DRAFT

FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
ARTICLE 2B - LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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With Comments

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ARTICLE 2B - LICENSES

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PREFACE

INFORMATION AGE IN CONTRACTS

INTRODUCTION

Article 2B deals with transactions in information; it focuses on transactions relating to the “copyright industries.”[1] It thus deals with transactions and subject matter that largely have never been directly covered by the U.C.C. Of the transactions covered, **only** software contracts have been considered within the U.C.C. Even for computer software, coverage under the U.C.C. is limited. But *Article 2B is not just a software contract statute.* The other subject matter for which licensing contracts are used are today governed not by the U.C.C. but by common law, federal property law, and some regulation. Part of the project involves accommodating the various legal traditions.

Yet, in the modern digital economy, these industries and subject matter are rapidly converging around the digital technology that dominates the information industry and, even, much of the goods sector. The lines of demarcation will, and already have, become less and less significant while businesses converge into a multi-faceted industry with common concerns.2 That converged industry exceeds in importance the goods manufacturing sector in our economy. The information industry is growing rapidly and commands large portions of the national economic product. The copyright industries and information transactions affected by Article 2B involve subject matter entirely unlike the traditional transactional framework which focuses on transactions in goods. In Article 2B transactions, the value of the subject matter lies in the intangibles, the information and associated rights to use that information.

This Article is being developed by consultation among many groups. When completed, Article 2B will provide a framework for contractual relationships among industries at the forefront of the information era and permeate the global economy. The test of the project lies in its ability to accommodate the parties involved and the practices that are driving this vital part of the economy. Evaluating the balance achieved hinges on one’s perspective, yet, as the following indicates, the Draft distributes benefits among the various parties.

BENEFITS AND POSITIONS IN
DRAFT ARTICLE 2B BY PARTY

GENERAL BENEFITS

+ creates balanced structure for electronic contracting
+ reduces uncertainty and non-uniformity of software and online contract law
+ provides contract law roadmap for converging industries with differing traditions
+ confirms contract freedom in commercial transactions
+ innovates concept of mass market transaction that extends U.C.C. consumer protections to businesses
+ establishes strong protection encouraging dissemination of published informational content
+ recognizes layered contract formation occurring over time
+ clarifies enforceability of standard forms in commercial deals
+ proposes solution for battle of forms
+ applies “material breach” concept corresponding to common law
+ sets standards relating to access and Internet contracts
+ establishes contract rules for idea and content submission
+ adjusts statute of frauds to information transactions
+ provides ownership rules for outsourcing and development contracts
+ creates understandable implied warranty for commercial deals
+ outlines relationship between retailer, publisher and end user
+ refines standards for enforcement of liquidated damages rule
+ allows parties to contract for specific performance
+ provides standard interpretations for often litigated grant terms

LICENSOR BENEFITS

+ establishes licensing framework consistent across **converging** industries
+ workable **choice of law** rules for Internet
+ enforceable choice of **forum** clause in commercial contracts
+ establishes guidance for **attribution procedure** in electronic contracts
+ settles enforceability of **mass market licenses**
+ creates method for contracting in **Internet** and similar contexts
+ excludes **consequential damages** for published informational content
+ establishes guidance on the meaning of license **grants**
+ establishes control and protections on **transferability** of a license
+ deals with effect on warranty of **modification** of code in a copy of a program
+ codifies contract treatment of electronic **limiting or management devices**
+ reconciles inspection with presence of vulnerable **confidential** material
+ establishes guidance on procedures to **modify** on-going contracts
+ confirms that **exceeding** a license as a breach of contract
+ establishes standard on connection of **remedy** and consequential damages limits

LICENSEE BENEFITS

+ creates **refund** right from two sources
+ creates procedural protections for **contract** in mass market
+ gives absolute **non-infringement** warranty
+ gives licensee a right of **quiet enjoyment**
+ codifies that **advertising** can create an express warranty
+ creates warranties by **retailer** not disclaimed by publisher license
+ creates a warranty for **accuracy** for some informational content
+ creates implied **system integration** warranty
+ requires **disclaimers** of implied warranties be in a record (e.g., writing)
+ expressly recognizes **implied licenses** for licensee
+ creates broad **scope** presumptions

The significance of Article 2B has been recognized. See Intellectual Property and the National Information Infrastructure, The Report of the Working Group on Intellectual Property Rights, at 58. ([the] challenge for commercial law . . . is to adapt to the reality of the NII by providing clear guidance as to the rights and responsibilities of those using the NII. Without certainty in electronic contracting, the NII will not fulfill its commercial potential.”). That report endorsed the Article 2B project. Subsequent statements by the White House embody the assumption that private contract, rather than regulation should guide the new economy and that the basis for this lies in the development of a “commercial code” for electronic and other information contracts, both within the United States and internationally.

Motion pictures, books and records are now often digital in content and provided through various digitally enabled systems, such as Internet access. Thus, for example, a recently successful motion picture (“Toy Story”) was in effect a lengthy computer program, entirely digital in development and presentation. Various publishers, such as the New York Times, the Wall Street Journal, and West Publishing, provide their basic information resources on-line as well as in paper form. They do business in the same environment in which Oracle Software provides its commercial software products to end users.

+ makes mass market licenses **transferable**
+ enables **financing** licensee interest without licensor consent
+ **perfect tender** rule for mass market transactions
+ right to demand a **cure** for accepted imperfect tender in commercial contracts
+ requires **affirmative acts of assent** to a record instead of mere passive retention
+ creates direct contract with **remote publisher** in mass market
+ increases **class of people** to whom warranty runs for all types of damage
+ enforces **releases** without consideration
+ enforces term providing that a license cannot be **canceled**
+ places substantial limits on electronic **self-help** by licensor
+ presumes **perpetual term** in single payment software license
+ prohibits choices of **forum** that unfairly disadvantages a consumer

PART 1
CONTEXT: LAW REFORM AND THE UCC

Modern Economy and Law Reform

The current UCC affects contract practice and law throughout the economy, but it was based primarily on transactions in "goods" and a financing structure that refers to that model. It reflects a 1950's economy. Then, clear distinctions between goods, intangibles and services in commercial relationships were clear and sharply differentiated. Sales of goods dominated then. They no longer do so. In addition, today, computerization blurs the models. "The distinction that used to be drawn between "goods" and "services" is meaningless, because so much of the value provided by the successful enterprise ... entails services [and information]."3

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

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

Project History

Although it today involves participation by motion picture, publishing, banking, and online industries, Article 2B began with a focus on the contract issues associated with computer software licensing as many of those transactions were brought within the scope of Article 2, a statute dealing with **sales of goods**.

Under modern copyright law, software and most other digital products are governed by an intellectual property rights regime under which the copyright owner holds the exclusive right to authorize or make additional copies of the work, distribute the work in copies, engage in public display or performance of the work, and make modifications of the work (a so-called derivative works). This copyright regime (along with other intellectual property rights) creates property law much different from that associated with goods and places importance on the contractual terms relating to a grant conveyance or restriction of rights in the intangible subject matter. In this regard, software and other digital products are treated in law more like manuscripts and motion pictures, than television sets and cars. Even though a purchaser acquires a copy of the work, the producer retains rights and control with respect to various uses of the copy, including uses that make additional copies or alterations.

This underlying difference coupled with the ease of copying involved in modern digital products causes sharp differences in contracting practices. The differences are only enhanced with the development of the Internet and online services as an important feature of contemporary commerce since these systems allow for transfer of information without the intermediation of tangible objects. Indeed, in the modern marketplace for information, a major conflict looms between systems in which the end user has in its own machine the software and other information assets needs for its business as compared to systems that use rapid communications and Internet capabilities to enable that end user to seamlessly employ software and other information assets located hundreds or thousands of miles away in "cyberspace."

Over several years, committees of NCCUSL, the ABA and other groups examined the consequences of what appeared to many to be a mismatch in concept between contract law aimed at defining relationships relating to the sale of goods (article 2) and contract relationships in which information (or more generally, intangibles) were the centerpiece of the transaction and the contractual format most often involves a license, rather than a sale. The conclusion reached by these committees and by representatives of the information industries entails two basic observations:

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

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

Many court decisions place software licensing in Article 2 even though software is licensed and not sold and even though the focus of the transaction from the standpoint of both parties centers not on the acquisition of tangible property, but on transfer of capability and rights intangibles. See Advent Systems Ltd v. Unisys Corp., 925 F.2d 670 (3d Cir. 1991); RRX Industries, Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. 1985); Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737 (2d Cir. 1979); In re Amica, 135 Bankr. 534 (B.R. ND Ill. 1992). Cases excluding software and data processing from Article 2 include: Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 1329, 1 UCC Rep. Serv.2d 29 (Ind. Ct. App. 1986) (software development); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988) (development contract).

1. Distinct From Sales. Information transactions and, especially, transactions involving licensing of digital information, differ substantively from transactions involving the sale or lease of **goods**. The differences are manifested in both the conditional nature of the transaction and that the value obtained or conveyed lies not in the tangible property, but in the information and rights that are severable from the tangibles. Indeed, it will continue to be increasingly the case that no tangible items are needed to convey information on-line or in electronic transactions. Because of the differences, a body of law tailored to transactions whose purpose is to pass title to tangible property can not be simply applied to transactions whose purpose was to convey rights in intangible property and information. A separate treatment of this commercially important class of transactions was needed.

2. Commercial Significance. The commercial importance, both currently and in the future, of the information industry is obvious. Software and related information technologies currently account for in excess of 6% of the gross national product and the size of the industry continues to grow. Adding in the other industries (publishing, motion pictures, on-line systems) swells the figure to a huge share of the economy The treatment of digital information, both in intellectual property law and in contract law, has become a major focus of contemporary debate. These industries and the transactions they engage in are major factors in the commercial landscape more than sufficient to justify coverage in a **commercial** code.

Deliberative Process

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

This project began at the recommendation of an ABA Study Committee that consideration be given to developing uniform law treatment of software contracts, either in or outside the UCC. A subsequent study committee of NCCUSL agreed and proposed a separate article of the UCC for software and related contracts. Shortly after that, however, the software industry objected. A second study committee was appointed. After extensive consultation and review, a Special Committee on Software Contracts was created to work parallel to the Drafting Committee on Article 2 Sales. This Special Committee was later folded into the Article 2 Committee.

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

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

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

Working Drafts

From the outset, the Article 2B process has reached out for the widest range of input and commentary possible. To a greater extent than in any other recent UCC project, this has led to an active engagement of the views of many different groups and individuals. During the period of from March, 1994 through today, the Reporter and various members of the Committee have met with representatives or members of a wide range of groups to review provisions of various interim drafts. More than thirty organizations have had representatives at Drafting Committee meetings including:

ABA Business Law Section

ABA Section on Intellectual Property
ABA Section of Science and Technology
ABA Law Practice Management Section
American Film Marketing Association
American Intellectual Property Law Association
Association of American Publishers
American Electronics Association
Association of Scientific, Technical and Medical Publishers
Commercial Law League of America
Consumer Project on Technology
Consumers Union
CBEMA
Equipment Leasing Association
Federal Reserve System
ITAA
Information Industry Association
Licensing Executives Society
Information Technology Council
Interactive Digital Software Association
Software Publishers' Association
Business Software Alliance
Silicon Valley Software Industry Coalition
Society of Information Management
Motion Picture Association of America
California Bar Association
Association of the Bar of the City of New York
Chicago Bar Association
Texas State Bar Association
Recording Industry Association of America

Drafting Committee meetings are routinely attended by a large number of practicing lawyers not affiliated with associations and by representatives of various companies. Drafts of Article 2B have been discussed at over 150 seminars and public meetings; a large number of individual attorneys have provided written commentary on draft provisions.

PART 2: BASC THEMES

Licensing Law and Practice

A paradigmatic transaction involves a **license**, rather than a sale.

> "License" means a contract that grants permission to access or use information if the contract expressly conditions, withholds, or limits the scope of the rights granted, grants only non-exclusive rights, or affirmatively grants less than all rights in the information, whether or not the contract transfers title to a copy of the information. 6

The transaction is characterized by 1) the conditional nature of the rights or privileges conveyed, and 2) the focus on information, rather than tangible property.

A license is not a lease or a sale. Both of those terms apply to transfers in goods, rather than rights in intangibles. The Supreme Court described a patent license as "a mere waiver of the right to sue." 7 The Federal Circuit Court of Appeals stated:

> [A] patent license agreement is in essence nothing more than a promise by the licensor not to sue the licensee. . . . Even if couched in terms of "[L]icensee is given the right to make, use, or sell X," the agreement cannot convey that absolute right because not even the patentee of X is given that right. His right is merely one to exclude others from making, using or selling X.8

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

Many licenses regulate rights in intellectual property. There are many situations, however, in which a license occurs in the absence of intellectual property. A license also exists in situations in which one party receives permission to enter the physical premises or computer of another or where property owned by the licensor

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1 UCC § 2B-102.

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

1 2 3 Spindelfabrik Suessen-Schurr v. Schubert & Salzer, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. denied, 484 U.S. 1063 (1988). See also Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir 1988).

is made available to the licensee.9 That model exists in the digital world in reference to the many transactions in which parties are licensed to use computer or other information resources of a licensor. In this Draft, that model is encompassed in the concept of an "access contract" which, as to rights to access a facility, is treated in current law and this draft as generally analogous to is a more complete transfer of property rights. Section 2B-102 defines such contracts as:

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

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

Licenses are common commercial transactions. The key fact is that the value resides in the intangibles, rather than goods. One does not purchase a book to admire the paper (goods), but to use the information. One does not acquire software to enjoy the diskette, but to use the program, encyclopedia or other content.

Licensing is a dominant means of commerce in digital information and in commercial information transactions. In distributing information products, as with goods, several different transactional options exist; licensing is a primary option, especially in digital information industries. Typically, as a simple matter of contract law, license restrictions are enforceable even though their terms do not mirror the "exclusive rights" in copyright or patent law. Indeed, while many courts use Article 2 to resolve contract disputes relating to themes covered by that article, Article 2 has never been applied to determine the effectiveness of use restrictions. Courts consistently apply licensing law paradigms to issues involving software and online contracts where the issues involve enforcing restrictions on use of information.

Courts generally enforce contract terms unless a specific term in a particular context conflicts with federal antitrust or related doctrines of patent or copyright misuse. Thus, courts have enforced license restrictions precluding non-commercial use of a mass market digital database, limiting a right to access by barring the making of a copy of software, limiting use to a specific computer, limiting use to internal operations of the licensee, restricting redistribution to a particular grouping of software and hardware, precluding modification of a computer game, and various other contract limitations. In these and other cases, the license accompanied distribution or delivery of a copy that enabled the licensee to use the licensed information.

Article 2B does not change the balance between contract and federal law. It could not do so even if that were the intent. Article 2B does not *create* contract law here – contracts have long been used to control distributions. Article 2B merely provides a more coherent and workable basis for contract issues.

Commercial Practice

As in transactions in goods, licensing spans a wide range of commercial practices. Article 2B focuses on many of the most commercially important transactions in modern commerce.10

For purposes of illustration, it is useful to distinguish various types of licensing. One factor differentiates between licenses that relate to information physically transferred to a licensee, as contrasted to licenses that enable a licensee to access a location (i.e. a computer) in which information resides. The latter access contract is used widely in modern Internet and online transactions. What is licensed is a right to have access to an environment that the licensor owns or controls.

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

In areas covered by Article 2B, copyright law is a dominant source of intellectual property rights. It gives the copyright owner the exclusive right to make copies of its work, to distribute copies, to make derivative works, to publicly display or perform the work, and other rights. A basic commercial choice made by a copyright owner is whether to license or to sell a copy of its work. In book publishing and most records, in current practice in the mass market, copies are sold. In the motion picture industry, licensing is the common approach in reference to theaters who publicly perform the movies, while in the consumer market, copies are either sold or leased (with a license that precludes public performance) for a brief time. Software is typically licensed, although computer game distribution frequently involves sales of copies.

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

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

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

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

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

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

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

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

Nature of a Commercial Statute

The fundamental philosophy of Article 2B centers on supporting contractual choice and commercial expansion in information contracting. In addition, an important theme has increasing force as the technology revolution in Internet and similar contexts expands. That theme involves a need to create and preserve as broad as possible a field for expression and communication, commercially and otherwise, of ideas, images, and facts; material that this draft refers to as "informational content."

Informational Content

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

The thought that information content becomes something entirely different if the provider or author distributes it commercially can hardly be a premise.

See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92 C 0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993); Soderholm v. Chicago Nat'l League Ball Club, 587 N.E.2d 517 (Ill. Ct. App. 1992).

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

Commercialization (that is controlling who receives the information or charging a fee for its receipt) is not inconsistent with the role of information in political, social and other venues of modern culture. If it were, newspapers, books, television, motion pictures, video games, and other modern sources of information content for the general public or for specialized groups could not exist. What we do in Article 2B in creating (or avoiding) liability risk, in allowing (or precluding) author's to control distribution of their ideas, or in allowing (or denying) the right to contract for licenses of information has a significant impact on the future of information in new and in older systems of distribution.

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

Freedom of Contract

The philosophy in UCC provisions on commercial law builds on two basic assumptions about commercial contract law. The first commercial law theme assumes that a rule of contract law is to preserve freedom of contract. This permeates the UCC. "This article was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases of goods: freedom of the parties to contract. . . . These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care."11

The idea of contract flexibility is embedded in general contract law theory. The idea that parties are free to choose terms can be justified in a number of ways.12 It leads to a preference for laws that provide background rules, playing a default or gap-filling function in a contract relationship. A default rule applies if the parties do not agree to the contrary. A default rule should mesh with expected or conventional practice in a manner that projects a favorable impact (as judged by relevant policy) on contracting and that can be varied by the contracting parties. This is in contrast with rules that dictate terms and regulate behavior. As a matter of practice, default rules are common in commercial contexts, while consumer law contains many fixed rules designed to protect the consumer against overreaching.

Default Rules

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

> The principal objects of draftsmen of general commercial legislation ... are to be accurate and not to be original. Their intention is to assure that if a given transaction ... is initiated, it shall have a specified result; they attempt to state as a matter of law the conclusion which the business community apart from statute ... gives to the transaction in any case. But achievement of those modest goals is a task of considerable difficulty.13

To be accurate and not original refers to commercial practice as an appropriate standard for gauging appropriate contract law unless a clear countervailing policy indicates to the contrary or the contractual arrangement threatens injury to third-party interests which social policy desires to protect. Uniform contract laws do not regulate practice. They seek to sustain and facilitate it. The benefits of codification lie in defining principles consistent with commercial practice which, because of their codification and their relevance to actual practice, can be relied on and are readily discernible and understandable to commercial parties.

How one decides what rules will best facilitate contracting practice is a matter of dispute in literature. In this context, the best source of substantive default rules lies not in a theoretical model, but in reference to commercial and trade practice. This is not simple faith in empirical sources for commercial law. It stems from the reality that, even though we may not know how law interacts with contract practice, decisions about contract law will continue to be made. In those decisions, we should refer for guidance to the accumulation of practical choices made in actual transactions. The goal is a congruence between legal premise and commercial practice so that transactions adopted by commercial parties achieve commercially intended results.14 Background rules tied to the ordinary, but actual commercial context tend both to provide a legal base that falls within the tacit expectations of the parties and to ameliorate problems from lack of knowledge by supplying common sense outcomes.

Yet, in Article 2, Article 2A, and Article 2B, a wide range of transactions exist and a variety of diverse industries are affected. The transactions range from a casual deal between two individuals at a garage sale to transactions between sophisticated businesses employing multiple lawyers and affecting billions of dollars of business. The approach needed is not to draft rules that an individual party would draft tailored to each case, but to select an intermediate or ordinary framework whose contours are appropriate, but whose terms will be altered in the more sophisticated environments. A UCC Article designs default rules that are acceptable in ordinary transactions where they can be frequently used without disruption or costly negotiation.

Intellectual Property Overlay

Many, but by no means all of the information that provides the subject matter in commercial exchanges receives protection under federal intellectual property law. In most cases, patent and copyright law do not affect contract law; they coexist with it. Article 2B does not create contract law as an option in this field. For many years, owners of intellectual property have contracted for selective distribution of their property and placed limits on contracted-for use. Licensing law reflects this broad and long-standing contract practice and generally allows contract options, subject only to specific restrictions in federal property law, to antitrust-related restrictions on some contracts in some settings, and in some limited types of claims or contexts, to over-riding mandatory federal policies.

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

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

This interaction of state law and specific federal yields default rules that, in some cases, do not correspond to the treatment of analogous issues in other parts of the UCC. This is true, for example, with respect to the transferability of a licensee's interest in a non-exclusive license. Federal law reflected in a series of cases holds that the licensee's interest is **not** transferable without the licensor's consent.17 The rationale for this rule is discussed in relevant notes in this draft, but the principle, which contradicts some state law assumptions about transferability, is followed in the Draft. Similarly, in patent and copyright law, no concept of good faith purchase exists against a claim of infringement and this principle limits the ability of a party taking outside of the terms of a license to claim insulation from infringement and

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UCC 2A-101, Comment.

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

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

Charles J. Goetz & Robert E. Scott, <u>The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms,</u> 73 Cal. L. Rev. 261, 266 (1985). See also Randy E. Barnett, <u>The Sound of Silence: Default Rules and Contractual Consent</u>, 78 Va. L. Rev. 821, 822 (1992) ("default rules [that reflect the conventional or common sense in the relevant community] are likely to reflect the tacit ... agreement of the parties and thereby facilitate the social functions of consent.").

17 U.S.C. § 301.

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

See <u>Everex Systems, Inc. v. Cadtrak Corp.,</u> 89 F.3d 673 (9th Cir. 1996).

other property claims based on making or retaining unauthorized copies or uses.18 The Draft corresponds to this federal law approach. Also, copyright law precludes a transfer of ownership of copyright in the absence of a writing conveying ownership. In discussing development contracts, this Draft reflects that limitation, but attempts to ensure that the agreement of the parties is enforced to the extent possible within that federal law constraint.

These provisions reflect a policy of correspondence of rules in addition to simple recognition that federal law preempts contrary state law. There are other situations where federal law and policy shapes contract law and practice, but the nature of that role is less clear and typically more controversial. The Draft adopts a position of neutrality on such issues, leaving determinations about their content to be determined under federal law, the appropriate venue for such discussion.

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

PART 3

THEMES IN THE DRAFT

The content of this draft have been formed by various policy choices relevant to the subject matter and types of transactions involved.

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

In the world of information, the goal is to acquire the knowledge, technology, or content along with the right to use the them. Unlike in goods, information cannot always be returned, nor need the same copy be transferred in order to establish the harm caused by breach. Thus, remedies differ from those for goods. Also, because of its intangible character, information can be transferred in many different ways: a telephone call, a electronic message, a delivery of a diskette. Article 2B seeks transfer method irrelevance. How a transfer occurs should not alter the applicability of the article or, in general, what substantive rules apply. Some information transactions involve remote access to a computer, while others occur by delivery of a diskette or a book. This does not place one transaction within the UCC, while the other is under common law. In some cases, the method of transfer and the market in which the transfer occurs affects what default rules apply, but this should only be true if the commercial practices are different or if there are substantive policy concerns that indicate a different result is proper.

Beyond this, important concepts emerge around 1) the scope of the Article; 2) the electronic contracting rules; 3) the concept of mass-market licenses; 4) the treatment of standard forms; 5) the use of a substantial performance standard other than in mass market transactions; 6) the tailored warranties for programs and informational content; 7) the treatment of transferability; and 8) the handling of remedies.

Scope: Licenses and Information

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

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

The origins of the project lie in proposals about software transactions. Today, however, software is an ubiquitous element of information products. In a digital world, a focus on "software" transactions would be arbitrary and ineffective. The Draft focuses on transactions in "information."

"Information" means data, text, images, sounds, and works of authorship, including computer programs, databases, literary, musical or audiovisual works, motion pictures, mask works, or the like, and any intellectual property or other rights in information.

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

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

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

Overlap Within the UCC

Obviously, many transactions entail mixed subject matter, including both information and goods (either sold or leased). Article 2B handles this overlap in two ways. The primary approach applies a variation of the gravamen of the action test. Article 2B covers aspects of a mixed transaction involving information, copies and documentation. Article 2 (or 2A) covers other goods in the same transaction. Which Article applies to a particular dispute depends on the focus of the dispute. No predominant purpose test is intended.

The second approach delegates full coverage to Article 2 in cases of embedded software (e.g., software used to operate the braking system of a car), thus leaving product liability and product quality issues in that context to that law. Defining the scope of this exclusion has been difficult.

Patent, Trademark and Services

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

The exclusions deal with a variety of services and employment contracts. These include any employee relationship and services agreements related to entertainment (e.g., actor, musical group performance, producer, etc.). In the excluded cases, personal services contracts involve different default provisions than here. The motion picture and publishing industries have suggested that the Committee consider exclusion of talent and author contracts generally (e.g., the upstream portion of the industry).

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

A more controversial exclusion deals with patent and trademark licenses. The desirability of this exclusion has been extensively debated by the Committee. The rationale for exclusion lies in the differences between digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that in the areas covered in this draft. The exclusion allows the draft to concentrate on a more focused area of commerce. In practice, however, one can anticipate that courts will apply aspects of this Article to other fields of licensing.

Electronic Contracts

Article 2B deals with electronic contracts. This area of contract practice is one that the White Paper referred in endorsing the value of this project for commercial practice in the information era.

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

Formation Issues

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

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

means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.19

The term divorces concepts associated with writings from the traditional paper environment, making electronic records fully equivalent to paper records. The language here relates to language in the federal Copyright Act defining a "copy."

Article 2B also changes terminology in the idea of signature. The Draft replaces signature with "authentication." That term encompasses electronic actions to encrypt electronic records and is defined in a manner independent of concepts of a handwritten signature. The draft follows the emerging consensus that actions other than handwriting can suffice. The definition provides:

> "Authenticate" means to sign or to execute or adopt a symbol, including a digital identifier, or encrypt a record in whole or in part with present intent to adopt, establish the authenticity of or signify a party's acceptance of a record or term that contains the authentication or to which a record containing the authentication refers.20

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

Under the Draft, if the parties agree to a commercially reasonable method of attributing a document to a party, compliance with that methodology per se gives the status of a signature.21 The idea of an "attribution procedure" is adapted from UCC Article 4A, security procedure. This parallels digital signature statutes in that, if the parties agree to use digital signature procedures, that choice is validated in the draft as conclusively constituting a signature. The requirement that the procedure be commercially reasonable allows a court an opportunity to consider the nature of the system adopted in any cases where the accuracy of the attribution is contested.

A more significant proposal deals with an "electronic agent." This concept refers to a computer program or similar automated device established to act on behalf of a party. While not an "agent" in traditional senses, the use of programmed surrogates to make contracts, find information, and otherwise interact with computers of other parties is increasingly important in electronic commerce and will be even more so in the future with respect to information assets where no specific need ever exists for a human being handling the transaction or its result in a digital world.22

Article 2B deals with the fact that electronic contracts, driven by computer capabilities, will increasing involve arrangements entered into and performed without there being any necessity for human intervention or decision making on both ends of the transaction. This yields a number of questions about offer and acceptance, notice and the like. Article 2B adopts the view that electronic contracts can be formed without human choices being made to offer and accept a particular transaction and that notice can occur without a human review of the subject matter. If a party creates a situation in which an electronic agent is to act on its behalf, then that party is bound by the actions of the "agent."23

An aspect of this concept is that contracts can be formed by the interaction of such agents with or without the active involvement of an individual representing the contracting party.24 In an electronic world of information-based transactions, human review of particular transactions and reaction to that review will often be displaced by electronic review within preprogrammed parameters with programmed or "learned" responses. These provisions, and other similar sections, are aimed at identifying and validating these commercial practices under appropriate standards.

There are risks of fraud and error, of course. Article 2B deals with these through a concept of "attribution." The idea that a computer can act on behalf of a party assumes that it serves as an electronic agent, selected, created or otherwise made available by the party for that purpose. More generally, attribution implies that a party will be charged with responsibility for a particular message or performance rendered electronically. There are three methods of attribution: actual involvement of either the person or its electronic agent, compliance with an attribution procedure, and lack of reasonable care resulting in loss to the other party. These concepts parallel international developments relating to the more closed-end use of Electronic Data interchange. They balance between a number of potential, other regimes for allocating loss or risk in electronic deals.

ASS MARKET DEFINITION AND USE M

This Article creates the idea of a "mass market" contract that achieves a shift away from traditional patterns in the UCC which focus on "consumers." The term moves to a retail marketplace definition in which consumers and some businesses are treated under the same protective law. This extends some protections typically reserved for consumer to a business licensee and brings in various marketplace assumptions about transferability and the like that may be pertinent to mass market environments.

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

Definition.

The definition of mass market has been elusive.

Part of the difficulty lies in the fact that the concept has not been used in any other statutory provision. Most contract statutes focus on the consumer-commercial dichotomy. Some consumer protection rules broaden the idea of "consumer" to include some business purchasers, but typically do so in terms of dollar amount limitations. Federal protections focus on consumers, but the Magnuson Moss Act uses a concept of "consumer product" which focuses on the most common purchaser of a product and then applies the federal regulations regardless of whether the specific purchaser was or was not a consumer.

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

As drafted, the idea of a mass market centers on small transactions directed to the general public in a retail marketplace. In light of the risk allocation issues involved and new nature of the undertaking, the goal is to focus on relatively small transactions. This Draft incorporates most consumer transactions within the ambit of mass market. For non-consumer transactions (e.g., transactions between two businesses in a retail market), the definition utilizes a combination of a retail, general public reference point and a monetary cap to achieve the intended focus. The monetary cap does not limit consumer inclusion in the concept.

Applications

The issue with reference to the idea of a mass market in this Article goes beyond the definition and deals with how the concept is applied. The two uses of the concept: 1) treat the marketplace as a surrogate for consumer protection, thereby extending consumer protections to business transactions, or 2) use the concept a marketplace identifier which allows definition of various expectations about the nature of transactions in that market.

In contract law statutes, the idea of a "consumer transaction" has traditionally been associated with a theme of protection and enhanced notice requirements justified largely by the assumption that many consumers will be unsophisticated and lacking in economic power to negotiated terms or seek alternative sources of supply. That term and that tradition are present in various articles of the UCC. Clearly, in Article 2B, use of a reference to a consumer transaction should signal similar concerns.

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

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 presumably lack the expertise to understand contract issues (e.g., consumer) and cases where the goal is to identify and define a marketplace by reflecting presumed

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2B-102.

2B-102(2).

2B-110.

2B-102.

In Article 2B, this is a question of "attribution." 2B-111.

2B-203.

assumptions applicable in that marketplace. The Committee opted to apply the concept of “mass market” as the theme in all but a few sections in which the issue arises.

“CONSUMER” APPLICATIONS:
2B-108 (choice of law): default rule
2B-109 (choice of forum): contract choice limited
2B-117 (electronic error): proposed consumer defense
2B-303 (effect of no-oral modification clause): contract method restricted
2B-618 (hell and high water clauses): effectiveness of clause limited

“MASS MARKET” APPLICATIONS:
2B-106 (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-208 (terms): procedural protections in mass market
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
2B-607 (perfect tender): required in mass market
2B-610 (refusal for imperfect tender): allowed in mass market

Relationship to Existing Consumer Law

Although the idea of “mass market” goes past traditional concepts of consumer protection, the combined effect of using that term and covering some transactions involving consumers specifically produces a draft that, in general, retains all existing UCC consumer protections and in fact creates some protections that are not present under current law.

For mass market transactions, the Draft retains the idea of perfect tender, important for consumer transactions as a means of allowing a simple remedy for products that do not meet standards. In addition, the Draft retains the implied warranty of merchantability in the mass market, applicable to consumers and businesses purchasing in that marketplace. As under current law, the warranty can be disclaimed, but Article 2B goes beyond existing UCC law to require that the disclaimer be in writing (a record) and by requiring a plain language disclaimer that gives the consumer more notice of what its rights are.

There are several situations in which the Draft creates rights beyond current Article 2.

More importantly, as discussed below, the Article allows a consumer to object to terms of a mass market license based on arguments that the term would have caused a refusal of the licensee had it been brought to the licensee’s attention. This incorporates ideas from the Restatement, but brings them to a general commercial marketplace where they have generally not been previously accepted. This rule covers both consumers and businesses who acquire information in the mass market.

A chart summarizing consumer-related issues in Article 2B as compared to current law is attached at the end of the Preface.

STANDARD FORMS AND MANIFESTED ASSENT

In Article 2B makes a direct effort to deal with standard form contracts. The basic principle lies in the fact that in commercial agreements, standard form use is widely and broadly acceptable. It provides a number of economies in transaction costs and, quite simply, provides a strongly supported commercial practice. Article 2B adopts the position that standard forms used to document an agreement are enforceable so long as the party being charged with the terms of the form manifested its assent to the form.25 No other position would be workable in modern commercial practice.

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

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

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

The UNIDROIT Principles of International Commercial Contracts, reflecting a similar background, deals with **standard terms** (not forms) and invalidates terms that the “party could not reasonably have expected.” For such terms, there must be specific agreement to the term.” UNIDROIT art. 2.20. Unlike the Restatement, this emphasis is on the reasonable expectations of the assenting party and creates, one suspects, an impossible burden for a licensor who must structure its forms to fit diverse transactions and diverse contexts, especially in the mass market. This approach is particularly suspect because it centers on terms that are standard, rather than terms in standard forms. The UNIDROIT standard has not been adopted in any country, or any state of this country.

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

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

In a mass market, the transaction is anonymous and for often not fully considered by the transferee. Section 2B-208 recognizes this in two ways: 1) expressly recognizing that unconscionability provides a limitation on what terms can be created in these contracts; and 2) providing that the form itself cannot alter negotiated terms reached by the parties to the license.

INFORMATIONAL CONTENT.

Article 2B deals with a large number of informational content transactions that are not transactions involving computer programs per se. In dealing with contracts pertaining to information content, however, choices must be made about the applicability of Article 2 sale of goods concepts. In many respects, these concepts do not comfortably fit practices and relevant interests involved in handling contracts about informational content.

Transactional Aspects

This Draft contains two sections dealing with informational content transactions in terms of the transactional processes. One deals with the application of Article 2 concepts of tender, rejection and revocation to information industries. Unlike general rules in common law and the Restatement, the Article 2 model contains an 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 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 and until there is an express indication of acceptance (or rejection) by the licensee. This corresponds to commercial practice in this context.

