justify refusal or to establish breach only if:

19 (1) the other party was not aware of the defect and could have cured the defect if  
20 stated seasonably ~~and the other party was not aware of the defect; or~~

21 (2) between merchants, the other party ~~after refusal of a performance~~ has made a  
22 request in a record for a full and final statement in a record of all defects on which the refusing  
23 party proposes to rely.

24 (d) A waiver may not be revoked as to the performance to which the waiver applies.

1 However, waiver of breach of contract in one performance does not waive the same or similar  
2 breach in future performances of like kind unless the party making the waiver expressly so states.  
3 Except for a waiver pursuant to subsection (a) or a waiver supported by consideration, a waiver  
4 affecting an executory portion of a contract may be retracted by seasonable notice received by  
5 the other party that strict performance is required in the future of any term waived unless the  
6 retraction would be unjust in view of a material change of position in reliance on the waiver by  
7 the other party.

8 **Committee Action:** This section was considered in December without substantial substantive concern.

9 **Reporter's Notes:**

10 [The bracketed language in (a) raises the question of whether manifesting assent to a record, rather than authentication  
11 should be used in light of the electronic environment with which this Article deals.]

12 1. A "waiver" is "the voluntary relinquishment" of a right. As with respect to cure, ideas of waiver in  
13 this Article must be considered in both directions. Conduct and words may constitute a waiver by either the licensor or  
14 the licensee. This section brings together rules from various portions of existing Article 2 dealing with waiver issues and  
15 recasts those rules to fit the broader number and variety of types of performance that are involved in Article 2B  
16 transactions. The section also applies principles from the Restatement.

17 2. Subsection (a) stems from 2A-107. Written waivers are, in effect, contractual modifications. The  
18 Restatement is consistent with this view. Restatement (Second) ' 277 ("a written renunciation signed and delivered by  
19 the obligee discharges without consideration a duty arising out of a breach of contract."). Subsection (a) does not preclude  
20 other ways of making an effective waiver, but that it merely confirms that waivers that meet its provisions are effective.  
21 For example, an oral waiver, if effective under common law of a state, remains effective.

22 3. Subsection (b) brings together rules from current Article 2-607(2) and (3)(a) and generalizes the  
23 language. In Article 2, the rules apply **only** to a tender by the seller and acceptance of delivery by the buyer. Here, the  
24 effect also applies to acceptance of tendered performance by the licensee (e.g., a payment of royalties). The rule does  
25 not apply to cases where the party merely knows that performance under the license is not consistent with the contract  
26 unless that defective performance is tendered and accepted. This section on waiver is from current law in Article 2 and  
27 follows that rule. It is also consistent with the Restatement (Second) ' 246 which provides that retention of a performance  
28 with reason to know it was defective creates a promise to perform despite the breach. The following illustrates the rule  
29 here:  
30

31 **Illustration:** Licensee has an obligation to pay royalties to the Licensor based on 2% of the sale price  
32 of products licensed for its manufacture and distribution. The royalty payments must be received on  
33 the first of each month. A 5% late fee is imposed for delays of more than five days and the license  
34 provides that delay of more than five days is a material breach. In one month, the licensee does not  
35 tender payment until the 25<sup>th</sup> day of the month and its tender does not include the late charge. Licensor  
36 may refuse the tender and cancel the contract. If it accepts the tender it knows of the breach and  
37 cannot thereafter cancel the contract for that breach. If it fails to object in a reasonable time to the late  
38 tender and the nonpayment of the late fee, it is also barred from recovering that amount.  
39

40 4. Subsection (c) comes from current UCC ' 2-605 and, except for changes that adopt the language of  
41 waiver, is substantively identical to that section. The basic principle is that, having given notice of refusal, there is  
42 ordinarily no further obligation to delineate the reasons for refusal.

43 5. Subsection (d) sets out a default rule common in most contracts involving ongoing relationships by

1 indicating that waivers are presumed to be related to the performance accepted only. This does not alter estoppel  
2 concepts; a waiver by performance may create justifiable reliance as to future conduct in an appropriate case. Such  
3 common law principles continue to apply. The section goes on to take language from former 2B-303 and the Article 2  
4 predecessor of that section setting out when waiver as to executory obligations can be retracted. On the treatment of  
5 waivers supported by consideration, see Restatement (Second) of Contracts ' 84, comment f.

## 6 7 **SECTION 2B-621. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.**

8 (a) A contract imposes on a party an obligation not to impair another party's expectation  
9 of receiving due performance. If reasonable grounds for insecurity arise with respect to the  
10 performance of either party, the other party may demand in a record adequate assurance of due  
11 performance and, until that assurance is received, if commercially reasonable, may suspend any  
12 performance for which the agreed return performance has not already been received.

13 (b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of  
14 the assurance offered is determined according to commercial standards.

15 (c) Acceptance of improper delivery or payment does not prejudice an aggrieved party's  
16 right to demand adequate assurance of future performance.

17 (d) After receipt of a justified demand, failure to provide assurance of due performance  
18 that is adequate under the circumstances of the particular case within a reasonable time, not  
19 exceeding 30 days, is a repudiation of the contract.

20 **Committee Action:** This section was considered in December without substantial substantive comment.

21 **Uniform Law Source:** 2-609.

22 **Reporter's Note:**

23 This Section corresponds to existing law in Article 2.  
24  
25

## 26 **SECTION 2B-622. ANTICIPATORY REPUDIATION.**

27 (a) If either party to a contract repudiates a performance not yet due and the loss of  
28 performance will substantially impair the value of the contract to the other, the aggrieved party  
29 may:

(1) await performance by the repudiating party for a commercially reasonable time or pursue any remedy for breach of contract even if it has urged the repudiating party to retract the repudiation or has notified the repudiating party that it would await the agreed performance; and

(2) in either case, suspend its own performance.

(b) Repudiation includes but is not limited to language that one party will not or cannot make a performance still due under the contract or voluntary affirmative conduct that reason appears to the other party to make a future performance impossible.

**Committee Action:** This section was considered in December without substantial substantive comment.

**Uniform Law Source:** 2-609.

**Reporter's Note:**

This Section corresponds to current law in Article 2.

#### **SECTION 2B-623. RETRACTION OF ANTICIPATORY REPUDIATION.**

(a) A repudiating party may retract a repudiation until its next performance is due unless an aggrieved party after the repudiation has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction under subsection (a) may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 2B-621.

(c) Retraction under subsection (a) reinstates a repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay caused by the repudiation.

**Committee Action:** This section was considered in December without substantial substantive comment.

**Uniform Law Source:** Section 2-610.

**Reporter's Note:**

This Section corresponds to existing law in Article 2.

1  
2 **[E. Loss and Impossibility]**

3 **SECTION 2B-624. RISK OF LOSS.**

4 (a) Except as otherwise provided in this section, the risk of loss as to a copy of  
5 information passes to the licensee on receipt of the copy. In an access contract, risk of loss as to  
6 the information to be accessed remains with the licensor where the resource is in the possession  
7 or control of the licensor, but risk of loss as to information copied by the licensee as a result of  
8 that access passes to the licensee when it receives the copy.

9 (b) If a contract requires or authorizes a licensor to send a tangible copy by carrier, the  
10 following rules apply:

11 (1) If the contract does not require delivery at a particular destination, the risk of  
12 loss passes to the licensee when the copy is delivered to the carrier even if the shipment is under  
13 reservation.

14 (2) If the contract requires delivery at a particular destination and the copy arrives  
15 there in the possession of the carrier, the risk of loss passes to the licensee when the copy is  
16 tendered in a manner that enables the licensee to take delivery.

17 (3) If a tender of delivery of a copy or a shipping document fails to conform to the  
18 contract, the risk of loss remains on the licensor until cure or acceptance.

19 (c) If a copy is held by a third party to be delivered or reproduced without being moved,  
20 or if a copy is to be delivered by making access available to a resource that contains the  
21 information, the risk of loss passes to the licensee upon:

22 (1) the licensee's receipt of a negotiable document of title covering the copy;

23 (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 delivery or access or of access codes

enabling delivery or access.

**Uniform Law Source: Section 2-509**

**Reporter's Notes:**

1. While, in many cases, there is no risk of loss element present in an information contract, there are situations where the risk of loss is potentially as significant as it is in the case of transactions in goods. For example, a licensee's data may be transferred to the licensor for processing and destruction of the processing facility may destroy the data. Alternatively, a purchaser of software transferred in the form of a tangible copy may (or may not) suffer a loss when or if the original copy is destroyed (depending of course on whether additional copies were made before that time). This section uses a concept of transfer of possession or control as a standard for when risk of loss is transferred to the other party. Unlike in the buyer-seller environment, however, the transfers of control or the like may go in either direction. Basically, the proposition is that the risk passes to the party who has access to, taken possession of copies, or received control of the information.

2. Subsection applies that basic principle to internet or similar transactions. The risk remains with the licensor, but as to copies made by the licensee passes on the making of the copy.

**SECTION 2B-625. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.**

(a) Delay in performance or nonperformance by a party is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency 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, statute, or order, whether or not it later proves to be invalid, if the parties assumed that the delay would not occur.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance. If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall also allocate performance among its customers in a manner that is fair and reasonable and notify the other party of the estimated quota made available. However, the party may include regular customers not then under contract

as well as its own requirements for further manufacture.

(c) A party that receives notice in a record of a material or indefinite delay, or of an allocation which would be a material breach of the whole contract, may:

(1) terminate and thereby discharge any unexecuted portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(d) If, after receipt of notification under subsection (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.

~~(e) The procedures in subsection (c) and (d) may be varied by agreement only to the extent that the parties have assumed a different obligation under subsection (a).~~

**Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.**

**Committee Votes:**

**a.** Voted unanimously to delete former section 2B-624, with reporter free to replace some of the concepts in another section.

**b.** Voted 12-1 to delete section on invalidity of intellectual property.

[Deletion of subsection (e) reflects the overall premise of contract freedom.]