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.

Liability Issues.

This Draft creates a concept of “published informational content” and relies on First Amendment and related policies to avoid the creation of expansive

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1 2B-307.

liability risk under contract law for distributions of information to the public. The issue here involves drawing a balance that allows for the continued, vibrant dissemination of content for use by people in an open society.

Published informational content is exempted from any implied warranty under 2B-404. This is critical insulation for such information providers and also corresponds to what rules exist under current law, such as in the Restatement (Second) of Torts § 552 as applied by the courts. The Draft also proposes an exclusion of third party product liability claims with reference to published information under Section 2B-409. This brings the Article into correspondence with the Restatement and with better reasoned cases. Liability for information content is generally restricted to special relationships of reliance.

Section 2B-402 on express warranties leaves current law in place without change for published content. It declines to transport Article 2 express warranty rules into this environment, allowing courts to continue to work out under what conditions a content provider should be held liable for alleged breach of contractual representations.

WARRANTIES AND PERFORMANCE OBLIGATIONS

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

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

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

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

Computer Programs

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

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

For computer programs not in the mass market, there is an implied warranty that the program substantially conforms to its documentation. This corresponds to the most common negotiated warranty in commercial licensing. It differs from the merchantability warranty in its focus. The warranty focuses on the program's documentation itself for the implied obligation, rather than seeking to discern "ordinary" characteristics in "similar" programs outside the mass market as would be required by a merchantability concept. Besides creating a parallel with modern commercial practice, this warranty reflects the fact that *outside of the mass market* a wide diversity exists in program capabilities and characteristics, even within the same generic type of software. Non-mass-market programs of similar type differ widely in attributes, speed, capacity, and other traits that make comparisons across categories of software uninformative. An "ordinary" data compression program may not exist in this market.

Informational Content.

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

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

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

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

Disclaimers of Implied Warranties.

UCC law allows parties to disclaim warranties. Article 2B follows that tradition.

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

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

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

TRANSFERABILITY AND FINANCING

Article 2B deals with transferability, financing and related issues concerning licensed information. It does so in context of an important group of restraints present in modern federal law relating to intellectual property rights.

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

> Allowing free assignability . . . 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.26

The issue reflects the fact that licensed information that is again transferred is not second hand property, but **identical** to the original. This is true not only in reference to the pure licenses, but also in licensing rights in digital information.

Copyright and patent law also have long held that acts that infringe rights under those statutory property regimes are actionable, even if done in good faith. Copying infringes even if the copyist is not aware of the underlying right. Copying (or other action in violation of the exclusive rights, such as distribution of copies) that goes beyond a license is infringement unless protected by fair use or similar doctrines. These rules shape the available range of good faith purchaser rules in this Article.27

A basic principle is that state law rules should not create a misleading impression by contradicting partially preemptive federal law. This shapes Part 5 on transfers and how financing can be accommodated. In both settings, the Draft contains suggested provisions that push close to limits. They accommodate financing by allowing creation and enforcement *against the licensee*, but not sale or control as *against the licensor* without consent of the licensor. (See 2B-504) Article 2A, not faced with the over-riding gloss of federal intellectual property policy, recognized a similar right of an owner to control its property, noting that the "lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3.

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

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

This Draft allows creation of a financing interest in a licensee's interests, but limits enforcement without consent of the licensor. Resale is excluded because of support for the licensor's intellectual property rights. The Draft also proposes an integrated concept of "financier" which includes both a security interest and a financing lease. It does not include unsecured interests. The concept, defined in Section 2B-102, is applied in the two sections on financing. The first is 2B-504. The second, 2B-618, contains a limited discussion of the relative relationship between a licensor, a financier, and a licensee (debtor).

REMEDIES

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

The damages formulae give either party a right to recover for consequential damages. The Restatement uses a licensing illustration in describing its general damages approach:

> "A" contracts to publish a novel that "B" has written. "A" repudiates the contract and B is unable to get his novel published elsewhere. Subject to the limitations stated [elsewhere], B's damages include the loss of royalties that he would have received had the novel been published together with the value to him of the resulting enhancement of his reputation.[28]

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

In digital information, the technology enables automated enforcement techniques that are not available in other contexts. The automation allows a provider of digital information to limit its uses consistent with a contract and, when that permitted use expires, to cancel the capability to use the material in the future.

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

Section 2B-314 deals with electronic monitoring devices, such as programmed limits on the number of users, number of uses or the like. It enables passive monitoring and restriction. That is, restrictions that simply prevent extra-contractual activity, but do not otherwise alter the information. Beyond that, such devices are generally allowed only if notice is given and their use is assented to.

The more controversial restriction deals with cases of breach. A licensor retains an interest in the intangible subject matter of the transaction. This interest is different from that of a lessor because is applies to an intangible rather than goods. In 2B-716, in cases involving a license (as contrasted to an unrestricted transfer of information), the licensor's remedies include a form of repossession or, at least, taking steps to preclude further use of the information by the licensee. This right is sharply circumscribed and requires prior notice to the licensee and authorization to do so in the contract.

Self-help here contrasts to the far broader provisions in Article 9. A secured party can exercise a right of self help so long as the exercise of that right does not result in a breach of the peace. Material breach is not required and there are no limitations on possible damage to property; it allows repossession of "equipment" by disabling it. Article 2A remedies are similarly broad.

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

APPENDIX A

CONSUMER ISSUES

COMPARISON OF EXISTING ARTICLE 2 AND OTHER LAW WITH PROPOSED ARTICLE 2B

Issues	Art 2: Existing Rules Relating to Consumers	Art. 2B: Rules Relating to Consumers	Effect[1]
			GENERAL RULES
"Consumer" defined	**Article 2** contains no definition. **Article 9** refers to consumer goods as acquired primarily for personal, household or family use. **Outside the UCC:** definitions vary.	**Article 2B** refers to: licensees that acquire primarily for personal, family or household use. Resolves case law debate on profit making, investment or professional uses.	**NC**
"Mass market" defined	**Article 2:** Concept does not exist.	**Article 2B** defines to include retail transactions of information earmarked for the general public. Consumers covered without dollar limitation.	+
Mass Market: Consumer protections extend to businesses.	**Article 2** does not provide for this	**Article 2B:** implicit in "mass market" concept. All businesses protected, not only small businesses. Protections include refusal term concept.	+
Non-UCC consumer rules; relationship to UCC	**Article 2** did not "impair" existing consumer statutes. **Outside the UCC:** Several states have digital signature laws with wholesale repeal of "signature" and similar requirements in all state laws	**Article 2B** expressly retains and defers to consumer law outside U.C.C., except for electronic contract formation issues involving authentication, records, and assent. This enables electronic commerce.	**?**
Unconscionable clause invalid	**Article 2** allows court to invalidate unconscionable clause; procedural and substantive unconscionability.	**Article 2B: same rule.** (2B-111)	**NC**
Unconscionable: clause or contract can be invalidated for unconscionable inducement	**Article 2:** no provision. **Article 2A:** provides for this for consumer leases. **Outside the UCC:** unfair and deceptive trade acts, fraud or similar law.	**Article 2B: same rule as Article 2** (2B-111) Concepts of manifest assent, opportunity to review, refund, and refusal term concept add procedural and substantive protections.	+ *or* **NC**
Parol evidence	**Article 2:** no special rule for consumers	**Article 2B: same rule.** (2B-301)	**NC**
Modification: contract clause that bars oral modification	**Article 2,** in consumer contract, clause enforceable if separately signed.	**Article 2B:** in consumer contract, manifest assent to the clause makes clause enforceable (2B-303)	**-**
			TRANSFERABILITY, DURATION AND BASIC PRESUMPTIONS OF CONTRACT
Transferee right to transfer without consent	**Article 2** contains no provision. **Outside the UCC:** right to transfer a copyrightable work is subject to the copyright owner's exclusive right to distribute copies except after a first sale. Licensee cannot transfer without consent (except after first sale).	**Article 2B** allows mass market licensee to transfer copy and related license even if there was no first sale.	+
Transferee right to finance license rights.	**Article 2** contains no provision. **Article 2A** leaves control with lessor. **Outside the UCC:** right is subordinate to copyright owner's rights.	**Article 2B** allows mass market licensee to create security interest in its contract rights even if no first sale occurred.	+
Fair use: relationship between contract and fair use under copyright law.	**Article 2** has no provision. **Outside the UCC:** issues are debated; cases generally enforce contract terms.	**Article 2B** takes no position on this dispute; it involve federal policy. Rules on contract creation merely clarify existing ability of parties to contract.	**NC**
Right to make uses "necessary" to granted use.	**Article 2** has no provision. **Outside the UCC:** some cases hold grants are interpreted against licensee to protect licensor; ungranted uses are sometimes protected via implied license.	**Article 2B** requires reasonable interpretation of grants and presumes that the uses necessary for agreement are granted. Even if not mentioned (2B-310)	+
Duration of contract: no successive performances	**Article 2** contains no rule for cases not involving successive performances	**Article 2B:** term presumed perpetual.	+

Duration of contract: successive performances	**Article 2:** "reasonable time" subject to termination at will. (2-309) **Outside the UCC:** similar rule, although the "reasonable time" limitation is not always present.	**Article 2B: same as Article 2.** (2B-308)	**NC**
Termination: notice required, ordinary contracts	**Article 2** does not require notification unless termination is for other than an agreed event. Contract term dispensing with notice is valid unless unconscionable. (2-309)	**Article 2B: same rule.** (2B-627)	**NC**
Termination: ongoing or access contracts.	**Article 2** does not require notification if terminate for an agreed event. (2-309) **Outside the UCC:** can be terminated without notice where license use of licensor's facility.	**Article 2B** adopts the common law rule for access contracts.	**?** or **NC** **MASS MARKET AND CONSUMER** STANDARD FORMS
Standard Forms: general enforceability in consumer market	**Article 2** contains no provision. **Outside the UCC:** cases generally enforce contract in absence of contrary, regulatory statutes. Restatement allows enforcement, subject to eliminating some terms. **Contract of adhesion** analyses generally enforce contract, but scrutinize terms for unconscionability.	**Article 2B** allows enforceability of forms only if there was an opportunity to review the form and an affirmative manifestation of assent to it. Does not alter conscionability standards	**+**
Mass Market Forms: require affirmative act to be bound	**Article 2** does not deal with this, but recognizes that conduct can be acceptance. Cases do not always require affirmative act. See <u>Gateway 2000; Cruise Lines</u>	**Article 2B** provides a contract is not enforceable unless consumer agrees or manifests assent. Assent requires **affirmative** conduct, not mere retention without objection. (2B-112)	+
Mass Market Forms: enforceability of terms not seen until after price is paid	**Article 2** does not deal with this **except** through battle of forms and contract modification rules. Case law varies but cases do exist in various contexts that enforce post payment terms.	**Article 2B** allows terms to be enforceable **only** if there is a right to obtain a refund. Gives right to cost-free refund and repair of any system problems caused by review. This right exists even if product is perfect.	**?**
Mass Market Forms: refund if terms of form are not acceptable	**Article 2** does not deal with this. Cases enforcing post-payment terms do not routinely require a refund.	**Article 2B** requires right to refund if license refused. Refund from remote publisher or the retailer. (2B-113)	+
Mass Market Forms: remote publisher contract impact on retailer	**Article 2** does not deal with this. Cases vary, but often make the two contracts independent	**Article 2B:** retailer is not bound by and does not receive the benefits of the remote party's contract terms (2B-616)	**NC**
Mass Market Forms: ability to contract with remote copyright owner to vary use terms to permit otherwise infringing act	**Article 2** does not deal with this. **Outside the UCC:** in the absence of a contract with the copyright owner, party may not do any infringing act; rights depend on whether or not there was an authorized first sale and are limited to first sale rights..	**Article 2B** creates method for contract between end user and copyright owner. The contract terms may expand rights on first sale (e.g., copies on portable and desk top system, multiple users, public display) or may reduce rights as compared to a first sale.	**?LAW AND FORUM CHOICE**
Choice of forum: when is a contract term dealing with the issue enforceable?	**Article 2** does not deal with this. **Outside the UCC:** cases often presume enforceability. Some consumer laws preclude enforcement.	**Article 2B**: not enforceable against a consumer if it selects a jurisdiction that would not otherwise have jurisdiction and is "unjust and unreasonable." Subject to consumer statutes. (2B-109)	+
Choice of forum: no contractual choice.	**Article 2** does not deal with this.	**Article 2B same rule**.	**NC**
Choice of law: in the absence of a contract term dealing with the issue	**Article 2** does not deal with this. **Article 1** chooses any state with an "appropriate" relationship to transaction. No special rule for consumers. **Outside the UCC:** Wildly divergent rules.	**Article 2B:** Creates rule for on-line information contracts (licensor location) and delivery of tangible copies involving consumers (delivery place). Otherwise adopts Restatement (2d) (2B-108)	**+**
Choice of law: enforceability of contract term dealing with the issue	**Article 2** does not deal with this. **Art. 1** requires that contract choice have a reasonable relationship to transaction, **but** other articles contain different rules. **Outside the UCC:** contract generally governs unless consumer law or other mandatory law bars.	**Article 2B:** Allows contract choice except where precluded by consumer statute or judicial rule.	**?** **WARRANTIES**
Warranty: title or authority	**Article 2** imposes a good title warranty.	**Article 2B:** imposes a warranty of	**?**

	Article 2A does not require "good title". **Outside the UCC**: in licensing, status of good title warranty is uncertain.	authority to make the transfer. (2B-401)	
Warranty: **delivery** does not infringe intellectual property rights	**Article 2** warranty that merchant will deliver goods free of infringement; liability is without knowledge	**Article 2B** imposes same warranty. (2B-401)	**NC**
Warranty: **use** does not infringe intellectual property rights	**Article 2** warranty does **not** apply to use of information nor does **Article 2A**. **Outside the UCC:** warranty does not exist unless created expressly.	**Article 2B** imposes a warranty that authorized use of the information by the licensee does not infringe; warranty is that there is no knowledge (2B-401)	+
Warranty: quiet enjoyment	**Article 2** does not deal with this. **Art. 2A** gives this warranty. **Outside the UCC:** the cases are unclear.	**Article 2B** imposes a warranty of quiet enjoyment (2B-401)	+
Implied Warranty: merchantability of product	**Article 2:** an implied warranty given to buyer by merchant seller of a product. **Art. 2A** same warranty. **Outside the UCC:** does not exist.	**Article 2B: same warranty** for mass market (which includes consumers**)**. (2B-403)	**NC**
>> Merchantability: includes "pass without objection in the trade"	**Article 2** requires goods to "pass without objection in the trade"	**Article 2B: same rule.** (2B-403)	**NC**
>> Merchantability: measure by effect on an "ordinary system"	**Article 2** does not deal with this directly, **focuses** on relationship between product and ordinary <u>descriptions</u> of the product.	**Article 2B: same rule.** (2B-403)	**NC**
Implied Warranty: accuracy of informational content	**Article 2:** no provision.	**Article 2B creates** a warranty except for published informational content (2B-404)	+
Implied Warranty: product will be fit for purchaser's particular purpose	**Article 2** implies a warranty if seller had reason to know purpose and that buyer was relying on seller's expertise. The warranty is only for sales of "goods". **Outside the UCC:** no warranty.	**Article 2B: same warranty** if transaction is to deliver a product. **Creates** a standard to distinguish this from services contracts. (2B-405)	**NC**
Implied Warranty: services will give result fit for transferee purpose	**Article 2** contains no provision. **Outside the UCC:** no warranty.	**Article 2B creates** a warranty that the services will not fail of the purpose because of a lack of effort. (2B-405)	+
Implied Warranty: system components will work in integration	**Article 2** contains no provision; may be implicit in the fitness warranty**.** **Outside the UCC**: no warranty, general services contract rules**.**	**Article 2B creates** a warranty that components will perform as a system in addition to being independently functional. (2B-405)	+
Express warranty: standard applicable to its creation	**Article 2** includes in the warranty any affirmations or promises that become part of **basis of bargain**; except puffery. **Outside the UCC** cases do not use basis of the bargain test.	**Article 2B: same rule,** but **adds** advertising as a possible source of warranty. (2B-402)	**NC**
Express Warranty: is proof of actual reliance required?	**Article 2:** basis of bargain test intended to exclude requiring <u>specific</u> reliance. Cases vary, but tend to use some variant of reliance.	**Article 2B: same rule.** (2B-402)	**NC**
Express warranties: created by advertising	**Article 2** contains no express provision for this. Case law varies.	**Article 2B codifies** that advertising can create an express warranty if it becomes part of the basis of the bargain. When that occurs is left to the development of case law. (2B-402)	**+DISCLAIMERS**
Title & infringement: is the warranty disclaimable?	**Article 2** allows disclaimer through specific language or circumstances	**Article 2B: same rule.** (2B-401)	**NC**
>> Infringement disclaimer language	**Article 2** contains no provision on this.	**Article 2B** suggests language to notify party and give a safe harbor for vendor.	+
Express warranties: is the warranty disclaimable?	**Article 2:** in most cases cannot be disclaimed; disclaimer and warranty must be read as consistent or, if that is not possible, disclaimer not effective	**Article 2B: same rule.** (2B-406)	**NC**
Merchantability warranty: can disclaim the warranty?	**Article 2** allows disclaimer.	**Article 2B: same rule.** (2B-406)	**NC**
>> merchantability: is there a general standard for disclaimer:	**Article 2** contains no provision for this. It provides merely that disclaimer must mention merchantability.	**Article 2B: same rule**, but provides more informative disclaimer language. (2B-406)	**NC**
> >merchantability – how disclaim, is record and conspicuousness required?	**Article 2** allows disclaimer without a writing and disclaimer that mentions merchantability; if a writing is required, disclaimer must be conspicuous.	**Article 2B** requires a "writing" and a plain language disclaimer or mention the word merchantability; requires conspicuous disclaimer (2B-406)	+
>> merchantability: can it be disclaimed by "as is"?	**Article 2** allows disclaimer subject to some limitations.	**Article 2B: same rule.**	**NC**
>> merchantability: is a disclaimer adequate under the statute still potentially unconscionable?	**Article 2** contains no provision for this. Case law varies.	**Article 2B: same rule.** (2B-406)	**NC**
Fitness warranty: can the	**Article 2** allows disclaimer.	**Article 2B: same rule.** (2B-406)	**NC**

warranty be disclaimed? >>fitness: how disclaim?	**Article 2** allows disclaimer by a mere statement that "no warranties beyond this"	**Article 2B** allows disclaimer, but creates a plain language model. (2B-406)	+
General Disclaimer: effect of "as is" language	**Article 2** allows this language for all warranties but the warranty of good title, under some limitations focused on the circumstances of the disclaimer.	**Article 2B: same rule.** (2B-406)	**NCTHIRD PARTY LIABILITY**
Third party claims: general rule	**Article 2** contains three options, two focus on breach of warranty personal injury. **Outside the UCC:** cases generally reject third party claims against information products. Restatement recognizes that information is not a product for that law; negligent misrepresentation may be raised by third parties if they are part of an intended group.	**Article 2B** does not deal with tort rules and takes a neutral position on products liability. It defines a concept of third party beneficiary consistent with contract law and current Restatement themes involving information liability.	**?**
Third party liability majority version: does warranty extend to the consumer's household	**Article 2** majority adopted version covers household for personal injury; one other version allows for all damages. 2-318	**Article 2B: same rule as majority** version for personal injury, but expands to economic loss. (2B-409)	+
Warranty of title and non-infringement: does it extend to third parties?	**Article 2** generally does not extend warranties to third parties except for personal injury claims.	**Article 2B:** does not extend the warranty to third parties.	**?**
Third Party claims: damages covered	**Article 2:** Two of three options, including majority version, personal injury only; may disclaim warranty in the original transaction. In some states, no privity bar for sale of goods and upstream disclaimer may or may not be enforceable later.	**Article 2B** extends to third party, generally intended beneficiaries and allows claims for both personal injury and economic loss; party may disclaim warranty. (2B-409)	**?** **ACCEPTANCE AND REJECTION**
Acceptance of tender	**Article 2:** acceptance of goods can only occur after opportunity to inspect. **Outside the UCC** inspection right not separately developed; applies materiality and conditions theories	**Article 2B same rule** for delivery of copies; for services and informational content, reverts to general standards where inspection would give all value to recipient (2B-602, 609)	**NC**
Acceptance: time to accept or reject	**Article 2** specifies no specific time period and generally contemplates brief inspection even for complex goods unless agreement otherwise indicates	**Article 2B: same rule.** (2B-612)	**NC**
Right to reject extended to defined or extended period after delivery (e.g., 7 days)	**Article 2** does not allow rejection after extended period even for complex goods; remedy is revocation of acceptance if defect substantially impairs the goods	**Article 2B: same rule.**	**NC**
Transferee's right to reject: single delivery contract	**Article 2** allows buyer to reject any tender of delivery "perfect tender"	**Article 2B: same rule** for the mass market. (2B-610)	**NC**
Transferee's right to reject: installment contracts	**Article 2** requires that defect cause substantial impairment	**Article 2B** requires material breach (2B-601)	**NC**
Transferee's right to revoke acceptance.	**Article 2** requires substantial impairment of value caused by the defect.	**Article 2B** requires material breach (2B-613)	**NC**
Transferor's right to cure rejected tender	**Article 2** allows cure within original time for performance or seller reasonably expected tender would be acceptable.	**Article 2B** allows cure only if the licensee did not refuse or cancel before cure occurs.	+
Transferor's right to reject transferee's performance	**Article 2** does not deal with this issue. **Outside UCC:** law varies and allows contract to control; material breach concept is preferred norm.	**Article 2B** requires material breach.	**NC** DAMAGES AND REMEDIES
Damages: transferor may recover lost profits	**Article 2** allows this in reference to a "lost volume" vendor	**Article 2B: same rule.**	**NC**
Damages: transferor has a duty to mitigate	**Article 2** does not specifically require, but common law does.	**Article 2B** requires that the injured party act to mitigate damages.	**NC**
Damages: Consequential damages recovery	**Article 2** allows consequential damages unless contract indicates otherwise	**Article 2B: same rule** (2B-707, 709)	**NC**
Consequential damages include personal injury	**Article 2** allows this if proximate causation exists	**Article 2B: same rule** (2B-102)	**NC**

Contractual limitation on economic loss recovery	**Article 2** allows this if the limitation is not unconscionable	**Article 2B: same rule.** (2B-704)	**NC**
Contractual limitation on personal injury loss recovery	**Article 2** limitation is prima facie unconscionable in consumer cases. **Outside the UCC:** No presumption in information contracts.	**Article 2B** contains no presumption regarding this exclusion. (2B-704)	**-**
Contractual Modification of Remedies	**Article 2** allows this limitation.	**Article 2B: same rule** (2B-704)	**NC**
Contract Modification: limiting damages to replace or repair or refund	**Article 2** allows this limitation.	**Article 2B: same rule** (2B-704)	**NC**
Modification: Effect failure of limited remedy on limit of consequential damages	**Article 2** is unclear. Case law splits on whether terms are independent or dependent.	**Article 2B** provides that the two contract terms are independent unless the contract provides otherwise	**?**
Contract Modification: party must have minimum adequate remedy	**Article 2** black letter does not require this. (comments suggest this is unconscionable)	**Article 2B** black letter does not require this.	**NC**
Statute of limitations: basic term	**Article 2** provides for four years from date of breach in most cases; cannot be reduced below one year or extended.	**Article 2B:** four years from breach, extended to five by discovery rule; cannot be reduced to less than one year, can extend (2B-705)	+
> Limitations: when warranty extends to future, from what date does limitation period run?	**Article 2** cause of action accrues when breach was or should have been discovered.	**Article 2B:** accrues when conduct that is a breach occurs or should have occurred, but no later than date warranty expires (2B-705)	**-**
Self Help Repossession	**Article 2** has no specific self-help, but if seller reserves title to goods, Article 9 applies. **Article 9** allows for any default; limits self-help cannot breach the peace. **Article 2A** has same rules.	**Article 2B** allows only if there is a license. It requires statutory material default and places other restrictions significantly greater than in Art. 9 or Art. 2A. (2B-716)	**NC Or** +
Self Help: Electronic remedies	**Article 2** contains no provisions. **Article 9 and Article 2A** allow disabling in place. **Outside the UCC:** limited case law allows if prior notice or agreement in contract, but not otherwise.	**Article 2B** allows, but requires assent to contract term permitting this and places restrictions on when and how it can be implemented that exceed restrictions under Article 9 or 2A.	**?**

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PART 1
GENERAL PROVISIONS

PART 1

GENERAL PROVISIONS

SECTION 2B-101.

SHORT TITLE. This article may be cited as Uniform Commercial Code - Licenses.

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

SECTION 2B-102.

DEFINITIONS.

(a) Unless the contract otherwise requires:

(1) "Access contract" means a contract for electronic access to a separate resource containing information or ~~, a resource~~ for processing information, ~~a data system,~~ or other similar facility of a licensor, licensee, or third party. The term does not include access to a physical facility such as a movie theater or the like.

(2) "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 exercise the right or privilege.

(3) "[Authenticate] [Sign]" means to sign, or to execute or adopt a symbol or sound, or encrypt a record in whole or in part, with intent to

(i) identify the party;

(ii) adopt or accept a record or term; or

(iii) establish the authenticity of a record or term that contains the authentication or to which a record containing the authentication refers.

(4) "Cancellation" means an act by either party which ends a contract because of a breach by the other party. "Cancel" has the corresponding meaning.

(5) "Computer program" means a set of

statements or instructions to be used directly or indirectly to operate an information processing system in order to bring about a certain result. The term does not include any informational content created or communicated as a result of the operation of the system.

(6) "Consequential damages" include compensation for any loss ~~of a party~~ resulting from a party's ~~its~~ general or particular requirements and needs of which the other party at the time of contracting ~~the other party~~ had reason to know and which could not reasonably be prevented by the aggrieved party by mitigation or otherwise. ~~and which would probably result from a breach of the contract. The term does not include compensation for losses which are unreasonably disproportionate to the risk~~

~~assumed under the contract by the party in breach or which could not have been prevented by the aggrieved party by reasonable measures~~. The term includes compensation for losses resulting from injury to person or property proximately resulting from any breach of warranty. The term does not include compensation for losses which are unreasonably disproportionate to the risk assumed under the contract by the party in breach. The term does not include direct or incidental damages.

(7) “Conspicuous”, with reference to a term or clause, means so written, displayed or presented that a reasonable person against whom it is to operate ought to have noticed it or, in the case of an electronic message intended to evoke a response by an electronic agent without the need for review by an individual, in a form that

would enable a reasonably configured electronic agent to take it into account or react to it without review of the message by an individual. A term or clause is conspicuous if it is:

(A) a heading in ~~all~~ capitals (as: NON-NEGOTIABLE BILL OF LADING) equal or greater in size to the surrounding text;

(B) language in the body of a record or display in larger or other contrasting type or color than other language, but in a telegram or other similar communication any stated term is conspicuous;–

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

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

(E) language readily distinguishable in another manner.

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

management of the individual's personal or family investments.

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

(10) "Contractual use restrictions" include obligations of nondisclosure and confidentiality and limitations on scope, manner, method, or location of use to the extent that those obligations or duties are created by the contract.

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

(12) “Court” includes an arbitrator or other dispute-resolution officer.

(13) “Delivery” means the transfer of physical possession~~,~~ or the communication, of a copy to a recipient, to a facility, or to ~~an information processing or storage system used, designated, or otherwise held out by the recipient or its intermediary for receipt, or to~~ a bailee if the recipient has a right of access to the copy in the bailee’s possession. If an electronic copy is to be delivered, delivery occurs when the copy enters or comes into existence in an information processing or storage system or a part thereof in a form capable of being processed by or perceived from a system of that

type, and the recipient uses, has designated or otherwise holds out that system or the part thereof as a place for the receipt of such communications.

(14) "Direct [general] damages" compensation for losses of a party consisting of the difference between the value of the required performance as measured by the contract and the value of the performance actually received~~[~~, or in an appropriate case, ~~and any~~ compensation for losses in the nature of reliance or restitution~~]~~. The term does not include consequential damages and incidental damages.

(15) "Electronic" includes electrical, digital, magnetic, optical, electromagnetic, or any other form of technology that entails capabilities similar to these technologies.

(16) “Electronic agent” means a computer program or other electronic or automated means used, selected, or programmed by a party to initiate or respond to electronic messages or performances in whole or in part without review by an individual.

(17) “Electronic message” means a record that, for purposes of communication to another person, is stored, generated, or transmitted by electronic means. The term includes electronic data interchange, electronic or voice mail, facsimile, telex, telecopying, scanning, and similar communications.

(18) “Electronic transaction” means a transaction formed by electronic messages in which the messages of one or both

parties will not be reviewed by an individual as an ordinary step in forming the contract.

(19) "Financier" means a person that under ~~to~~ a security agreement or lease provides a financial accommodation to a licensor or licensee and obtains an interest in the license rights ~~under a license~~ of the party to which the financial accommodation is provided.

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

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

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

(ii) stopping delivery, shipment, or transmission;

(iii) effecting cover, ~~or~~ return or re-transfer of copies or information; or

(iv) ~~reasonable efforts to minimize or avoid the consequences of breach; and~~

~~(v) actions~~ otherwise ~~incidental~~ resulting from or incident to ~~to~~ the breach.

(B) The term does not include compensation for consequential or [direct] [general] damages.

(22) "Information" means data, text, images, sounds, and works of authorship, including computer programs, databases, literary, musical or audiovisual works, motion pictures, mask works, or the like, and any intellectual property or other rights in such information.

(23) "Informational content" means information which is intended to be communicated to or perceived by a person in the ordinary use of the information.

(24) "[Intellectual] [Informational] property rights"

includes all rights in information created under laws governing patents, copyrights, trade secrets, trademarks, publicity rights, or any similar law that permits a party independently of contract to control or preclude another party's use or disclosure of information because of the rights owner's interest in the information.

(25) "License" means a contract that authorizes, prohibits, or controls access to or use of information and expressly ~~by its terms~~ limits the scope of the rights or permissions granted, is described by the parties as a license of information, or affirmatively grants less than all rights in the information, whether or not the contract transfers title to a copy of the information and whether or not the rights granted are made

exclusive to the licensee. The term includes an access contract and a consignment of copies of information. The term does not include: ~~a contract that assigns~~ (i) an unconditional transfer of ownership of intellectual property rights, (ii) reservation or creation of ~~reserves or creates~~ a financier's interest, ~~or that makes~~ (iii) a transfer by will or operation of law, or (iv) restrictions on identifying or access-enabling information that is merely incidental to another contract or relationship.

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

(27) "Licensor" means a transferor in a contract under this article, whether or not the

contract constitutes a license. The term includes a provider of services. In an access contract, as between a provider of services and a customer, the provider of services is the licensor, and as between the provider of services and a provider of content for the service, the content provider is the licensor. If performance consists in whole or in part of an exchange information, each party is a licensor with respect to the information it provides.

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

(29) "Mass-market transaction" means a transaction in a retail market involving information directed to the general public as a whole under substantially the same terms for the same information,

and involving an end-user licensee that acquired the information under terms and in a quantity consistent with an ordinary transaction in the general retail distribution. The term does not include:

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

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

(C) a license of the right publicly to perform or display a copyrighted work; or

(D) a site license, or an access contract not involving a consumer.

(30) “Merchant” means a person that deals in information of the kind involved in the transaction, a person that by occupation purports to have knowledge or skill peculiar to the practices or information involved in the transaction, or a person to which knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that by its occupation holds itself out as having the knowledge or skill.

(31) “Nonexclusive license” means a license in which the licensor or other person authorized to make a transfer or license is not prohibited from licensing the same rights in information ~~within the same scope~~ to other licensees or from having

previously done so in a license that remains in force at the time of the contract. The term includes a consignment of copies.

(32) “Present value” means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties in their agreement if that rate is not manifestly unreasonable at the time the transaction was entered into. Otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(33) “Published informational content” means informational content that is prepared for, distributed, or made available to all recipients

or a class of recipients in substantially the same form and not provided as customized advice tailored for the particular licensee by an individual or group of individuals acting on behalf of the licensor using judgment and expertise. The term does not include informational content provided within a special relationship of reliance between the provider and the recipient.

(34) "Receive" as to a copy of information means to take delivery of a copy. A person "receives" a notice or notification or a copy when (i) it is duly delivered at the individual's residence or the person's place of business through which the contract was made, or at any other place held out by the person as a place for receipt of such communications, or (ii) in the case of an electronic notice, notification or copy, it enters or

comes into existence in an information processing or storage system or a part thereof in a form capable of being processed by or perceived from a system of that type, and the recipient uses, has designated or otherwise holds out that system or the part thereof as a place for the receipt of such communications. In addition, a person receives a notice or notification when it comes to his attention. "Receipt" has a corresponding meaning. -**[note: see 1-201(21) regarding when notice is "effective"]**

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

(36) "Release" means an agreement not to object to, or exercise legal or equitable remedies against, the use of information if no

affirmative acts are required by the party granting the release ~~is not required to act affirmatively to~~ to enable ~~or~~ or support the other party's use of the information by providing copies of the information or access or otherwise. The term includes a waiver of intellectual property rights and a covenant not to sue.

(37) "Sale" means the passing of title to a copy of information for consideration.

(38) "Scope", with respect to a license, means the terms of the license that define the licensed copies or subject matter and intellectual property rights involved ~~or copies~~; the uses and number of users authorized, prohibited, or controlled; the geographic area, market, or location in which the license applies; and the duration of the license.

(39) "Send"

means to deposit in the mail or other commercially reasonable carrier or to deliver for or otherwise take steps that initiate transmission to or creation within another system or location by any usual means of communication with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed. A party sends an electronic copy, message or notice when it initiates operations that in the ordinary course will cause the copy, message or notice to enter or come into existence in an information processing or storage system or a part thereof in a form capable of being processed by or perceived from a system of that type, and the recipient uses, has designated or otherwise holds out that system or the part thereof as a place for the receipt of such communications. Actual receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(40) "Software" means a computer program, including any informational content included or to be included as part of a program and any supporting material provided by a licensor as part of the transaction.

(41) "Software contract" means a contract that constitutes a sale of a copy of software, that licenses software or that conveys ownership of software, including a contract to develop software as a work for hire, whether or not the contract transfers ownership of a copy of the software.