**[F. Termination]**

**SECTION 2B-626. SURVIVAL OF OBLIGATION AFTER TERMINATION.**

(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 survive termination of a contract:

(1) a right or remedy based on breach of contract or performance;

(2) a limitation on the use, ~~scope~~, manner, method, or location of the exercise of rights in the information;

(3) an obligation of confidentiality, nondisclosure, or noncompetition;



(4) an obligation to return or dispose of information, materials, documentation, copies, records, or the like to the other party or of a party to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes through means of alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for providing notice;

(8) an indemnity term;

(9) a limitation of remedy or disclaimer of warranty; and

(10) any right, remedy, or obligation stated in the agreement as surviving.

**Committee Action:** This section was reviewed by the Committee in December with no substantial substantive concerns.

**Uniform Law Source:** Section 2A-505(2); Section 2-106(3).

**Reporter's Note:**

**1.** Subsection (a) states the primary effect of termination, which refers to the discharge of executory obligations. This corresponds to current law.

**2.** Subsection (b) provides a list of provisions and rights that presumptively survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The exceptions deal with remedies. The list indicates terms that would ordinarily be treated as surviving in a commercial contract and the intent is to provide background support, reducing the need for specification in the contract with resulting risk of error. Of course, under the basic theme of contract flexibility, additional surviving terms can be added and the terms provided here can be made to be non-surviving.

**3.** Subsection (b) is a default rule. 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. Mere failure to list an element of subsection (b) does not mean that it does not survive.

## **SECTION 2B-627. NOTICE OF TERMINATION.**

(a) Subject to subsection (b), a party may not terminate a contract except on the happening of an agreed event such as the expiration of the stated term, unless the party gives reasonable notice of termination to the other party.

(b) Access to a facility under an access contract not involving information that the licensee provided to the licensor may be terminated without notice.

(c) In cases not governed by subsection (b), a contractual term dispensing with notice required under this section is invalid if its operation would be unconscionable, but a contractual term specifying standards for the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

**Uniform Law Source:** Section 2-309(c)

**Reporter's Notes:**

1. Termination involves an end to the contract for reasons other than breach of the contract. This section indicates that, for termination based on an agreed event (e.g., the end of the stated license term), no notice is required. In cases where termination may occur based on judgments or decisions of the other party, notice must be given of the termination. The notice must be reasonable. Of course, to terminate, the terminating party must have a right to do so under the contract or other applicable law.

2. Article 2 requires receipt of notice, but this section requires "giving" notice. The receipt standard creates 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. 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 reference to licenses of this type. 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). 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. Of course, the concept of termination refers to events not associated with breach. Where the reason to end the access relates to the existence of a breach, the section on discontinuing access controls.

4. The language in the last portion of (c) derives from Article 9-501 and sets out a standard for measuring the validity of contract provisions relating to time, place and method of termination notice. As applied in Article 9, that standard creates substantial room for effective exercise of contract freedom. The subsection invalidates waivers of notice so far as they may be unconscionable, but allows specification of standards for notice subject to a standard of manifest unreasonableness. This standard derives from Article 9 and sets a limit on standards setting, while maintaining contractual flexibility in this context which may be important for the parties.

**SECTION 2B-628. TERMINATION: ENFORCEMENT AND ELECTRONICS.**

(a) On termination of a license, a party in possession or control of information, materials, or copies it does not own, but which are the property of the other party or subject to a possessory interest of the other party, shall return all materials and copies or hold them for disposal on instructions of the other party. If the information, materials, or copies were subject to restrictions on use or disclosure, the party in possession or control following termination shall cease continued exercise of the terminated rights. Termination discontinues all rights of use under the

1 license. Continued exercise of the terminated rights or other use is a breach of contract unless it  
2 is pursuant to a contractual term that survives cancellation or which was designated in the  
3 contract as irrevocable. If information, materials, or copies are jointly owned, the party in  
4 possession or control shall make the information, materials or copies thereof available to the  
5 other joint owner.

6 (b) Each party is entitled to enforce by judicial process its rights under subsection (a). To  
7 the extent necessary to enforce those rights, a court may order the party or an officer of the court  
8 to:

9 (1) take possession of copies or any other materials to be returned under  
10 subsection (a);

11 (2) render unusable or eliminate the capability to exercise rights in the licensed  
12 information and any other materials to be returned under subsection (a) without removal;

13 (3) destroy or prevent access to any record, data, or files containing the licensed  
14 information and any other materials to be returned under subsection (a) under the control or in  
15 the possession of the other party; and

16 (4) require that the party in possession or control of the licensed information and  
17 any other materials to be returned under subsection (a) assemble and make them available to the  
18 other party at a place designated by that other party or destroy records containing the materials.

19 (c) In an appropriate case, the court may grant injunctive relief to enforce the rights  
20 under this section.

21 (d) A party may utilize electronic means to enforce termination pursuant to Section 2B-  
22 314. If termination is for reasons other than expiration of the license term, the party terminating  
23 the contract by electronic means shall notify the other party before using the electronic means

1 either directly or through the electronic means.

2 **Uniform Law Source:** None.

3 1. This section only deals with licenses. Subsection (a) states the unexceptional principle that the  
4 expiration of the contract term justifies immediate termination of contract rights and performance.

5 2. Termination differs from cancellation in that cancellation applies only in cases of ending a contract  
6 for breach. Subsection (d) deals with electronic means to enforce contract rights, a phenomenon present in digital  
7 information products, but not generally available in more traditional types of commercial products. The provisions here  
8 involve use of electronics to enforce contract rights that are not characterized by enforcing a breach of the agreement.  
9 Enforcement in the event of breach is discussed in 2B-716.

10 3. The ability to use electronic means to effectuate a termination does **not** allow use of those means to  
11 destroy or recapture records, but merely enables the licensor to preclude further use of the information. Section 2B-314  
12 requires notice in the contract, except in stated cases. The electronic means to enforce termination would include, for  
13 example, a calendar or a counter that monitors and then ends the ability to use a program after a given number of days,  
14 hours, or uses, whichever constitutes the applicable contract term.

15  
16 **Illustration 1:** Sun licenses Crocker to use a word processing system for one use; the system operates  
17 through the internet and the use of mini-program modules that are downloaded into the system as  
18 needed and remain in the system for brief periods. The license as to each applet terminates at the end  
19 of its brief use period. This section allows the use of electronic means to effectuate that termination.  
20

## 21 **PART 7**

## 22 **REMEDIES**

### 23 **[A. In General]**

#### 24 **SECTION 2B-701. REMEDIES IN GENERAL.**

25 (a) The remedies provided in this article are to be liberally administered with the purpose  
26 of placing the aggrieved party in as good a position as if the other party had fully performed.

27 (b) Rights and remedies provided in this article are cumulative, but a party may not  
28 recover more than once for the same injury.

29 (c) Except as otherwise provided in an term liquidating damages agreement, a court may  
30 deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a  
31 substantially better position than if the other party had fully performed.

32 (d) If a party breaches a contract and the breach is material as to the entire contract, the  
33 other party may pursue all remedies available under this article or the agreement, subject to the

conditions and limitations applicable to the remedy, including remedies available for nonmaterial breach. If a breach is material only as to a particular performance, the remedies may be exercised only as to that performance.

(e) If a party is in breach of contract, the other party has the rights and remedies provided in the agreement and this article. Unless the contract so provides, the party also has the rights and remedies available to it under other law.

**Uniform Law Source: Section 2A-523.**

**Reporter's Note:**

1. This section organizes a number of principles relating to administration of remedies. Subsection (a) restates a basic theme of contract remedies: placing a party in the position that would occur if performance had occurred as agreed. This language gives explicit guidance to a court and to parties to a contract. UCC 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 ...."

4. Subsection (b) provides that the remedies in this article are cumulative and there is no concept of election of remedies such as would bar seeking multiple forms of remedy. This is a fundamental approach in the UCC and expressed in Section 2A-501(4) as to leases. This cap is appropriate for contract-related remedies.

5. Subsection (c) gives the court a right to deny a remedy if it would place the injured party in a substantially better position that performance would have. This is a general review power given to the court. It does not justify close scrutiny by a court of the remedies chosen by an injured party, but only a broad review to prevent substantial injustice. The basic remedies model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation idea as a safeguard.

## **SECTION 2B-702. CANCELLATION.**

(a) A party may cancel a contract if the other party's conduct constitutes a material breach that has not been cured or if the agreement so provides.

(b) Cancellation is not effective until the canceling party notifies the other party of cancellation.

(c) On cancellation:

(1) a party in possession or control of information, materials, or copies shall comply with Section 2B-628; .

(2) all obligations that are executory at the time of cancellation are discharged.

However, the rights, duties, and remedies described in Section 2B-626(b) survive cancellation.

(d) A contractual term providing that a party's ~~licensee's~~ rights may not be canceled is enforceable and precludes cancellation as to those rights. However, a party whose right to cancel is limited retains all other rights and remedies under the agreement or this article.

(e) Unless a contrary intention clearly appears, language of cancellation, rescission, or avoidance or similar language is not a renunciation or discharge of any claim in damages for an antecedent breach of contract.

**Uniform Law Source: 2A-505; Sections 2-106(3)(4), 2-720, 2-721. Revised.**

**Reporter's Note:**

1. Cancellation means putting an end to the contract **for breach** and is distinct from termination (this terminology is not necessarily common in licensing practice, which tends to treat ending the contract for breach as a termination of the contract). In this article, the right to cancel exists **only** if the breaching party's conduct constitutes a **material breach** of the entire contract or if the contract creates the right to cancel under the circumstances. There is substantial case law in licensing and other contexts on this point. The concept of a breach material as to the entire contract is also found in Article 2A (Section 2A-523) and Article 2 (installment contracts). Interestingly, Article 2A defines any failure to pay rent as such a breach, while this draft treats non-payment of fees as material only if substantial. The primary issue in this section concerns whether the injured party must give notice to the other party before the cancellation for material breach is effective.