(42) "Standard form" means a record, or a group of linked records presented as a whole, prepared by one party for general and

repeated use and consisting of multiple contractual terms used in a transaction without negotiation of or changes in most of the terms. Negotiation or customization of price, quantity, method of payment, standard performance options, or time or method of delivery does not preclude a record from being a standard form.

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

(44) "Termination" means ending 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. "Terminate" has a corresponding meaning.

(b) In addition, Article 1

contains general definitions and principles of construction that apply throughout this article and sections of this article contain definitions applicable to the particular section.

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 to particular types of damages from 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)

9. Voted as a sense of the house that the term should be the same in all three articles and that the definition should retain safe harbor language. (Annual Meeting 1997)

10. Sense of the house that conspicuousness should be a matter of law for decision by court. (Annual Meeting 1997)

Selected Issues:

a. Based on comments at the annual meeting, should the Committee revisit the decision to not list illustrative types of consequential damages in the black letter as a guide to courts and drafting contracts?

b. Several observers have questioned the desirability of the "unreasonably disproportionate" test in the definition of consequential damages, should the Committee revisit this question and return to existing law by deleting this reference?

c. Should the Committee reinstate the term "sign" instead of the term "authenticate"?

d. Should the Committee adopt a dollar limitation for mass market transactions?

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

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

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

2. Authenticate. This article replaces the traditional idea of "signature" or "signed " with a term that incorporates modern electronic systems, including **all** forms of encryption or digital symbol systems. Basically, the fact of authentication can be proved in any manner including proof of a process that necessarily resulted in authentication. Use of an "attribution procedure" agreed to by the parties per se establishes that a symbol or act constitutes an authentication. Authentication differs from manifesting assent. Authentication (signing) always constitutes manifesting assent, but the reverse is not true. For example, tearing open a package or clicking on an icon indicating assent may manifest assent, but does not constitute a signature.

3. Computer program. This definition parallels the federal Copyright Act with additional language reflecting the distinction drawn in this Article for "informational content.".

4. Consequential damages. Based on ALI discussion, this definition was redrafted to correspond to existing Article 2 language, removing mere language changes, but retaining changes that reflect substantive decisions, including that consequential loss is recoverable by either party. The second major substantive decision was to adopt an explicit disproportionality test. A motion to delete that concept in revisions of Article 2 was rejected on the floor of the Conference.

It follows current law with respect to personal injury and property damage; <u>as under current law</u>, property damage and personal injury damages are treated under a standard of proximate causation, rather than simple foreseeability.

The basic test for whether a loss is direct or consequential damage lies in the degree to which the loss is directly associated with a reduction in the value received through contract performance as contrasted to what was anticipated as measured by the values assigned to events under the contract itself. Thus, consequential damages include damages in the form of lost profit or opportunity, damages to reputation, lost value in confidential information because of wrongful disclosure or misuse, damages for loss of privacy interests associated with the contract, loss of data as a result of the operational defect, and like damages. Comments will discuss the various types of loss and how they might be characterized as an aid for the negotiation process. The theme here is that consequential losses go outside the principle that the performance itself was less in quality than was agreed to by the parties.

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

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

The idea of being conspicuous in a message to an electronic agent the reference is to whether the agent has the 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 be otherwise separated out. Computers do not respond differently to capital letters or lower case. The electronic message suffices if it is designed to invoke such a response from a "reasonably configured" electronic agent, a concept that will be spelled out in the commentary to indicate that it intends an analogous construct that parallels the reasonable man standard used for the general concept of conspicuous.

A sense of the house motion in July 1997 affirmed the decision in this draft to retain safe harbor concepts present in current law. The theme of conspicuousness blends both a notice function and a planning function giving certainty to the party preparing and using the term. It is equally important to ensure that the recipient of a record receives notice of the contents and that the party who reasonably desires to rely on the terms of the record can do so. Taking out all safe harbor language eliminates the second objective and jeopardizes the first.

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

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

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

This issue has been considered in many areas of law that have evolved since the original definition of Article 9. The issues have proven to be difficult and subject to litigation under the Article 9 concept in lending, bankruptcy and other contexts. For example, a number of reported decisions focus on whether or when a purchase of stocks or limited partnership assets for investment purposes would be considered a consumer purchase since it might fall within the general reference to "personal" purposes. See, e.g., Thomas

v. Sundance Properties, 726 F.2d 1417 (9^{th} Cir. 1984); In re Manning, 126 B.R. 984 (M. D. Tenn. 1991) (UCC definition "not especially helpful on its face"). Some courts emphasize the difference between acquisition for "consumption (consumer)" and acquisition or use "for profit-making". This approach comes in part from the Truth in Lending Act which uses a definition of consumer debt much like the definition in Article 9 of consumer but additionally contains an express exemption for business transactions. The "profit-making" test has been applied in bankruptcy cases interpreting a Bankruptcy Code provision identical to the standard UCC definition. For example, the Fifth Circuit commented that "[The] test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family or household purposes is whether it was incurred with an eye toward profit." In re Booth, 858 F.2d 1051 (5^{th} Cir. 1988). See also In re Circle Five, Inc., 75 B.R. 686 (Bankr. D. Idaho 1987) ("The farm operation is a business for the production of income. Debt used to produce income is not consumer debt "primarily for a personal, family or household purposes.").

7. Copy: This definition corresponds to copyright law. In the Copyright Act, a copy does not require permanence, but cannot be purely transitory, such as an image on a screen.

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

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

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

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 UNCITRAL Model Law and to expressly include fax, telex and similar electronic transactions. The expansion serves an important purpose in reference to issues about when a contract is formed. 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. That formulation was supported by a vote of the Conference at the 1996 Annual Meeting.

13a. Incidental damages. Based on the goal of harmonizing to existing Article 2 in the absence of an intended change in substance, this definition was edited to carry forward the language of the two existing Article 2 definitions of incidental damages.

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. The comments will make clear that interactive informational content product falls within the concept since the basic set of all information is generally available and the end user selects, perhaps interactively from this.

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 definition emphasizes the conditional or limited nature of the contract rights. The distinction between an unrestricted sale of a copy and a license revolves around the express terms of the contract, 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, is subject to implicit restrictions on use of the information derived from intellectual property law. In a license, whether or not ownership of the copy is transferred, the transferee is subject to express contract restrictions or receives a contract grant that expressly gives less than all rights in the information.

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

- title to the goods.

This Draft adds language to the end of the definition that is intended to exclude inadvertant coverage under this Article of the myriad situations where information is provided incidental to another relationship under conditional terms. Thus, an access code or PIN number used to accomplish transactional purposes outside this Article does not, simply because its use is conditioned, come within the Article.

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

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

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

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

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

The dollar limit should be selected based on empirical evidence relating to the pricing structure of modern software transactions. Few items of consumer software exceed $200. The price curve is downward, rather than increasing. A $500 limit would exceed the average cost of retail <u>business</u> software. The Committee has not voted on the dollar amount.

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

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

This Draft proposes a bifurcated treatment of on-line (Internet) transactions. Most consumer transactions on Internet fall within the definition and a vast number of consumer transactions occur on Internet. It is especially important however, with this new transactional environment, to not regulate business transactions.. The approach excludes from the definition of mass market any online transaction not involving a consumer. This gives the online industry room for expansion and growth not subject to unintentional regulations, while preserving consumer protections in that environment. **It is consistent with the position on non-regulation advanced in the White House paper of electronic commerce.**

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

20a. Record: The comments will indicate that there is no requirement of permanent storage or that there be anything beyond temporary recordation. The analogy is to case law under the copyright act and the idea of an electronic copy. Also, the comments will make clear that perception can be either directly or indirectly with the aid of a machine.

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

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

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

[A. General Scope and Terms]

SECTION 2B-103.

SCOPE.

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

(b) Except to the extent that this article deals with financial accommodation contracts and except as otherwise provided in subsections (c) and (d), if another article of [the Uniform Commercial Code] applies to a transaction, this article does not apply to ~~the part of the transaction involving~~ the subject matter or related rights and remedies governed by the other article ~~except to the extent that this article deals with financial accommodation contracts~~.

(c) If a transaction involves both information and goods, this article applies to the information and to the physical medium containing the information, its packaging, and its documentation, but Article 2 or 2A governs standards of performance of goods other than the physical medium containing the information, 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) or (2), this article applies to the information, physical medium containing the information, and its packaging and documentation. A transaction excluded from this article by subsection (d)(4~~3~~) is governed by Article 2 or 2A.

(d) This article does not apply to:

(1) a contract of employment of an individual other than ~~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;

(2) a license of a trademark, trade name, trade

dress, patent, or know-how related to a patent, unless the license is or is associated with a software contract, a motion picture license, an access contract, or database contract;

[(3) a contract for access to, or use, transfer, clearance, or processing of money, a deposit account, a certificate of deposit, or information signifying or conveying a right to funds or other money substitutes, and any information as used by the parties to document the foregoing~~information that represents money or deposit accounts~~;] or

(4) a sale or lease of a copy of a computer program that was not developed specifically for a particular transaction and which is embedded in goods other than a copy of the program or an information processing machine, unless the program

was 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.

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

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

Reporter's Notes:

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

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

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

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

4. Subsection (b) and (c) discuss issues pertaining to the interface between Article 2B and other UCC Articles. For transactions governed within the trio of UCC transactional articles (2, 2A and 2B), the primary rule applies each to its particular subject matter. *This is the "gravaman of the action" test*. It rejects the "predominant purpose" test used under current law for allocating coverage between transactions governed by Article 2 or law outside the UCC. The primary exception involves embedded software as discussed in (d)(4). Based on a suggestion from the floor of the 1996 Annual Meeting, comments will make it clear that manuals delivered in connection with software are covered under Article 2B.

For other articles of the UCC, subsection (b) contains the applicable rule. It excludes coverage of the subject matter generally, including any treatment of rights or remedies associated with the subject matter. **By subject matter, the Draft means the general topic of the article, and not just the specific provisions.** Thus, Article 2B does not apply to an Article 4A **funds transfer**. Likewise Article 2B does not deal with the subject matter of Article 8.

5. Subsection (d) exclusions. Because Article 2B brings into the UCC a variety of transactions that were previously covered under common law, the broad scope of inclusion has be tempered by the development of specific exclusions. These are brought together in subsection (d). While some exclusions have been suggested based on industry-specific activities, the exclusion in general refer to particular types of contractual activities in a more generic form.

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

The motion picture and publishing industries have suggested that the Committee consider exclusion of author and other upstream contracts generally , but at this point have not pressed that issue, preferring to work toward a draft that accommodates the characteristics of those contracts. Indeed, while sometimes involving different practices, the issues in upstream contracts across the various areas of commerce discussed in Article 2B are very similar. Upstream software contracts are clearly included. Illustrations of the provisions resulting from discussion of this topic include the treatment of "to the satisfaction" clauses in 2B-305 and submissions of information in 2B-602.

b. Subsection (d)(2) excludes patent and trademark licenses not associated with the other subject matter of the Article. The rationale lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that are not contemplated by this draft. This is also true for trademark licensing. A similar analysis may also be true, to an extent that needs further discussion and clarification either in text or comments, for merchandising transactions and commercial tie-ins, such as those involving the use of images, film indicia, or graphics on a toy, apparel, or other tangible goods. Whether these licenses should be specifically excluded from the scope of this Article requires further analysis in like of concerns expressed by the affected industry and the fact that trademark licensing is current excluded.. As to trademark licensing, there is the additional consideration of coverage of aspects of that industry under federal and state franchising laws

While the Article excludes patent and trademark licensing, in practice, however, courts are likely to apply

Article 2B by analogy to other fields of licensing. The comments will discuss the role of application by analogy of this Article in context of the history of reasoning by analogy in other contexts. See, e.g., Article 2A comments

c. Subsection (d)(4~~3~~) excludes computer programs such as airplane navigation or operation software, software that operates automobile brake systems, and the like. Issues relating to this type of software are governed by the law governing the transaction in the entire product (e.g., Article 2 or Article 2A).

6. Banks as licensors. Article 2B as drafted does not cover transactions governed under other law (e.g., Article 4A, Article 4). It is preempted to the extent of specific controls under federal or state banking regulation. In implementing this exclusion, the Committee recognized that modern developments in digital cash and similar systems place many companies other than traditional banks in the same situation. Regulations, such as Regulation E on funds transfer, do not apply solely to banks, but to any holder of a depository account and, depending on regulatory decisions, non-bank entities will be included (e.g., a digital account 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).

Equally important, modern banks engage in many commercial activities that are identical to companies whose licensing practice and online systems are clearly within Article 2B, such as Netscape, Westlaw, Home Shopping, Microsoft Network, America On-Line, and others. As the information industries converge, so too is the banking industry converging into fields identical to that of the information industries. Bank ***entry*** into these fields is regulated - a bank must obtain approval under Regulation Y to do so. But this is scope regulation, not content regulation. A review of bank websites, for example, reveals that some deal only with on-line banking, while others do not. The Wells Fargo site, for example, offers a general shopping mall, a link to purchase software and various other information services. Complete exclusion of banks is not warranted.

7. Motion pictures. The motion picture industry has expressed concern about the impact of Article 2B on licensing practices in that industry, especially in its core business of developing, producing, distributing, exhibiting and performing motion pictures, which can be defined as audiovisual works that are primarily intended for viewing in a predetermined, continuous and sequential manner (e.g., those that do not rely on interactivity). The industry has raised this issue, but has devoted substantial resources to working with the Committee and that work has yielded significant improvements in the Draft.

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

(a) Subject to subsection (b), ~~the conflicting law governs~~ in the case of a conflict between this article and a statute or any regulation of this State or any final decision of a court of this State interpreting the statute or regulation, the conflicting statute, regulation or decision controls, if it exists on the effective date of this article and ~~that~~:

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

(2) ~~a law of this~~

~~State~~ regulates~~ing~~ purchase or license of rights in motion pictures by exhibitors; or

(3) ~~any law of this State that~~ establishes a consumer protection ~~different rule for consumers~~.

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

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

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

(3) A requirement that a contractual term be conspicuous or the like is satisfied by a term that is conspicuous in accordance with

this article.

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

(c) A statute authorizing electronic or digital signatures, or authorizing electronic or digital substitutes for requirements of a writing is subordinate to the provisions of this article to the extent of a conflict with this article, but may supplement the provisions of this article.

(d) With respect to this article, failure to comply with a law referred to in subsection (a) has only the effect specified therein.

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)
b. Reviewed without substantive change. (February, 1997)
Selected Issues:
1. Should (c) be retained?.
2. Is the language in (a)

appropriate?

Reporter's Notes:

The language in (c) was added in response to an issue raised in comments to the June Draft revised Article 2. In underscores the intent of this Draft to fit alongside and in conformity with Digital and Electronic Signature statutes that have been enacted in many states. To date, most of these statutes do not deal with the subject matter of this Article.

General 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. While these rights may be the subject of a license within this article, the underlying 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 deals with contract terms and remedies. While privacy and public access laws are especially relevant for the increasing commercial use of information, this article 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). The comments perhaps should also discuss professional regulations in a transaction involving a lawyer or medical professional. Also, based on a suggestion at the Annual Meeting, the comments will discuss the relationship between the reference to acts of "this" state in situations involving choice of law questions.

Subsection (a)(2) 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.

Subsection (a)(3) refers to and preserves consumer protection laws.

During the Annual Meeting, written comments of several Commissioners asked for clarification of the prior draft reference to conflicting "law" and clarification of as to what point in time the conflict is assessed. Existing Article 2 provides that it does not impair or repeal "any statute" relating to consumers, farmers or other special class of buyers. Existing Article 2A, defers to certificate of title statutes and consumer protection statutes or court rulings existing at the effective date of the Article. The prior language was taken from proposed revisions of Article 2, but leaves open **both** timing and source of law. One question, for example, is whether a common law ruling after the effective date of the Act can reverse a specific provision of this Article? The answer is **no** under both existing Article 2 and existing Article 2A. If the answer were yes, in effect, Article 2B would govern consumer transactions **only unless or until a court** decides otherwise.

The issue does not relate to a distinction between prior or subsequent consumer protection statutes or regulations. Both control over Article 2B: the pre-existing statute because of the carve out here and the subsequent statute because it, presumably, contains its own scope and conflict provisions.

The solution here links the deference to other law to statute and regulatory law, in addition to case law that interprets the statute or regulation. The conflict is measured at the time of the effective date of this article. As indicated above, subsequent regulations and statutes on these (or any other topic) have the capability of preempting provisions of Article 2B if the legislature so chooses.

2. Subsection (b) implements a balance between the modernization themes in Article 2B relating to electronic commerce and existing law on consumer contracts. It adopts a limited reconciliation approach that contrasts to non-uniform digital signature statutes enacted in Utah, Washington, Texas, Minnesota, and a number of other states. Many of these other statutes replace or amend all signature and writing requirements with a rule that allows a digital record or other electronic indicia of a signature to satisfy writing, signature, certification and other formalities. Digital signature laws define 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. *One proposal is to provide, in lieu of the current text, a statement that:* "A requirement that a contractual obligation, waiver, notice, or disclaimer be in a writing, signed, agreed to, or conspicuous, is satisfied respectively by compliance with concepts of record, authentication, conspicuousness, and manifestation of assent under this article, unless to do so would fundamentally impair the purpose of the rule in general."

The problem addressed in this section is the fact that literally thousands of potentially relevant statutes may affect electronic commerce transactions. For transactions governed by Article 2B, the provisions of this Article would ordinarily replace the other law. That is not true for consumer transactions. Yet, the policies that led to a required "writing" most often did not consider the digital alternative. The balance must preserve important policies (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 some aspects of UCC electronic commerce rules where it is appropriate to reverse that presumption. In final form, the structure of Article 2B must reflect some state's constitutional and other laws that preclude general revision without specific authorization, of laws beyond the particular enactment. This will be through a legislative note.

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

A legislative note should accompany the final draft highlighting that each state should examine existing law to determine if the changes in (b) should not apply to particular existing rules.

In response to concerns expressed by consumer groups, subsection (b)(4) was altered and does not cover cases where state law requires negotiation of a term. Negotiation requirements entail a mandate that a party actually dicker over a term with there being an actual and direct exchange and alteration of positions, the concept of manifesting assent does not meet this.

SECTION 2B-105.

RELATION TO FEDERAL LAW. A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption.

Votes and Action:

a. At the 1997 ALI Annual Meeting, the general membership after a brief debate and by a narrow vote of 86-82, approved a motion that Section 2B-308 (mass market licenses) be amended to provide that a term inconsistent with federal copyright law does not become part of a contract under Section 2B-308.

b. At the 1997 NCCUSL Annual Meeting, the Conference adopted by a substantial majority a motion that Article 2B should not deal in its text with questions of federal preemption but should be neutral and that position should be stated in the comments.

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

Reporter's Note:

1. This section states an underlying premise of the Article 2B

project. Article 2B deals with general contract law, not with the issues addressed in federal property law and regulation. The relationship between federal law and state contract law pertaining to transactions in information is complex. Ultimately, however, if federal law invalidates a particular contract rule or its application in a given transaction, that federal law obviously controls over any contrary state law. Similarly, if federal law precludes a particular contract provision (or its enforcement) in a particular setting, that federal premise controls. The reason for stating the obvious preemption principle here is to give clear guidance and an identifiable caution to persons involved in commerce in information to recall the role of federal law. The comments to this section will make clear that Article 2B does not alter federal law or shift the balance in property rights an regulations that it mandates. The comments will discuss cases where the interaction of contract and federal policy occurs.

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

3. Beyond property law, many situations involving disclosure, access, and transfer of information are subject to federal regulations, such as in Regulation E, the Electronic Communications Privacy Act, the Communications Act of 1996, the

Freedom of Information Act, the Food and Drug Administration Act, and various other regulations or statutes. An enumeration of these sources of regulation would be futile and the list would change over time.

4. The basic principle is that federal law controls if it preempts. When or whether that occurs is not a question of state law. State law, including the UCC, cannot alter that balance and does not intend to do so. Thus, a federal law determination that a specific form of disclosure creates an enforceable term cannot be altered by state law. Similarly, a limit on liability mandated by federal law cannot be abridged by state contract law. A requirement in federal law that there be a signed writing to effectively transfer a copyright cannot be altered by abolishing a state statute of frauds. A rule that precludes transfer of a licensee's rights under a non-exclusive license without the licensor's consent as a matter of federal law precludes a contrary state law rule. The approach of Article 2B has been to correspond state contract law to clear rules of federal law where appropriate and to take no position regarding controversial or context-determined rules whose application cannot be predicted and must of necessity await determinations by individual courts in particular cases or by congress as a general federal policy question.

5. The basic theme of preemption is supplemented in licensing law by the fact that federal competition, antitrust, and intellectual property rules also provide a basis for courts to monitor some practices in licensing involving the use of particular terms in particular setting that may be viewed as abusive. They involve determinations about federal law and policy that go beyond state law. Article 2B takes no position on the complex competition, social policy and other issues present here. Indeed, state contract law cannot control or alter those rulings or the policy determinations that they suggest even were it inclined to undertake that effort. Article 2B sets out contract principles governing the contractual relationship in information transactions. It governs the contractual relationship; federal law and policy determines whether a particular contract in a particular setting is barred by federal law.

In determining whether or when such policies apply, courts accept that contract law generally prevails, but ask whether a particular contract clause in a particular setting conflicts with federal policies when balanced against the general role of contracts in the economy and legal system. How far the federal policies reach or will ultimately be extended is uncertain. The approach of Article 2B and, indeed, of contract law generally, on these sensitive policy issues is one of aggressive neutrality. That is, as is the case with contract law today, Article 2B sets out underlying contract law principles and leaves the federal policy determinations to federal courts and federal law determinations.

Not surprisingly, in light of the shifts caused by digital technology, defining the proper scope of rights under federal property law has been controversial; it remains unresolved despite extensive negotiation and political discussion. Some disputed issues deal with reverse engineering copyrighted, but unpatented technology, while others deal with the scope of educational or scientific fair use of digital works. These are questions of federal policy. They must be resolved by courts and Congress, rather than through state legislation. As applied to particular contexts or issues involving contractual relationships, there are two levels of determination involved in such contexts. One involves a questions of whether a contractual provision exists and is enforceable as a matter of contract law. The second involves a decision about whether that contract provision is enforceable in light of federal policy. Article 2B takes no position on this latter question, whether an arguable preclusion of a particular term potentially stems from antitrust law or from intellectual property law or other source of federal preemption. Article 2B merely provides a contract law framework.

To underscore this position, the comments will point to existing case law on several potentially important questions. Thus, for example, modern copyright case law holds that in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use as a matter of copyright law. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). The scope of this fair use concept here is not clear and it is similarly unclear to what extent a contract term can alter the analysis of the fair use policy. However, it is clear that is some contexts contractual bars on reverse engineering are enforceable. In others, they may not be enforceable. See Triad Systems Corp. v. Southeastern Express Co., 64 F3d 1330 (9th Cir. 1995). Article 2B cannot and does not change the federal policy analysis here.

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

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

Even without Article 2B's clarification of contract rules, contracts already control most distribution of information. The contract law regime exists today and is not created by Article 2B. In most cases and with respect to most issues, contracts control as the method by which parties obtain value from information. While, as stated in the Copyright Act, federal property law precludes state law that creates rights equivalent to the property rights created under copyright, both as a practical and as a conceptual matter, copyright (or patent) do not generally preclude or preempt contract law. Indeed, contracts are essential to use one's own property, even when the property is tangible, let alone when it is intangible. A contract defines rights between parties to the agreement, while a property right creates rights against all the world. They are not equivalent.

5. With the transition from print to digital media as a main method of conveying information, major policy disputes have erupted concerning the redistribution of rights in light of the fact that the media of distribution allows many different and potentially valuable (for users or authors) uses of information products. The difficulty of

balancing fundamental rights in this context is demonstrated by the fact that disputes about underlying social policy have erupted and been left unresolved in numerous contexts in the U.S. and internationally. These fundamental questions are beyond the scope of this Article. State law that conflicts with the resolution of those questions in federal law may be preempted if that is the policy choice made in federal law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

SECTION 2B-106.

APPLICATION TO OTHER TRANSACTIONS. Except in a mass market transaction, in an agreement represented by a record:

(1) parties to a transaction ~~not governed by this article~~ may elect ~~in their contract~~ to have all or part of this article apply to the transaction; and

(2) if part of a transaction is governed by this article and part is governed by other law, the parties may provide that the transaction is to be governed entirely by this article or by the other law.

~~(b) An agreement~~

~~described in subsection (a) is effective to the extent that it deals with issues that the parties could resolve by agreement.~~

Committee Vote:

a. Voted 7-4 to replace consumer contract with mass market contract.

Selected Issue:

a. In an on-line contract, should there be an opt-in right even if the mass market based on suggestions by a White House study group that there be an opportunity to elect into a uniform law tailored to electronic environments?

b. Alternatively, should the section be deleted and the issue left to general choice of law concepts?

Reporter's Notes:

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

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

SECTION 2B-107.

EFFECT OF AGREEMENT.

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

(b) Except as expressly provided in this article or in Article 1, the effect of any provision of this article may be varied by agreement of the parties. To the extent stated in the following sections, the agreement may not vary:

(1) the right to relief from an unconscionable

contract or clause;

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

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

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

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

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

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

(8) the remedies stated ~~limits on inclusion of refusal terms~~ in Section 2B-208(b~~a~~);

(9) the limits on choice of forum in consumer contracts in 2B-109~~7~~; or

[other provisions

to be added]

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

(d) Unless this article requires a term to be conspicuous, negotiated, or that there be manifest assent or express agreement to the term, ~~neither~~ these requirements are not ~~is~~ a prerequisite to enforceability of the term.

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

Uniform Law Source: None.

Reporter's Notes:

1. This section

implements the basic policy that all of the provisions of this Article are subject to contrary agreement with the exception of listed sections or rules that are not subject to contractual modification. It deals with an important issue created by virtue of the drafting approach applied here. As a general rule, sections in Article 2B (and Article 2) are drafted in apparently mandatory terms as rules of law. This is subject to the over-riding principle, described in subsection (b), that all of the terms of the article can be altered by agreement. The difficulty rests in the fact that this general principle is, itself, subject to important limitations. The difficulty thus created is how to provide guidance to persons drafting or planning a transaction who are not aware of all of the nuances of when or whether a particular statutory term can be varied and, indeed, even what one means by varying the statutory terms by agreement. The section reverses decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995) which applied the "plain meaning" of an Article 9 provision and held that the specific terms of Article 9 rule supersede the general terms of UCC ' 1-102 (permitting contractual variation of statutory rules).

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

3. Subsection (d) holds that conspicuousness is a matter of law and applies that principle to related issues under 2B-208.

4. Subsection (f) deals with a major concern that arises from the drafting style used in the UCC revisions. It resolves interpretation questions about the existence of a so-called negative pregnant in many of the rules in this article. Thus, if a section indicates that "If the originator of a message requests acknowledgment, then the following rules apply: ---" that does not indicate what rules apply in the absence of that request; in itself, it does not bar a court from adopting some or all of the same rules in the absence of a request, but merely states the affirmative proposition. Of course, in many cases, the more exclusionary result is intended. This can be inferred from the context or the associated policies.

SECTION 2B-108. LAW IN MULTI-JURISDICTIONAL TRANSACTIONS.

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

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

(1) In an access contract or a contract providing for delivery of a copy by electronic communication, the contract is governed by the law of the jurisdiction in which the licensor is located when the contract becomes enforceable between the parties.

(2) A consumer contract not governed by subsection (b)(1) which requires delivery of a copy on a physical medium to the consumer is governed as to the contractual rights and obligations of the parties by the

law of the jurisdiction in which the copy is located when the licensee receives possession of the copy or, in the event of nondelivery, the jurisdiction in which receipt was to have occurred.

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

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

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

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

Committee Votes:

a. Voted 9-1 to use consumer, rather than mass market.

b. Voted 8-5 to adopt alternative A of subsection (a) validating contract choice of law. (Feb. 1997)

c. Voted 11-0 to adopt significant relationship test as back-up rule. (Feb. 1997)

Reporter's Notes:

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

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

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

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

3. Common law generally enforces contractual choice of law in transactions involving intangibles. See Finch v. Hughes Aircraft Co., 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985) (patent license); Medtronic Inc. v. Janss, 729 F.2d 1395 (11th Cir. 1984); Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products, 229 U.S.P.Q. 335 (D. Md. 1985); Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co., 986 F.2d 607 (1st Cir. 1993). The major exception occurs where the choice contradicts the basic policy of the state that would otherwise have its law apply, but reported cases outside of consumer or other regulated contracts often go relatively far to avoid finding such fundamental policies. Shipley Co., Inc. v. Clark, 728 F. Supp. 818, 826 (D. Mass. 1990). The Restatement (Second) allows choice of law terms to govern in any case (including consumer contract) where the issue could be resolved by contract. In addition, even if contract rules might not otherwise govern, under the Restatement, the contract choice is presumed to be valid, subject to limited exceptions. Restatement (Second) of Conflict of Laws 187 (may be invalid if not resolvable by contract and either there was no "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue."

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

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

> **Illustration 1:** AOL provides on-line services throughout the United States and has its chief offices in Virginia. Under the proposed draft, in a contract with a consumer who resides in Oklahoma, the contract may choose the law of Virginia (licensor location) or

Oklahoma (licensee residence). If it purports to choose Alaska law, that choice of law is enforceable except to the extent that it denies the licensee fundamental protections that would be available to it under Virginia or Oklahoma law outside this Article.

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

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

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

The language in (b)(2) only deals with contract issues. It does not affect tax or other relevant concerns. In Quill Corp. v. North Dakota, 504 U.S. 298 (1992) the Supreme Court held that no adequate nexus for tax purposes was established where the only contact of an entity with a state was advertising and delivery through common carrier. This Article, of course, deals only with contract issues.

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 rule is not uniformly accepted. Many states use principles from the Restatement (First) or theories evolved by academic authors. One text states: ***"[C]hoice-of-law theory today is in considerable disarray - and has been for some time. [It] is marked by eclecticism and even eccentricity. No consensus exists among scholars.... [Like] revolutionaries who can unite only to eliminate the existing government, they cannot agree on the establishment of a new one. The disarray in the courts may be worse. Four or five theories are in vogue among the various states, with many decisions using - openly or covertly - more than one theory."*** William Richman & William Reynolds, Understanding Conflict of Laws 241 (2d ed. 1992). The disarray argues for giving guidance for contracts in cyberspace.

8. 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-109.

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 is unreasonable and unjust as to the consumer. A choice-of-forum term 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)

Selected Issue:

a. Should the choice of forum be validated in Internet transactions?

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 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 (6th 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:

> [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....

The bracketed language relating to access contracts refines a concept that was discussed without objection by the Committee in February, 1997.

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 section has modified to remove the former bracketed language and adopt the language that has become the dominant theme in reported case law. "Unjust and unreasonable" has become the dominant standard to measure enforceability and, indeed, most courts now suggest that choice of forum clauses are presumptively enforceable unless this standard is proven. The intent is to conform to Supreme Court and other holdings in reference to what type of limits on choice of forum are appropriate. The comments will spell out the case law development in greater detail.

6. This section does not deal with arbitration or other alternative dispute resolution clauses. The law there is characterized by substantial federal preemption and specific, existing state law rules that should not be disturbed here.

SECTION 2B-110. BREACH OF CONTRACT.

(a) Whether a party is in breach of contract is determined by the contract. Breach of contract includes a party's failure to perform an obligation in a timely manner, repudiation of a contract, or exceeding a contractual limitation on the use of information.

(b) A breach of contract is material if the contact so provides [or if the breach is a failure to perform an express contract condition]. Otherwise, ~~In the absence of an express contractual term,~~ a breach is material if the circumstances, including the language of the agreement, reasonable expectations of the parties, standards and practices of the trade or industry, and character of the breach, indicate that:

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

(2) the breach will substantially deprive the aggrieved party of a benefit it reasonably expected under the contract.

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

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

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

Committee Votes:

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

Selected Issue:

1. Should the proposed recognition of express contract conditions in subsection (b) be adopted?

Reporter's Notes:

1. In this Article, as in general contract law, a party must perform in conformity with its contract. For purposes of remedies, this Article also follows common law and distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 in cases other that cases of a single delivery of a product, The reference to material breach corresponds to common law and the Restatement (Second) of Contracts which govern many of the transactions brought under Article 2B. **Material breach rules apply in current law to all transactions not governed by the Article 2.** ~~revisions~~

The materiality standard parallels international laws which often use the term "fundamental breach" to describe the same concept. The Convention on the International Sale of Goods (CISG) states: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A require "perfect tender", but only in a single situation: delivery of goods not part of an installment contract. Outside that context, use of materiality is unanimous..

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

3. Subsection (b) defines material breach. "Material breach" and "substantial performance" are interchangeable.(See Section 2B-102: defines substantial performance as "performance of a contractual obligation in a manner that does not constitute a material breach of that contract.") The relevance of the term lies in what remedies are available. As in common law (except for mass market transactions) a party can refuse to perform payment or other obligations and can cancel only if a breach is material. For immaterial breaches, the remedy is damages. Restatement (Second) of Contracts § 237 expresses the rule as follows: "[It] is a condition of each party's remaining duties to render performances ... under an exchange of promises that there be no uncured **material** failure by the other party to render any such performance due at an earlier time."

The basic theme lies in the fact that, while parties are entitled to the contract performance for which they bargained, some breaches are sufficiently immaterial that they do not justify forfeiture of the entire bargain. For example, a one day delay in payment may or may not be material. A reasonable failure to fully meet advertised performance expectations of handling 10,000 files may not be material where the licensee's needs never exceed 4,000 if the system handles 9,999 and the contract did not expressly require 10,000 files Subsection (b) has been revised to make clear that, as in common law, if the parties agree to an express contract condition, that condition must be satisfied. Thus, for example, in a development contract, the parties agree that the final product must meet 10 conditions before it is acceptable. One condition provides for operation at a speed of no less than 150,000 rev. per second. The delivered product fails to meet that standard, falling short by a relatively small amount. Since meeting that conditions was an express contractual standard, the failure to perform is material, justifying refusal of the product. On the other hand, in a contract for delivery of a database to be used as a mailing list, assume that no specific delivery date is specified. The product is delivered but arguably later than expected. Whether the breach is material in the absence of an express term hinges on the effect of the delay on the overall value of the contract.