2. In an ongoing relationship, the remedy of cancellation is important to the injured party because it obviates the party's duty to continue to perform executory obligations under the agreement. In licenses that involve intellectual property rights, cancellation or termination are relevant not only as contract remedies, but under intellectual property law. This is true because, at least in some cases, a breach of a license agreement by the licensee if coupled with continued use of the intangibles by the licensee or use outside the scope of the license infringes the underlying property rights of the transferor. In practice, contract damages pertaining to licenses are often not sought because a licensor relies on the property right and infringement claim, rather than on contract law for recovery, but both types of recovery exist and the ability to cancel the license may trigger the intellectual property recovery right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228 (2d Cir. 1982). A license is a permit granted by the licensor to the licensee that allows the licensee to use, access or take whatever other actions are contracted for with respect to the intangibles without threat of infringement action by the licensor. If the license terminates, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying intellectual property rights of the licensor exposes itself to an infringement claim. Intellectual property remedies are in addition to contract remedies. The infringement and the contract remedies deal with a different injury (breach of contract expectation or damage to exclusive rights).

3. The right to cancel (rescind) the license and pursue an infringement claim in lieu of or in tandem with the contract claim is important in two respects unique to information contracting. First, if the information is covered by federal intellectual property law, the infringement claim places the licensor within **exclusive** federal court jurisdiction. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992). Schoenberg comments: "If the breach would create a right of rescission, then the asserted claim arises under the Copyright Act." In order to sue for infringement (in addition to or in lieu of the breach of contract), the licensor must establish that the contract no longer grants permission to the licensee to do what it alleges that the licensee is doing. A contract claim arises under state law and comes under federal jurisdiction under diversity or pendent jurisdiction concepts. Second, licensors often prefer intellectual property remedies, rather than contract remedies because the recovery is greater and there is a clearer right to prevent further use. Damages for copyright infringement include "actual damages suffered by [the copyright owner] as a result of the infringement **and** any profits of the infringer that are attributable to the infringement and are not taken into account in

1 computing the actual damages...." 17 U.S.C. ' 504(b). There is also a statutory damages provision.

2 4. Of course, the fact that a material breach occurred does not require the injured party to cancel. It may  
3 continue to perform and collect damages under other remedial provisions. Under the section dealing with cure, the ability  
4 to cure a material breach is subject to the injured party's right to cancel. Thus, there is no obligation to wait for a possible  
5 cure. Cancellation may be immediate. However, if cure precedes cancellation, cure precludes cancellation.

6 5 Cancellation is effective when the injured party notifies the other party of this act. In the case of a  
7 single delivery in the mass market, refusal of delivery itself provides such notice. More generally, since the right to cancel  
8 arises in the event of a **material** breach, the equities favor optimal flexibility for the injured party. Nevertheless, the draft  
9 does not allow cancellation without any effort to notify the breaching party. "Notifies" is defined in Article 1 (1-201(26))  
10 as taking steps reasonably required to inform the other party of the fact, but does not require **receipt** of the notice. An  
11 obligation to ensure receipt would be inconsistent with the balance of rights here and other law, such as in Article 9. Since  
12 cancellation requires a material breach, however, the Committee should consider whether an precondition of giving notice  
13 should be imposed at all or whether, at least in some cases, cancellation without notice is appropriate.

14 6. Subsection (e) clarifies the enforceability of contract terms that provide that a licensee's right cannot  
15 be canceled, even for material breach. These have importance in transactions where the licensee contemplates  
16 distribution of the information product developed or licensed by the other party and makes a significant investment in  
17 developing the information product based on the license. The non-cancellation term has as much or more importance in  
18 information industries as does the refund and replacement term in transactions involving the sale of goods.

19 7. Subsection (f) is from Article 2.

## 20 **SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.**

21  
22 (a) An agreement may add to, limit, or provide a substitute for the measure of damages  
23 recoverable for breach of contract or limit a party's other remedies, such as by precluding the  
24 licensor's right to cancel or limiting the remedies to return of all copies of the information and  
25 refund of the contract fee or repair and replacement of copies of the information by the licensor.

26 (b) Resort to a modified or limited remedy is optional, but a remedy expressly described  
27 as exclusive precludes resort to other remedies. However, if the agreed remedy requires  
28 performance by the party that breached the contract and the performance of that party in  
29 providing the agreed remedy fails to give the other party the remedy, the aggrieved party is  
30 entitled to specific enforcement of the agreed remedy or, to the extent that the performance failed  
31 to provide the agreed remedy ~~failed~~ and subject to subsection (c), to other remedies under this  
32 article.

33 (c) Failure or unconscionability of an agreed remedy does not affect the enforceability of  
34 separate terms relating to consequential or incidental damages unless those terms are expressly

made subject to the performance of the agreed remedy.

(d) Consequential damages and incidental damages may be excluded or limited by agreement unless the exclusion or limitation is unconscionable. A conspicuous term enforceable under this section is not subject to invalidation under Section 2B-308(b).

**Uniform Law Source: Section 2-719 (revised).**

**Reporter's Note:**

1. Subsection (a) validates the ability of parties to contractually limit and shape remedies. It generally conforms to current law, but lists additional remedy limitations (e.g., non-cancellation) that are relevant in information transactions, but not in modern sale of goods law. The list does not purport to be an exclusive exposition of what options are appropriate, but to provide guidance on what options are clearly acceptable, if performed.

2. Subsection (b) begins with language from current article 2: a contractual remedy is not the exclusive remedy unless the terms of the contract expressly so provide. The second sentence of subsection (b) clarifies language used in current Article 2 which provides that the contractual limit is obviated if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential purpose". This language has led to a myriad of case law rulings and does not truly identify what is at issue in failed remedy cases. The need for clarification was suggested from the floor of the NCCUSL meeting in 1995. The basic principle is that, if a party agrees to some performance as a remedy in lieu of other remedies, its failure or inability to perform its own agreement on remedies vitiates the remedy limitation or allows specific performance at the aggrieved party's option. Language in this draft and in revisions of Article 2 differs on this point.

3. The provision regarding exclusive remedies in this context is exclusive only as to contractual remedies, it does not refer to being exclusive as to all "rights" of a party, such as the right to prohibit use or copying, or disclosure.

4. This Draft does not restate the sales law presumption that exclusion of loss for personal injury in **consumer** cases is unconscionable. Case law holds that in information products and services, reliance on inaccurate information does not cause liability even in the case of personal injury to the relying party except in unusual cases or cases of digital software incorporated into more general products. Sales law concepts of products liability are not generally present in reference to information. An assumption that limitation of such loss is wrongful is not appropriate since the availability of such a remedy is not generally established in law. The draft simply takes no position on this issue.

5. Subsection (c) deals with a controversial topic that has produced inconsistent results in litigation. It concerns whether a failure of a limited remedy causes a failure of a limit or exclusion of consequential damages. Case law under Article 2 splits; most states holding that the failure of one remedy does not necessarily exclude enforceability of the other limitation. This draft presumes that the two terms are separate unless made dependent by the agreement.

## **SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.**

(a) Damages for breach of contract by either party may be liquidated in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. A term fixing unreasonably large liquidated damages is unenforceable. If a term liquidating damages is unenforceable, the aggrieved party has the remedies provided in the agreement or this article. However, the



unenforceability of that term does not affect the enforceability of separate terms relating to consequential damages or incidental damages unless the separate terms are expressly made subject to the liquidated damages terms.

(b) A party in breach of contract is entitled to restitution of the amount by which the payments it made for which performance was not received exceeds

(1) the amount to which the other party is entitled under terms liquidating damages in accordance with subsection (a); or

(2) in the absence of such terms, 20 percent of the value of the total performance for which the licensee is obligated under the contract or \$500, whichever is smaller.

(c) A party's right under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under the agreement or this article other than under the terms liquidating damages in accordance with subsection (a) and the amount or value of any benefits received by the licensee 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, that Drafting Committee accepted a motion from the floor to clarify that no after the fact determination of excessive or too minimal damages is intended.

**Reporter's Note:**

This draft continues the presumption that contractual choices should be enforced unless there is a clear, contrary policy reason to prevent enforcement or there is over-reaching. If the choice made by the parties was based on their assessment of choices at the time of the contract, that choice should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party.

## **SECTION 2B-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 accrued. By agreement, the parties may reduce the period of limitations to not less than one year after the right of action

1 accrues and may extend it to a term of not longer than 8 years.

2 (b) A right of action accrues when the act or omission constituting the breach occurs or  
3 should have occurred, even if the aggrieved party did not know of the breach. Breach of warranty  
4 occurs when the activation~~transfer~~ of rights occurs, except that if a warranty extends to future  
5 conduct, breach of warranty occurs when the conduct occurs or should have occurred which  
6 constitutes the breach of warranty, but no later than the date the warranty expires.

7 (c) A right of action for breach of warranty under Section 2B-401 or for a breach of  
8 contract involving disclosure or misuse of confidential information accrues on the later of when  
9 the act or omission constituting the breach is or should have been discovered by the aggrieved  
10 party. A cause of action for indemnity accrues on the later of when the act or omission that  
11 constitutes a breach of the obligation to indemnify is or should have been discovered by the  
12 indemnified party.

13 (d) This section does not apply to a right of action that accrued before the effective date  
14 of this article.

15 **Uniform Law Source: Section 2A-506; 2-725. Revised.**

16 **Reporter's Note:**

17 1. This section combines a discovery rule with a rule of repose. The discovery rule extends the limitations  
18 period for one additional year if applicable.

19 2. The cause of action as a general rule in this draft when the conduct constituting a breach occurs. In  
20 ordinary warranties, including all implied warranties, the warranty is met or breached on delivery of a product or service,  
21 even if the performance problem may not appear until later. Performance, in the sense of ongoing operation of a  
22 program, is not the measure of when the breach occurs. Performance in the sense of completion of one's required conduct  
23 in the transaction is the measure.

24 3. This draft follows Article 2A and Article 2 and adopts a four year limit for the contract action, but  
25 allows extension by one year if the breach could not have been discovered earlier. Article 2A uses a "discovery" rule.  
26 In a license, this can create an extended period of exposure to suit because of the long term nature of the contract and  
27 because many defects in software and similar intangibles do not become manifest until particular conditions arise.  
28 Additionally, of course, breaches occur during the contract performance and do not relate to circumstances present at  
29 the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause of action arises, except in cases where  
30 warranty extends to future performance and the breach cannot be discerned until that performance occurs. In most  
31 warranty cases, the breach of warranty arises on delivery. See Intermedics, Inc. v. Ventritex, Inc., No. C 90 20233 JW  
32 (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) (cause of action for contract breach related to the  
33 misappropriation would not entail a continuing breach); Computer Associates International, Inc. v. Altai, Inc., (Tex.  
34 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute of limitations in trade secret

misappropriation claim). A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

4. Subsection (a) applies the basic principle of contract freedom and holds that parties can contract for a longer period of limitations than under the statute. Modern practice routinely allows and relies on “tolling agreements” in contractual disputes. The basic issue is whether a contract can extend as well as limit the term. The draft allows extension with a ten year maximum.

5. This section deletes the "future performance" remedy exception as defined in current Article 2 and substitutes a standard that avoids the litigation that the current standard generates. In current Article 2, the time of accrual standard is dropped entirely if a warranty extends to future performance.

## **SECTION 2B-706. LIABILITY OVER.**

(a) In this section:

(1) “indemnified party” means a party who has a right of action over against another party based on a claim brought by a third party.

(2) “indemnifying party” means a party liable to the indemnified party because of the third party claim.

(b) If a indemnified party is sued by a third party other than for infringement, the indemnified party may notify the indemnifying party of the litigation. If the notice states that the indemnifying party may come in and defend and that if it does not do so the indemnifying party will be bound in any action between the indemnifying party and the indemnified party by any determination of fact common in the two litigations, the indemnifying party is ~~so~~ bound by any determinations of fact in the litigation unless the indemnifying party after seasonable receipt of the notice comes in and defends.

(c) If a indemnified party receives notice of litigation against it for infringement, relating to information provided by the indemnifying party, the following rules apply:

(1) Unless the indemnifying party has notified it of the litigation, the indemnified party shall seasonably notify the indemnifying party of the litigation.

(2) If the indemnifying party is answerable over to the indemnified party for the

claim or the contract is a nonexclusive license, the indemnifying party has a right to take over control of the litigation, including settlement, if it demands in a record that the licensee turn over control and:

(A) the demand states that the indemnifying party will bear all of the expenses and satisfy any adverse judgment or settlement; and

(B) the indemnifying party provides adequate assurance of its capability to do so.

(3) A indemnified party is barred from any remedy or recovery from or against the indemnifying party for liability established by the litigation if it fails to notify the indemnifying party of the litigation or refuses to turn over control of the litigation to the indemnifying party when presented with a demand that complies with subsection (c)(2).

**Uniform Law Source: Section 2A-516; 2-607. Revised.**

**Reporter's Note:**

1. This section adapts the answerable over rules of Article 2 to licenses. In reference to intellectual property rights, where the issue involves a nonexclusive license or a obligation over to the licensee, the licensor's interests in protecting against an adverse infringement claim are often dominant. This section gives the party a right to control the case if it provides adequate assurance that it is capable of doing so, including satisfying a potnetial judgment.

2. Unlike in Article 2, this section reflects that indemnity provisions and answer over obligations run in both directions in information contracts.

**[B. Damages]**

**SECTION 2B-707. DAMAGES FOR BREACH.**

(a) An aggrieved party may recover any unpaid contract fees for any performance by it that was accepted accepted by the other party, and any other [direct] [general] damages incurred in the ordinary course as measured in any reasonable manner, including, in the case of a proper refusal of a copy under Section 2B-610, any fee paid for the refused performancecopy, together with the present value of any incidental and consequential damages, less expenses avoided as a

1 result of the breach.

2 (b) The remedy for breach of contract relating to disclosure or misuse of information in  
3 which the aggrieved party has a right of confidentiality or which it holds as a trade secret may  
4 include compensation for the benefit received by the party in breach as a result of the breach. A  
5 remedy under the agreement or this article for breach of confidentiality or misuse of a trade  
6 secret is not exclusive and does not preclude remedies under other law, including the law of trade  
7 secrets, unless the agreement expressly so states.

8 (c) Except as otherwise provided in the agreement or this article, an aggrieved party may  
9 not recover compensation for that part of a loss that could have been avoided by taking measures  
10 reasonable under the circumstances to avoid or reduce loss, including the maintenance before  
11 breach of contract of reasonable systems for backup or retrieval of information. The burden of  
12 establishing a failure to take reasonable measures under the circumstances is on the party in  
13 breach.

14 (d) In a case involving published informational content, neither party is entitled to  
15 consequential damages unless the agreement expressly so provides.

16 **Committee Votes:**

- 17 a. Voted 7-6 in March, 1996 to allow consequential damages only in cases where the parties agreed to provide  
18 for that remedy.  
19 b. Voted 14-0 in September, 1996, to return to consequential damages rule of common law, but to consider  
20 specific types of circumstances in which consequential damages should be allowed only if agreed to by the  
21 parties.  
22 c. Voted 5-7 in December, 1996, to reject a motion to reverse the consequential damages presumption in the  
23 case of a battle of forms.  
24 d. Consensus to retain the exception for consequential damages in reference to published informational content.  
25 (December, 1996)

26 **Reporter's Notes:**

27 1. Subsection (a) defines a broad approach to remedies intended to cover the myriad of contexts that are  
28 potentially encountered within this Article. Unlike in current Article 2, reliance on formula-driven damage computation  
29 is not always appropriate in Article 2B. Breach does not always or even primarily entail defects in delivered products  
30 or failures to pay by a recipient (e.g., buyer). The Article covers a wide range of performances and this section allows  
31 a court and a party to resort to general, common sense approaches to damage computation for such occurrences. Article  
32 2A-523(2) provides for recovery of "the loss resulting in the ordinary course of events from the lessee's default as

determined in any reasonable manner ... less expenses saved in consequence of the lessee's default." The UNIDROIT Principles provide: "[An aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain by the aggrieved party resulting from its avoidance of cost or harm. UNIDROIT art. 7.4.2.

3. 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 like. However, the principle is that the aggrieved party controls the choice, while the court (or jury) controls the computation. The Restatement (Second) provides for computation of damages in the following manner: "Subject to [limitations], the injured party has a right to damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or deficient, **plus** (b) any other loss, including incidental or consequential loss, caused by the breach, **less** (c) any cost or other loss that he has avoided by not having to perform."

4. Subsection (a) maintains the distinction between general or direct damages and consequential damages. The measurement provided here is intended to relate only to direct loss and the definition suggested in 2B-102 should be considered in placing limitations on this concept. That definition provides: "Direct [general] damage" means compensation for losses to a party consisting of the difference between the value of the expected performance and the value of the performance received." Direct [or general] damage refers to the value of the performance, while consequential loss refers to foreseeable resulting losses caused by breach. The Restatement (Second) of Contracts defines recoverable damages as consisting of three elements: (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform. Restatement (Second) of Contracts § 347.

**Illustration 1:** OnLine Corp. provides access to stock market price quotations for a fee of \$1,000 per hour. It fails to have the system available during a period that proves to be critical for Meri-Lynch, a client, during a ten minute period. Meri-Lynch can recover as direct damages under this formula, the value of the breached performance (e.g., the difference in the value of the monthly performance if perfect and as delivered), but losses from not being able to place profitable investments during the ten minute period are consequential damages, if recoverable at all.

**Illustration 2:** Sizemore Software licensed its database software to General Motors, restricting the licensed use to no more than twenty simultaneous users. General Motors used the system with an average of twenty two simultaneous users over a two month period. Sizemore can recover as direct damages the difference in the value of a twenty-two person license for the applicable term and the value of the twenty person license, or may recover the value difference as measured in any reasonable manner. The excessive use is also likely to constitute copyright infringement.

5. 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 never previously been stated in the UCC. The basic principle flows from the idea that remedies are not punitive in nature, but compensatory. Especially in context of the information products considered here, the need to consider whether mitigating efforts occurred are significant given the potentially wide ranging losses that breach might entail.

6. This draft excludes consequential damages for "published informational **content**." As noted elsewhere, published informational (Internet and newspaper) invokes many fundamental and important values of our society. Whether characterized under a First Amendment analysis or treated as a question of simple social policy, our culture has a valued interest in promoting the dissemination of information, this Article should take a position that strongly advocates support and encouragement of broad distribution of information content to the public. Indeed, a decision to do otherwise would place this Article in diametric contrast to how modern law has developed. One aspect of promoting publication of information is to reduce the liability risk; that principle has generated a series of Supreme Court rulings that deal with defamation and libel. Beyond the global concern about encouraging information flow, there are other principles that suggest the same result. As indicated in the definition of published 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. That activity should be sustained. Furthermore, the information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk.

1 Finally, with few exceptions, modern law recognizes the liability limit even under tort law and the exclusion would  
2 merely decline to change the law on this issue. The Restatement of Torts, for example, limits exposure for negligent error  
3 in data to cases involving an intended recipient and even then to “pecuniary loss” which courts typically interpret as direct  
4 damages.

5  
6 **Illustration 3:** Dow Jones distributes general stock market and financial transaction  
7 information through sales of newspapers and in an on-line format for a fee of \$5 per hour or  
8 \$1 per copy. Dow, the financial officer of Dupond, reviews information in the online system  
9 and relied on an error to trade 1 million shares of Acme at a price that caused a \$10 million  
10 loss. If Dupond was in a situation of special reliance on Dow Jones, the consequential loss  
11 would be recoverable. If this is published content, Dupond cannot recover for the  
12 consequential loss.