Breach entitles the injured party to remedies. What remedies are available depends on whether the breach is material or immaterial. The material breach concept rests on the common law belief that it is better to preserve a contract relationship in the face of minor performance problems and the related belief that allowing one party to cancel the contract for minor defects may cause unwarranted forfeiture and unfair opportunism. Materiality relates to the injured party's perspective and to the value that it expected from performance. Faced with an immaterial breach, the injured party can recover for damages that arise in the ordinary course as a consequence of the breach, but cannot cancel the contract or reject the tender of rights unless the contract expressly permits that remedy. Faced with a material breach, a wider panoply of remedies is available to the injured party, including the right to cancel the contract. This Article carries the distinction throughout with respect to both parties to a contract, except that a different standard applies to mass market transactions involving a refusal of a single delivery of software; there, the Article follows existing Article 2.

4. What constitutes a material breach? One cannot define materiality in absolute terms any more than one can define concepts such as negligence, reasonable care, merchantability, or the like. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements: contract terms and the extent to which breach causes significant harm to the aggrieved party. For some cases, see Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) ("breach … is material if it is so substantial as to defeat the purpose of the transaction or so severe as to justify the other party's suspension of performance"); Compuware Corp. v. J.R. Blank & Associates, Inc., 1990 WL 208,604 (N.D. Ill. 1990).

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

The factors in subsection (b) are not exclusive. Courts should draw on common law cases. For example, the concept incorporates questions about the motivation of the breaching party. A series of minor breaches may constitute a material breach where the motivation for this conduct involves a bad faith effort to reduce the value of the deal to the other party or to force that party into a position from which it will be forced to relinquish either the entire deal or, through re-negotiation, aspects of the deal that are otherwise important to it.

5. The materiality concept provides a flexible standard that allows courts to deny unwarranted forfeitures. That flexibility, however, creates potentially disruptive uncertainty in commercial contracts. It is important, therefore, that ideas of materiality hinge on the terms of the contract. As expressed in subsection (b), the contract terms can define what is material. As drafted in this section, that can happen in three ways. The first two involve either expressly providing a remedy for a particular breach (e.g., failure to meet "X" test permits cancellation of the contract) or expressly defining a particular breach per se material. The third context involves what, under common law is described as "express conditions." These are express contract terms conformance to which is implicitly or expressly a precondition to the performance of the other party. Here, the nature of the express agreement itself conditions the remedy.

> **Illustration 1.** The licensee agrees to specifications for a new word processing program. The standards expressly require a dictionary with no less than 5 million words. The actual dictionary has 4.99 million. The developer fails to meet the standard within the agreed time. The failure to meet the **express** standards constitutes a material breach. The licensee can refuse the product.

> **Illustration 2.** A contract requires delivery of a database program but does not expressly describe the characteristics required of the program. The database program meets its own specifications, but fails to in a manner comparable to other similar type programs. There is a breach. Materiality hinges on whether the defect causes substantial harm to the licensee under subsection (b).

8. Restatement (Second) of Contracts § 242 states:

> In determining the time after which a party's uncured material failure to render performan

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

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

SECTION 2B-111. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court ~~finds~~ as a matter of law finds that ~~a~~ the contract or any ~~term thereof~~clause of the contract to have been ~~was~~ unconscionable at the time it was made~~,~~ the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable

~~term~~clause, or it may so limit the application of any unconscionable clause ~~the term~~ as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination. ~~Before making a finding of unconscionability under subsection (a), the court, on motion of a party or on its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the contract or term thereof.~~

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

Conference and Committee Action:

1. At the 1997 NCCUSL Annual Meeting, the Conference adopted a motion that the three transactional articles should follow a consistent "core" definition.

No motion was voted on to define the content of that core and the movant explicitly made clear that he did not intend to resolve that issue. This Draft retains current Article 2 law as the applicable core definition.

Reporter's Note:

This section was substantially edited to harmonize language to existing Article 2. No changes are intended from current law in this section.

1. This draft follows current law in Article 2. Since many of the transactions covered by Article 2B are not now within the UCC, in many states, it expands the ability of courts to monitor transactions beyond the law that current governs. The intent is to adopt in full modern contract law decisions on unconscionable contracts and clauses of those contracts. An important expansion of judicial review, however, is contained in 2B-308, which imposes procedural requirements on mass market form contracts and allows courts to invalidate some terms even though they are conscionable.

2. This Draft does not contain language regarding unconscionable inducement of a contract. The inducement concept does not exist in current law other than Article 2A. In Article 2A, the concept is limited to consumer leases; it does not apply to mass market or other commercial contracts. Notes to the one draft of revised Article 2 suggest that the concept is intended to incorporate a wide-ranging inquiry about the value promised and received, the nature of the advertising and the sales context. The argument for extending the doctrine is not clear and is especially unpersuasive beyond consumer contracts (the limit adopted in current Article 2A). In this article, many situations where inducement may be an issue are dealt with by the new concepts of manifesting assent, opportunity to review and statutory creation of a right to exclude surprising terms. An ABA subcommittee recommended that the inducement provision be rejected in Article 2B.

SECTION 2B-112. MANIFESTING ASSENT.

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

(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) The mere retention of 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, a party's 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) A manifestation of assent may be proved in any manner, including by a showing that a procedure existed by which a party or an electronic agent must have engaged in conduct or operations that manifests assent to the contract or 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 conduct by the party.

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

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

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

Third, the assent must come after a party had an opportunity to review the record or term. Assent requires proof that the party actually read the terms to which it assents. "Opportunity to review" is a defined term that requires that the term or record be called to the party's attention before the actions occur. The terms need not all be in a single record, so long as the location creates an opportunity to review and the requirement of explicit consent are met. Thus, a hyper-link reference to a license actually contained in a different record would, all other conditions being met, 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 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 records of the content at all periods of time. The issues of proof here, while potentially difficult, are primarily matters of evidence law and reflect ordinary problems encountered in dealing with proof of electronic records.

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

I Agree	I Decline

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

therefore, a contract was formed.

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

Illustration 2: In a shrink wrap license, which license is available and readable on the outside of the envelope containing the diskette, the license provides: OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR AGREEMENT TO THE LICENSE WHICH IS CONTAINED ON THE OUTSIDE OF THE ENVELOPE.

WE CALL YOUR ATTENTION SPECIFICALLY TO:

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

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

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

5. Manifestation of assent is not the only manner in which the parties define the terms and limits of their deal. For example, clear indications that the product has specific characteristics and limitations become part of a bargain even if there is no specific, formal manifestation of assent, simply because they in effect define the bargain itself. A party can license a database of intellectual property attorneys to an end user and rely on the fact that the product need only contain intellectual property attorneys as a basic

term of the deal without obtaining a manifestation of assent in formal terms to that aspect of the deal. The nature of the product would, in that case, presumably be part of the deal itself. The comments will make clear that the standard is met if the party has actual notice of the terms, the terms are actually part of the bargain of the parties, or other methods are used to call attention to the term and the party accepts it.

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

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

7. Manifesting assent hinges on the opportunity to review the contract or term; the record must be called to the party's attention before assent is obtained. This excludes devices to create or modify a contract

designed to misled or conceal, rather than to obtain assent. For example, a notation on the back of a check stating elaborate license terms and sent to the cashier's office of a company would not create terms when the check is cashed. The cashier lacks authority and the terms have not been called to the attention of the company.

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

(a) A party or electronic agent has an opportunity to review a record or term if it is made available in a manner ~~designed to~~ calls it to the attention of the party and ~~to~~ permits review of its terms or enables the electronic agent to react ~~to the record or term~~.

(b) Except for a proposal to modify a contract, if a record is available for review only after the party becomes obligated to pay ~~a 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 bundled price:

(1) if the party whose license is ~~terms are~~ refused is the transferor of the bundled product, and the license that is refused is material to the whole, 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 fee attributable to the rejected license; and

(2) in all other cases, including if the party whose license is ~~terms are~~ refused was not the transferor 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 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 an receive a refund if it declines the terms of the record. This refund right does not exist in current law. See Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997). It 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 Same places the copy on screen, a statement appears that the copy is for home and personal use only, and not for display to an audience for a fee. 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 required for some transactions under federal law involve an opportunity for review even if the party does not avail itself of that opportunity.

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

5. While this section does not create an obligation to make a refund, it conditions the creation of terms of contract between the licensor and the licensee that arise after payment on that opportunity. The failure to provide a refund is not a breach of contract, but results in failure of the terms to become part of the bargain. Under Section 2B-616, a retailer is required to refund the price paid if an end user declines the publisher's license. That right to a refund, if and when it occurs, fulfills the refund option stated here.

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

> **Illustration:** Producer transfers a copy of a copyrighted musical work to User, subject to a license that restricts use to home use only. The license terms are presented after delivery of the copy. User can either assent to the license or obtain a refund of the fee. It assents. User later transfers the copy to

Jones. Jones need not have any refund right. If Jones uses the music in a commercial context, the license is breached. Producer has contract recourse against User. Producer may also have a copyright claim against Jones for use (performance) that was not authorized. Producer has a contract claim against Jones only if Jones took an assignment of the license or assented to a license from Producer.

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

[B. Electronic Contracts: Generally]

SECTION 2B-114. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND SIGNATURES [NEW]. A record or signature shall not be denied legal effect, validity, or enforceability solely on the grounds that it is an electronic record or signature accomplished electronically.

Reporter's Note:
This section derives from pending Digital Signature legislation in several

states, most notably, in the developing Illinois legislation. The purpose is to avoid any uncertainty about the efficacy of electronic records and signatures under state law as they apply to transactions covered by Article 2B. it would become part of the electronic commerce package of sections applicable to other UCC articles if accepted by the Committee.

SECTION 2B-115. ATTRIBUTION PROCEDURE.

(a) An attribution procedure is a procedure established by law or agreement or adopted by the parties for the purpose of verifying that electronic authentication, records, messages, or performances are those of the respective parties or for detecting changes or errors in content, if the procedure is commercially reasonable.

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

(c) Except as otherwise provided in Section 2B-116 (a), if a loss occurs because a party complies with a procedure for attribution that was not commercially reasonable, a party that required use of the procedure bears the loss unless ~~if~~ it disclosed the nature of the risk to the other party or offered commercially reasonable alternatives that the party rejected. The liability of the party that required use of the procedure is limited to losses that could not have been prevented by the exercise of reasonable care by the other party.

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

1. The comments to the final Draft will outline that among the considerations to be addressed in determining the reasonableness of the procedure are: including the nature of the transaction, sophistication of the parties, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, cost of alternative procedures, and procedures in general use for similar types of transactions.

2. Subsection c has been returned to this section from former section 2B-111 without substantive change.

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 <u>both</u> 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-116. ATTRIBUTION TO A PARTY OF ELECTRONIC MESSAGE, RECORD, OR PERFORMANCE.

(a) As between the parties, an electronic authentication, message, record, or performance is attributable to a party if:

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

(2) the other party, in good faith and in compliance with an attribution procedure for identifying a party concluded that it was the action of the other party , a person authorized that party, or

the party's electronic agent; or

(3) the authentication, message, record, or performance:

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

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

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

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

(1) The relying party has the burden of proving reasonable reliance, and the

alleged actor has the burden of proving reasonable care.

(2) Reliance on an electronic record or performance that does not comply with an agreed attribution procedure is not reasonable unless authorized by an individual representing the other party.

(c) Attribution under subsection (a)(2) creates a presumption that the authentication, message, record or performance was that of the party to which it is attributed. However, except as otherwise provided in this section, if a loss occurs because a party relied on an electronic message or record as being attributable to the other party, as between the two parties, the party who relied bears the loss.

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

Committee Votes:

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

Reporter's Notes:

1. This section states risk allocation rules relevant to the

anonymous nature of electronic commerce. The intent is to balance making electronic commerce possible in an open environment (as contrasted to the closed structures of funds transfer, credit cards, and EDI transactions), while apportioning risk in a reasonable manner. It should be noted that the risk allocation rules do not apply to handling of funds, bank accounts, or other subject matter outside the scope of Article 2B.

2. Subsection (a) describes three circumstances under which a message or action is attributed to a party. Subsection (a)(1) relies on general agency rules, but adds the idea of an electronic agent. "Electronic agent" is a defined term, covering a computer program programmed to respond or initiate without human review and selected by the party for that purpose. The general approach holds that, to be bound by electronic activity, a party must affirmatively create the agency. Having opted to rely on an electronic device or system, the party becomes responsible for its actions. The idea of an electronic agent does not exist under current law, but has importance in electronic contracting for information because of the increasing use of preprogrammed software to acquire information assets. The principle is that the individual or company who created and set out the program undertakes responsibility for its conduct. That result could be reached under agency theory, but the goal is to eliminate uncertainty on this point. This parallels the UNCITRAL Model Law. Article 13 provides that as between the parties, a message is deemed that of the originator if sent "by an information system program by or on behalf of the originator to operate automatically."

3. Subsection (a)(2) focuses on **agreed** procedures for authentication and makes a message attributable to a party if the other used the procedures and reached that conclusion. This covers the desirable goal of establishing greater certainty when the parties adopts a reasonable way of identification of a party. The attribution here creates a presumption that it was the party identified who in fact sent the message, created the record, or engaged in the performance or authentication. The case also deals with situations where, for example, a party obtained a PIN or other identifier and used it without authorization.

4. Paragraph (a)(3) deals with when can a person be held accountable for messages not sent by it,

but on which the other party relied? Subsection (a)(3) adopts a middle ground. It attributes the message to one party if the means of making the identification occurred by way of an intrusion into a source controlled by the "sender" and enabled by the lack of reasonable care. This occurs only if the receiving party reasonably relied. Thus, if the nature of the message or performance clearly indicates or gives reason to doubt the source, reliance that causes harm may not be protected, but where the reliance is reasonable, the receiving party has a protected right under this article.

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

In determining which approach to take, the Committee elected an intermediate position. The provisions of (a)(3) deal only with cases where access codes or similar systems are in place to establish authentication of a message. The Committee rejected a rule of liability without proof of fault. The issue requires drawing a balance between senders and reliance interests of recipients of messages.

5. The rule restricting consumer risk for credit cards and funds transfers is not viable for an open system, heterogeneous environment such as that dealt with in Article 2B. In cases where the electronic process involves transactions between large businesses and consumers, allocation of the risk of fraud or false attribution developed in a way that responds to the better ability of the system operator to **spread loss** than the consumer. Our context requires a more general structure that goes beyond consumer issues; the problems will not routinely entail consumer protection questions or, even, a licensor with better ability to spread loss. An individual may be an injured party or the wrongdoer. Transactions will often involve two businesses or two individuals. Also, the transactions occur in a public network,

not owned, operated or controlled by a single operator. Also, unlike in electronic funds transfers the messages here involve the creation or performance of contracts and the risk of financial loss without reciprocal value will typically be less.

Here, one could look to communications law for its allocation of risk. In telephone systems, the proprietor of a system (telephone) is responsible for all calls using that number, even if produced by a hacker engaged in entirely illegal and unauthorized access. The loss allocation there, of course, is between the owner of the system and the system operator.

6. Concerns had been expressed about the effect of use of an attribution procedure for determining identity under 2B-111(a)(2). In the open marketplace to which Article 2B refers, irrebuttable presumptions may often be inappropriate because of the open-ended nature of the relationships and the open nature of the assumption that the procedure must be commercially reasonable. A review of recent digital signature laws revealed what might be expected. The identification procedures create a presumption, rather than a certainty. Subsection (c) creates a rebuttable presumption of attribution by use of the procedure. The presumption can be rebutted by showing a lack of attribution under the three rules outlined in (a).

SECTION 2B-117. DETECTION OF CHANGES AND ERRORS; CONSUMER DEFENSES.

[(a) If through an attribution procedure to detect changes in an electronic message, record or performance, the electronic message, record or performance can be shown to be unaltered since a specified point in time, it shall be presumed to have been unaltered since that time.

(b) If an electronic record, performance or other action is created or sent pursuant to an attribution procedure for the detection of error, the information in the message, record, or performance is presumed to be as intended by the person creating or sending it as to portions of the content to which the procedure applies.] If the message, record or performance nevertheless contained an error but the error was not discovered, the following rules apply:

(1) If the sender complied with the attribution procedure and the error would have been detected had the receiving party also complied with the attribution procedure, the sender is not bound if the error relates to a material element of the message, record

or performance.

(2) If the sender receives a notice required by the attribution procedure that describes the content as received, the sender shall review the notice and report any error detected by it in a commercially reasonable manner.

[(c) In an electronic transaction involving a consumer, the consumer is not responsible for an electronic message that the consumer did not intend but that was caused by an electronic error if, on learning of the other party's reliance on the erroneous message, the consumer:

(1) in good faith promptly notifies the licensor of the error and that it did not intend the message received by the other party;

(2) takes reasonable steps, including steps that conform to the

licensor's reasonable instructions, to return to the licensor all copies of any information received or, on instructions from the licensor, to destroy all copies; and

(3) has not used or received value from the information or made the information available to a third party.

(d) In subsection (c), the burden of proving intent and lack of an error is on the party dealing with the consumer, while the consumer has the burden of proving compliance with subsection (c)(1),(2), and (3).

(e) In this section, "electronic error" means an error created by an information processing system, by the communication of the information, or by an error of the consumer made in an electronic system that did not allow for correction of the error.]

Selected Issue:

1. Should the bracketed language in (a) and the beginning of (b) be retained?

2. Should the bracketed material in (c)(d)(e) be retained?

Reporter's Notes:

1. Subsection (a) sets out a presumption (rebuttable) regarding the effect of the use of an attribution procedure, at least part of which has the effect of precluding changes made in a record without detection. The language is taken largely from a pending Illinois Digital Signature statute which contains far more elaborate provisions regarding so-called secure electronic records. This verification or protection function is a by-product of at least one of the currently used electronic encryption technologies. In other contexts, some debate has been held concerning whether it is desirable to clarify whether the presumption shifts the burden of proof or merely requires offering of some evidence to the contrary of the presumed fact. Article 1 contains a definition of the meaning of "presumption" as used in the UCC.

2. Subsection (b) sets out a similar presumption for error detection procedures. It is limited to materials to which the error detection methodology applies. Alleged errors in other aspects of an electronic transaction are, with the exception of consumer cases, left entirely to law outside this Article. The common law of multilateral and unilateral error applies. The greater certainty available to parties through a commercially reasonable procedure provides an incentive for such techniques to develop. The idea of error here is not limited to documents involving offers and acceptances, but also to performances.

3. Subsection (c) and (d) contain a major new proposal and an important form of protection for consumers in electronic transactions. The basic approach is to provide a relatively simple method for an consumer to contest the results of errors in his or her transmissions to a third party. Under current law, the effect of errors in contract formation, for example, would be resolved under common law theories of mistake – in many instances, where there is a unilateral mistake, the party making that error may be held liable for its consequences. They would, in any

event, face a difficult dispute about the nature and source of the error.

The proposal stems from materials submitted by Professor Jay Dratler who described the risks of electronic and system errors and suggested the development of a simple remedy, at least presumptively for a consumer as a means to encourage use of electronic commerce and avoid unjust results. The basic model adopted here is that, if an electronic error occurred (e.g., one within the system, as compared to a simple mistake by the individual), and the consumer acts promptly to notify the other party, presumptions of accuracy shift and a contract is not formed so long as the consumer has not used or received the benefits of the mistakenly transmitted information or mistakenly shipped product.

The section does not create a rescission right. It is not sufficient that the consumer reconsidered its order. It creates an error resolution system, allowing immediate return to place the other party in the position of having to establish that there was no error without the benefit of the presumption that might otherwise apply in (b).

> **Illustration 1:** Consumer intends to send an order for ten copies of the latest video game released by Jones Corp. In fact, the information processing system records 110. The electronic agent maintaining Jones' site, after validating that the order came from Consumer and that the number entered was 110, electronically disburses 110 copies to Consumer's location. The next morning, Consumer notices the mistaken shipment. He sends an E-Mail to Jones describing the problem, offering to immediately return or destroy copies, and does not use the games.. Under subsection (c), there is no presumption that the content was as intended and, if it pursues the matter, Jones must prove that there was no error. Jones may instruct Consumer to destroy the excess 100 game copies and pay a revised bill for 10.
>
> **Illustration 2:** Same facts as above, except that Jones' system before shipping the materials sends a confirmation notice, asking Consumer to confirm that it ordered 110 games. Consumer sees the

message. If it confirms 110 copies, even though its later claim rebuts any presumption, confirmation of the same volume twice would be strong evidence of intent to contract at the indicated amount. If it refuses to confirm, of course, the contract must be made later on the basis of the 10 copies confirmed.

SECTION 2B-118. AUTHENTICATION EFFECT AND PROOF; ELECTRONIC AGENT OPERATIONS.

(a) Unless the circumstances otherwise indicate that a party intends less than all of the effect, authentication is intended to establish:

(1) the party's identity,

(2) its adoption and acceptance of a record or a term, and

(3) the authenticity of the record or term.

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

(c) A record or message is authenticated as a matter of law if the party complied with an attribution procedure. Otherwise, authentication may be proven in any manner including by showing that a procedure existed by which a party necessarily must have executed or adopted a symbol in order to proceed further in the use or processing of the information.

Reporter's Notes:

1. Subsection (a) has not been reviewed by the committee. It deals with the fact that "authentication", as with a signature under current law, potentially serves many different functions. On approach to this would be to design language that captures each function and differently describes what will often be the same act – signing or encrypting a record. This draft takes the less formalistic approach of providing that, unless circumstances indicate to the contrary, all three functions of a signature or an authentication are intended. Any other rule creates complexity and traps that serve no useful commercial purpose. Under this subsection, an authentication that relates only to identity (as compared to accuracy of content) has only that effect, not more. The appropriate approach is to allow the context and actual intent to control.

2. Subsection (b) contains a specific application of the general principle that actions of an electronic agent bind the party that selected and deployed the agent for that purpose. Subsection (c) states that compliance with an agreed attribution procedure, if followed, removes factual questions about whether an authentication (signature) occurred. This happens, of course, only if the procedure was commercially reasonable since commercial reasonableness is part of the statutory definition of an authentication procedure. The second concept allows proof of an authentication in any manner, but specifically allows proof gauged by showing that a process exists that required this result in order to proceed further. This responds to on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

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

SECTION 2B-119. 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 intent to be bound, a contract exists:

(1) when 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 unless the originating message prohibited that form of response.

(b) Subject to Section 2B-120, an electronic message is effective when received, even if no individual is aware of its receipt.

Committee Vote:

a. Approved in principle.

Reporter's Notes:

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. 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, a contract exists even if no human being reviews or reacts to the electronic message of the other or the information delivered. This adapts 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-120. 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 the message expires if acknowledgment is not received within a reasonable time after the message was sent.

(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 the originator, on notice to the other party, may either treat the message as having expired or specify a further reasonable time within which acknowledgment must be received or the message will then be treated as not having expired. 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, the originator may exercise the options in paragraph (2) if receipt does not occur within that time.

(b) Receipt of acknowledgment establishes that the message was received but does not in itself establish that the content sent corresponds to the content received.

Committee Vote and Action:

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

b. Reviewed without substantive change. (April, 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.

PART 2

FORMATION AND TERMS

[A. General]

SECTION 2B-201.

FORMAL REQUIREMENTS.

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

(b) A grant or limitation governed by Section 2B-307 or 2B-502 may not vary the terms of those sections except by a record authenticated or prepared by a party against which enforcement is sought.

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

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

[(2) if the agreement is a license and the term of the license is less than ninety days;]

(3) to the extent that a person authorized by the

holder of intellectual property rights delivered copies of the information or access materials to the licensee or performance has been otherwise tendered by one party and accepted by the other; or

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

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

(e) For agreements covered by this article, this article states the only formal requirements for enforceability under the laws of this state.

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

Votes:

1. In debate on Article 2 at the Annual Meeting, repeal of the statute of frauds in that Article was sustained by a ~~relatively~~ narrow vote (**65-52**). Subsequently, the Article 2 drafting committee ~~has~~ voted to include a statute of frauds in that article.

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

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.

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

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

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

Selected Issues:

1. Should an exception be provided for short-term licenses (e.g., up to six months) involving use of information provided by the licensor?

2. How should indefinite term license be handled?

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~~information. 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. For each, it delivers a copy of the motion picture to enable the showing. Regardless of the dollar value of the license and any renewals, the license is excepted from the requirement of a record because a copy was delivered to the licensee and subsection (c)(3) applies. The terms of the license are determined by the actual agreement, the customs of the business, and default rules of this Article.
>
> **Illustration 2:** Booker acquires releases from various parties to enable completion and

publication of its books. The releases are often not acquired for any payments to the releasing party. This section allows enforcement without a writing based on both subsection (c)(2) and (c)(1) (the latter being applicable because the total payments were less than $20,000, i.e., no payments). The absence of consideration is permitted under the section dealing with releases.

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

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

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

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

However, in copyright law, a nonexclusive license that is not in writing may lose priority to a "subsequent" transfer of the copyright.

SECTION 2B-202.

FORMATION IN GENERAL.

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

(b) If the parties intend to make a contract, an agreement sufficient to constitute a contract may be found even if the time that the agreement was made cannot be determined, one or more terms are left open or to be agreed upon or one party reserves the right to modify terms~~, or the standard forms of the parties contain varying terms.~~ However, a contract is not formed if the parties do not agree ~~disagree~~ about scope.

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

(d) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is fixed or agreed 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. The licensor shall return any portion of the contract fee paid for which performance has not been received and retained by the licensee. The parties remain bound with respect to any obligation of confidentiality, or similar obligations, to which the parties have agreed.

Uniform Law Source: Section 2-202; 2-305(4); 2A-204.

Committee Votes:

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

Changes Since Last Draft: This section and the remaining sections on formation and terms have been restructured for clarity and flow of concepts. The provisions removed from this section have been placed in other sections, including Section 2B-204. Subsection (d) was moved here from Section 2B-305 since the provisions deal with contract formation, rather than terms and set out part of the important concept of how a contract conditional (expressly or impliedly) on agreement to additional terms is unraveled where the agreement does not occur.

Reporter's Note:

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

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

agreement.

SECTION 2B-203. OFFER AND ACCEPTANCE.

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

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

(2) An order or other offer for prompt or current performance invites acceptance either by a prompt promise to perform or by prompt or current performance. However, a performance involving nonconforming information is not an acceptance if the party that provides the information seasonably notifies the transferee that the information is offered only as an accommodation.

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

(c) Subject to subsection (d), a definite and seasonable expression of acceptance may create a binding obligation even if it is in a record ~~standard form~~ that contains terms that vary from the terms of the offer unless it conflicts with the offer concerning a material term. If there is a material conflict, ~~However, if records exchanged by the parties conflict on the scope of a license~~, no agreement exists unless from all the other circumstances it appears that an agreement, including with respect to the material term,~~scope,~~ existed. If a contract is formed by an acceptance containing varying terms, the terms of the contract include the terms of the offer and additional terms in the acceptance only if the additional terms do not materially alter the terms of the offer and are not seasonably objected to by the offeror.

(d) An offer or acceptance that because of the circumstances or the language ~~of the offer or acceptance~~ is conditional on assent by the other party to the terms of the offer or acceptance precludes contract formation except by ~~compliance~~ assent to the terms~~with the condition~~. However, such language in a standard form ~~which makes an offer or acceptance expressly conditional on assent by the other party to the terms of the form~~ precludes the formation of a contract based on the absence of such assent only if the party proposing the form acts in a manner consistent with the stated conditions, such as by refusing to perform, to ~~or~~ permit performance, or to accept the benefits of the contract until its terms are accepted. If a party agrees, including by manifesting assent, to the terms of an effective conditional offer, it adopts the terms of that offer pursuant to Section 2B-207 or 2B-208 as applicable. ~~and the other party does not accept the terms.~~

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

Committee Vote:

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

Reporter's Notes:

1. This section was modified based on discussions at the September Meeting and continuing analysis of how the formation rules interact in situations where ordinary offer-acceptance activity does not result in matching records or assent to a particular record.

2. 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. Subsection (c) has been modified to deal with the question of when variations in the offer and acceptance does and does not constitute an acceptance. Current Article 2-207 does not deal expressly with this question, except for cases of conditional acceptances. The prior Draft of Article 2B referenced that no contract existed if there was disagreement on scope. That rule is continued in 2B-202. Here, if has been generalized to allow a varying term acceptance to form a contract unless the variations do not involve material terms. The new sentence of (c) follows current law in this setting and allows the offer to control the terms of the contract, except where “additional” terms in an acceptance do not materially alter the terms of the offer.

3. This leaves the question of what is the effect of a conditional offer or acceptance. Subsection (d) sets out the general idea that terms of condition are effective. Contract formation here requires either acceptance of the conditions or, of course, conduct of **both** parties recognizing the existence of the agreement.

To deal with the classic battle of forms setting (where either or both forms are conditional, but neither party pays attention to the conditions), however, the second part of the subsection limits the effectiveness of a conditional standard form to cases where the party’s behavior is consistent with those terms. The approach validates conditional offers (or acceptances) 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 behavior manifests the existence of a contract, a contract exists despite the language of condition. If, however, a party refuses to ship or allow performance until the conditions are accepted, the conditioning language preclude formation of a contract.

> **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 with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. Under these circumstances, neither party acted 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 sections on conflicting forms [2B-209] and general interpretation law, including the actual terms of any affirmative agreement the parties may have had. If 2B-[209] applies, there is a knock-out rule; conflicting terms 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 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. See 2B-209 regarding the superseding effect of actually conditioned terms.

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.

4. The last sentence of subsection (d) clarifies what is implicit in current law. If a party agrees or manifests assent to a conditional (or any other record), the terms of that record control the contract and, in effect, the case is taken out of the battle of forms context.

SECTION 2B-204. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS.

(a) Operations of one or more electronic agents which confirm the existence of a contract or that signify agreement form a contract even if no individual representing either party was aware of or reviewed the actions or results.

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

(1) A contract may be formed by the interaction of two electronic agents. A contract is formed if the interaction results in both agents engaging in operations that signify agreement, such as by engaging in performance of the contract, ordering or instructing performance, accepting performance, or making a record of the existence of a contract. The terms of the contract are

determined under Section 2B-209.

(2) A contract may be formed by the interaction of an electronic agent and an individual. A contract is formed if an individual has reason to know that the individual is dealing with an electronic agent and the individual takes actions she 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. The terms of the contract are determined under Section 2B-207 or 2B-208 as applicable, but do not include terms provided by the individual in a manner to which the electronic agent could not react.

Committee Vote:

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

Reporter's Notes:

1. Subsection (a) 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 1. Tootie is an electronic system for placing orders for Home Shopping

Network. When you dial the number, a voice comes on line instructing you to indicate your card number, the item number you will purchase, the quantity, your location, and other items. You indicate this by striking keys and numbers on your telephone. Tootie automatically orders shipment. Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the 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 2. User dials the ATT information system. A computerized voice states: "If you would like us to dial your number, strike "1", there will be an additional charge of $1.00. If you would like to dial yourself, strike "2". User states into the phone that he will not pay the $1.00 additional charge, but would pay .50. Having stated his conditions, User strikes "1". The computerized voice asks User to state the name of the recipient of the call. User states "Jane Smith". The ATT computer dials Jane Smith's number, having located it in the database.

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

2. As between electronic agents 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 principals 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-205. FIRM OFFERS. An offer by a merchant to enter into a contract made in an authenticated record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term providing assurance that the offer will be held open that is contained in a standard form supplied by the party receiving the offer is ineffective unless the party making the offer [authenticates the term] [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.

Issue: Should the Committee reconsider and follow existing Article 2 by requiring that the term be signed (authenticated)?

SECTION 2B-206. RELEASES.

(a) A release of intellectual property rights in whole or in part is effective without consideration if it is:

(1) contained in a record to or in which the party giving the release manifested assent and which identifies the rights released; 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 specify its term and does not require:

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

(2) on-going payments or other affirmative performance by the party receiving the release except minor acts such as acts done in complying with an agreement to

give acknowledgments or credits in subsequent use of the information or to provide a small number of copies of any new works.

Reporter's Note:

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

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

Subsection (b) is a specific application of a rule previously expressed in Section 2B-311, creating a presumption that some single or no-payment contracts create perpetual rights if no term is specified. The broader rule was abandoned based on extensive discussion at the April, 1997 meeting, but this specific application was developed to deal with issues common in software, publishing and other industries where parties develop products in part on reliance on general releases or waivers that do not contain specific duration terms. Leaving those cases to the general "reasonable time" standard in Section 2B-311 would create unwarranted and potentially costly uncertainty.

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

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 2. 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 medium. 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 a record 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 party's attention.

[B. Terms of Records]

SECTION 2B-207. ADOPTING TERMS OF RECORDS.

(a) If a party adopts the terms of a record, including a record that is a standard form, the terms of the record become terms of the contract without regard to the party's knowledge or understanding of the terms of the record. However, a term which is unenforceable for failure to satisfy a requirement of this article, such as a requirement for conspicuous language, is not part of the contract.

(b) Except as otherwise provided in Sections 2B-208, a party adopts the terms of a record if the party agrees, including by manifesting assent, to the record before or in connection with the initial performance or use of or access to the information. If performance or use of the information is commenced with the expectation that the agreement will be represented in whole or in part by a record that a party has not yet had an opportunity to review or that has not yet been completed, the party adopts the terms of the record if the party agrees to or manifests assent to that record after having had an opportunity to review the record.

Uniform Law Sources: Common law decisions; Restatement (Second) of Contracts 211.

Committee Votes:

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

b. Rejected a motion to make specific reference to excluding terms that are unconscionable in addition to general exclusion under section 2B-109.

(September, 1996)

c. Consensus to expand the section to cover all records, rather than merely standard forms, provided that it be made clear that standard forms are covered. (September, 1996)

d. Reviewed without substantive change. (April, 1997)

Reporter's Notes:

1. Article 2B deals with standard form records in three separate sections. This Section and 2B-207 deal with standard forms in "single form" cases. Section 2B-209 deals with cases involving an exchange of conflicting forms. These sections assume that a contract exists and do not address formation issues. If no contract is formed under other provisions of this Article, the sections are not applicable. What is addressed here is, given a contract, what are the terms?

2. The theme in Article 2B is that, while contracts are in some situations, formed and their terms delineated at a single point in time, in many modern transactions, a rolling process occurs in which terms are provided, clarified or introduced at more than one point. Formation and term delineation is a process, rather than a single event.