13 **Illustration 4:** Disney licenses a motion picture to Vision Theaters. Vision shows the movie  
14 to audiences under a ticket contract that qualifies as an access contract (e.g., on-line). One  
15 member of the audience who pays five dollars hates the movie and spends a sleepless week  
16 because the movie was more violent than expected. That audience member should have no  
17 recovery at all, but if it can show that there was a breach, the individual could not recover  
18 consequential loss because this is published content. If liability for a violent movie exists, it  
19 exists only under tort law.  
20  
21

## 22 **SECTION 2B-708. LICENSOR'S DAMAGES.**

23 (a) Subject to subsection (b), for a material breach of contract by a licensee, the licensor  
24 may recover as damages compensation for the particular breach or, if appropriate, as to the entire  
25 contract, the sum of the following:

26 (1) as [direct] [general] damages, the value of accrued and unpaid contract ~~license~~  
27 fees or other consideration for any performance for which the licensor has not received  
28 consideration~~been paid~~, plus:

29 (A) the present value of the total unaccrued contract fees or other  
30 consideration required for the remaining contractual term, less the present value of expenses  
31 saved as a result of the licensee's breach;

32 ~~———— (B) the present value of the profit and general overhead which the licensor~~  
33 ~~would have received from full performance by the licensee; or~~

34 (B€) damages calculated pursuant to Section 2B-707; and

35 (2) the present value of any consequential and incidental damages, as permitted

under the agreement or this article, determined as of the date of entry of the judgment.

(b) If the breach of contract makes possible a substitute transaction concerning the same subject matter that would not have been possible in the absence of breach, the damages ~~provided for in subsection (a)~~ must be reduced by due allowance for the proceeds of any actual substitute transaction or the market value~~price~~ of the substitute ~~a transaction made possible that could have been made~~ because of the breach.

(c) The date for determining present value of unaccrued contract fees and date for determining the sum of accrued contract fees under subsection (a) is:

(1) if the initial activation of rights ~~licensee never occurred~~~~received a transfer of rights~~, the date of the breach of contract;

(2) if the licensor cancels and discontinues the right to possession or use, the date the licensee no longer had the actual ability to use the information; or

(3) if the licensee's rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.

(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.**

**Reporter's Note:**

1. This section gives the licensor a right to elect damages under two measures described in (a). As is also true for licensee remedies, the basic principle assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables a double recovery. Thus, no order of preference is stated for the three options.

2. Licensor remedies are formulated in a manner that differs from those made available for lessors or sellers. The most significant difference lies in the intangible character of the value with reference to which the transactions was conducted. Given their ability to be recreated easily and rapidly, with little cost, contracts involving digital information assets are prime candidates for damage assessment focusing on net return or profit lost to the licensor. Most importantly, this draft eliminates the resale remedy standard. That approach to damages results from a focus on the goods as the critical element of the contract and does not apply to cases where the value of the transaction lies in the services, information, or other non-goods elements. Instead of that resale or contract market focus, this Draft centers damages on the contract fee and lost benefits of the licensor. This is consistent with common law approaches in similar cases.



1           3.       The measure used here reflects the subject matter. Unlike for goods, information can be replicated  
2 many times over with little cost or none. Thus, the remedies do not relate to resale or re-license of the particular diskette  
3 or copy. Instead, the approach taken here allows a court to consider cost savings and alternative transactions made  
4 possible by the breach. The reference to alternative transactions is in subsection (b). This due allowance approach is  
5 appropriate in this setting because of the nature of the subject matter and the variety of circumstances that can be  
6 encountered. Similar language is employed in the **Restatement**. In addition, of course, the injured licensor is also subject  
7 to an obligation to mitigate damages.

8  
9           **Illustration 1:** Chambers agrees to supply a master disk of its software to Wilson Distributing and  
10 agrees to allow Wilson to distribute 10,000 copies of the software in a wholesale marketplace. This  
11 is a nonexclusive license. The cost of the license is \$1 million. The cost of the disk is \$5. Wilson fails  
12 to pay, but instead repudiates the contract. Under (a)(1)(A), Chambers recovers \$1 million less the \$5.  
13 Chambers recovery is also to be reduced by dues allowance for (1) any alternative transaction made  
14 possible by this breach (e.g., another transaction in a market created by the lack of the 10,000 products,  
15 and (2) by any failure to mitigate under 2B-707.

16           **Illustration 2:** Same as in Illustration 1, except that the contract also requires Chambers to deliver  
17 manuals, boxes and other distribution materials for Wilson to distribute the software. The cost of  
18 10,000 of these materials is approximately \$800,000. In computing damages, the \$800,000 cost  
19 savings is deducted from the \$1 million. In considering what “due allowance” should be made for any  
20 alternative transactions, a court should take into account that this expense adjustment already reflects  
21 some accommodation to the alternative transaction, but if a second deal had the same terms, the issue  
22 would be whether the second transaction was made possible by the breach.

23           **Illustration 3:** Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach,  
24 Chambers makes an identical license with Second Distributor for a fee of \$900,000. This transaction  
25 was possible because the first was canceled. Chambers recovery is \$100,000 less any net cost savings  
26 that are not accounted for in the second transaction.

27  
28           4.       This draft deletes the lost profits concept that had been developed in parallel to Article 2 concepts,  
29 deploying instead flexibility in computation. See Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex.  
30 1996) (discussing of the application of the alternative transaction concept in reference to a lost profits claim relating to  
31 a license breach).

32  
33           **Illustration 4:** Compart licenses robotics software designed to operate aircraft engine plants making  
34 a particular type of engine. There are five such plants in the world. One is operated by Boeing. Boeing  
35 decides to sell the plant to Douglas and, since the license is not transferable, it repudiates the license  
36 at the time of sale. Douglas enters into a separate license with Compart. The second transaction was  
37 made possible because of the breach by Boeing. The profit and contract fees it generates off-set any  
38 profit or fees lost in the Boeing breach.

39           **Illustration 5:** Parkins grants an exclusive license to Telemart to distribute products comprised of  
40 copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at \$50,000 per year.  
41 In Year 2, Telemart breaches the license and Parkins cancels. It sues for damages. Its recovery is the  
42 present value of the remaining contract fees with due allowance for alternative transactions made  
43 available by virtue of the breach and subject to a duty to mitigate. Here, since the breached license was  
44 exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution  
45 of the encyclopedia.

46  
47           5.       The damages rules follow common law and give both the licensor and the licensee a right to  
48 consequential damages. The **Restatement** uses a licensing illustration in describing its general damages approach in an  
49 illustration that, under this Article, deals with consequential damages, rather than the direct damages measure of the  
50 formulae in subsection (a) and (b).

51  
52           “A” contracts to publish a novel that “B” has written. “A” repudiates the contract and B is unable to  
53 get his novel published elsewhere. Subject to the limitations stated [elsewhere], B’s damages include

1 the loss of royalties that he would have received had the novel been published together with the value  
2 to him of the resulting enhancement of his reputation.  
3

4 Restatement (Second) of Contracts ' 347, illustration 1. The UN Sales Convention applies the same damages approach  
5 to the buyer as to the seller. UN Convention art. 74.

6 Recovery of consequential (or any other damages), of course, is limited by the principle that the loss must be  
7 proven with reasonable certainty. See ' 352. The Restatement example, although apt for purposes of this Article, fails  
8 to reflect a number of cases that reject claims of recovery for lost potential profits as being too speculative. This Article  
9 does not disturb the basic rule requiring adequate proof of loss.

10 The formulae in subsection (a) relate to direct (general) damages. The consideration referred to in that section  
11 does not, therefore, include what gains the licensor hoped to recover from full performance by the licensee which might  
12 yield a broader profit for the licensor. It refers to consideration agreed to be paid and independent of the market success  
13 or other unpredictable resulting gains from the success.  
14

15 **Illustration 6.** I receive a promise to be paid \$10,000 for an item that cost \$1,000 and receive a  
16 further commitment of 3% royalties for any sales of copies of that item. Assume that the licensee  
17 repudiates the entire contract. As direct damages under (a), I receive \$10,000 less any expenses saved.  
18 The potential loss of royalty profits is treated as potential consequential loss. It can be recovered only  
19 if proven with the degree of certainty required under general contract law cases in the applicable  
20 jurisdiction.  
21

22 6. If the breach relates to use or disclosure restrictions, consequential damages are appropriate. This is  
23 consistent with current law. See Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed.  
24 Cir. 1987) (On breach of license, under California law, "Universal was entitled to recover the profits it lost as a result  
25 of [defendant's] breach ... The court correctly undertook to determine (1) which of the sales that [defendant] made after  
26 the agreement was terminated would have been made by Universal if [defendant] had not violated that provision and (2)  
27 the profit Universal would have made on those sales."); United States Naval Institute v. Charter Comm., 936 F.2d 692  
28 (2d Cir. 1991) (Premature publication under book publishing license entitled licensor to lost profits caused by the effect  
29 of early publication on the sales of hard copies).

30 7. The Section provides that, for consequential damages, present values are measured as of the date of  
31 the entry of the judgment. The section distinguishes between contract fees and royalties on the one hand (as direct  
32 damages) and consequential damages on the other. As to the direct damages, a distinction will often be required between  
33 when a fee is accrued and when a fee is not accrued. The provisions of subsection (c) provide guidance on this issue,  
34 making computation of accrued and unaccrued fees occur on the same date.  
35

36 **Illustration 7:** A five year license requires that the Sony pay a \$5 royalty to Smith, the licensor, for  
37 each copy of the Power Rangers video game that it produces for the retail market from a master copy  
38 given to it by the licensor. Payments are made on a monthly basis. After non-payment for three  
39 months, Smith notifies Sony that it is canceling the license. Assume that \$50,000 of royalty fees would  
40 accrue each month of the ten year contract. Under (c)(2), the date for distinguishing accrued and  
41 unaccrued fees arises when Sony no longer had possession or the ability to continue use of the  
42 information. Assume that it returned the master disk at the end of month 3. The sum of accrued and  
43 unpaid fees is \$150,000, while the unaccrued fees total (assuming this can be proven or reliably  
44 estimated) \$50,000 times the remaining 57 months of the license. The present value of that amount  
45 would be determined as of the end of the third month. If Sony's performance also breached quality  
46 requirements in the license, Smith may be able to recover consequential loss to the value of the images  
47 as computed on the date of judgment.  
48

49 8. The licensor may have remedies under other law. The primary alternative is intellectual property law.  
50 Default by the licensee introduces the possibility of an infringement claim if (a) the breach results in cancellation  
51 (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b)  
52 the default consists of acting outside the scope of the license and in violation of the intellectual property right. See