In single form cases, Article 2B proposes a balance is implemented in two elements. The **first,** contained in this section, solidifies the enforceability of standard forms in commercial deals. This confirms an important aspect of commercial law. The principle, already followed in the vast majority of modern commercial case law, flows from the belief that in the absence of fraud, unconscionable or similar conduct, commercial parties are bound by the writings to which they assent, without being able to later claim surprise or a failure to read the language presented to them. Assent does not depend on the party actually reading the terms. As the language in (a) clarifies, however, the adoption of terms does not circumvent separate rules requiring that a term be conspicuous.

The **second** is that, in mass market transactions, protections can be created altering the idea that a party is bound by the entire form to which it assents in a way the accommodates the possibility of unfair surprise. This counterbalance arises in 2B-207 with reference to mass market contracts. That Section adopts the approach of the Restatement (Second) of Contracts § 211, which creates a limited basis to argue that a term in a record to which the party assents may have been so surprising that it should not be enforced unless called to that person's attention. The Restatement rule is seldom applied to commercial contracts not involving insurance policies, and has been adopted fewer than ten states. Other states rely solely on concepts of fraud, unconscionability, bad faith and similar devices to police, in a limited way to preclude serious cases of abuse.

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

4.

Subsection (b) rejects the idea that a contract and all of its terms must be formed at a single point in time. Case law adopts a more fluid conception of the process of contracting, where parties define the agreement over a period of time that is not constrained to an instantaneous "closing" in most cases. See, e.g., Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997). This rolling contract concept reflects that, in many agreements, terms are considered at two different points in time (some at the initial discussion and others when the products arrives), while in still others, terms may continue to be created and modified over time.

Terms can and often are created in modern commerce by assent after beginning performance. Thus, in the entertainment industry and in many development contracts, contract terms are developed and drafted **while** performance occurs, not before performance begins. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section accommodates that process as well as the common practice of providing terms for assent at some point prior to the initial performance, even if not at the first step in the agreement process.

SECTION 2B-208. MASS-MARKET LICENSES.

(a) ~~Except as otherwise provided Section 2B-209, a~~ A party adopts the terms of a mass-market-license for purposes of Section 2B-207(a) if the party agrees, including by manifesting assent, to the license before or in connection with the initial performance or use of or access to the information. However, a term does not become part of the contract (i) if it is unconscionable or (ii) subject to Section 2B-301 with regard to parol or extrinsic evidence, if it conflicts with the negotiated terms of the agreement between the parties to the license.

(b) If a party does not have the opportunity to review the terms of a mass-market license before becoming obligated to pay for the information and does not agree, including by manifest assent, to the license after having that opportunity, the party is entitled, on returning all copies of the information, to:

(i) refund of the consideration paid and cancellation of any obligation to pay for the information;

(ii) reimbursement of any reasonable expenses incurred in compliance with any reasonable instructions of the other party for return or destruction of the information or, in the absence of such instructions, reasonable expenses in connection with return of the information; and

(iii) compensation for any foreseeable harm caused to that information or system by the installed information and any reasonable expenses incurred in the restoration of the system to its condition prior to the installation, if the information must be installed in an information processing system to enable review of the license and the installation alters the system or information contained in the system.

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).

h. The Committee **adopted** a motion to delete the refusal terms concept and to apply the idea of unconscionability to all such contracts with a post-payment rescission right consistent with the proposal of the American Bar Association Committee. Vote: 10 – 2 (Sept. 1997).

Selected Issue:

1. Should the exception for negotiated terms be retained?

2. Should the section be approved?

REPORTER'S NOTES:

1. This Section was rewritten based on the vote of the Committee in September 1997. Prior drafts had presented variations of a "refusal term" concept which allowed a court to invalidate certain, unidentified clauses in a mass market license unless those clauses were brought to the attention of and assented to by the other party. Among the reasons for rejecting this concept was that it allowed a court to invalidate terms that were <u>acceptable</u> under the doctrine of unconscionability and not obtained fraudulently, but that it gave no clear guidance as to how such terms can be identified. Also, the concept was essentially a disclosure rule, but gave

no guidance on what terms should or must be disclosed. This Draft follows recommendations of an ABA Subcommittee and returns to traditional commercial law approaches. It nevertheless places significant limitations on mass market licenses and creates a right to a refund and restoration of a system in any case where the assent occurs after the information is installed in a computer system.

2. This section deals with all standard forms in the mass market, including 1) forms presented before a purchase fee is paid and situations where a publisher's terms are made available for assent by the user only after the end user pays the retailer.

3. Forms Presented Prior to Payment. Where the terms of a form are presented before a price is paid, the validity of the form involves issues that have been presented to courts for years. Cases generally enforce the contract. The fact that the terms are non-negotiable or a "contract of adhesion" results in close scrutiny of *terms* under interpretation and unconscionability theory, but seldom results in a decision that invalidates the contract itself. While neither party bargained for terms, the vendor did not agree to sell under any other terms than those set out in its contract and, as long as there is fairness, disclosure or notice to the other party, contract law does not vitiate those terms. Some argue that law should preclude a vendor from defining the terms under which it markets its product or service. That viewpoint argues that law should mandate terms, conditions and risks under which information is distributed. *This regulatory structure is not accepted in Article 2B.*

a. **Assent.** Subsection (a) states a principle in the Restatement (Second): by manifesting assent to a standard form record, a party adopts the terms of that record. Article 2B places significant restrictions procedurally on the idea of manifesting assent. These restrictions ensure that the record be available for review and that the assenting party make some **affirmative** indication of assent. Compare Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997) (assent to a form based on failure to object sufficient). In cases where the license arises through initial screens presented to the licensee before it pays, the issue is identical to paper-based formats, except for the automated nature of the contracting. The issues are whether there are adequate indicia of assent.

b. Unconscionability. Subsection (a) expressly references that terms in mass market licenses are not enforceable if they are unconscionable. This UCC concept would apply in any event, but the reference here makes clear that the policy is important in standard form contracting in the mass market. The idea of unconscionability is one that limits contract terms to avoid bizarre and oppressive results. Traditionally, the doctrine blends questions about the contracting process with questions about the substantive character of the terms themselves. It is aimed at preventing abuse and unfair surprise.

In the mass market, this doctrine might apply to invalidate terms that over-reach and are hidden in boilerplate. For example, a contract term buried in a mass market license that provides that default on the mass market contract involving a $50 software results in a cross default on all other licenses between two companies may be unconscionable in setting where there was no reason to suspect that the linkage of the small and the larger licenses. Similarly, a clause abrogating any responsibility for intentionally wrongful acts buried in a mass market form would violate general public policy in most states and, in addition to being unenforceable on that ground, might very well also be found to be unconscionable.

The essential character of unconscionability doctrine lies in a contextual analysis to avoid abuse and one thus cannot fully describe the various applications that might spell out its scope here without detailed information about various contexts. In information transactions, the doctrine is sufficiently flexible to encompass consideration of various underlying policies about fairness and protection of public interests in free flow of ideas. As discussed in the Notes to 2B-105, Article 2B and contract law generally must take a neutral position relating to the difficult federal policy issues that arise in reference to preemption, misuse and other law. Within that general approach, however, issues about the relationship between a clause and underlying principles of free speech, information flow, and the like in the mass market are appropriate elements in an unconscionability analysis. Thus, for example, a contract term purporting to prevent the buyer of a publicly distributing magazine from quoting the magazine's observations about consumer products might in context be considered to be unconscionable. In practice, however, as discussed in Section 2B-105, the primary standards under which such clauses would be measured come from concepts of copyright misuse, free speech, and related federal policy restrictions on contract enforcement. The fact that the contract itself is generally enforceable under Article 2B (if that is the case in particular setting) does not alter the application of these broader federal law concepts.

c. Negotiated Terms. The Draft of subsection (a) also provides that the form in itself cannot contract and, thus, alter the negotiated terms between the parties to the license. It is not clear that the Committee vote in September encompassed this restriction and that issue must be considered at the next meeting.

The restriction creates a balance that is found in the Restatement (Second) of Contracts, but does so in terms gauged to identifiable elements of actual transactions. The basic concept holds that the form cannot alter agreed-to terms in this marketplace.

Illustration 1:

The acquisition librarian of University Libraries places an order with the sales representative of Zen Software for a copy of Zen's multi-media product to be used in University's public collection network and agreeing on a price for that use. The software is shipped for the agreed price, but the mass market license provides that the software is only for use on a single user system. University assents to the license. The single user provision of the mass market license is not part of the contract under subsection (a) because the parties had agreed otherwise.

Stating this concept in this section corresponds to the comments to Restatement (Second) 211 which talk about invalidating “bizarre” (unconscionable) terms and terms that vitiate the basics or essence of the agreement between the parties. In other standard form contexts, it is not clear when the language of a form adopted by a party supecedes or is subordinate to otherwise agreed terms.

The

concept is especially important in mass market information transactions in that the importance of the contract is far greater here than in other settings. The contract defines the product (e.g., it defines what rights are conveyed and which rights are withheld). This concept is, of course, subject to the parol evidence rule. The express reference to that rule here is to correspond the section to the presentation of the section on express warranties and their disclaimer or limitation in current Article 2.

4. Forms presented after payment. In modern commerce, licenses and other contract terms are often presented after a price is paid to a retailer.

These situations (which include so-called “shrink-wrap” licenses) present additional questions.

In many cases, the form contract gives benefits to the end user that are not present in the deal with the retailer. Typically, the license presented after payment is between the *copyright owner* and the end user, rather than between the end user and *the retailer*. In this **three-party** setting (end user, retailer, copyright owner), the post-payment license is important **to the end user**. The form establishes *for the first time* a relationship between the copyright owner and the end user that may be central to the end user’s right to use the information. This is true because of a confluence of copyright law and how some products are distributed.

A copyright owner may elect to give **distributors** a right to sell copies of its work or it may preclude a right to sell and instead authorize distributors to license works under terms it specifies to the distributor. **Copyright law** supports either choice. If the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected under **copyright law**. Thus, a common distribution situation is:

1) copyright owner licenses distributor to distribute, but not sell, copies, and only subject to a

license; 2) distributor (retailer) transfers copies to end users for a price, but under applicable law, this cannot be a “first sale” unless the copyright owner authorized sales; 3) if it is not a first sale, end user has possession, but an uncertain status in copyright until is assents to a license with the copyright owner 4) if it is a first sale, end user has some statutory rights, but cannot make a public performance, display or multiple copies of the work under copyright law.

The "post-payment" license is the first contract between the end user and the copyright owner. It is the only setting in which the end user can obtain rights that are in excess of rights to a first sale purchaser or any rights at all under copyright law if there was no authorized sale to it.

In post-payment license terms, the unique contract law issue is what protections does the end user have if the license terms are unacceptable. Under Article 2B, the a robust refund and reimbursement right is created. The intent is that, if there is no assent to the contract, the end user can return itself to the place that it was in before acquiring the copy and reviewing the license.

Illustration 2: End user desires information available under a mass market license. End user #1 goes to a web site and, after reviewing the license terms, provides his credit card number and downloads the information. Subsection (b) does not apply because opportunity to review the license contract existed before payment. End user #2 places a telephone order for the information and provides his credit card number, but the license is not available for review until the information arrives in the mail. Subsection (b) applies because there was no opportunity to review the license before payment was made.

Illustration 3: In the above example, End user #2 opens the package and finds a license printed on an envelope that contains a copy of the informati on inside. The outside of the envelope clearly states that opening the envelope constitutes consent to the license. The user reads the license and rejects it, deciding to not open the envelope. Subsections (b)(i) and (ii) entitle him to return the information with costs covered by the licensor. Subsection (b)(iii) does not apply; it was not necessary to install the license in order to read it. In the same circumsta nces, End user decides to test the information to see if he likes it. Subsection (b) does not apply because the end user assented to the license. Any right to test is governed by the inspection rules of Article 2B which assume the existence of a contract and focus on determining and providing a remedy for breach.

5. In single form cases, no appellate case law rejects the contract-based enforceability of the forms and recent cases support it. See Hill v. Gateway

2000, Inc., 1997 WL 2809 (7th Cir. 1997); ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). Compare Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th 1988) (applying a preemption analysis to statute validating a particular term after the lower court held otherwise the contract was invalid as a contract of adhesion; the appellate court did not address the contractual enforceability issue). Case law is less clear in the conflicting forms setting where the presence of differing terms creates questions about assent to either form. See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir.1991);

Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). These cases do not contest the underlying enforceability of standard forms, but deal with conflicting terms. See Douglas G. Baird & Robert Weisberg, Rules, *Standards, and the Battle of the Forms: A Reassessment of ' 2-207,* 68 Va. L.Rev. 1217, 1227-31 (1982).

6. Intellectual Property Issues. As noted in Section 2B-105 and earlier in these notes, important and difficult federal policy issues can arise about distribution of information in a mass market and the relationship between distributional restrictions by contract on the one hand and federal information policy on the other. Article 2B adopts a neutral position on these issues and nothing in this section should be understood to reverse or alter decisions and policy choices about under what circumstances particular contractual provisions might be preempted or otherwise precluded as a result of federal law and applicable, mandatory policies. In general, these federal policies, which include ideas of free speech and concepts of copyright (or patent) misuse, apply to particular clauses in contractual relationships. The fact that, under Article 2B, as under current law, the contract is enforceable in general does not alter decisions about which otherwise enforceable contract terms might be invalid under these policies and in what circumstances that policy choice is made.

To underscore this position, the comments will point to existing case law on several potentially important questions. Thus, for example, modern copyright case law holds that in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use as a matter of copyright law. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). In some contexts contractual bars on reverse engineering are enforceable. In others, they may not be enforceable. See Triad Systems Corp. v. Southeastern Express Co., 64 F3d 1330 (9th Cir. 1995); DSC Communications Corp. v. DGI Technologies Corp., 898 F. Supp. 1183 (ND Tex. 1995). Similarly, federal case law (and statutory provisions) establish a federal interest in the broad distribution and use of ideas and concepts that have been distributed to the public. See Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989). On the other hand, however, it is quite clear that the federal policy on dissemination of information co-exists with concepts about the ability of parties to make confidential disclosures and deal with information to be kept secret. See Computer Assoc. Int'l, Inc. v. Altai, Inc., 982 F2d 693 (2d Cir. 1992). Some case law supports the view that, in some situations involving mass distribution of the information in a generally unrestricted form, the provision is unenforceable. See Consumers Union v. General Signal Corp., 724 F.2d 1044 (1983). On the other hand, in other situations, modern law clearly allows the creation of enforceable contract restrictions on the ability of a recipient to reproduce or publicly redistribute confidential information. See Restatement (Third) Unfair Competition.

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

SECTION 2B-209. TERMS WHEN CONTRACT CREATED BY PERFORMANCE ~~CONFLICTING TERMS~~.

~~(a) If the parties exchange standard forms which contain varying terms, and a contract is formed by conduct or otherwise, subject to subsection (b), the terms of the contract are:~~

~~(1) negotiated terms agreed to by the parties and any term in a form if the party claiming exclusion of the term agreed, including by manifesting assent, to the term;~~

~~(2) terms on which the standard forms agree in substance;~~

~~(3) terms of the licensor's form governing scope of a license if they do not materially alter terms included under (a)(1);~~

~~(4) terms on which the forms do not conflict, if the terms do not materially alter the agreement and the party receiving the term does not seasonably give a notice of objection to the other party; and~~

~~(5) supplementary terms included under this [Act].~~

~~(b) Terms in a record authenticated [signed] by the party to be bound or in a record containing conditional terms enforceable under [Section 2B-203(d)], supersede subsection (a). In the case of a conflict among terms included under subsection (a), terms rank in priority in the order of the paragraphs of subsection (a) in which they are listed.~~

~~(c) If a standard~~

~~form of one party deals with a term, silence of the other standard form on the subject is not a conflicting term unless the term materially alters the agreement.22~~

~~(d) In determining whether a term materially alters an agreement, a court shall consider whether the term conflicts with the negotiated terms of the agreement and whether it is consistent with the course of dealing of the parties or the customs and practices of the applicable trade or industry for transactions of the type.~~

(a) Except as provided in subsection (b), if the records of the parties do not establish a contract, but a contract is formed because conduct by both parties recognizes the existence of a contract, the court shall determine the terms of the contract considering the commercial context, the conduct of the parties, the terms on which the parties agreed, and all other relevant circumstances.

(b) In a case governed by subsection (a), if the records exchanged by the parties are standard forms purporting to state the terms of an offer or acceptance, the terms of the contract are:

(1) negotiated terms agreed to by the parties;

(2) terms on which the forms agree in substance;

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

(4)

supplementary terms incorporated under any other provisions of this [Act].

(c) Terms in (b) rank in priority in the order listed. If a standard form of one party deals with a term, silence of the other standard form on the subject is not a conflicting term unless the term materially alters the contract otherwise established. In determining whether a term materially alters an agreement, a court shall consider whether the term conflicts with the negotiated terms of the agreement and whether it is consistent with the course of dealing of the parties or the customs and practices of the applicable trade or industry for transactions of the type.

(d) The rules of this section do not apply if there is an authenticated record or a conditional record effective under Section 2B-203(d) to which the party to be bound agreed, including by manifesting assent, containing terms of the agreement.

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)

Changes Since Last Meeting:

This section was substantially redrafted based on continued review of existing law, comments from various industries, debate at the NCCUSL Annual Meeting, and analysis of the relationship between the section and other formation rules. It deals with **one** of the issues considered in current 2-207 and applies a modified "knock out" rule to resolve the situation in which the parties exchange standard forms, but do not generally discuss or consider the terms of the respective forms. The basic goal of the redraft, reflected here and in section 2B-202 and 203 is to bring the Draft into conformance with existing Article 2, but to provide standards and clarification for decisions made in what is definitely a complex and uncertain area.

Reporter's Note:

1. This Section deals with cases where the writing, if any, do not themselves establish that a contract exists, but a contract is formed by conduct. It thus conforms in general context with 2-207(c) in current law. The section is no longer limited to standard forms.

2. In cases not involving the classic "battle of forms" generated in modern markets, subsection (a) applies to determining what terms govern the contract. Subsection (a) requires that the court consider the entire context. It generally conforms in that setting to common law principles. In cases involving an exchange of writings that do not entirely agree, the typical interpretation approach involves considering all of the terms of all of the writings and reconciling them in light of all the circumstances. See Abram & Tracy, Inc. v. Smith, 88 Ohio App.3d 253, 623 N.E.2d 704, 708 (1993) ("Generally, a writing should be interpreted as a whole and all the writings that are part of the same transaction should be interpreted together."); Restatement (Second) of Contracts § 202(1) (2) (1981); 2 Farnsworth, Contracts § 7.10 (1990). In such unstructured environments, requiring that a court adopt a "knock-out" rule such as that described here would needlessly place blinders and restraints on courts whose focus in such settings should more generally deal with determining the intent of the parties. Since Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., this rule allows courts to continue existing practice, rather than enforcing an entirely new regime on the interpretation process.

3. Current Article 2-207 is not limited to standard forms, but the cases and literature concentrate largely on the problem of the exchange of forms that disagree on important matters. **If the exchanged forms create a contract, this section does not apply.** Instead, under 2B-203, a contract forms around the terms of the offer with whatever additional terms are permitted there or, in the case of an effective conditional offer, around those terms. Subsection (d) confirms that result.

4. If the standard form writing do not establish a contract (e.g., because of a material conflict in terms or because of a failure to assent to a conditional offer), but conduct does create a contract, this section adopts a modified knock-out rule. 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. 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.

The rule here essentially excludes conflicting terms in the forms, regardless of which form was the first received or sent.

Illustration 1: a. In response to a standard order form from DuPont, Developer ships software subject to a form. The two forms disagree on warranty terms. Under (b), both warranty terms drop out and the default rules apply. **b.** If Developer sends an E-mail or a letter rather than a standard form, rejecting the proposed warranty terms, but goes 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. Subsection (a) governs.

5. This section identifies three cases where a knock-out rule would be inappropriate even though the parties exchanged standard forms. The **first** involves a case where one party, by conduct **and** by its form, conditions its agreement to a contract on the other party’s assent to its forms. Although a naked exchange of forms that conflict gives neither party priority, conditional offers or acceptances must be recognized and enforced when appropriate, even if made by a standard form. By matching the form with the behavior, a party expressly takes the transaction outside the battle of forms by actually conditioning participation in the contract on agreement to the terms of its form. Often, when this occurs, there is no agreement between the parties unless the other party assents to the conditional offer. See 2B-203.

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

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

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

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

(2) If an agreement exists, did the parties agree on scope and, if so, what agreement was reached? If there is an affirmative agreement on scope terms, that affirmative agreement governs and,

pursuant to this section, the agreed terms take precedence over any terms in the forms of either party.

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

PART 3

CONSTRUCTION

[A. General]

SECTION 2B-301. PAROL OR EXTRINSIC EVIDENCE.

Terms with respect to which confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to such ~~the~~ terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement~~.~~ ~~However, the terms~~ but may be explained or supplemented ~~by~~:

(1) by course of ~~performance, course of~~ dealing, or usage of trade (Section 1-205) or by course of performance (Section 2B-302); and

(2) by evidence of

consistent additional terms unless the court finds ~~that~~ the record to have been intended also as a complete and exclusive statement 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.

c. At the 1997 Annual Meeting, a sense of the house motion was adopted to harmonize the parol evidence rules in the three articles.

Reporter's Notes:

1. This Draft follows current Article 2 with edits to return to that language.

2. UNIDROIT Principles of International Commercial Contract Law provide that a: "contract in writing

which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing." Art. 2.17.

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

(a) Where the~~If an~~ contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other~~ party~~, any course of performance accepted or acquiesced in without objection ~~is~~ shall be relevant ~~in~~ to determine~~ing~~ the meaning of the agreement.

(b) The e~~E~~xpress terms of an agreement and any such~~,~~ course of performance, as well as any course of dealing~~,~~ and usage of ~~trade~~ trade, shall ~~must~~ be construed whenever reasonable as consistent with each other; ~~.~~ ~~However, if that~~but when such construction is unreasonable~~:~~

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

~~(2)~~

~~course of~~ performance controls ~~over~~ both course of dealing and usage of trade,~~;~~ and ~~(3)~~ course of dealing controls over usage of trade.

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

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

Committee Vote:

a. The Committee voted unanimously to adopt this section. (September, 1996)

b. Reviewed without substantive comment in April, 1997.

This section was edited to correspond to

existing Article 2 language.

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement ~~which~~ modifing~~es~~ a contract within this Article ~~is~~ needs no consideration to be binding ~~without consideration~~.

(b) An ~~agreement that contains a term that~~authenticated record which excludes modification or rescission except by an authenticated record ~~authenticated may~~ cannot otherwise be modified or rescinded. However, in a standard form supplied by a merchant to a consumer, a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.

(c) The requirements Section 2B-201 must be satisfied if the contract as modified is within its provisions.

(d) Although an attempt~~ed~~ at modification or rescission ~~that~~ does not satisfy the requirements of subsection (2~~b~~) or (3) it ~~may~~ can operate as a waiver subject to Section 2B-620(e).

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

Committee Vote:

a. The Committee voted 12-1 to approve the section and the use of manifest assent.

b. The Committee voted to retain the reference to consumer, rather than mass market. (11-1) (Feb. 1997).

c. The Committee rejected a motion to make a "no oral modification" clause unenforceable in a consumer transaction. (1-10) (April, 1997).

Reporter's Notes:

1. **The Section has been modified to follow existing Article 2-209 except for a change in substance voted by the Committee. Subsection (5) of 2-209 is not included here but is included in the separate Article 2B section on waivers, reference to which is made.** In subsection (2), Article 2 and Article 2A require no oral modification terms to be signed by the consumer; that concept appears here in the form of a requirement of manifestation of assent to the term, rather than signature. This allows the concept to operate in electronic environments where signatures / authentication is not feasible, while still providing protection in the form of binding the

consumer only to terms where the consumer affirmatively and specifically adopted.

2. As in Article 2-209, the statute of frauds provisions are expressly applied to modifications by subsection (3). Thus, if the agreement of the parties limits enforceability to modifications that are in a record, that agreement will be enforced. The rule is especially important in the on-going relationships that characterize many commercial licenses and development contracts.

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of an agreement involving repeated performances apply to all later performances unless modified in accordance with this article, even if the terms are not subsequently displayed or otherwise brought to the attention of the parties or electronic agents in the context of the later performance.

(b) A modification in good faith of the terms of a continuing contract made pursuant to a term in a contract providing that the contract may be modified as to future performances by compliance with a described contractual procedure is effective if:

(1) compliance with the procedure reasonably notifies the other party of the change; and

(2) in a mass-market license, the

procedure permits the licensee to terminate the contract if the modification deals with a material term and the licensee in good faith determines that the modification is unacceptable.

(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:

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. What constitutes notification varies depending on the circumstances. In many cases, reasonable notification requires notification before the change is effect, but in some emergency situations, notice that coincides with the change or follows the change would be sufficient (e.g., blocking access to a virus infected site, or a change in the access codes required for access). See 12 CFR 205.8(a)(2) as an example. The standard requires that the party be notified of the change. A procedure for the posting of changes in an accessible location of which the other party is aware will ordinarily satisfy this section.

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.

4. This subsection deals with changes in contract terms and does not cover changes in the content made available under an access contract, such as a multifaceted database. Under subsection 2B-614(a), an access contract grants rights of access to materials **as changed and modified** by the licensor over time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete an element of the databases made available does not modify the contract, but merely constitutes performance by the licensor and is not within this subsection. Withdrawal is without penalty, but the mass market licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due at that time).

SECTION 2B-305. OPEN TERMS.

(a) An agreement that is

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

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

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

(1) Specification must be made in good faith.

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

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

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

(d) An agreement that provides that the

performance of one party be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied. However, the agreement requires performance to the subjective satisfaction of the other party to the extent that:

(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.

Uniform Law Source: Section 2-305; Section 2-311; Restatement 228. 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 <u>if</u> 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.

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

(a) A ~~contractual~~ term ~~that~~ which measures the quantity or volume of use by the output of the licensor or the requirements of the licensee means such actual output or requirements ~~that~~ as may occur in good faith ~~. A party may~~

~~not offer or demand~~ ~~a~~except that no quantity or volume of use unreasonably disproportionate to a stated estimate or~~,~~ in the absence of a stated estimate, to any normal or otherwise comparable ~~previous~~ prior output or requirements may be tendered or demanded unless there are no outputs or requirements in good faith.

(b) A~~n~~ lawful agreement by either the licensor or the licensee for exclusive dealing in the kind of information concerned imposes an obligation by the~~on a~~ licensor that is the exclusive supplier to use good faith efforts to supply, and by the~~on a~~ licensee that is the exclusive distributor to use good faith efforts to promote, the information ~~or product~~ commercially.

Uniform Statutory Source: Section 2-306.

Committee Vote:

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

Reporter's Notes:

This section was edited to correspond to Article 2 except where a substantive change was intended.

1. Licenses do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. A prime characteristic of information as a subject matter of a transaction lies in the fact that the information is subject to reproduction and use in relatively unlimited numbers; the goods on which they may be copied are often the least

significant aspect of a commercial deal. Rather than supply needs or sell output, the typical approach would be to license the commercial user to use the information subject to an obligation to pay royalties based on the volume or other measurable quantity figure.

2. Subsection (b) accommodates the various bodies of law that pertain to exclusive dealing relationships in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for resale by the other party. Article 2 and case law dealing with patent licensing create a best efforts default rule. Article 2-306 creates the same rule for goods. That rule, however, is not the law in other fields governed by Article 2B and, in any event, uses a standard that has been difficult if not impossible to define with reliability.

After extended discussion of the standard, no clear resolution was reached. The final basic choice was between reasonable commercial efforts and good faith. After the April, 1997 meeting, the Reporter reviewed the possibility of employing a business judgment standard, but that was rejected for several reasons, including questions about with reference to which business and about how corporate law decisions about conflict of interest handles situations where one party has two products of similar type. The approach suggested here relies on a good faith standard - honesty in fact and adherence to commercial standards of fair dealing. This allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. Interpretation]

SECTION 2B-307. INTERPRETATION OF GRANT.

(a) A license grants 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 neither ~~not~~ expressly granted nor expressly withheld breaches ~~exceeds~~ this implied limitation unless the use was necessary to the granted uses or would be legally permitted in the absence of the implied limitation.

(b) A license that does not specify the number of simultaneous users permitted only authorizes use by one party at any one time. However, if the license authorizes display or performance of the information, it permits viewing by any number of persons but only of a single display or performance 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, 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 the information. A licensor's agreement to provide updates to or new versions of information requires provision of ~~that the~~

~~licensor provide only such~~ updates or new versions ~~that are~~ developed by the licensor from time to time for use by third parties and made generally available ~~unless the agreement otherwise expressly provides~~.

(d) Terms dealing with the scope and subject matter of an agreement must be construed under ordinary principles of contract interpretation in light of the commercial context. In ~~interpreting language of a license grant, a court shall look to the commercial circumstances of the transaction and, in~~

addition, the following rules apply:

(1) A grant of "all possible rights and media" in information, "all rights and media now known or later devised", or similar terms, includes all rights then existing or created by law in the future and all uses, media, modes of transmission, and methods of distribution or exhibition in all technologies or applications then existing or developed in the future, whether or not anticipated at the time of the grant.

(2) A grant of "all possible

rights", "all rights now known or later devised", or similar terms, includes all rights then existing or created by law in the future, whether or not anticipated at the time of the grant.

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

(4) In a contract between

merchants, a grant of a "quitclaim" of rights, or a grant in similar terms, is a contract without implied warranties as to infringement or the rights actually possessed and transferred by the grantor.

(5) A grant of ~~that states that it is~~ an "exclusive license", or in ~~uses~~ similar terms, conveys to the licensee exclusive rights in the information as against the licensor and all other 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. 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.

3. 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, scholarly use of a direct quotation from a licensed text not covered by confidentiality restrictions would likely be a fair use and would not conflict with the implied limitation. Sitting in one's office doing a letter to a family friend using software that is under a commercial use license would likely not conflict with any implied limitation. 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 picture s.” 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-counseled parties.

Illustration 4: Same as illustration 2, except that the license provides in addition to the grant that “all uses not expressly granted are expressly reserved to the licensor.” This is the same as Illustration 3. **Illustration 5.** EXL licenses software to Dangerfield. The license is silent regarding reverse engineering and consumer use, but expressly gives Dangerfield the right to use the software in the 1000 person network Dangerfield operates for its employees. Dangerfield reverse engineers the software to discover its interface with Digital Computer systems for purposes of making a new system. Also, a Dangerfield employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is clearly authorized since it would be a fair use if the implied limitation were not present. The reverse engineering would also most likely be authorized under case law allowing reverse engineering if necessary to discover interoperability requirements.

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

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

Illustr

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

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

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

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

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

8. Subsection (d)(3) deals with the effect of language of exclusivity in a grant. The case law and treatises on this issue are in conflict. The issue focuses on two distinct elements: **a looking forward and looking backward issue about exclusivity as to other persons, and the issue of whether the exclusivity also applies to actions of the licensor.**

SECTION 2B-308. DURATION OF CONTRACT. If an agreement is indefinite in duration, the following rules apply:

(1) Except as provided in paragraph (2), the duration is a reasonable time determined in light of the commercial circumstances unless this article or other law provides for a different duration,~~term.~~ but if a party is required to render successive performances to the other party, the agreement may be terminated at any time during that

duration on reasonable notice by either party.

(2) If the agreement provides for the sale or delivery of a copy on a physical medium [for the payment of a single fee at the outset of the contract] [and neither party is required to render successive ~~on-going affirmative~~ performances to the other party after delivery], the duration of a license as to use of the information in that copy is perpetual subject to cancellation for breach of contract.

~~(3) In an agreement~~

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

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

Committee Votes:

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

Reporter's Note:

This section was modified to more closely conform to existing Article 2 in the use of the phrase "successive performances."

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

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

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

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

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

2. Paragraph (1) refers to other law as providing other terms for a contract. In this field, there are various federal policy considerations that impinge on the duration of licenses and which may have an impact here. This can occur either through direct application of the other law or by its influence on determining what is a reasonable time. Thus, for example, a patent license that does not state its term can reasonably be presumed (at least in many cases) as extending for the life and validity of the patent. A similar premise exists with reference to an indefinite copyright license term. This interpretation would also allow a court to take into account the patent law premise that invalidity of a patent invalidates royalty obligations as to that patent.

3. Paragraph (2) differs from Article 2 and general common law in presuming a perpetual term for a license associated with the sale or delivery of a tangible copy. This rule corresponds to licensing practice in general. It applies, as redrafted, to cases where neither party has an obligation to deliver on-going

affirmative performances to the other party. This language is intended to clarify what, under current Article 2 is a reference to a contract that does (does not) entail "successive performances."

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

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

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

SECTION 2B-309. RIGHTS TO INFORMATION IN ORIGINATING PARTY.

(a) ~~Except as~~

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

(1) As

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

(2)

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

(b) ~~Except as otherwise provided in subsection (c), i~~If technical or scientific information is developed during the performance of an ~~the~~ agreement, as between the parties, the following rules apply:

(1) If information is developed jointly by the parties, rights in the information are held jointly ~~by both parties~~ subject to the

obligation of each to handle the information in a manner consistent with protection of the reasonable expectations of the others respecting confidentiality.

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

(c) This section does not apply to transactional data, including information collected to initiate or maintain a contractual relationship, maintained to effect or record a transaction, or used to describe the subject matter of the transaction, or to information intended by the parties to be published by the licensee.

Uniform Law Source: None.

Committee Votes:

1. Voted unanimously to approve the section in principle.

Reporter's Note:

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

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

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

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

[C. Electronics]

SECTION 2B-310~~1~~. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, a "restraint" means a program, code, device or other limitation that restricts use of information.

(b) A party entitled to enforce a contractual limitation or restriction that does not depend on the existence or non-existence of a breach may include in the information and utilize a restraint that restricts use in a manner consistent with the agreement if:

(1) a term in the contract authorizes use of the restraint;

(2) the restraint merely prevents uses of the information inconsistent with the agreement, or with a licensor's rights under intellectual property law that were not granted to the licensee;

(3)

the information is obtained for a stated period of time not more than 90 days or a stated number of uses and the restraint merely enforces that limitation; or

(4)

the restraint prevents use at the expiration of the term of the license and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) Operation of a restraint authorized under (a) is not a breach of contract, and the party that included the restraint is not liable for any loss created by its operation. Operation of a restraint which prevents use permitted by the agreement is a breach of contract. Nothing in subsections (a)(2), (3) or (4) authorizes a restraint that affirmatively prevents a licensee's access to its own information from its own resource without use of the licensor's information.

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

~~(c) A restraint included in information in accordance with this section or as authorized under other law is not a virus for purposes of Section 2B-313.~~

Uniform Law Source: None

Reporter's Notes:

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. Of course, the electronic regulation discussed here assumes that the licensor is enforcing a restriction that is, itself, enforceable under applicable intellectual property and contract law that may limit license terms in some cases. 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 (b) distinguishes between active and passive electronic devices. An active device terminates the ability to make any further use of the information. These are dealt with in subsection (b)(1) and subsections (b)(3)(4). Passive devices merely prevent unauthorized use, but leave the subject matter otherwise unaltered. These are dealt with in subsection (b)(2). The concept of an active device.

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

Illustration 1: The license provides that no more than five users may employ the word processing software at any one time. An electronic counter is embedded in the software and, if a sixth user attempt to sign on for simultaneous use, that sixth user is denied access until another user discontinues use. This limiting device is effective without prior notice or contractual authorization.

Illustration 2: The same situation as in Illustration 1, except that the limiting device permanently disables the software if a sixth user attempts access. This device is not authorized by subsection (b)(2). It involves a form of cancellation for breach. Section 2B-716 applies.

Illustration 3.

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

5. Subsection (b)(2) allows use of passive devices that merely preclude infringing intellectual property rights reserved to the licensor. Merely preventing the act does not require contract or other notice. Thus, for example, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so is authorized under (b)(2).

6. The devices described in subsections (b)(3) and (b)(4) may be passive or active. Since this section deals only with cases where no breach of contract occurs, the contractual right to do this arises only in the event of termination pursuant to contractual terms. Subsections (b)(3) and (b)(4) state the basic principle in such cases. Creation and use of the electronic means to terminate a contract (end it other than for breach) requires either a contractual term that permits the action (b)(1), a short term contract (b)(3), or reasonable notice before termination. If notice is required, of course, it can come directly from the licensor (a letter, e-mail, or telephone call) or through operation of the electronic restraint.

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

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

Illustration 4. A software license requires monthly payments of $1,000 due on the first of the month and covers a one year term with a right to renew based on written notice before the expiration of the term. Licensee makes a payment five days late because of accounting proble ms. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract. The section on self-help applies and the action may be appropriate if the breach was material.

Illustration 5. In Illustration 4, there was no late payment, but the licensee fails to give notice of renewal within the contractual time period. Licensor turns off the software. This action is covered by this section. The termination electronically is valid if either the contract contained a term authorizing that action, or the licensor or the device gave prior, reasonable notice of termination to the licensee.

6. Subsection (c) states the obvious premise that actions consistent with a contract are not a breach and do not give rise to liability under this Article or the contract. What this section permits is enforcement of contract terms with respect to the subject matter of the contract. It does not deal with rights to exclude, block out, or otherwise impact other information owned by or licensed to the licensee.

PART 4

WARRANTIES

SECTION

2B-401.

WARRANTY AND OBLIGATIONS CONCERNING AUTHORITY AND NONINFRINGEMENT.

(a) A licensor warrants that:

(1) for the contract term no person holds a claim to or interest in the information that arose from an act or omission of the licensor, other than a claim by way of ~~a claim of~~ infringement or the like, which will interfere with the licensee’s enjoyment of its ~~rights under the contract~~license interest;

(2) in an exclusive license,

the intellectual property rights that are the subject of the license are valid and exclusive within the scope of the license for the information delivered as a whole; and

(3) ~~if the~~except for financier, a licensor of information who is a merchant regularly dealing in information of the kind~~;~~ warrants that the information ~~is~~ shall be delivered free of the rightful claim of any third person by way of infringement.~~, except that a party who acts as a conduit for information of another warrants only that it has no~~

~~[knowledge] [notice] that the information infringes the rights of third parties.~~

(b) The warranties in this section are subject to the following:

(1) If intellectual property rights are subject to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) Unless the contract expressly applies to uses or rights outside the United States, the warranties under (a)(2) and (a)(3) apply solely to rights arising under the intellectual property

laws of the United States or a state thereof. If the license of an intellectual property right expressly includes territories outside the country of its origin, the warranties under subsection (a)(2) and (3) extend only to countries specifically named in the license ~~and countries included in the license but not named that, at the time of the license, had entered into a treaty or other binding international obligation granting the foreign intellectual property right protection under the applicable intellectual property~~

~~law~~.

(c) A licensee that furnishes ~~technical~~ specifications to a licensor or financier shall hold the licensor and financier harmless against any claim of infringement that arises out of compliance with the specifications~~.~~ [unless options were reasonably available to the licensor to implement the specifications without infringement].

(d) A warranty under this section ~~may~~ will be ~~disclaimed~~ excluded or modified only by ~~express~~ specific language or by circumstances ~~giving~~ which give 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 it is conspicuous as to that term. Otherwise, language in a record is sufficient if it states "There is no warranty of quiet enjoyment or against infringement", 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.

c. Voted to move the section toward standards applicable under current Article 2. Vote 11- 0.

d. Voted to delete an express exception for a conduit and to express the sense of the Committee that a mere passive transmittal entity is not intended to be covered in this context. Vote 12 – 0.

REPORTER'S NOTES:

This Draft implements the Committee vote and the discussion at the September, 1997 meeting to return the substantive standards here to correspond to Article 2 and Article 2A. Edits were made to bring in language identical to Article 2 in several cases. The Draft also suggests a solution (discussed below) to the issue of dealing with "conduit" liability. Finally bracketed language is provided with respect to licensee hold harmless obligations which is intended to limit that obligation to cases where the infringement was caused in fact by the specifications, rather than by options exercised by the licensor.

1. Subsection (a) contains the affirmative warranties. Subsection (a)(1) deals 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).

2. Subsections (a)(2) and (a)(3) deal with intellectual property risks. 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.

3. Subsection (a)(2) deals with the first two of theseand 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 since it does not affect the right to use the information. The subsection also deals with exclusivity. That 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)(2) reflects practice in motion picture and publishing industries and is 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 **non-exclusive licenses**, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant. It does not alter the end user's ability to continue to use the licensed rights without challenge. A license from one co-owner adequately grants rights to the licensee and the dispute would then shift to one between the two co-owners to determine accounting for and distribution of the proceeds f the license.

4. The subsection (a)(3) and (c) have been the subject of extensive discussion. This Draft conforms to the Committee vote and adopts current law under both existing Article 2 and Article 2A in defining the warranty and hold harmless obligations relating to infringement risk. The warranty is absolute and does not depend on there being knowledge of the infringement. As in Article 2 and 2A, it creates an "as delivered" warranty. <u>Motorola, Inc. v. Varo, Inc.,</u> 656 F. Supp. 716 (N.D. Tex. 1986). Section 2A-211 speaks 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."

5. The

adoption of the Article 2 approach in this Draft highlighted an issue of how to deal with passive transmission entities whose contracts might fall within Article 2B. In the area of copyright infringement, the issue of under what circumstances a transmittal entity has liability for infringement is a major political question. Article 2B is a contract statute and has no impact on or direct relationship to federal infringement questions. See 2B-105. This section states an affirmative obligation which, as drafted, creates an implied warranty of non-infringement by licensors of information. This excludes many of the cases where the copyright infringement issue is most difficult. It flows from the contract law premise that commitments about the absence of infringing material between two parties to a contract are appropriate in transactions in the provision of information as compared to services contracts that might (or might not) fall within the Article 2B concept of an access contract. When, or whether, a particular contracting party is a "licensor of information" for contract law, will depend on the circumstances of the contract. It has no bearing on questions about when or whether a passive transmission provider has liability to the owner of the intellectual property rights. To the extent that this discussion does not make that point clear, it will be amplified in the official comments to the draft.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) Subject to subsection (c), ~~a licensor creates an~~ express warranties are created by the licensor as follows:

(1) An affirmation of fact or~~,~~ promise~~, or description of information~~ made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information and any services required under the agreement will conform to the

affirmation or~~,~~ promise~~, or~~ ~~description~~.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will reasonably conform to the performance illustrated by the model, sample, or demonstration,

taking into account such differences between the sample, model, or demonstration and the information as it would be used as would be apparent to a reasonable person in the position of the licensee.

(b) It is not necessary to the creation of an express warranty that the licensor ~~The licensor need not~~ use formal words~~,~~ such as "warrant" or "guarantee", or state a specific intention to make a warranty, but an~~. However, a mere~~ affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics or market appeal of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) This section does not create any express warranty for published informational content but does not preclude the creation of an express warranty for published informational content under other law or the creation of an express contractual obligation. If an express obligation in contract is established for published informational content and that obligation is breached, the remedies of the aggrieved party arise under this article.

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 and that the issue can be made clear in the comments.

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.

d. Motion to change the presentation of the except clause for published informational content, making an affirmative statement in (c) that leaves the development of obligations for informational content to common law under standards evolved therein. Adopted: 6-2 (June, 1997)

Reporter's Note: **Subsection (c) implements the Committee vote clarifying that the Article is neutral on the basis for the creation of express obligations for published content, leaving that issue to other law. Based on concerns expressed at the 1997 Annual Meeting, language has been added to clarify that, while the creation of express contract obligations does not occur under the basis of the bargain test for published content, an obligation created and breached gives rise to remedies under this Article.**

1. This section adopts existing law with edits to more closely conform to the text of current Article 2 except where differences in subject matter and approach are intended. It preserves current law relating to express warranty obligations in reference to published information content.

2. The section retains the "basis

of the bargain" standard from current law relating to transactions in goods. This allows courts and parties to draw on an extensive body of case law for distinguishing express warranties from puffing and other, non-enforceable statements. While the cases involve many difficult factual determinations, they provide better guidance than would an entirely new standard. See, e.g., Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. 1977); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495 (E.D.N.Y. 1984), rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986); Management Sys. Assocs. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985); Consolidated Data Terminal v. Applied Digital Systems Inc., 708 F.2d 385 (9th Cir. 1983) ("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) (express warranty that 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 proposed revisions of Article 2, an extended debate and new structure has developed for warranties through advertising. That debate was triggered in part by the adoption of an entirely new approach to warranties in in that proposal. Subsection (a)(1) makes clear that advertising can create an express warranty if the basis of the bargain test is met. Article 2B clarifies appropriate law on this point. No conceptual barrier exists to a published statement becoming part of the bargain sufficient to constitute a warranty.

3. Subsection (a)(2) deals with samples and the use of beta models. These are employed in testing not yet completed products. A beta model may include elements that are not carried into the final product and may include defects that are not cured in the final product. In either event, the parties both expect that the product being demonstrated or used is not representative of what will eventually be the product and the exclusion here is designed to protect against harm to either party as a result (e.g., licensee believes a defect will be cured, but it is not cured; licensor elects to delete an element in the test model when it produces the eventual product).

4. The section also preserves current 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 for 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. As stated in Subsection (c), 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 largely unknown change or over-reaching of liability in a sensitive area.

5. The term, "published information content" focuses on information **content** not customized to particular end users. (see Section 2B-102) The exclusion follows current law, requiring more than just general, undifferentiated statement for expanding liability in the public market of ideas and content. The basic assumption in current law is that liability for information content does not exist unless there is a special or direct relationship creating it. There are no cases using warranty theory for generally distributed information based on contract concepts and only a small number of cases under other contract theory.

SECTION 2B-403. IMPLIED WARRANTY: MERCHANTABILITY AND QUALITY OF COMPUTER PROGRAM.

Unless excluded or modified, ~~Subject to Sections 2B-406, 2B-407 and 2B-408, in a mass-market transaction a licensor that is a merchant with respect to information of the kind that provides a computer program to a licensee makes an implied~~ a warranty that the computer program and media ~~are~~ shall be merchantable is implied in a mass-market transaction if the licensor is a merchant with respect to computer programs of that kind.

~~:~~ To be merchantable, the computer program and any physical medium containing the program at minimum must:

(1) pass without objection in the trade under the contract description;

(2) be fit for the ordinary purposes for which it is distributed;

(3) ~~)~~ ~~conform to the promise or affirmations of fact made on the container or label, if any;~~

~~(4)~~ in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved; and

(4~~5~~) be adequately contained, packaged and labeled as the agreement ~~or circumstances~~ may require; and

(5) conform to the promise or affirmations of fact made on the container or label if any.~~:~~

(b) In cases not governed by subsection (a), a licensor that is a merchant with respect to computer programs of that kind ~~and delivers a program to a licensee~~ warrants to its licensee that any physical medium on which the program is transferred is merchantable and that the computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation provided by the licensor at or before the delivery of the program. However, an ~~mere~~ affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics or market appeal of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) A warranty under this section pertains to the functionality of a computer program, but does not pertain to informational content in software, or to the quality, aesthetic appeal, marketability, accuracy, or other characteristics of the informational content.

Uniform Law Source: Section 2-314; 2A-212. Revised.

Committee Votes:

a. Rejected a motion to add language warranting that the program will not damage ordinary configured systems because no "ordinary system" exists in modern licensing and the general premise is covered under the language of existing Article 2 as brought forward here.

b. Voted 10-2 to use "mass market" in this section, rather than "consumer." (Feb. 1997)

Reporter's Notes:

Edited based on the harmonization meeting to more conform to existing Article 2 except as to substantive differences.

During the June Meeting in a memorandum signed by a leading consumer advocate and an attorney from a major publisher, the following alternative formulation of subsections (a) and (b) was suggested:

(a) A merchant licensor of a computer program warrants to the end user that the computer program is reasonably fit for the ordinary purpose for which it is distributed.

(b) A merchant licensor of a computer program warrants to a retailer that (1) the program is adequately packaged and labeled as the agreement or circumstances may require; and (2) in the case of multiple copies, that the copies are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all the units involved.

This proposal should be considered by the Committee and reflects earlier proposals in the Draft to consider a restructuring of the merchantability warranty in a manner that would provide acceptable and tailored protections for both sides, thereby reducing the desirability of disclaimers except in exceptional cases. The proposal follows part of the tradition under which the original Article 2 warranty was developed. As explained in the Comments to the current 2-314, some of the various elements of the warranty were developed for specific types of products (e.g., "fair average" developed with reference primarily for agricultural bulk products, "adequately packaged" refers to cases where agreement requires a certain type of container).

General Notes:

1. Article 2B warranties blend three different legal traditions. **One** tradition stems from the UCC and focuses on the quality of the product. This tradition centers on the result delivered: a product that conforms to ordinary standards of performance. The **second** tradition stems from common law, including cases on licenses, services contracts and information contracts. This tradition focuses on how a contract is performed, the process rather than the result. The obligations of the transferor are to perform in a reasonably careful and workmanlike manner. The **third** tradition comes from the area of contracts dealing with informational content and essentially disallows implied obligations of accuracy or otherwise in reference to information transferred outside of a special relationship of reliance. Current law selects the applicable tradition in part based on characterizations about whether a transaction involves goods or not. That distinction is not reliable in information contracting, especially in light of the ability to transfer ~~intangibles~~ information electronically without the use of any tangible property to carry the intangibles.

2. This section and the next following section define the basis on which the different traditions apply, focusing on a distinction between "computer programs" and services or informational content. This expands the scope of the quality warranty here by including at least some cases where a court would otherwise conclude that the transaction is actually a services contract. See, e.g.,, Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W. D. Pa. 1991) (license of manufacturing process described as "services"). Compare Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992); The Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993)

3. The two implied warranties are not mutually exclusive. In many cases, both will apply to the same transaction and the same digital product (e.g., an encyclopedia). In the final comments to the statute, notes will be developed containing illustrations indicating the manner in which the warranties work together.

Illustration 1: Party A contrac

ts to transfer software to Party B that will allow B to process its accounts receivable. Whether the transfer is by diskette or by electronic conveyance into B's computer, the implied warranty in this section applies. <u>Under current law, this would be a transaction in goods with an implied warranty attached to the performance of the product.</u>

Illustration 2: Party A licenses Party B to use a copy of the Marvel Encyclopedia. This warranty applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia. Under current law, this would be an information contract most likely involving no warranty about the accuracy of the information. **Illustration 3:** Party A reaches a license with Party B. Party A will transfer its data to B's computer for processing there. B agrees to return various reports and summaries to

A. The 2B-403 warranty does not apply since the contract did not deliver a computer program to A, but use of B's facility. Under current law, most cases hold that this is a services contract containing at most a warranty of workmanlike conduct; it is governed here under general standards of contract and by the implied warranty in Section 2B-404.

4. Merchantability sets the standard for computer programs in the mass market, where the idea of comparing a particular program to other mass market programs of similar type. This draft uses a substantial conformance to documentation standard for non-mass market software. That warranty is common in commercial licenses. The prevalence in commercial cases of disclaiming merchantability is such that virtually no software cases dealing with that warranty. The reliance on conformance to documentation reflects the wide range of variations involved in the non-mass market. The two standards both give assurances of quality, but focus on different reference points. Merchantability asks what are normal characteristics of ordinary products of this type, while the documentation warranty focuses on the manuals and contours of the particular product. Beside conforming to ordinary commercial practice (e.g., disclaim merchantability and give substantial conformance warranty), the substantive question here deals with whether merchantability is a relevant standard and at all protective in cases where software is often relatively unique. For example, assume a commercial computer program that provides data compression functions on an ABC computer with an XYZ operating system. Merchantability would ask whether that product passes without objection among all data compression products of all types (e.g., mass market, Windows-based, Apple systems, etc.) even though the particular environment, approach and capabilities of this product may be unique. How that standard protects the licensee is not clear and in fact it may set out standards well below what the documentation provides.

5. Most agreements disclaim merchantability; there are few reported commercial cases involving merchantability in any industry. Most licenses substitute a warranty of conformance to documentation. The section treats this as the presumed warranty, conforming to a commercial norm. This warranty measures performance by reference to what is said about the particular product. The argument in favor of retaining a merchantability warranty for transactions is that it would maintain a congruence between this article and Article 2 and 2A. This may be ephemeral and could be reversed: those articles should adapt to commercial practice. Merchantability measures performance obligations by reference to other like products, while the documentation warranty measures performance by what the licensor says about its product.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Subject to Sections 2B-406, 2B-407, and 2B-408, and to subsections (b) and (c), a merchant that provides informational content in a special relationship of reliance or that provides services to collect, compile, transcribe, process, or transmit informational content, warrants to its licensee that there is no inaccuracy in the informational content caused by its failure to exercise reasonable care and workmanlike effort in its performance.

(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, which is merely incidental to an- 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 no more that 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 is not avoided 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 system. "[Those] who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct ... unless the parties have contractually bound themselves to a higher standard of performance..."

2. Restatement (Second) of Torts § 552 regarding negligent misrepresentation provides a framework. It states that: "One who, in the cause of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."

In most states, this liability does not exist in the absence of a "special relationship" between the parties justifying a duty of reasonable care. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship); A.T. Kearney v. IBM, -- F.3d – (9th Cir. 1997). The obligation consists of a commitment that the content provided will not be wrong due to a failure by the provider to exercise reasonable care. Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (license of index; liability for inaccurate number tested under Restatement concepts in light of contractual disclaimer; information, although handled in commercial deals is not a product taking it outside this Restatement approach). Under Restatement case law, the obligation is limited to cases involving a special or fiduciary relationship. Under subsection (a) the obligation does not center on delivering a correct result, but on care and effort in performing. A contracting party that provides inaccurate information does not breach unless the inaccuracy is attributable to fault on its part. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Liability under the Restatement for inaccurate information exists only if the information was intended or designed to guide the business decisions of the other party. This section is not limited to cases involving business guidance.

3. The cases largely exclude liability for information distributed to the public. This concept is captured by the term "published informational content" in subsection (b)(2). "Published informational content" refers to information made available without being customized for a particular business situation of a particular licensee and where no "special relationship" of reliance exists between the parties. It is material made available in a standardized form to a public defined by the nature of the material involved. The information is not tailored to the client's needs. This definition and the liability exclusion reflects the vast majority of case law under the Restatement and modern values of not inhibiting the flow of content. The policy values supporting this stem in part from First Amendment considerations, but also from ingrained social norms about the value of information and of encouraging its distribution.

Illustration 1: Sam opens a website making available information on restaurants for a small monthly fee for subscribers. One item of information concer ning Restaurant A is incorrect and a subscriber has a bad experience because of the error. Sam's website contains published informational content and creates no warranty or resulting liability. The same would be true of a restaurant review in the New York Times. **Illustration 2:** Sam, an expert on restaurants, contracts with Able to provide advice about which restaurants should be included in Able's book on the "most profitable” Chicago restaurants. Sam makes a negligent error in providing a list of restaurants. Sam has liability under this warranty as to Able since the information is not “published informational content” but was tailored to the specific purposes of the specific client. When the book is published, however, no warranty exists for either provider to the end user since the book is published informational content.

4. Subsection (b) lists situations in which the warranty does not arise under current law. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy, an element present in current U.S. law and important in the publishing and entertainment industries affected by this Article. This point, although it could be inferred from the affirmative terms of the warranty, has substantial importance and language was added to this subsection based on suggestions from a licensee representative involved with entertainment issues.

5. Subsection (b)(4) states as a contract law principle case law that holds the publisher harmless from claims based on inaccuracies in third party materials that are merely distributed by it. In part, this case law stems from concerns about free speech and leaving commerce in information free from the encumbrance of liability where third parties develop the information. In cases of egregious conduct, ordinary principles of negligence apply. As a contractual matter, however, merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to that data by the third party. See Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991); Walter v. Bauer, 109 Misc 2d 189, 439 N.Y.S.2d 821 (S. Ct. 1981). Compare: Brockelsby v. United States, 767 F.2d 1288 (9th Cir. 1985) (liability for technical air charts where publisher designed product) (query whether this is a publicly

distributed product).

6. The issue is important for information systems analogous to newspapers and are treated as such here for purposes of contract law. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship). The District Court in Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information."

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Subject to Sections 2B-406, 2B-407 and 2B-408, except with respect to the aesthetic value, commercial success, or market appeal of informational content, if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish a suitable information:

(1) if, from all the circumstances, it appears that the contract is for a price for performance which will not be fully paid if the end product is not suitable for the

particular purpose, there is an implied warranty that the information will be fit for that purpose; but

(2) if, from all the circumstances, it appears that the licensor was to be paid for the amount of its time or effort regardless of the suitability of the end product, there is an implied warranty that there is no failure to achieve the licensee's particular purpose caused by the licensor's failure to exercise workmanlike effort to achieve the licensee's purpose in its performance.

(b) If an

agreement requires a licensor to provide or select a single or integrated system consisting of computer programs, hardware or similar components and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components, there is an implied warranty that the components selected will function together as a system.

(c) Subsection (a) does not apply to published informational content, but if the conditions of the subsection are met, may apply to the selection among different items of existing published informational content for the purposes of the particular licensee.

Uniform Law Source: **Section 2-315; 2A-213. Substantially revised.**

Committee Action:

a. A consensus to expand this section to cover all forms of information with the possibility of an exception or special treatment for published informational content and manufacturer/publishers.

Reporter's Note:

1. This section builds on existing Article 2-315, but substantially alters the concepts contained in that section to fit the diverse traditions that exist in the various information industries that are covered by Article 2B. In computer software contracts, the issues raised here are most often encountered in development and design contracts. There, the basic issue is whether (if not disclaimed) the appropriate implied obligation involves an obligation to produce a satisfactory result (present in sales of goods contract) or an obligation to make workmanlike efforts (present in services contracts). The software cases choose between a warranty of result and a warranty of effort based on whether the court views the transaction as involving goods (result) or services (effort). The reported cases split on this issue, often turning on the subjective impressions of the court, rather than on any differences in the actual transactions. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. 108, 546 N.E.2d 888 (1989) (goods); Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987) (goods) with Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988) (services); Wharton Management Group v. Sigma Consultants, Inc., 1990 WESTLAW 18360, aff'd 582 A.2d 936 (Del. 1990) (services contract); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) (services).

2. Software development contracts are covered under Article 2B without regard to classification of the contract as involving services or goods. Given that coverage, subsection (a) presents a different approach to determining which type of implied obligation is appropriate. That approach in effect attempts to directly identify a consistent factor that will indicate which type of implied obligation is appropriate in the circumstances. The factor centers on whether the agreement hinges payment on the time and effort spent (services like) or only on the completion of an adequate product (goods like). While the section refers to all of the circumstances as providing the basis for this determination, it is clear that the express contract terms on the relevant point control.

3. During the June Meeting, the Committee expanded the section to cover more than computer program cases. Given that expansion, a third body of case law becomes important as to warranties. This is the body of case law that holds that, in some situations, as a matter of law, the implied obligation of either type stated in subsection (a) can never arise. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977) (An implied warranty is inconsistent with the nature of the contract. Fitness of outcome can be contracted for only as an express warranty.). That approach is, of course, common in publishing and entertainment industries. In new subsection (c), it is made clear that the implied warranty does not arise for published content as to creation or distribution in general. It may arise, however, if an expert selects among existing products to suit the other party's needs.

4. Subsection (b) provides an implied warranty of system integration. This differs from the fitness concept, but is closely related to that concept. The obligation is that the selected components will actually function as a system. That is an additional step beyond the obvious fact that the components themselves must be separately functional in a manner consistent with the contract.

SECTION 2B-406. DISCLAIMER OR

MODIFICATION OF WARRANTY.

(a) ~~Language~~ Words or conduct relevant to the creation of an express warranty and ~~language~~ words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, ~~language~~ words or conduct disclaiming or modifying an express warranty is ~~ineffective~~ inoperative to the extent that such construction is unreasonable.

(b) Subject to subsection (c) and (d), to disclaim or to modify an implied warranty other than the warranty in 2B-401, the following rules apply:

(1) Except as otherwise provided in paragraph (5), language of disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty under Section 2B-403 or 2B-404, language that mentions "quality" or "merchantability" is sufficient as to Section 2B-403 and language that mentions

"accuracy", or words of similar import, is sufficient as to Section 2B-404. Language sufficient to disclaim or modify the implied warranty of merchantability in a transaction governed by Article 2 is sufficient to disclaim or modify 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 this information or my efforts will fulfill any of your particular purposes

or needs", or words of similar import. Language sufficient to disclaim or modify a warranty of fitness for a particular purpose under Article 2 is sufficient to disclaim or modify the warranty under Section 2B-405.

(c) Nothwithstanding subsection (b):

(1) Unless the circumstances indicate otherwise, all implied warranties are disclaimed by ~~language~~ expressions ~~stating that the information is provided~~like "as is," ~~or~~ "with all faults"~~;~~ or other language

that in common understanding calls the licensee's attention to the exclusion of ~~all~~ warranties and makes plain that there is no implied warranty; and~~.~~

~~(5)~~

~~An implied warranty may be disclaimed or modified by course of performance or course of dealing.~~

(2~~c~~)

There is no implied warranty with respect to a defect that before entering the contract was known by, discovered by, or disclosed to the licensee, or which would have been revealed to the licensee if it had not refused to make use of a reasonable opportunity provided to it prior to entering into the contract to examine, inspect, or test the information or a sample thereof , unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time; and

(3) an implied warranty can also be excluded or modified by course of dealing or course of performance [or usage of trade].

(d) In a mass-market license, language that disclaims or modifies an implied warranty must comply with subsection (b) and be conspicuous. To disclaim all implied warranties in a mass-market license, other than the warranty under Section 2B-401, language in a record is sufficient if it states: "Except for express warranties stated in this contract, if any, this [information] [computer program] is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user," or words of similar import.

(e) If a

contract requires ongoing performance or a series of performances by the licensor, language of disclaimer that complies with this section is effective with respect to all performance that occurs after the contract is formed.

(f) ~~A contractual term disclaiming implied warranties which complies with this section is not subject to invalidation under Section 2B-308(b)(1).~~

~~(g)~~ Remedies for breach of warranty may be limited in accordance with the provisions of this

A~~a~~rticle on liquidation or limitation of damages and contractual modification of remedy under Sections 2B-703 and 2B-704.

Uniform Law Source: **Section 2A-214.** **Revised.**

Selected Issues:

1. Should (c) be modified to conform to current law and revised Article 2 which provides: "If a buyer before entering into a contract has examined the goods, sample, or model as fully as desired or has declined to examine them, there is no implied warranty with regard to conditions that an examination in the circumstances would have revealed to it."

2. Should the section be modified to allow disclaimers that are not in a record as under current Article 2 and proposed revisions of Article 2 and 2A and in light of the recognition of oral contracts and exclusion of express warranties by conduct?

3. Should the section on disclaimer by course of dealing and course of performance reinstate disclaimer through "trade use" as under current Article 2 and revisions of Article 2 and 2A?

4. Should the disclaimer of merchantability etc. in subsection (b)(2) provide that the indicated words

"must" be used as in current Article 2, or should the "is sufficient" language be retained as in revisions of Article 2?

Committee Votes:

a. Voted to delete requirement of conspicuousness for non-mass market disclaimers.

b. Rejected a motion to delete conspicuousness for mass market contracts.

c. Rejected a motion to delete (b)(5) by a vote of 3 - 6.

d. Accepted a motion to delete (b)(6) by a vote of 6 -4 with the ability to rewrite to focus and clarify effects, perhaps in reference to known defects.

e. Adopted a motion to delete the reference to use of trade in (b)(5) by a vote of 8 - 2.

f. Adopted a motion to restrict the impact of the "as is" language to exclude coverage of 2B-405 because at that time that warranty created a services-like obligation. Vote was 6- 3.

g. Motion to adopt the idea of mass market, rather than the idea of consumer on disclaimers. Adopted 8-2 (Dec. 1996)

h. Motion to adopt language from Article 2 precluding disclaimer of consequential damages relating to personal injury, rejected by a vote of 2-8.

i. Motion to delete subsection (e) and replace that section with provision indicating that a term that is conspicuous is not a refusal term under 2B-308. Accepted 9-1

j. Voted 7-6 to use mass market, rather than consumer in this section. (Feb. 1997).

Reporter's Note: Edited to move closer to existing Article 2 language.

1. Subsection (a) restates current law.

2. Subsection (b) brings together provisions dealing with commercial disclaimers. Subsection (b)(1) requires that the disclaimer be in a record, thus not following the possibility in drafts of Article 2 that an oral disclaimer suffices Subsection (b)(2) sets out a safe harbor for the merchantability warranties and also allows an Article 2 disclaimer to be effective in reference to the two merchantability like warranties in Article 2B. The purpose of this latter rule is to avoid requiring that the guess about coverage of the two articles. Importantly, as in existing and revised Article 2, the specified language is not mandatory, but merely sets out a safe harbor. This language works, but other language may also work. (b)(3) provides a more common language disclaimer treatment than in current law.

3. Subsection (c) deals with concerns expressed during the November meeting

which deleted prior language taken directly from existing Article 2. The revised language emphasizes knowledge or opportunity to know of the defect and also expressly disallows a licensor's failure to disclose defects that it knows to be present. Equally important, by focusing on reasonable use and resulting disclosure, the redraft avoids the potential problem in which might disallow any implied warranty where inspection was as fully as the licensee "desired". In complex systems often provided through retail outlets, that standard is not workable.

3. Subsection (d) deals with mass-market disclaimers. The subsection adds two requirements applicable to mass market transactions that do not apply for other transactions. First, the disclaimer must be conspicuous. That requirement does not apply to commercial transactions in Article 2B. Second, if the intent is to disclaim all warranties in a single sentence, the subsection sets out a common language disclaimer based on proposals by the software industry as a means of giving more disclosure to the consumer of what is disclaimed. That language is a safe harbor, rather than a required statement.

5. Subsection (f) exempts disclaimers that qualify under this section from further consideration under the "refusal terms" concepts outlined in Section 2B-308.

6. Subsection (g) was added to conform to current law and revised Article 2.

SECTION 2B-407.

MODIFICATION OF COMPUTER PROGRAM.

Modification of a computer program by a licensee that was not made using capability of the program intended for tat purpose in the ordinary course of operation of the program invalidates any warranties, express or implied, regarding the performance of the modified copy of the program, but not the unmodified copy, unless the licensor agreed that the modification would not invalidate the warranty~~ or the modification was made using capabilities of the~~

~~program intended for that purpose in the ordinary course of operation of the program~~. A modification occurs if a licensee alters code, deletes code from, or adds code to the computer program.

Uniform Law Source: None

Reporter's Notes:

1. This method of losing warranty protection applies only to warranties related to the performance or results of the software. It does not apply to title and non-infringement warranties. More importantly, the voiding of performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

2. The basis for the provision lies in the fact that because of the complexity of software systems changes may cause unanticipated and uncertain results. This language follows common practice. It voids the warranties whether the modification is authorized or not unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes in the program that are not part of the program structure or options itself.

Thus, if a user employs the built-in capacity of a word processing program to tailor a menu of options suited to the end user's use of the program, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties as to the altered copy.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties, whether express or implied~~,~~ ~~must~~ shall be construed as consistent with each other and as cumulative~~.~~ ~~However~~, but if ~~that~~ such construction is unreasonable~~,~~ the intention of the parties shall determine~~s~~ which warranty ~~prevails~~is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications ~~prevail over~~displace an inconsistent sample, model, demonstration, or general language of description.

(2) A sample, model, or demonstration ~~prevails over~~displaces inconsistent general language of description.

(3) ~~An~~ ~~e~~Express warranties~~y~~ ~~prevails over an~~displace inconsistent implied warranties~~y~~ other than the implied warranty under ~~of~~

~~effort to achieve a purpose~~Section 2B-405(a).

Uniform Law Source: § 2-317.**Committee Action:**

Approved in principle.

Reporter's Note:

Modified to correspond to existing Article 2 language.

This Section follows existing Article 2. A substantive difference exists between this Draft and the proposed revisions to Article 2 which indicate that an express warranty does not prevail over inconsistent implied warranties in a consumer contract. The apparent intent of this is to eliminate the ability to replace implied merchantability warranties with express warranty concepts.

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for information made available as published informational content, a warranty made to a licensee extends to persons for whose benefit the licensor intends to supply the information, directly or indirectly, and which use the information in a transaction or application in which the licensor intends the information to be used.

(b) For purposes of this section, a licensor that provides the information to a consumer 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 or 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).

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 mater 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 <u>Artwear, Inc. v. Hughes,</u> 615 N.Y.S.2d 689 (1994). For a discussion of information liability to third parties, see <u>Bily v. Arthur Young & Co.</u>, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts <u>Restatement</u> 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.

PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If an agreement transfers ownership of intellectual property rights and does not specify when ownership is to pass~~; subject to the transferee's performance of its~~

~~obligations under the agreement~~, ownership passes to the transferee:

(1) if the information is in existence at that time, when the contract becomes enforceable between the parties and the information is identified to the contract; and

(2) if the information is not in existence when the contract becomes enforceable, when the information has been identified to the contract ~~and is distinguishable in fact from similar information~~ even if it has not been fully completed and any

required delivery has not yet occurred.

(b) Transfer of title to or possession of a copy of information does not transfer ownership of intellectual property rights in the information.

(c) In a license, the following rules apply to copies of information:

(1) Title to a copy is determined by the contract.

(2) A licensee's right to possession or control of a copy is governed by the contract and does not depend on title to the copy.

(3) Reservation of title to a copy reserves title in that copy and any copies made by the licensee unless the license contemplates that the licensee will make and transfer copies of the information to other purchasers, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(d) If the parties intend to transfer title to a copy and the contract does not specify when title transfers:

(1) delivery of a copy on a physical medium

transfers title to the copy on delivery to and acceptance by the licensee; and

(2) electronic delivery of a copy to the licensee transfers title of the copy when a first sale occurs under federal copyright law.

Uniform Law Source: Section 2-401; section 2A-302. Revised.

Committee Vote:

a. Voted 11-0 to delete a sentence restricting exercise of rights until it pays according to the terms of the contract. That concept can be transferred to comments in a form that also accommodates in kind and other value.

Reporter's Notes:

1. This section distinguishes title to the copy from ownership of the intellectual property rights, a point that is made explicit in subsection (b). This distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may carry with it some rights with respect to that copy, it does not convey ownership of the underlying rights to the

work of authorship or the patented technology. This represents a basic theme in differentiating intangibles and tangible objects. The media here is not the message, but the conduit.

2. Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that limit. The subsection solves the problem in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article 2 theories of title transfer to goods to hold that title to an intangible (a computer program) being developed for a client could not pass until the program was fully completed and delivered.) The transfer of title hinges on completion to a sufficient level that separates the transferred property from other property of the transferor. See In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallows transfer of title in software where "new" code could not be separately identified from old or pre-existing code.).

In this Draft: A change was made in the timing of the transfer of ownership to accommodate concerns about the following circumstance: developer substantially completes the program, but client refuses to make any payment, even though there are no defects. In this case, given the breach by the client, title should not be in the transferee.

3. **Under subsection (c)**, in a

license, the right to the copy of information depends on the terms of the contract and not on the label one applies to handling underlying media. As in Article 2A, this draft does not spell out title transfer rules with reference to licenses. The question of whether title to a copy in fact transfers in a license may depend on the terms of the license and the marketplace in which the license transaction occurs. Especially in many commercial licenses, it is inappropriate to presume that title does pass to the licensee in the absence of contractual reservation. The typical presumption is that the transfer there is conditional as reflected in the license terms. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (licenses transferred rights for exhibition or distribution and did not constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license not a sale).

The circumstances may be different in the mass market even where purchasers are aware that a license will be involved. As drafted, the section takes no position on that issue or how one distinguishes these cases. The mass market licensee receives protections under applicable default rules that are not based on title issues. If the issue were to become important in litigation and were not dealt with by contract, a court would presumably inquire about the intent of the parties as to title to the copy.

In subsection (c)(3), the primary rule is that a reservation of title in a delivered copy extends that reservation to all copies made by the licensee. That presumption is altered in cases where the license intends the making of copies for sale. Thus, for example, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all the books. This concept does not apply where the expectation is that the licensee will transfer copies by a further license.

4. Subsection (d) deals with cases involving an intent to sell a copy and states various presumptions 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 <u>from</u> 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), a party's rights under a contract may be transferred, including by an assignment or through a financier’s interest, unless the transfer would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, cause 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.

(b) A transfer of a licensee's contractual rights under a nonexclusive license is ineffective unless:

(1) the licensor consents to the transfer; or

(2) the transfer is subject to the terms of the license and:

(i) the contract is a mass-market license, the licensee received delivery of a copy of the information, and transfers or destroys the original copy and all other copies made by it; or

(ii) the licensee received title to the copy of the information by a transfer authorized by 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 copyright 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 2-210. 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. "Transfer" means a conveyance of rights and duties under a contract and contrasts to 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. Section 2B-506 deals with delegation of performance or sublicensing.

2. 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. 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) 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 (9th Cir. 1996); Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972). The non-transferability premise flows from the fact that a nonexclusive license is a personal, non-assignable contractual privilege, representing less than a property interest. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (copyright); In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W. D. Tenn. 1987).

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 (9th Cir. 1996). The approach to non-exclusive copyright licenses in federal law is the same. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984).

6. The three exceptions in subsection (b) situations in which the basis of this policy are not present. The first deals with the case of actual consent. The second, 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 third 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) The following contractual restrictions are not effective to prevent creation of a financier’s interest, but violation of the restriction constitutes a breach:

(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 transfer; and

(2) a term that prohibits a party’s transfer of its interest or creation of a financier’s interest except to the extent that creation of the financier’s interest would be precluded under

Section 2B-502.

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 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 of the interest would be effective under Section 2B-502 and

2B-503. However, enforcement of a financier's interest thus created is effective only if enforcement would also be effective under Section 2B-502 and 2B-503.

(b) If the creation or enforcement of a financier's interest in a licensee's rights under a nonexclusive license is not effective under subsection (a), the following rules apply:

(1) Subject to paragraph (2), the creation 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 precluded by Section 2B-502(a) other than as to the obligation to make payments to the licensor.

(2) In the event of a breach of contract by the licensee, as between the financier and the licensee, the financier has a right under Section 2B-715 to prohibit the licensee from using the information covered by the financier's interest but may take possession of copies of the information or related materials covered by its

interest only if the licensor consents or the conditions of Section 2B-502(a)are met.

(c) A financier that creates or enforces an interest and any transferee of the financier is subject to the terms and limitations of the license and to the licensor's intellectual property rights. The financier may not use, sell, or otherwise transfer rights in the license or copies of the information or access to the information unless the conditions of subsection (a) are met as to enforcement of the interest.

(d) The creation or enforcement of a financier's interest imposes no obligations or duties on the licensor with respect to the financier.

Committee Action:

a. Consensus that Article 2B should allow creation of limited rights in licensee side of non-exclusive licenses, but not permit sale and the like without consent of the licensor.

Reporter's Notes:

1. This section reflects the general approach of Article 2B of combined treatment of security interests and financing leases in an integrated treatment. The definition of "financier" covers both secured parties and lessors. See 2B-102.

2. As redrafted, subsection (a) makes clear that, in general, a financier's interest can be created in any contractual right that can be transferred and that, in all other cases, consent by the other party to the contract makes transfer possible, but that the act of creating a security interest and the act of enforcing that interest are separable events. Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's rights are dominant. Thus, a critical limit on enforcement and, except for non-possessory interests, creation of a financier's interest lies in 2B-502(a) which disallows transfers that impinge on licensor interests of the type described therein.

3. For non-exclusive licenses, the transferability of a licensee's rights is even further constrained in law by federal policy limitations that presume non-transferability without licensor consent. See 2B-502(b). This Article pushes the scope of secured lending in the absence of licensor consent as far are possible in light of that strong contrary and preemptive federal policy. It assumes that the license is non-assignable and personal for reasons noted in the cases cited in Section 2B-502 notes, but tailors a right to **create** a security interest without the licensor's consent in a manner that avoids preemption by satisfying the policy interests that underlie the basic non-assignability principle. Thus, while an interest can be created, it cannot, without the licensor's consent, result in an actual change of control, access or use or any sale. This preserves the licensor's protected interest under federal law in controlling the resale market and the identity of the licensee to whom it transfers rights in its intellectual property. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996).

4. The approach is modeled after

Article 2A-303(3) which limits the enforceability of lease provisions restricting security interests in the lessee's interests. It applies here to both a contract clause and to a non-exclusive license that contains no such clause because, unlike in leases, the underlying law does not routinely allow assignment of the licensee's interest. The comments to Article 2A-303 state: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, Comment 3. As in Article 2A, the licensor (lessor) has a right to control who is in effective possession (including use and access) of the subject matter of the license. In many cases, this will preclude repossession or sale without the licensor's consent. It does not prevent repossession and sale if the licensed rights would be transferable under 2B-502 and 2B-503.

5. The provisions here allow creation of a security interest in many cases because mere creation does not make an actual change of possession, use, or access, nor does it delegate obligations. The argument against preemption is that "creating" a security interest does not "transfer" or assign the interest under the license. The **Everex** case indicated that one aspect of the federal policy was that the intellectual property rights holder has a protected interest in restricting the use of its intellectual property by persons other than those it specifically authorizes. The approach in this draft draws a balance that allows full pursuit of that federal policy, but gives substantial scope to the state law policy of allowing creation of security interests. The same would not be true, for example, with a rule that allows all assignment of rights under the other section of transferability, a rule that would be specifically subject to preemption.

6. The draft also parallels Article 2A in providing that the secured lender and any transferee take subject to the terms of the original license. The license is the dominant document in that it defines the licensee's rights. A lender does not have the ability to abrogate those rights and the limitations that are attached to the rights.

7. The result of the financing provisions allow creation of a security interest in any case where creation, in itself, alters none of the actual interests of the parties. When it comes to enforcement of the interest, however, the lender's rights are subordinate to actual interests of either party and to federal policies about transferability. The effect of the provisions is illustrated in the following examples.

Illustration 1. Financing a Licensor's Interest. Creditor desires to finance the licensor's interest in a commercial license. To determine whether it can do this, the creditor must make the following determinations: a) under

2B-502(a) would creation of the interest make a change that impinges one or more of the interests listed there; b) if not, under Section 2B-503 is there an enforceable no transfer provision that precludes creation of the interest without consent; c) if not, then the interest can be created under 2B-504(a). However, if the transfer is precluded by either of the above, no security interest can be created.

If an interest can be created, the lender would make the same analysis in reference to enforcement (e.g., repossession or sale). The issues are different, of course, since repossession or sale precludes some further uses and changes the party in control in a way that may adversely impact the licensee. The result of the analysis would depend on the licensor's personal role in the on-going license. In cases of fully paid up, [perpetual licenses, enforcement would not be barred unless, for example, it threatens trade secret rights of the licensee.

Illustration 2. Financing the Licensee in a Commercial License. Assume creditor desires to finance the licensee's interest in a commercial, non-exclusive license. It would ask the following questions: a) is the creation of the interest blocked by 2B-502(a) in that it would cause an inappropriate delegation, deny the return expected by the licensor, or otherwise adversely impact the interests listed there; b) if the interest is **permitted** under 2B-502(a), it is still prohibited under 2B-502(b) unless it falls into one of the exceptions there (mass market, or title without contract restriction); c) if it is not within an exception, the Creditor would not need to consult 2B-503, if it did so, however, and there was a contractual limitation on creation of an interest or on transfer, that contract terms is effective since creation of an interest is barred under 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 softw3are, 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 License 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 agreement 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 duties of the transferor. The promise is enforceable by the transferor or any other party to the contract.

(b) A transfer of contractual rights does not relieve the transferor of a duty under the contract to pay or perform, or of liability for breach of contract, except to the extent the other party to the original contract agrees.

Uniform Law Source: 2-210; 2A-303.

Committee Action: Discussed in November, 1996, without substantial comment.

Reporter's Note:

1. This section implements a policy in current Article 2 and Article 2A. The recipient of a transfer is bound to the terms of the original contract and that obligation can be enforced either by the transferor or the other party to the original contract.

2. This section clarifies that an effective transfer (assignment or otherwise) of rights under a contract constitutes a transfer of those contract rights and, a delegation of duties if accepted by the transferee. This language follows Article 2 (which uses the word assignment) and Article 2A (which refers to transfers).

3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent to the novation.

SECTION 2B-506. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may delegate or subcontract performance of its contractual obligations unless:

(1) the contract prohibits delegation or subcontracting

(2) transfer would be prohibited under Section 2B-503, or

(3) the other party otherwise has a substantial interest in having the original promissor perform or directly supervise or control the performance. ~~.~~

(b) Delegation or subcontracting does not relieve the delegator or subcontractor of any duty under the contract to pay or perform, or of liability for breach of contract, except to the extent the other party to original contract agrees.

Committee Action:

Reviewed in November, 1996, without substantial comment except that adjustments should be made to clarify that the section is subject to restrictions on transfer.

Uniform Law Source: Section 2-210; Section 2A-303.

Reporter's Notes:

1. Delegation or subcontracting of performance refers to a party's ability to use a third party in making an affirmative performance under an information contract. It does not refer to authorization or other allowance of third party exercise of rights in licensed information. pursuant to in a contract is generally allowed. In both cases, while the performance may be made by the delegee, the original; party remains bound by the contract and responsible for any breach thereof. The ability to delegate performance must be read in contrast to the general limitations on transferability of non-exclusive licenses under in 2B-502. A delegation or subcontract works a

transfer equivalent in substance to a transfer or assignment of

2. The ability to delegate is subject to contrary agreement. Thus, a contract that permits use of licensed information only by a named person or entity controls and precludes delegation. The result in such cases is determined by both the general principle that contract terms control and the more specific principle that the other party has, by the contract, expressed an interest limiting performance to the designated party.

3. In the absence of a contractual limitation, delegation can occur unless the circumstances come within one of three conditions are met. The first condition that prevents delegation arises if the transfer of an interest would be precluded under 2B-503. That section disallows transfers in cases where the contract prohibits such action. The second condition, arises if the contract is silent but the other party has a substantial interest in having performance rendered by the person with whom it contracted. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions outlined in 2B-502(a). On the other hand, neither of these provisions would deny a right to delegate or subcontract performance in a mass market transaction where, under Section 502, can be freely transferred by the licensee.

SECTION

2B-507.

PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer of ownership of intellectual property rights is subject to a previous nonexclusive license if that license was in a record authenticated by the licensor before the transfer of ownership.

(b) A financier’s interest created by a licensor or a transfer of ownership of intellectual property rights under a financier’s interest in information or in copies of the information is subordinate to a nonexclusive license that was:

(1) authorized by the secured party;

(2) documented in a record authenticated by the licensor before the security interest was perfected; or

(3) transferred in the ordinary course of the licensor's business to a licensee that acquired the license in good faith and without knowledge that it was in violation of the security interest.

(c) For purposes of this section, a transfer of ownership or of a financier’s interest occurs when the transfer is effective between the parties. However, if applicable intellectual property law requires filing or a similar act to obtain priority against other transfers, the transfer does not occur until the date on which priority begins under that law after the filing or similar act occurs.

UNIFORM LAW SOURCE: Section 2A-304. Revised.

REPORTER'S NOTE:

1. This is an area heavily influenced by federal copyright law as to copyright interests and the provisions here attempt to trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption in reference to data, trade secrets and other non-federal rights. For security interests and

their relationship in terms of priority to the rights created under an intangibles contract, the priority questions might be dealt with in this article as was done in Article 2A or they may be dealt with in Article 9. Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. Under the Copyright Act, a prior non-exclusive license is subordinate to a later transfer of copyright ownership unless the license is in a signed writing. This rule, while awkward and somewhat inconsistent with modern trends, was made part of the Copyright Act in 1976; there are no indications of probable repeal. The restatement of that rule here alerts persons who engage in commercial transactions about a priority rule that may not otherwise be expected. This avoids traps for unwary licensees. Note, however, that by using the new terms "record" and "authentication" this section are not yet explicitly adopted in federal law.

Illustration 1: Computer Associates sells the copyright in its data compression program to Major Holdings Corp. Five days before that sale, Computer Associates entered a non-exclusive license with Boeing Corp. for a 100 user site license, which license was in an unsigned form. Three days after the sale, Computer Associates entered a non-exclusive site license with Standard Corp. Under subsection (b) **and** under federal law, the licensees' rights to copy (e.g., use) the software are subordinate to the copyright ownership of Major. **Illustr**

ation 2: Lotus enters into a non-exclusive distribution license with Distributor, allowing Distributor to make and distribute copies of 1-2-3 Spreadsheet in the mass market subject to a standard form license for end users. Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale, Distributor provides a copy of 1-2-3 to Smith, who assents to the license. If the distribution license was a signed writing, the distribution was authorized by the license which has seniority over Taylor. Smith has priority over Taylor because it took through the valid license. If the distribution license was not a signed writing, Taylor's purchase is senior to that license and Smith is not an authorized user.

3. Subsection (b) also presents a preemption problem under federal copyright law, but the case for preemption is less clear since the UCC generally controls priorities and other aspects of law relating to security interests and the federal concerns in the priority statute are more focused on title transfers. This section does not take a position on whether a security interest should be filed in federal or state records systems; it simply refers to perfection of the interest. It adopts priority rules for a security interest

in conflict with a nonexclusive license that parallel priority positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions that enable the licensor whose intangibles are encumbered to continue to do business in ordinary ways.

4. Article 2A deals with the priority conflicts that arise when the licensor or owner transfers to a third party an interest in the property that is subject to a lease. The focus in such cases is on relating the rights of the transferee to the rights of the lessee in the particular item. That situation does not arise in intangibles involving two nonexclusive licenses since intangibles can be licensed an infinite number of times and each licensee receives the same rights. In contrast, if there is a transfer of ownership of the information there may be a conflict between the transferee and the licensee. There are two types of priority conflicts in such cases and modern law lacks clear guidance or commercially viable solutions. One conflict is between two transferees of ownership. The other is dealt with in this section: conflicting claims of a nonexclusive licensee as against a transferee of ownership rights, including a secured party.

5. For rights not created by federal law, the priority issue raised is a question of state law. The same is apparently true for rights that arise under federal patent law. The Patent Act contains provisions that deal with the respective priority of transfers of patent ownership. A nonexclusive license is not a transfer of ownership and the relationship

between the nonexclusive licensee and a transferee of a patent is not dealt with in current federal law. The situation is different in copyright law. Section 205(f) of the Copyright Act provides:

> A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if: (1) the license was taken before execution of the transfer; or (2) the license was taken in good faith before

recordation of the transfer and without notice of it.

17 U.S.C. § 205(f). There is no case law under this provision. Significantly, however, the provision does not allow a license made after recordation of the ownership transfer to attain priority under any conditions. Also, an unwritten license will lose even to a subsequent transfer of ownership if this section is regarded as a comprehensive priority rule.

6. Copyright Act § 205(f) can be viewed as a comprehensive rule of priority (e.g., an unwritten license never superior to a transfer of ownership and the priority status of a written license entirely controlled by Section 205(f)). Alternatively, one might view it as a minimum condition for a particular result (e.g., that a written nonexclusive license has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This draft adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, as a matter of enacted federal policy, a nonexclusive license prevails in the listed situations, but a nonexclusive license in cases not covered by Section 205 is not controlled by federal law. A contrary interpretation would mean that all mass market licenses currently are subject to being overridden by any subsequent transfer of the underlying copyright since many of these transactions may not qualify as involving a writing signed

by the owner of the copyright. Clearly, an assignee of the copyright to Word Perfect software should not be able to sue pre-existing Word Perfect licensees for continued use of the program without a license from the current owner. Even if this position is not correct, the priority rules here would apply to all intangibles other than copyrights, leaving a wide variety of important situations to be addressed here.

SECTION 2B-508. PRIORITY OF TRANSFERS BY LICENSEE.

(a) In a license, a creditor or other transferee of a licensee acquires no interest in information, copies, or rights held by the licensee unless the conditions for an effective transfer under this article and the license are satisfied. If the transfer is effective, the creditor or other transferee takes subject to the terms of the license.

(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 exception to these principles in Article 2A occurs in the case of a buyer (or sublessee) from who acquires in the "ordinary course" of the lessor-seller's business. The buyer here takes free of the lease under theories of entrustment. For a buyer to acquire these rights, however, it must purchase from a "person in the business of selling goods of the kind." In effect, the goods were entrusted to a sales business. Also, the buyer must be in good faith and without knowledge that the sale violates the lease or ownership rights of the lessor.

PART 6

PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT.

(a) A party shall perform in a manner that conforms to the contract.

(b) A party's duty to perform, other than with respect to contractual use restrictions, is contingent on the absence of an uncured material breach by the other party of obligations or duties that precede in time the party's performance.

(c) In a mass-market transaction, if the performance consists of delivery of a copy which constitutes the initial activation of rights, the licensee may refuse the performance if the performance does not conform to the contract.

(d) If a party is subject to contractual use restrictions or required to render future or on-going performance, the party's rights under the contract are contingent on the absence of an uncured material breach of the obligations or duties of that party.

Uniform Law Source: Restatement (Second) of Contracts ' 237. Substantially revised.

Committee Vote:

a. Motion to make an exception to the material breach rule for mass market contracts on the issue covered by Article 2 (the right to reject a transfer of rights). Adopted 12-0

b. Voted 10-3 to use mass market license, rather than consumer in this section.

c. Voted 1-7 to reject a motion to use the idea of perfect tender as the standard for the right to reject and cancel for breach in any performance of any type of contract term.

Reporter's Notes:

1. Subsection (a) states a generalized default rule which basically requires a court to look to reasonable commercial standards in any case not otherwise

governed by the contract or by provisions of this Article as to default terms.

2. Subsection (b) adopts the theme of material breach (or substantial performance) as the measure of the right to cancel or refuse a performance except in reference to certain mass market transactions. As is described in the Restatement, that rule holds that a duty to perform is contingent on the prior performance by the other party without a material failure of performance. Restatement. Restatement (Second) of Contracts § 237 states: "[It] is a condition of each party's remaining duties to render performances ... under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time." This is also the common law rule. In subsection (b), it is made clear that the contingent relationship does not refer to situations involving contractual use restrictions. A breach of a license by the licensor does not give the licensee unfettered rights to act in derogation of the licensor's ownership rights in the intellectual property and the use restrictions that these support.

This section sets out basic default rules. The model treats the performance of the parties as being mutually conditional on the substantial performance of the other party. Other sections dealing with specific types of contract supplement these with more specific provisions that enhance and amplify the general rules, but displace them only if there is a conflict.

3. The decision to adopt a

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

Illustration 1: Tom Jones has agreed to develop systems software for DNY. DNY promis es to pay the purchase price of $300,000 in three installments once every three months. Jones fails to complete stage 1 in month 2 and this failure is material. When the first payment is due, if the failure remains uncured, DNY is not required to pay. It can cancel the contract or seek assurances of performance. To alter this result would require an express agreement severing the obligation to pay from the performance of the deliveries.

5. The concept is simple: A minor defect in the transfer does not warrant rejection of performance or cancellation of a contract. Minor problems constitutes a breach of contract, but the remedy is compensation for the value lost. The objective is to avoid forfeiture based on small errors and to recognize that, especially if performance involves ongoing activity, fully perfect performance cannot be the expected norm. This is especially true in information contracts. Software often contains “bugs” or imperfections. Information services often entail small errors and incompleteness. The policy choice here adopts general law and allows a party whose performance has minor errors to expect performance by the other party; subject, in appropriate cases, to offsets and compensation for the problems.

6. The substantial performance rule does not hold that substantial (but imperfect) performance of a contract is not a breach. Substantial (but imperfect) performance is a breach of contract. The significance of substantial performance lies in the remedy for the injured party. Substantial performance is sufficient to trigger the injured party's obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject the initial tender or cancel the contract on that account, but it can obtain financial satisfaction for the less

than complete performance.

7. This section creates a carve out of perfect tender in mass market transactions with respect to tender of deliver of a copy other than in an installment contract setting. This tender rule does not mean that the tendered information is in fact perfect, but that it meet the general contract description in light of ordinary expectations and trade use. As in Article 2, this rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the single performance in the transaction (e.g., delivery of a television set, delivery of the diskette containing the software). As under current law, however, substantial performance rules apply in reference to on-going performance for both parties, services such as continuous access, and deliveries of a series of copies in an installment contract.

8. Article 2 applies a "perfect tender" rule to only one setting: the initial tender (transfer) of goods in a contract that does not involve installment sales. Article 2 does not allow the buyer to assert a failure of perfect tender in an installment contract (that is, a contract characterized by an ongoing relationship). Even in a single delivery context, the theory of perfect tender is hemmed in by a myriad of countervailing considerations. As a matter of practice, a commercial buyer cannot safely reject a tendered delivery for a minor defect without considering the rights of the vendor to cure the defect under the statute or under commercial trade use.

White and Summers state: "[we found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ." Indeed, in one case involving software, a court applied a substantial performance test to a UCC sales transaction. See D.P. Technology Corp. v. Sherwood Tool, Inc., 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven economic loss).

9. Definitions in Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach is defined in Section 2B-108 and is discussed in the Reporter's Notes to that Section. The definition largely adopts the definition in the Restatement (Second) of Contracts ' 241, adding some specificity related to this commercial context. This article rejects the less fully explored language used in Article 2A (and some parts of Article 2) which refers to breaches that "substantially impair" the value of a contract to the injured party. A material breach is a breach that significantly damages the injured party's receipt of the value it expected from the contract, but reliance on language that is common in general law and legal tradition enables this article to fall back on themes that courts are familiar with, rather than on language in other UCC articles that has not been well explored in case law.

SECTION 2B-602. SUBMISSIONS OF

INFORMATIONAL CONTENT.

(a) If a party submits informational content to a licensee under an agreement that requires that the information be to the satisfaction of the licensee, the following rules apply:

(1) Sections 2B-607 through 2B-613 and 2B-619 do not apply.

(2) If the informational content is not satisfactory to the licensee, the parties may engage in efforts to correct the deficiencies over a period of time and in a manner consistent with the ordinary

standards of the trade or industry.

(3) Neither refusal nor acceptance occurs unless the licensee makes an express, affirmative indication of refusal or acceptance of the submission to the licensor.

(4) Refusal terminates the agreement and does not constitute a breach of contract.

(b) If a person submits informational content or an idea other than under a pre-existing agreement, the following rules apply:

(1) A contract or

obligation does not arise and is not 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 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 the agreement expressly provides otherwise, an agreement to disclose an idea does not create an enforceable contract if the idea is not confidential, concrete, or novel to the trade or industry.

Prior Uniform Law: **None.**

Committee Action:

a.

Reviewed without substantive changes in May, 1997.

Reporter's Notes:

1. This section deals with a problem that was raised recurrently during the discussion of the Committee concerning the carrying forward of Article 2 rules concerning tender, acceptance and rejection into situations involving the informational content industries where practices are much different that in traditional sales of goods. The Section solves that conflict by carving out content submissions from the circumstances involved in reference to tender of a required performance in other respects.

2. For transactions involving traditional book and publishing upstream agreements, the solution lies simply in recognizing that the submission of a manuscript, even pursuant to an agreement, does not represent a tender of performance analogous to that involving a delivery of goods that requires immediate acceptance or rejection. Rather, the delivery of informational content in this context triggers a process that typically centers around the fact that the licensee has the right to refuse if the content does not satisfy its expectations. Once that fact is recognized, the inapplicability of the various rules on acceptance and the like becomes apparent. The provisions of subsection (a) attempt to capture basic principles of content submission in such case, but need to be reviewed by members of the industry for relevance and desirability.

3. An important aspect of the difference in the two circumstances lies in subsection (a)(3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since, by presumption, the circumstances are keyed to the subjective satisfaction of the receiving party.

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

SECTION 2B-603. ~~ACTIVATION OF RIGHTS;~~ LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) ~~Subject to Section 2B-601, a licensor shall complete the initial~~

~~activation of rights. The licensor completes its obligations with respect to the initial activation of rights when it completes the activation of rights and gives its direct licensee any notice reasonably necessary to make it aware of that occurrence in a commercially reasonable manner.~~

~~(b)~~ If applicable intellectual property law requires or allows the filing of a record to establish the priority of a transfer of ownership of intellectual property rights and a transfer of ownership is contemplated by the agreement, on request by the licensee, the licensor shall deliver a record sufficient for such purpose.

(b~~c~~) If no act is required to make information available, the activation of rights occurs when the contract becomes enforceable between the parties.

(c~~d~~) If information is made available by delivery of a copy to the licensee or a third party, the following rules apply:

(1) ~~If the contract is silent as to delivery~~Unless otherwise agreed:

(A) except

as otherwise provided in paragraphs (2) and (3), ~~in a~~the place for delivery of a copy on a physical medium~~;~~ ~~the licensor shall make the copy available to the licensee at the~~ is the licensor’s place of business or~~,~~ if it has none~~,~~ its residence;~~,~~ but, in a contract for ~~if the~~ copies~~y~~ which to the knowledge of the parties ~~is identified~~ at the time of contracting are in some other place, that place is the place for their delivery.

Documents of title may be delivered through customary banking channels ~~and located~~

~~elsewhere, the licensor shall make the copy available at that place~~; and

(B) in an electronic delivery of a copy, 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, and any similar information 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, and any similar information necessary for the licensee to obtain the copies or access.

(3) ~~If the contract~~Where the licensor is requireds~~s~~ or authorizeds~~s the licensor~~ to send a copy of the information to the licensee ~~or a third party but~~ and the contract does not require ~~the licensor~~it to deliver ~~it~~ the copy ~~to~~ at a particular destination, then it must:

(A) in a delivery of a copy on a physical medium, the licensor ~~shall~~ must

(i) put the copy in the possession of such a carrier and make ~~;~~ ~~make~~ such a contract for its ~~arrangements as are reasonable for~~ transportation as may be reasonable having regard to the nature of the information and other circumstances of the case with expenses to be borne by the licensee; and

(ii) obtain and promptly deliver or tender in due form any document, authorization, access code or similar information necessary to enable the licensee to obtain possession of the copy or as otherwise required by the agreement or by usage of trade. ~~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 or access from the carrier or third party; and~~

(B) in an electronic delivery of a copy, the licensor shall initiate an appropriate transmission of the information to the licensee or a third party.

(4) Where ~~If the contract requires~~ the licensor is required to deliver at a particular destination, the licensor shall make a copy available at that place with expenses to be borne by the licensor and tender ~~deliver~~ any documents, authorizations, access codes or similar information necessary for the licensee to obtain the copy or access.

(d~~c~~) If the licensor is to make ~~an activation of rights is to occur by making~~ access available to a licensee or provide ~~ing~~ the licensee with access to a facility containing the information, the licensor shall complete any acts necessary to make access available, including providing the licensee with any documents, authorizations, addresses, access codes, acknowledgments, and other materials necessary for the licensee to obtain access.

(e~~f~~) In an electronic transmission or delivery is required, information must be provided 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, 2-504, 2-509(a), 2-308; 2-319

Reporter's Notes: **This section was edited to conform to language in existing Article 2 in all places where no difference in substance was intended. The most recent draft of revised Article 2 makes a number of changes in text and substance that are not followed here.**

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 (d)(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 typically ~~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.

SECTION 2B-604. PERFORMANCE AT SINGLE TIME. If it is commercially reasonable to render all of one party's performance at one time, the performance is due at one time and the other party’s reciprocal performance is due only on tender of full performance.

Uniform Law Source: Section 2-307.

Committee Action: This section was reviewed in November without substantive comment.

Reporter's Note: The section adopts an approach found in both ' 2-307 and common law as described in the Restatement (Second) with reference to the relationship between performance and payment in cases where performance can be rendered at a single time. It adds the qualification that the ability to so perform must be gauged against standards of commercial reasonableness. The section does not affect the treatment of contracts calling for delivery of systems in modular form or for contracts that extend performance out over time, such as in data processing arrangements. In each of these cases, the performance of the one party cannot be completed at one time.

SECTION 2B-605. WHEN PAYMENT DUE.

(a) If the circumstances or the

agreement give a party the right to make or demand performance in part or over a period of time, payment, if it can be apportioned, may be demanded for each part performance.

(b) If payment cannot be apportioned or the agreement or circumstances indicate that payment may not be demanded for part performance, payment is due only on tender of completion of the entire performance.

Uniform Law Source: Restatement (Second) Contracts; Section 2-307~~310~~.

Committee Action: Considered in November, 1996, without substantive comment.

Reporter's Note:

This Section follows current law in Article 2 and in the Restatement.

SECTION 2B-605A. SHIPMENT TERMS [new].

Shipment terms such as F.O.B., C.I.F. and the like must be interpreted according to the provisions of Article 2 of this Act and any applicable custom or usage of the trade.

Reporter's Notes:
This section was added to reflect the deletion of the detailed treatment of shipment terms found in existing Article 2. Rather than to repeat or restate the variety of provisions in that statute or in applicable international or other laws, this section refers to Article 2 as a whole to provide meaning for such terms. The final comments to the Act will contain cross-references to the applicable provisions.

[B. Tender of Performance; Acceptance]

SECTION 2B-606. ACCEPTANCE OF PERFORMANCE;~~:~~ EFFECT.

(a) A party shall pay or render other performance required according to the contractual terms for any performance it accepts.

(b) The burden is on the party that accepted the performance to establish any breach of contract with respect to the performance accepted.

Uniform Law Source: Section 2-607~~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, the licensee may refuse the performance if it does not conform to the contract.

(c) If performance entails delivery of a copy, a licensor shall tender first but need not complete the performance until the licensee tenders any performance required at that time, including any payment that is due. Tender must be at a reasonable hour and requires that the licensor:

(1)

notify the licensee that the information or copies 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 access, control, or possession.

(d) Tender of payment is sufficient if made by any means or in any manner current 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,~~ 2-511(a)(b). Restatement (Second) of Contracts ' 238.

Committee Action:

a. Approved substantial performance rule. (September, 1996)

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.

Illustration 1. Jones contracts for the development of a system by Smith. Smith completes what it anticipates to be the full system and tenders a disk containing the software to Jones. Jones has a right to inspect the information before paying pursuant to an interaction of this section and the section on inspection. If the parties agreed to acceptance tests, those tests define the scope of the inspection right. If not, a reasonable inspection is required. Payment follows satisfactory inspection.

6. Subsection (d) is drawn from Article 2.

SECTION 2B-608. COMPLETED PERFORMANCES.

(a) If performance involves delivery of informational content, entertainment, or related artistic, personal or professional services that because of their nature provide the licensee substantially with the value of the information or other substantial commercial value and the value cannot be returned once delivery or performance is received by the licensee, Sections 2B-609 through 2B-613 and Section 2B-619 do not apply and the rights of the parties are determined under Section 2B-601 and the ordinary practices of the applicable business, trade, or industry.