1 Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d  
2 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir.1982); Rano  
3 v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) ("[Under] federal and state law a material breach of a [copyright] licensing  
4 agreement gives rise to a right of rescission which allows the non-breaching party to terminate the agreement. After the  
5 agreement is terminated, any further distribution would constitute copyright infringement."); Costello Publishing Co. v.  
6 Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

7 9. Remedies for copyright infringement include both monetary recovery and a right of action against the  
8 infringing works and the infringer's future conduct. The two remedies are not mutually exclusive and are simultaneously  
9 available. 17 USC ' 504. Loss is measured in terms of wasted advantage, lost profit or the like. See Data General Corp.  
10 v. Grumman Systems Support Corp., Civ. A. No. 88-0033-S, 1993 WL 153739 (D. Mass. May 11, 1993); Harris Market  
11 Research v. Marshall Marketing & Comm., Inc., 948 F.2d 1518 (10th Cir. 1991) (licensing fees due under sublicenses  
12 were admissible on the issue of damages under theory of breach of license agreement); Engineering Dynamics, Inc. v.  
13 Structural Software, Inc., 785 F. Supp. 576 (E.D. La. 1991) (infringing user manual; damage award adjusted to reflect  
14 the fact that losses suffered by copyright owner stemmed from factors other than actions attributable to improper use of  
15 the manual); Deltak, Inc. v. Advanced Systems, Inc., 767 F.2d 357 (7th Cir. 1985) (damages measure value of the  
16 infringing use; in case in which no directly attributable profit could be discerned, each infringing copy "had a value of  
17 use equal to the acquisition cost saved by the infringement instead of purchase which [defendant] was then free to put  
18 to other uses.")

19 10. Infringement of a patent entitles the patent holder to damages computed so as to place the patentee in  
20 the position that it would have been in had the infringement not occurred. 35 U.S.C. ' 284 (damages "adequate to  
21 compensate for the infringement.") The Patent Act also authorizes a court to award treble damages in the event of a  
22 willful infringement. Actual damages are assessed in terms of loss suffered by the patent holder with the measure of  
23 "loss" frequently gauged in terms of loss of profits in reference to the patented invention. Zegers v. Zegers, Inc., 458 F.2d  
24 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132 (1972); Henry Hanger & Display Fixtures  
25 Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959).

26 11. Trade secret law is grounded in state law relating to the enforcement of confidential relationships  
27 relating to information. There are three sources of trade secret law: the Restatement (First) of Torts ' 757, the  
28 Restatement (Third) of Unfair Competition, and the Uniform Trade Secrets Act (UTSA). While the first Restatement  
29 has dominated this field, the majority of all states have now adopted the UTSA. Restatement: in addition to injunctive  
30 and other relief, the trade secret owner may recover "damages for past harm ... or be granted an accounting of the  
31 wrongdoer's profits" and provides that the owner of the trade secret can have two or more of these remedies in the same  
32 action. Restatement (First) of Torts ' 757 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may  
33 recover damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust  
34 enrichment caused by the misappropriation that is not taken into account in computing damages for actual loss."

35 12. Licensors often opt for intellectual property remedies, rather than contract remedies under current law  
36 because the recovery is often greater and the standards for damages are more clearly defined. Federal intellectual property  
37 remedies do not preempt or displace contract remedies provisions since they deal with different issues. The two remedies  
38 may raise dual recovery issues in some cases. The general principle is that all remedies are cumulative, except that  
39 double recovery is not permitted. See Harris Market Research v. Marshall Marketing & Communications, Inc., 948 F.2d  
40 1518 (10th Cir. 1991) (licensing and processing fees due under sublicense admissible on the issue of damages under  
41 either the theory of copyright infringement or of breach of license agreement); Paramount Pictures Corp. v. Metro  
42 Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (award of damages for a breach of license contract and copyright  
43 infringement by unauthorized display was not an award of double damages).

## 44 **SECTION 2B-709. LICENSEE'S DAMAGES.**

45  
46  
47 (a) Subject to subsection (b), on material breach ~~of contract~~ by a licensor, the licensee  
48 may recover as damages compensation for the particular breach ~~of performance~~ or, if  
49 appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, the value of any payments made or 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 if any of any performances not provided minus the contract fees or other consideration for that performance, both of which must be calculated in the case of damages for the entire contract, for the remaining contractual period plus any extensions available as of right if the damages are for the entire contract;

(B) damages computed pursuant to Section 2B-707; or

(C) if the licensee has accepted performance from the licensor and 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 had there been no defect, not to exceed the agreed price; and

(2) the present value of incidental and consequential damages, as permitted under the agreement or this article, resulting from the breach as of the date of the entry of judgment.

(b) The amount of damages calculated under subsection (a) must be reduced:

(1) ~~reduced by expenses avoided as a result of the breach of contract; and~~

(2) ~~-if further performance is not anticipated under the agreement, reduced by any unpaid contract fees for that relate to performance by the licensor which has been received by the licensee but increased by the amount of any contract fees already paid that relate to performance by the licensor which have not been received by the licensee.~~

(c) ~~For purposes of this section, m~~Market value is determined as of the place for performance. Due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contractual terms, performance,

and information that were similar in terms, quality, and character to the information or agreed performance.

(d) To the extent necessary to obtain a full recovery, 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.**

**Selected Issue:**

a. Should a formula approach be used or should a general damages approach be stated without an attempt to develop formulae?

**Reporter's Notes:**

[The formula measures have been edited to eliminate redundancy with no substantive change intended]

1. As in licensor remedies, this section allows the licensee to choose among alternatives. Given a court's general overview to prevent excessive damages, there is no reason to make one option preferred over the other. Also, the type of breach involved here is more varied; greater flexibility is needed. Because of the diverse problems that might be involved in dealing with breach of a license, the narrow structure of Article 2 remedies for a licensee (buyer) is not appropriate. This Draft makes the choice of remedy broader and eliminates the hierarchy set out in current Article 2. The remedial options in this section should be read in conjunction with the general damages concepts of mitigation and avoiding double recovery.

2. Option 1 parallels the Article 2 concept of comparing contract price to market value for performance not received. It is predicated on the initial assumption that the breaching party will also return any contract fees already received for that performance. Unlike in Article 2, there is no provision dealing with a remedy based on contract price compared to "cover." This remedy is removed because, in dealing with intangibles that are, by their nature, often distinct or unique, the option of "cover" is often not viable and often uncertain of application. In this Draft, alternative transactions are to be given "due weight" in determining market value under subsection (c), but a failure to effect an alternative transaction does not bar recovery unless it affects concepts of mitigation. This approach was built on ideas from Article 2A. For purposes of subsection (a), performance has not been provided by the licensor if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, and with respect to any performance that was executory at the time that the licensee justifiably cancels.

**Illustration 1:** Amoco Oil contracts for a 1,000 person site license for database software from Meed Corp. The contract price is \$500,000 in initial payment and \$10,000 for each month of use. The contract term is two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and sues, applying subsection (a)(1). It is entitled to return of the \$500,000 payment plus recovery of any difference between the contract price and the market price for a similar site license of similar software.

**Illustration 2:** Same facts as in Illustration 1, but Amoco goes to Oracle Software and obtains a license for a 1,000 user site license for the Oracle database software. The contract terms involve a \$900,000 initial payment and a monthly use payment of \$12,000. The term is two years. In its lawsuit, if the issue is raised, the court must consider to what extent this second transaction gauges the market value applicable to the Meed contract. The issue would involve the terms of the license, the nature of the software and any other relevant variables.

**Illustration 3:** Same facts as in Illustration 2, but Amoco obtains a license for the Meed software from an authorized distributor (Jones) for a \$600,000 initial fees and under other terms identical to the Meed contract. The issue of similarity is the same, but giving due weight to this alternative transaction will presumably limit the Amoco recovery to its initial payment, \$100,000, and any incidental or consequential damages.

3. The third alternative is limited to cases in which the breach relates to performance that has been delivered and accepted. It parallels the provisions of current Article 2, but caps the recovery by the contract price. This is based on a differentiation between consequential and direct or general damages. For "accepted" goods under Article 2 (sales), the damages formula is in Section 2-714, consisting of any incidental and consequential damages resulting from

1 the seller's plus: (1) the "loss resulting in the ordinary course of events from the seller's breach as determined in any  
2 manner which is reasonable" or (2) "the measure of damages for breach of warranty [which is] the difference at the time  
3 and place of acceptance between the value of the goods accepted and the value they would have had if they had been as  
4 warranted, unless special circumstances show proximate damages of a different amount." UCC ' 2-714. Section 2A-  
5 519(3) provides that the measure of damages for accepted goods is: "loss resulting in the ordinary course of events from  
6 the lessor's default as determined in any manner which is reasonable" plus incidental and consequential damages less  
7 expenses saved. Article 2A provides that for breach of warranty the measure of damages is the present value of the  
8 difference between the value of the goods as warranted and their value as accepted.

9 4. As a general rule, the "value of the goods as warranted" focuses on the market value of the property  
10 if it were consistent with the represented quality it was to have. This should most often equal the purchase price, but it  
11 is not always so limited by courts. See Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3rd Cir.  
12 1980) (allows value measure that encompassed the value that the buyer would have obtained from a perfect computer  
13 system with specific capabilities, including advantages in inventory control, profits and the like, in excess of the  
14 contracted price). This draft reverses that approach. The additional value loss (e.g., lost benefits) are consequential  
15 damages and covered by treatment of that type of damage in the contract and under the article. This draft allows recovery  
16 based on the cost of repairs incurred to bring the product to the represented or warranted quality. Fargo Machine & Tool  
17 Co. v. Kearney & Trecker Corp., 428 F.Supp. 364 (E.D. Mich.).

18 5. Courts apply a flexible approach to licensee damages outside the UCC. If the damages are proven with  
19 reasonable certainty, they can include lost profits in this context. In Western Geographic Co. of America v. Bolt  
20 Associates, 584 F.2d 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits that the licensor  
21 earned from licensing following breach. In Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984) a company was entitled to  
22 recover lost profits when a California distributor of motion pictures breached licensing agreement where California  
23 distributor knew that the owner was attempting to obtain films for redistribution in Europe and should have known that  
24 owner and company intended to resell films. In Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir.  
25 1989) the court approved a lost profit recovery based on a failure of a licensor to make available to the licensee various  
26 films for showing in European markets. In Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir.  
27 1989) a licensee brought action for breach of contract and for wrongful termination of license related to trademarks and  
28 manufacturing know how. The contract breach consisted in part of actions taken by the licensor in violation of the  
29 territorial exclusivity provisions of the license. The court approved an award of lost profits for breach of contract based  
30 on estimates of lost sales, but reversed on the basis of how the profits were computed requiring computation of profits  
31 based on a marginal cost approach. Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975)  
32 (lost profit not proven).

## 33 **SECTION 2B-710. RECOUPMENT.**

36 (a) If a party is in breach of contract, the other party, after notifying the party in breach of  
37 its intention to do so, may deduct all or any part of the damages resulting from breach from any  
38 part of payments still due and owing to the party in breach under the same contract.

39 (b) If a nonmaterial breach of contract has not been cured, an aggrieved party may  
40 exercise its rights under subsection (a) only if the agreement does not require further affirmative  
41 performance to be rendered to the aggrieved party by the other party and the amount of damages  
42 to be deducted can be readily liquidated under the terms of the agreement.

1 **Uniform Law Source: Section 2-717. Revised.**

2 **Reporter's Note:**

3 1. Subsection (a) adopts language from Article 2 and Article 2A. It recognizes that the injured party can  
4 employ self-help by diminishing the amount that it pays under the contract. Unlike in the sale of goods, the obligations  
5 of the parties here often run continuously and in complex ways back and forth.

6 2. Subsection (b) applies that principle to the case of nonmaterial breaches, recognizing the different  
7 interests that are involved in ongoing performance contracts and minor breaches. Article 2 does not deal with this  
8 because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial  
9 breach. Importantly, this Article creates an obligation to cure nonmaterial breaches where the cost of that cure is not  
10 disproportionate to the harm.

11  
12 **[C. Performance Remedies]**

13  
14 **SECTION 2B-711. SPECIFIC PERFORMANCE.**

15 (a) A court may enter a decree of specific performance of any obligation, other than the  
16 obligation to pay a fee for information or services already received, if:

17 (1) the agreement expressly provides for that remedy and specific performance is  
18 possible; or

19 (2) the contract was not for personal services, but the agreed performance is  
20 unique and monetary compensation would be inadequate.

21 (b) A decree for specific performance may contain any terms and conditions the court  
22 considers just but must provide adequate safeguards consistent with the terms of the contract to  
23 protect the confidential information and intellectual property rights of the party ordered to  
24 perform.

25 (c) An aggrieved party has a right to recover information that was to be transferred to  
26 and thereafter owned by it if the information exists in a form capable of being transferred and,  
27 after reasonable efforts, the aggrieved party is unable to effect reasonable cover or the  
28 circumstances indicate that an effort to obtain cover would be unavailing.

29 **Uniform Law Source: 2A-521. Section 2-716. Revised.**

30 **Reporter's Notes:**

31 1. This section explicitly affirms the right of parties to contract for specific performance, so long as a  
32 court can administer that remedy. Literature clearly supports that this contractual option promotes freedom and flexibility

1 of contract. This premise is consistent with the overall approach in this Article to favor and support freedom of contract.  
2 The principle excludes the obligation to pay a fee, however, since this is essentially equivalent to a monetary judgment  
3 and not relevant to the principle of contract remedy choice. [Comments will discuss how this works with respect to  
4 development contracts; it depends on the type of commitment made in the contract.]

5 2. The second principle in subsection (a) outlines a common basis for specific performance (the unique  
6 nature of the performance). That principle cannot apply to a “personal services contract” in light of traditional concerns  
7 about not imposing judicial obligations requiring work or services by an individual. Article 2 does not deal with this latter  
8 issue, since it is not involved in transactions that might fall within this category. Excluding specific performance of the  
9 price element of a contract avoids creating a surrogate form of contempt proceeding. Of course, if there is a specific  
10 performance order requiring transfer of property under court order, a reciprocal obligation to pay any relevant fees is an  
11 appropriate condition of the specific performance decree.

12 3. Article 2 allows specific performance “where the goods are unique or in other proper circumstances.”  
13 UCC “ 2-716(1). The comments state: “without intending to impair in any way the exercise of the court’s sound  
14 discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection  
15 with specific performance of contracts of sale.” UCC “ 2-716, comment 1. There are few cases ordering specific  
16 performance in a sale of goods. In most cases, a court concludes that adequate substitutes are available and that any  
17 differences in quality or cost can be compensated for by an award of damages. Article 2A has a similar specific  
18 performance section. “ 2A-521.

19 4. In common law, despite the often unique character of intangibles, respect for a licensor’s property and  
20 confidentiality interests often precludes specific performance in the form of allowing the licensee continued use of the  
21 property. Courts often rule that a monetary award fits the circumstances, unless the need for continued access is  
22 compelling. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985); Johnson  
23 & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co., 715 F. Supp. 110 (D. Del. 1989). Very few  
24 cases award specific performance in information-related contracts.

25 5. The Restatement (Second) of Contracts distinguishes between specific performance awards and  
26 injunctive relief. Restatement (Second) of Contracts “ 357. Specific performance relates to ordering activity consistent  
27 with the contract. The most common use concerns injunctions against acts that the defendant promise to forebear or  
28 mandatory injunctions demanding performance of a duty that is central to preserving the licensor’s position. The  
29 Restatement states: “The most significant is the rule that specific performance or an injunction will not be granted if  
30 damages are an adequate remedy [to protect the expectation interest of the injured party].” Restatement (Second) of  
31 Contracts “ 357, Introductory note. Non-uniform case law deals with under what circumstances a damage award is or will  
32 be considered to be inadequate. The Restatement catalogues the following circumstances under which damages may be  
33 inadequate:

- 34 (a) the difficulty of providing damages with reasonable certainty,
- 35 (b) the difficulty of procuring a suitable substitute performance by means of money ...,
- 36 (c) the likelihood that an award of damages could not be collected.

37 Restatement (Second) of Contracts “ 360. The most frequently discussed illustrations of when these conditions are  
38 sufficiently met are cases in which the subject matter of the contract is unique.

39 6. Subsection (b) recognizes judicial discretion, but provides an important protection for confidential  
40 information that is relevant for both the licensor and the licensee. The section casts the balance in favor of a party not  
41 being required to specifically perform in cases where that performance would jeopardize interests in confidential  
42 information of the party. Confidentiality and intellectual property interests must be adequately dealt with in any specific  
43 performance award. Article 2A allows the court to order conditions that it deems just, but does not deal with  
44 confidentiality issues.

45 7. Subsection (c) creates an important right for a licensee It adapts language from Article 2 and Article  
46 2A to give the licensee a right to force completion of a contractual transfer if, at the time of breach, the information is  
47 capable of being identified and the contract contemplated that the licensee would own the information product had the  
48 transaction been fully performed. It applies in cases where the contract calls for a transfer of the intangibles, not merely  
49 rights to use. This occurs, for example, in cases of software development where the software is at least partially  
50 developed, but not yet delivered to the transferee. See, e.g., In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (uses  
51 Article 2 title rules to resolve rights in incomplete software in a bankruptcy proceeding).  
52



**SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE.** On breach of contract by a licensee, the licensor in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization may either complete and identify the information to the contract or cease work on the information. In either case, the licensor may recover damages or pursue other remedies.

**Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.**

**Reporter's Notes:**

1. This section adopts the premise of both Article 2 and Article 2A that the licensor faced with a material breach by the licensor while a development contract is in process can choose to complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to damages and other remedies gauged by the situation in which it finds itself following the choice. If the transferor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails. Article 2A-524 (2) provides: "If the goods are unfinished, in the exercise of reasonable commercial judgment ... the [lessor] may either complete the manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner."

2. This section does not use language in Article 2 and Article 2A that refers to a seller's right to identify goods to the contract or to treat goods "demonstrably intended" for the contract as a subject of resale even if they have not been finished at the time of the breach. These sections follow a policy similar to that adopted here, but deal with facts specifically linked to transactions in goods. The rights implied in the other language, to the extent appropriate, are covered within the more general theme in this section. As a general matter, identifying and completing the intangibles will be inappropriate since most intangibles have infinite number of transfers contained in or available with respect to one fund of information. The notion of resale as a way of relieving loss is often inappropriate.

3. This draft applies the cases in which contracts involve development or compilation. In such cases, intangibles may not have a general market. The option to complete often will often be commercially reasonable

**SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE.** On breach of contract by a licensor, the licensee may continue to use the information -under the contract. If the licensee elects to continue to use the information, the following rules apply:

(1) The licensee is bound by all of the terms of the agreement, including restrictions as to use, disclosure, and noncompetition, and any obligations to pay contract fees or royalties.

(2) Subject to Section 2B-620, the licensee may pursue remedies with respect to accepted ~~transfers or performances, including the right of recoupment.~~

(3) The licensor's rights and remedies remain in effect as if the licensor had not been in breach of contract.

1 **Reporter's Note:**

2 This section makes clear the consequences of a licensee's decision to accept flawed performance by the licensor and  
3 pursue remedies that do not involve a cancellation of the contract obligate the licensee to continued performance of the  
4 intangibles contract itself. A licensee faced with breach by the licensor can elect to continue the contract and claim  
5 damages for the breach. This section clarifies that, if this choice is made, the licensee is bound by the contract terms.  
6 However, it retains rights of action with respect to the prior, defective performance.  
7

8 **SECTION 2B-714. RIGHT TO DISCONTINUE.** In an access contract, ~~in the event~~  
9 of a material breach of contract or if the agreement so provides, a party may discontinue access  
10 by the party in breach ~~in an access contract~~ or instruct any third person that is assisting the  
11 ~~transfer of rights or performance of the contract to discontinue its performance.~~

12 **Reporter's Notes:**

13 1. This section deals with the right of the licensor to stop performance under two significant  
14 circumstances. This is not a right to retake transfers already made, but merely to stop future performance. Article 2 and  
15 Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This subsection derives  
16 in part from Section 2A-525(1). It does not create special rules for insolvency. Cases of insolvency will be handled  
17 either in the definition by contract of material breach or in the rules dealing with insecurity about future performance.  
18 This differs from and grants lesser rights to the transferor than do either Article 2 or 2A. Both give a right to stop  
19 shipment in the event of discovered insolvency.

20 2. The right to discontinue is recognized in licenses whose basic nature entails a contractual permission  
21 to access or use a resource owned or controlled by the licensor. In such cases, the contract will be treated as preemptively  
22 subject to termination a will (even without a breach). See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911,  
23 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned  
24 facilities).  
25

26 **SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.**

27 (a) On a breach of a license by the licensee which is material as to the entire contract, if  
28 not prohibited by the agreement, the licensor has a right to possession of all copies of the  
29 licensed information and any other materials that by contract were to be returned by the licensee  
30 and the right to prevent the licensee's continued exercise of rights in the licensed information.  
31 Subject to subsection (c), ~~to the extent necessary to enforce these rights,~~ a court may enjoin the  
32 licensee from continued use ~~exercise of rights in~~ of the information and may order that the  
33 licensor or an officer of the court take the steps described in Section 2B-628(b). The licensor may  
34 proceed by judicial process under this section but may proceed without judicial process only if it  
35 complies with Section 2B-716.

(b) If the agreement so provides, a court may require the licensee to assemble all copies of the information and ~~other~~ information relating thereto and make them available to the licensor at a place designated by the licensor which is reasonably convenient to both parties.

(c) The right to possession ~~remedies~~ under subsections (a) and (b) ~~is~~ are not available if the information, before breach and in the ordinary course of performance under the license, was altered or commingled so as to be no longer reasonably identifiable ~~from other property or information of the licensee~~ and the remedy cannot be administered without undue harm to the information or property of the licensee or another person.

**Uniform Law Source: Section 2A-525; Section 9-503; Section 2A-525(1);. Sections 2A-526; 2-705. Revised.**

**Reporter's Notes:**

[Subsection (c) was revised to reflect comments from the entertainment industry about the need to be able to enforce rights in images and similar information even though it might be connected to property of the licensee. The revision makes clear that the primary standard concerns whether the information remains reasonably identifiable. If it cannot be identified, by definition the changes are such that the image, slogan or text no longer exists in a form to which remedies would attach.]

1. This section defines the right of a licensor to use judicial process to prevent retake copies and to further use of information after material breach by the licensee. The right to act without judicial process, is covered under the next section and is more restricted than the equivalent rights in Article 9 and Article 2A.

2. Article 2A-525 states: "After default [that is material], the lessor has the right to take possession of the goods. ... Without removal, the lessor may render unusable any goods employed in trade or business ... The lessor may proceed ... without judicial process if it can be done without breach of the peace or the lessor may proceed by action." This, however, gives the lessor a right to repossess in the event of any non-payment of rentals. Article 9 repossession rights are even less limited in that they do not hinge on a material breach.

3. The right under this section flows from the conditional nature of the transaction. It arises only in the case of a license and applies only if there is a material breach of the contract. The right stated here exists only to the extent that the remedy can be administered without undue damage to the information or property of the licensee due to commingling in the ordinary course of performance under the license. The remedy entails a combination of an injunction and destruction or return of tangible copies of the information. Self help issues are in the next section.

4. A right to prevent use is appropriate in a license because the contract restricts use of the information. The right to enforce this does not depend on there being a property interest in the subject matter, but that interest would augment the contractual right. In effect, the right to enforce a discontinuation of use also stems from contractual principles of specific performance. The restrictive license provisions carry with them the implication that a material breach ends the right to use as created by contract. Also, if there are intellectual property rights associated with the material, the remedies most often available in those property law areas give the licensor a right to retake and prevent continued use in the event of infringement. This draft limits the repossession right in two ways. First, the section only applies to licenses. Second, the rights cannot be implemented to the extent they would yield undue harm to property of the licensee.

**SECTION 2B-716. LICENSOR'S SELF-HELP.**

(a) A licensor may proceed under Section 2B-715 without judicial process only if:

(1) ~~the there is a breach that~~ is material as to the entire contract without regard to contractual terms defining material breach; and

(2) ~~the . The licensor does not commit may act without judicial process only if this can be done without~~ a breach of the peace, or create a foreseeable risk of injury to person or significant damage to or destruction of information or property of the licensee.

(b) A licensor may not include in the subject matter of a license the means to enforce its rights under subsection (a) unless [the licensee manifests assent to a term of the license providing] [a conspicuous term of the license provides] that it may do so. If a contractual term authorizes the licensor to include a means to enforce its rights, the following rules apply:

(1) The licensor's use of electronic remedies to prevent further use of the information is subject to the limitations in subsection (a) and Section 2B-715. Exercise of the means to prevent further use in circumstances in which the licensee has not committed a material breach of contract constitutes a breach of contract by the licensor.

(2) If the licensor's use of the means to prevent further use of the information is improper under this section and results in loss to the licensor as described in subsection (a), the licensee may recover damages from the licensor, including damages incurred by the licensee resulting from any foreseeable breach of the peace and injury to persons.

(c) Except as otherwise provided in this section, the licensee's remedies, including its right to recover damages, and the limitations on the licensor under this section may not be waived or altered by agreement prior to the breach of the contract.

**Uniform Law Source: Section 9-503. Revised.**

**Reporter's Notes:**

1. In modern practice, self help remedies are being used, including remedies of "electronic self-help." This section applies to situations where electronic remedies are used in enforcing rights in the event of breach. The restrictions and options here are different from those in Section 2B-628, which are limited to situations in which electronics are utilized to enforce contract rights not connected to breach.

2. This section balances the rights of a licensor to specifically enforce its contract and any property rights that it holds as against the rights of the licensee to not be exposed to unwarranted pressure and risk of loss. It allows self help, but requires notice and materiality of breach as preconditions, while also exposing a licensor to some risk of liability in the event of its causing damages. The issue of self-help is important in a number of settings, but has been urged most strongly by representatives of smaller licensors as a means to enforce rights against larger licensees.

3. The remedy applies only in a license. Given the definition of licensor, the section applies to either party to the extent that the party transferred information to the other under conditions restricting use. Since this requires action in response to a material breach, this section deals with active, rather than passive electronic restrictions. It also only applies in the case of breach. Other sections deal with electronic monitoring of performance and electronic termination at the end of a license.

4. As compared to either Article 9 or Article 2A, the self-help remedy outlined here is substantially more restricted and limited. The limits are explicit in this section and in Section 2B-711, a predicate for proceeding under this section. One issue relates to coordination between this section and Articles 2A and 9. In both of those articles, a transaction governed under their provisions entails a right of self-help without the restrictions placed here and that right Article 2A contains an express right held by the lessor to repossess leased property after default. The right to repossession is patterned after Article 9. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The lessor also has a right to repossess by taking action in court. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC ' 2A-525, Comment 3, citing Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. den., 402 U.S. 909 (1971). However, the materiality can be determined by contract (which cannot occur in this draft) and applies in concept to any failure to pay rent (in this context, the failure must be material). As to self help, Article 2A merely provides: "The lessor may proceed under [this section] without judicial process if it can be done without breach of the peace or the lessor may proceed by action." UCC ' 2A-525.

5. Self-help cannot be pursued unless the breach is material without consideration of contract definitions of materiality. Thus, for example, a contract that provides that a one day delay in payment (or delivery) is a material breach would not, in itself, justify action under this section. It would still be necessary to determine whether the actual delay was a material breach under general standards of materiality.

6. Under subsection (c), for electronic repossession there must be a manifestation of assent to a contract term giving notice and authorizing the licensor to include a electronic capability and, under subsection (a), the use of that option is limited by breach of the peace and by the fact that it cannot result in foreseeable damage or destruction of property not related to the license. The position taken essentially requires disclosure of electronic remedial devices implanted in software and compliance with the contextual restrictions on self help generally. In American Computer Trust Leasing v. Jack Farrell Implement Co., 763 F. Supp. 1473 (D Minn. 1991) the court held that remote deactivation was permitted for a breach of payment obligations on a software license. The court's analysis was premised on the view that a breach of the license entitled the licensor to terminate the relationship by whatever means it could so long as no violence occurred. The transaction in Farrell involved a combined hardware lease and software license. Also important was the court's assumption that the licensee agreed to or authorized the remedies taken by the licensor. "ADP had a legal right to deactivate the defendants' software pursuant to the contracts and the extortion statutes do not apply."

7. The few reported cases on this point are consistent with an emphasis on prior notice, although they do not necessarily imply the explicit notice suggested in this draft. See Franks & Son, Inc. v. Information Solutions, Computer Industry Litigation Rep. 8927-25 (ND Okla. 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of inclusion); Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc., 157 App. Div. 2d 689, 549 NYS2d 789 (1990).

8. The draft also adopts a concept of proportionality by providing that self-help (electronic or otherwise) can occur only if there is a breach that would be material as to the entire contract independent of what definition of materiality exists in the contract. Thus, under the definition of material breach applicable in the absence of contract terms, there must be a breach by the licensee that substantially threatens or reduces the value of the contract to the licensor. This proportionality concept is substantially different from the provisions of Article 9 where self help hinges solely on default and the absence of a breach of the peace. A policy consideration exists about whether this greater precondition is justified and whether it will simply result in self help occurring through the creation of an Article 9 interest as an adjunct of a license.

9. Considered together with the prior section, self help remedies are limited in the following manner: a) non-electronic self-help can occur only if the information is not commingled so as to make damage to the licensee's

1 information or property inevitable, only if there is no breach of the peace or foreseeable risk of injury to persons, and  
2 only if there is no substantial damage to the licensee's information or property (irrespective of commingling); b) electronic  
3 self-help can occur only if the foregoing conditions are met and then only if the party manifests assent to the specific term  
4 that authorizes the electronic measures, furthermore, even if the preconditions are appropriate the licensor is liable for  
5 damages caused to the information or property of the licensee.

6 10. The licensee protections cannot be waived.