(b) In a contract governed by subsection (a), before payment, a party may inspect the media and label or packaging of a performance but may not view or receive the performance unless the agreement provides otherwise.

COMMITTEE ACTION:

a. Reviewed without substantive changes in June, 1997

REPORTER'S NOTES:

This section deals with a problem arising from the nature of the subject matter covered in this article. Some subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection, rejection and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. The parties should be left to general, common law remedies as described in section 2B-601. If the delivered performance constitutes a material breach, the receiving party can obtain its money back or sue for damages, but it cannot demand full performance prior to payment as would be the case with anything other than the limited inspection right described in subsection (b).

SECTION 2B-609. LICENSEE'S RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as provided in 2B-602 and 2B-608, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, a licensee, before payment or acceptance, has a right to inspect the physical medium and the information and to obtain any related documentation at a reasonable place and time and in a

reasonable manner in order to determine conformance to the contract.

(2) Expenses of inspection must be borne by the party making the inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, unless otherwise expressly agreed, the fixing of a place, method or standard does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance with the place or method

becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was clearly intended as an indispensable condition whose failure avoids the contract.

(4) A licensee's right to inspect is subject to the confidentiality of the information. Unless the licensor otherwise agrees, the licensee may not inspect before payment in a manner that would disclose or jeopardize trade secret or confidential information if that information is so designated by the licensor.

(b) If a right to inspect exists under subsection (a) and the agreement or the circumstances are inconsistent with an opportunity to inspect before making payment, the licensee does not have a right to inspect before payment. Nonconformity in the tender does not excuse the licensee from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-610; or

(2) in a documentary transaction, despite tender of the

required documents, the circumstances would justify injunction against honor under Article 5.

(c) Payment in accordance with 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: CISG art. 58(3); Section 2-508. Substantially revised.

Reporter's Note:

1. Subsection (a)(4) deals with the relationship between confidentiality and the right to inspect. Absent contrary agreement, inspection prior to payment is not appropriate if the type of inspection involved would reveal designated trade secrets or confidential information. This does not bar any inspection, but merely indicates that a right to see trade secret information cannot be presumed. Also, the balance here is limited to situations where the licensor designates information as confidential or a trade secret.

2. Subsection (b) follows the rules stated in current UCC.

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 performance;

(2) accept the 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 consisting of the delivery of a copy which constitutes the initial activation of rights if the performance does not conform to the contract.

(c) Refusal under subsections (a) or (b) is ineffective unless 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 a rightful refusal or revocation of acceptance, the following rules apply:

(1) Any use of the information or copies, or any disclosure of a trade secret or confidential information inconsistent with the agreement, constitutes a breach of contract. However, use 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 of the agreement.

(2) A licensee in possession of copies or documentation or additional copies, shall return all

copies and documentation to the licensor or hold them for disposal at the licensor's instructions for a reasonable time. If the licensee holds the materials, the following additional rules apply:

(A) The licensee shall follow any reasonable instructions received from the licensor. However, instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

(B) If

the licensor does not give instructions within a reasonable time after being notified of refusal, the licensee may in a reasonable manner to avoid or mitigate loss store the documentation and copies for the licensor's account or ship them to the licensor with a right of reimbursement for reasonable costs of storage, shipment, and handling.

(3) A licensee has no further obligations with respect to information or copies and documentation. However, both parties remain bound by any obligations of

nondisclosure or confidentiality and any scope or other contractual use restrictions which would have been enforceable had the performance not been refused.

(4) In complying with this section, a licensee is held only to good faith and a standard of care that is reasonable in the circumstances. Conduct in good faith under this section does not constitute acceptance or conversion and is not the basis for an action for damages or equitable relief.

Uniform Law Source: Section 2-602(2), 2-603, 2-604.

Reporter's Note:

1. This section does not give the licensee a right to sell

goods, documentation or copies related to the intangibles under any circumstance. The materials may be confidential and may be subject to the overriding influence of the proprietary rights held and retained by the licensor in the intangibles. As Comment 2 to current ' 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in respect of information. The licensor's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

2. Subsection (1) limits the revoking person's right to use the information in its possession. Uses inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse. The section does permit, however, limited uses for purposes of minimizing loss. That use does not extend to disclosure of confidential information or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to reach the balance discussed in Can-Key Industries v. Industrial Leasing Corp.,593 P.2d 1125 (Or. 1979) and Harrington v. Holiday Rambler Corp., 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved here.

3. Subsection (3) makes clear that, following refusal or revocation, both parties remain bound by confidentiality obligations with respect to the information. Unlike in

reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate.

4. The eventual comments to the Section will make clear that a wrongful refusal is not a refusal for purposes of this and other sections, but simply a breach of contract. That breach may or may not be material, but in either event, it triggers the sequence of remedies contained in the contract and this article, rather than the duties stated here.

SECTION 2B-612. WHAT CONSTITUTES ACCEPTANCE OF PERFORMANCE.

(a) Acceptance of a performance occurs when the party receiving the performance:

(1) substantially obtains the value or access expected from the performance and, without objecting,

retains the value or utilizes the access beyond a reasonable time to refuse the performance;

(2)

signifies or acts with respect to the information in a manner that signifies to the other party that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(3)

fails effectively to refuse performance under the terms of the agreement or Section 2B-610;

(4)

acts in a manner that makes compliance with the licensee's duties on refusal impossible because of commingling[; or

[(5) receives a substantial benefit or knowledge of valuable informational content from the performance and the benefit or knowledge cannot be returned].

(b) Except in cases governed by subsection (a)(4) and (5), if a right to inspect exists under Section 2B-609 or the agreement, acceptance of performance that involves delivery of a copy occurs only when the party has a reasonable opportunity to inspect the copy and any document.

(c) If an agreement requires performance in stages to deliver the complete information product, this section applies separately to each stage. If the agreement contemplates delivery of a product in stages, rather than repeated separate performances under an overall agreement, acceptance of any stage is conditional until acceptance of the activation of rights in the completed information.

Uniform Law Source: Section 2A-515. Revised.

Reporter's Note:

1. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general

remedies sections.

2. Subsections (a)(2) and (3) conform to the language of Article 2A, clarifying as in Article 2A, that actions as well as communications can signify acceptance. This section does not adopt existing Article 2 provisions relating to actions inconsistent with the party's ownership since, as in Article 2A, there is a split between performance and retention of ownership in many cases. That split indicates that, as in 2A, the ownership standard is not relevant to use of information assets and other performance relevant here.

3. Subsection (a)(4) and (5) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(4), the key fact is that it would be inequitable or impossible to reject the data or information having received and commingled the material. The receiving party can exercise rights in the event of breach, but rejection is simply not a helpful paradigm. Recall that a rejecting licensee must return or to keep the digital information available for return to the licensor. Commingling does not refer only to placing the information into a common mass from which they are indistinguishable; it also includes cases in which software is integrated into a complex system in a way that renders removal and return impossible or where they are integrated into a database or knowledge base that they cannot be separated from. Commingling is significant because it precludes return of the rejected property.

4. The second situation (a)(5) involves use or exploitation of the value of the material by the licensee. In information transactions, it is the case that in many instances merely being exposed to the factual or other material transfers the significant value. Also, often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient of the information can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due.

Illustration 1: Licensee receives a right to use a mailing list of names of customers of Macey's store. It notices that the list contains no names from a particular zip code, but goes ahead with an initial mailing. It then seeks to reject the performance. While this would not fit within subsection (a)(5), the section provides that the acceptance already occurred if substantial value was received. Licensee can collect damages for the error and, if the breach was material, avoid obligation for the price. But it cannot reject because of (a)(1).

Illustration 2: A contracts with

B to obtain the formula to Coca Cola and information from B about how to mix the formula. B delivers the formula, but the mixing information is entirely inadequate. If the mixing information is not significant to the entire deal, A cannot reject because it received substantial performance. If the mixing information is significant, a right to reject may arise because of a material breach. However, subsection (a)(5) bars rejection if A received substantial value by obtaining knowledge of the formula and cannot return that knowledge. Even though it can return copies of the formula, knowledge would remain. A can sue for damages, but cannot reject after the formula is made known to it.

Illustration 3: Intel contracts with John for a right to use John’s list of the ten largest users of Motorola chips in the Southwest. The price is $1 million.

John supplies the list, but there are two names that, through negligence, are not correct. After reading the list, Intel desires to reject the performance and cancel the contract. Subsection (a)(5) would ask whether Intel received substantial valuable knowledge and, thus, cannot reject. If so, its remedies are for breach under applicable sections involving a recovery for the difference in promised and received value. If it can reject, it can recover the part of the price already paid, plus any relevant and provable loss under the methods described in this Article. Subsection (a)(5) may be deleted if the Drafting Committee adopts the proposed section 2B-608 on performances complete when delivered.

5. This section must be read in relationship to the reduced importance of acceptance. Refusal and revocation both require material breach in order to avoid the obligation to pay according to the contract. This is unlike Article 2 which follows a perfect tender rule for rejection, but conditions revocation on substantial impairment. Acceptance does not waive a right to recover for deficiencies in the performance.

SECTION 2B-613. REVOCATION OF ACCEPTANCE.

(a) A licensee may revoke acceptance of a commercial unit that is part of a performance by the licensor if the nonconformity of the commercial unit is a material breach of the contract and the party accepted the performance:

(1) on the reasonable assumption that the breach would be cured, and it has not been seasonably cured;

(2) during a period of continuing efforts at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the breach, and the acceptance was

reasonably induced by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party sends notice of it to the other party and is barred if:

(1) the revocation does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) the revocation does not occur before any substantial change in condition or identifiability of the information not

caused by the breach of contract; or

(3) the party attempting to revoke acceptance received a substantial benefit or knowledge of valuable informational content from the performance or access, and the benefit or knowledge cannot be returned.

(c) A party that justifiably revokes acceptance:

(1) has the same duties and is under the same restrictions with regard to the information and any documentation or copies as if the party had refused the performance; and

(2) is not obligated to pay the contract price for the performance as to which revocation occurred.

Uniform Law Source: Section 2A-516; 2-608.

Reporter's Note:

1. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. Often, of course, other performance will have already occurred. This section deals with revocation of acceptance as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention of article 2.

2. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. It reduces the importance of when or whether acceptance occurs. In cases of continuing efforts to modify and adjust the intangibles to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both parties know that problems exist. The question is whether or not the licensee is obligated for the contract price, less a right to damages for breach by the licensor.

There has been substantial litigation in Article 2 on questions of whether or not an acceptance occurred (or can be revoked) in a situation in which the licensee participates with the licensor in an effort to modify, correct and make functional the software that is being provided. The issue has importance because acceptance obligates the licensee to the purchase price unless that acceptance can be revoked due to a substantial defect, while prior to acceptance the licensee can reject for a failure to provide "perfect" quality. National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785, 787 (Mich. App. 1975) ("Here, the malfunctioning was continuous. Whether the plaintiffs could have made it functional is not the issue. The machine's malfunctions continued after the plaintiff was given a reasonable opportunity to correct its defects. [The] warranty was breached."); Integrated Title Data Systems v. Dulaney, 800 S.W.2d 336 (Tex. App. 1990); Eaton Corp. v. Magnovox Co., 581 F. Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may constitute a waiver); St. Louis Home Insulators v. Burroughs Corp., 793 F.2d 954 (8th Cir. 1986) (limitations bar); The Drier Co. v. Unitronix Corp., 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); Computerized Radiological Service v. Syntex, 595 F. Supp. 1495, rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use precludes rejection); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573 (8th Cir. 1982); Aubrey's R.V. Center, Inc. v. Tandy Corp., 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App. 1987) (nine month delay did not foreclose revocation); Triad Systems Corp. v. Alsip, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years after the initial delivery of software and hardware system); Money

Mortgage & Inv. Corp. v. CPT of South Fla., 537 So.2d 1015 (Fla. Dist. Ct. App. 1988) (18 month delay permitted); Softa Group v. Scarsdale Development, No. 1-91-1723, 1993 WL 94672 (Ill. App. March 31, 1993); David Cooper, Inc. v. Contemporary Computer Systems, Inc., 846 S.W.2d 777 (Mo App 1993); Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

3. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation does not, however, serve as a precondition to suing for damages. In the context of information transactions, revocation is not appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection (b)(3).

4. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the

licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received.

[C. Special Types of Contracts]

SECTION 2B-614. ACCESS CONTRACT.

(a) A licensee under an access contract has rights of access to the information as modified from time to time and made generally available by the licensor during the period of the license. A change in the content of the information is not a breach of contract unless it conflicts with an express term of the agreement.

(b) Unless subject to a license

or other use restrictions in the access contract or a record to which the licensee agreed, including by manifesting assent to a record, information obtained by a licensee in an access contract is free of any use restriction by the licensor except restrictions resulting from the intellectual property rights of a licensor or other applicable law. The licensee may make a transitory copy for purposes of viewing or other agreed use 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 business, 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 business, trade or industry for the particular type of agreement; or

(3) scheduled downtime, reasonable needs for maintenance, reasonable periods of equipment, software or communications failure, or events reasonably beyond

the licensor's control.

Uniform Law Source: None

Reporter's Note:

1. 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 available , but that the subject matter be accessible to the transferee on a consistent or predictable basis. The transferee contracts for continuing availability of processing capacity or information and compliance with that contract expectation hinges not on any specific (installment), but on continuing rights and ability to access the system. The continuous access contract is unlike installment contracts under Article 2 which have more regimented tender-acceptance sequences. Often, the licensor here merely keeps the processing system on-line and available for the transferee to access when it chooses.

As

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

2. Subsection (b) outlines two important default rules with respect to the treatment of information obtained through an access contract. The first is that, unless there are license terms dealing with the information obtained through access, information obtained by access is received on an unrestricted basis, subject only to whatever intellectual property rights apply. Thus, for example, if an access contract merely enables access to news articles, but does not further limit their use by the licensee, no limitation exists other than as applied under copyright law. In contrast, if the agreement contains license restrictions on use of the articles obtained by the access, those license terms would be governed under Article 2B and other law.

3. The second issue considered in

subsection (b) concerns the making of copies. The default position here recognizes that access contracts will involve a wide variety of contexts, many of which do not contemplate that the license make and retain a copy of the information accessed (e.g., video on demand). The default rule assumes that transitory copies to enable viewing of the information are implicitly authorized.

4. Access contracts are a form of license in the pure common law sense that they entail a grant of a right to have use of a facility or resource owned or controlled by the licensor. This involves less of a traditional intellectual property license and more of a modern application of traditional concepts of licensed use of physical resources. See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993); Soderholm v. Chicago Nat'l League Ball Club, 587 NE2d 517 (Ill. App. Ct. 1992) (license revocable at will). For a discussion of how one potential vendor handles these problems, see Proposed Rule Regarding Postal Electronic Commerce Service (39 C.F.R. ' 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed regulations and terms of use for Postal Service electronic commerce systems).

5. Under current law, these contracts are services or information contracts. The fault based warranties noted in the warranty sections apply insofar as one deals with the accuracy of content or processing. The contract obligation deals with an obligation to make and keep the system available.

Obviously, availability standards are subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a database contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See Reuters Ltd. v. UPI, Inc., 903 F.2d 904 (2d Cir. 1990); Kaplan v. Cablevision of Pa., Inc., 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

6. In an on-going or continuous access contract, the transferee may receive substantial value before or despite problems in the overall transaction. The remedies provide for a concept of partial performance. For example, the fact that a company continues to use a remote access database processing system for several years while encountering problems and seeking a replacement system, may allow it to reject the future terms of the contract, but leaves the transferee responsible for the past value received. Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

SECTION 2B-615. CORRECTION AND SUPPORT CONTRACTS.

(a) If a party

agrees to correct errors or provide similar services, the following rules apply:

(1) If the services cover a limited time and are part of a limited remedy in a contract between the parties, the party undertakes that its performance will provide the licensee with information of a quality that conforms to that contract.

(2) In cases not covered by paragraph (1), the party shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt

with by the express terms, in a workmanlike manner and with a quality that is reasonably consistent with ordinary standards of the business, trade, or industry for similar contracts. 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 the 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 business, 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 basic principle, but (a)(1) recognizes an important, alternative obligation that is presumed when the obligation to correct errors arises in lieu of a remedy under a contract.

4. Subsection (a)(1) deals with situations in which the circumstances indicate that promissor agrees to a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort. The obligation stated in subsection (a)(1) arises in any case where the repair/ correction obligation is set out as a form of remedy for any breach of the contract. The focus is on the classic "replace or repair" warranty. When the obligation to correct errors arises in that context, the promissor's obligation is to complete a product that conforms to the contract.

5. Subsection (a)(2) deals with the broader case of the general repair obligation outside of the limited remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a perfect result.

6. Subsection (b) provides a default rule regarding the time, place and quality of the services in a support agreement in the absence of contrary agreement. The standard reflects a theme of "ordinariness" that provides default performance rule throughout the chapter. It measures a party's performance commitment by reference to standards of the relevant trade or industry.

Example: Software Vendor agrees to provide a help line available for telephone calls from its mass market customers. If this agreement constitutes a contractual obligation, the availability and performance of that help line is measured by reference to similar services or by express terms of a contract.

SECTION 2B-616. PUBLISHERS, DISTRIBUTORS AND RETAILERS.

(a) In this section:

(1) “End user” means a licensee that acquires a copy of the information by delivery on a

physical medium for its own use and not for the purpose of distributing to third parties by sale, license, or other means.

(2) "Publisher" means a licensor other than a retailer ~~that~~ if the licensor enters into an agreement with an end user with respect to the information.

(3) "Retailer" means a merchant licensee that receives information from a licensor for sale or license to end users.

(b) In a contract between a retailer and an end user, if the parties understand that the end user's right to use the information is to be subject to a license from the publisher for which there was no opportunity to review before becoming obligated to pay ~~payment to~~ the retailer, the following rules apply:

(1) The contract between the end user and the retailer is conditional on the end user's agreement ~~assent~~ to the publisher's license.

(2) If the end user does not agree to ~~refuses~~ the ~~terms of the~~ license with the publisher, the end user may return the

information to the retailer and receive from it a refund of any contract fee already paid in an amount consistent with Section 2B-113(b) and avoid any obligation for future payments to the retailer for the information. Refund under this paragraph constitutes a refund under Section 2B-113 and under Section 2-208.

(3) The retailer is not bound by the terms of, and does not receive the benefits of, an agreement between the publisher and the end user unless the retailer and end user adopt those terms as

part of their agreement.

(c) If a refund is made in good faith ~~pursuant to this section or Section 2B-113~~:

(1) a retailer that makes the refund to its end user because the end user did not agree to ~~refused~~ the publisher's license is entitled to reimbursement from the authorized party from which it obtained the copy of the amount paid for the copy by the retailer on return of the copy and documentation to that person; and

(2) a publisher that makes the refund to the end

user is entitled to reimbursement from the retailer of the difference between the amount refunded and the price paid by the retailer to the publisher for the product.

(d) If an agreement contemplates distribution of copies on a physical medium provided by the publisher, a retailer or other distributor shall distribute such copies and documentation as received from the publisher and subject to any contractual terms provided for end users.

(e) A retailer that enters

into an agreement with an end user is a licensor of the end user under this article.

Uniform Law Source: None

Committee Action:

a. Reviewed twice with no substantive changes.

Reporter's Note:

1. This section deals with the three party relationship common in modern information transactions, especially in reference to digital products. The three party transaction involves a publisher, retailer, and end user. While the end user acquires the copy of information from a retailer, the retailer often lacks authority to convey a right to use a copyrighted work to the end user or, even, the right to transfer title to the copy. The right to "use" (e.g., copy) arises by agreement between the end user and the producer (party with ownership or control of the copyright). Often, in retail markets, this latter agreement is a screen license or a shrink wrap license. The enforceability of the terms of that license with respect to the licensee and publisher are dealt with elsewhere.

2. While there are three parties involved in separate relationships, it is clear that the relationships are linked. Subsection (b) deals with the relationship from the perspective of the **retailer's** contract with the **end user**. The basic principle in (b)(3) is that a retailer is not bound by nor does it benefit from any contract created by the producer with the end user. This mirrors modern law and limited case law dealing with sales of goods where manufacturer warranties and warranty limitations do not bind the retailer, but also do not benefit that retailer. A prior draft of this section stated the opposite position, but that met strong dissent. This means, of course, that the retailer does not have the benefit of warranty disclaimers made in a mass market publisher's license. That result can be changed by contract, of course. However, it gives the end user two different points of recourse - retailer and publisher.

Subsection (e) confirms that warranties exist on the part of the retailer by stating that the retailer is a licensor with respect to its licensee.

3. Subsection (b)(1) and (b)(2) deal with the reality that performance of the retailer's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the retailer and that this depends on the license between the producer and the end user. The net effect is to give the end user who declines a license a right to refund. and to not being forced to pay the purchase price to the retailer. This refund concept creates a refund right, rather than an option on the part of the retailer. It reflects the conditional nature of the transaction with the end user. It differs from the publisher's option to provide a refund opportunity as a means of enabling the effective assent to the publisher's license terms. While they are distinct, however, a refund made by the retailer under the conditions of subsection (b) satisfies the refund opportunity required under 2B-113 for creating an opportunity to review.

4. There are several ways to view the retailer-end user relationship in reference to the publisher's license. One is to treat the publisher's license in full as an element of the retailer contract, understood as present by both the retailer and the end user from the outset, even if the precise terms are not yet known. See ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996). An alternative treats the retailer's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter unless or until the end user assents to the publisher's license since, in most cases, the retailer's contract with the publisher authorizes only distributions subject to end user licenses and distributions that go outside this restriction constitute copyright infringement in cases where the information consists of copyrightable material. The end user's assent to the producer's license is then, as to its situation with the retailer, either a condition precedent (there being no final agreement until the end user can review and assent to or reject the license) or a condition subsequent (the agreement being subject to rescission if the terms of the license are unacceptable). In either case, if the end user declines the license, it can return the product to the retailer and obtain a refund or, if it has not already paid, avoid being forced to pay the contract fee. Subsection (b)(1) and (b)(2) create this result. The contract 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 publisher's license. When the end user assents to the license, the publisher's license in effect replaces the retailer-end user license except as to obligations expressly created and earmarked as continuing on the part of the retailer (such as a services or support obligation). Of course, in addition, if the information breaches a warranty, the right to recover from the retailer remains present unless it was disclaimed by the retailer's contract.

5. In a recent European case, Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd., the court gave the end user a right to return the software and not pay the purchase price as to the retailer when the contract terms were unacceptable. The analysis was that the retailer's contract with the end user must have contemplated that the end user would have a right to copy/use the software, but that right could be obtained only through license or other agreement from the copyright owner. When the end user declined the license, in effect the conditions of the retailer's obligation were not met. The court did not treat this as a breach of contract, but as a failure to conclude the contract between the parties. No final agreement was present until the end user could review and accept or reject the license terms. In effect, the contract was concluded (or to be concluded) over a period of time, as opposed to at a single point in time over the counter.

Illustration 1: User acquires three differe nt 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 diskett

e. 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, 94th 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 for ~~use by~~ a client but does not include an employee of a client, 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 a different result:

(A) the developer retains ownership of the intellectual property rights except to the extent that the program includes intellectual property owned by ~~of~~ the client or the client would be considered a co-owner under other law; and

(B) the client receives a nonexclusive but ~~irrevocable~~ perpetual license to use the computer program in any manner consistent with the

agreement.

(2) If the client requests response in a record, the developer shall notify the client if it used independent contractors or information provided by other third parties and shall provide the client with a statement that either confirms that all applicable intellectual property rights have been obtained or will be obtained, or that it makes no representation about those rights beyond any stated in the agreement. The response must be made within 30 days after the request is received unless the

time for performance is less than 30 days, in which case the response must be before the activation of rights.

(3) If an authenticated record or applicable intellectual property law provides that ownership of the intellectual property rights in the program passes to the client, but does not otherwise deal with the following issues, the following rules apply:

(A) Ownership of the ~~completed~~ program passes under Section 2B-501, but ownership revests in the developer if the developer cancels under Section 2B-702.

(B) The client receives the program free of restrictions on use ~~and its rights in the program may not be canceled by the developer after ownership vests in the client~~.

(C) The developer retains ownership of methods, components or code developed before or independent of the contract, or developed during the contract but not to be delivered to the client, and ~~but~~ the client has an

~~irrevocable~~ perpetual license to use consistent with the agreement the components or code as part of the completed program delivered to the client.

(4) Language in an authenticated record is sufficient to provide that ownership of intellectual property rights in the completed program will pass to the client or be retained by the developer if it states "All rights, title, and interest in the ~~completed~~ program will be owned by [named party]", or words of similar import.

Uniform Law Source: None

Committee Action:

a. Motion to delete the clause in (b)(2)(D) following the word "but", rejected 2-5 (June, 1997).

b. Motion to delete (3)(D) on ownership allocation between licensor and licensee, accepted 8-1 (September 1997)

REPORTER'S NOTES:

1. This section deals with an important area of software contracting. It is an area affected by federal intellectual property law rules and also characterized by both, extensively negotiated contracts as well as very informal relationships. In many cases, the licensor-developer is a smaller firm dealing with larger companies. The section is specifically limited to development contracts relating to computer programs. The section has been controversial in that it attempts to develop contract themes that reflect what would be the most likely expectation of the parties in development contract and rules that provide a sound basis for allocating rights between the developer and client in the absence of addressing two important issues. The section creates an implied license for the client who does not have documentation capable of obtaining ownership rights under copyright law and creates an implied license in development tools for the developer who needs those tools to continue in business.

2. Federal copyright law provides that, unless there is an express transfer of the copyright in a writing, copyright ownership remains in the developer, rather than the client for whom the developer worked. The copyright

rule was adopted after substantial deliberation and placed in the 1976 Copyright Act. It sets the background for default rules in this section. In addition, the default rules seek to balance the interests of the developer in continuing in business with the interests of the client in obtaining a right to use the information developed for it. In many cases, retention of rights in elements of a developed program is critical for the developer who will reuse program components and routines in subsequent projects. It should be noted that, while this section creates rights as between the parties pursuant to the contract, Section 201(b) of the Copyright Act, when applicable, may affect the enforcement of those rights against third parties who obtain transfers of copyright.

3. Subsection (b)(1)(A) states a default rule that corresponds to copyright law rules about ownership. In the absence of an employment relationship, ownership remains in the creative individual or company unless the contract expressly provides for a transfer of that ownership to the client (licensee). This rule states an important premise relating to the rights of the individual or other small developer to retain the primary rights in its intellectual work product unless it specifically and clearly transfers those rights. This policy reflect federal intellectual property law and protects small developers. Subsection (b)(1)(B), however, ameliorates the possibility of an adverse impact due to a misunderstanding by providing what amounts to an implied license for the client. The license is non-

exclusive. A critical issue needs to be resolved about the scope of the license, with the two alternatives being to make the rights unrestricted or to limit the implied license to uses consistent with the developmental purposes.

The implied license approach is consistent with case law dealing with this type of case. In the reported cases, the implied license tends to be limited to uses consistent with the purposes of development.

4. Subsection (b)(2) provides important protection for a licensee not found in current law. The section stems from a problem created under federal intellectual property law, especially as to copyright ownership. Copyright law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to potentially avoid those problems.

5. Subsection (b)(3) deals with cases where the contract gives ownership of the intellectual property in the program to the client. The default rule is intended to provide protection for small developers and small licensees who may not address the basic questions presented. The theme is that ownership transfers in all code <u>developed</u> <u>for</u> and <u>included</u> <u>in</u> the program

and that no conditions limit the licensee's use. However, two interests are balanced in the event that the contract does not deal with them: 1) the developer's right to continue to use general applicability code and tools and 2) the licensee's rights in code developed outside the project which are not clearly transferred to it. In each case, a split between ownership and a non-revocable license is used to give each party rights in the materials as a default rule. The developer retains ownership of previously developed materials, but the licensee has an irrevocable license to use them. In reference to included general tools, on the other, the licensee has ownership, but the developer has a license to continue to use.

Subsection (b)(3) deals with ownership interests in the program itself and, therefore, does not cover ownership questions about tools or methods developed by the developed during the project, but not included or to be included in the deliverable (e.g., the completed program). These work product elements remain in the developer and are critical elements of its professional assets, unless of course, the contract expressly provides that the client acquires rights in them.

It should be noted, of course, that while Article 2B refers to an authenticated record, copyright law refers to a signed writing as required to transfer ownership in cases not involving employees. Whether the two will be treated eventually as equivalent is a question of federal law, but it would seem that the copyright law should be read in this regard in a manner that reflects modern commercial developments.

6. Subsection (4) provides safe harbor transfer language for effectuating a transfer. The terminology is designed to clearly indicate that more than a transfer of a copy was contemplated. **Comments** will indicate the language here deals solely with creating the transfer, while the timing and nature of the rights transferred is governed elsewhere, including in 2B-501(a) and, when applicable, other law.

SECTION 2B-618. FINANCIAL ACCOMMODATION CONTRACTS.

(a) A financier is subject to the terms and limitations of the license and to the intellectual property rights of the licensor. Except as otherwise provided under subsection (c)(1), the creation and enforcement of a financier's interest in a license is subject to

Section 2B-504.

(b) If a financier is not a licensee that transfers rights under the license to a licensee receiving financial accommodation, the following rules apply:

(1) The financier is not required to perform the obligations owed to the licensee under the license and does not receive the benefits of the license.

(2) The licensee's rights and obligations with respect to the information are governed by the license and any rights of the licensor

under other law and, to the extent not inconsistent with the license or other law, the terms of the financial accommodation agreement.

(c) If a financier is a licensee that transfers the license to a licensee receiving the financial accommodation, the following rules apply:

(1) The transfer to the licensee is not effective unless:

(A) the transfer meets the conditions for transfer under Section 2B-502 and

2B-503; or

(B) the accommodated party agrees to the license and the financier becomes a licensee solely to make the financial accommodation and before the licensor provides the information, the financier delivered notice to the licensor giving the name and location of the accommodated party and indicating that the accommodated party will be the only end user of the information, but the financier may make only the single transfer contemplated by the notice financial accommodation unless the licensor consents to a subsequent transfer or the subsequent transfer is effective under Section 2B-504.

(2)

After transfer to the licensee, the licensee becomes a party to the license and the licensee's rights and obligations with respect to the information are governed by the license and any rights of the licensor under other law and, to the extent not inconsistent with the license or other law, the terms of the financial accommodation agreement.

(3) With respect to the licensee, on completion of an effective transfer to the licensee, the financier is no longer a licensor and, except for the warranty under Section 2B-401 concerning authority and quiet enjoyment, makes no warranties to the licensee other than any express warranties in the agreement.

(d) Unless the licensee is a consumer, if the financial accommodation agreement so provides, as between the financier and the licensee and any transferee of either party, the licensee's promises under the financial accommodation and any related agreements become irrevocable and independent of the license on:

(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.

(e) 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 under the license, but the financier's rights with respect to the licensor are determined under Section 2B-504.

(f) 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.

(g) 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:

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 tree 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 the licensee's assent be a condition to the creation of the lease. This transaction is different from the ordinary equipment lease because of the central importance of this license agreement and the provisions here recognize that importance. (see also the treatment of when promises become irrevocable).

3. Subsections (b) and (c) outline some attributes of the two scenarios. Subsection (b) involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract relationship with the licensee. The key factor here is that the lessor is not bound by the obligations of the license, but is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement. In subsection (c) we deal with the less common situation where the license is actually provided to the lessor and then passed down through to the licensee. Here, when the licensee takes on the license, the lessor is taken out of the transaction as between the licensee and financier for purposes of qualitative and other issues except for quiet

enjoyment and authority to transfer consideration. The licensee becomes a direct party to the license.

4.

Subsection (d) provides rules pertaining to hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context. Additionally, the provisions have been modified to reflect a problem not present in ordinary equipment leasing. Article 2A-407 provides that the promises become irrevocable on the lessee's acceptance of the goods. In the stereotypical transaction under that article, the goods are sold to the lessor and sent to the lessee. If there is non-payment by the lessor, the seller's remedies are against the lessor (not the lessee). In a license transaction, however, there are two different factors. First, in many cases, the licensee contracts directly with the licensor. Non-payment then may give a contractual right of action for the price against the licensee even though its lease called for payment by the lessor. Second, in a license, payment is typically a condition on the licensee's rights to continue to use the information. Thus, although the lessor was to pay, the licensee may be placed in a position of paying twice if the lessor fails to do so. To avoid this type of problem, the irrevocability concept is limited here not only to acceptance of the transfer, but also payment to the licensor. Comments to d(1) will indicate that selecting involves actual choices, rather than merely following orders.

5. Subsection (e) deals with a common area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As between the licensor, however, the general provisions of Section 2B-504 control.

6. Subsection (f) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. Performance Problems; Cure]

SECTION 2B-619. CURE.

(a) A party in breach of a contract, at its own expense, may cure the breach if:

(1) a performance is properly refused, the time for performance has not yet expired,

the party seasonably notifies the other of its intention to cure and, within the contract time, makes a conforming performance; or

(2) the party without undue delay notifies the other party of its intent to cure and effects cure promptly before cancellation or refusal of a performance by the other party.

(b) Other than in a mass-market license, the licensor promptly and in good faith shall make an effort to cure if:

(1) it receives timely notice of a specified nonconformity and a

demand for cure;

(2) the licensee was required to accept an initial activation of rights because a nonconformity was not material; and

(3) the cost of the cure effort for the licensor would not 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 or refuse a performances. Mere notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source:
Sections 2-508; 2A-513
Reporter's Note:

1. I n

Article 2B, unlike in Article 2, the idea of cure applies in important respects in both directions. This, coupled with the fact that this Article uses a material breach concept like common law, makes the idea of cure as substantially different theme in Article 2B than in Article 2. 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. <u>Restatement</u> <u>(Second)</u> <u>of</u> <u>Contracts</u> ' 237 provides that a condition to one party's performance duty in a contract is that there be no <u>uncured</u> 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 be discussed include: fully perform the obligation that was breached, compensate for

loss, timely perform on all assurances of cure, and provide assurance of future performance.

SECTION 2B-620. WAIVER.

(a) A claim or right arising out of an alleged breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record authenticated by the party making the waiver or to which it agrees, including by manifesting assent.

(b) A party that accepts a performance, knowing or with reason to know that the performance constitutes a breach of contract:

(1) waives its right to

revoke acceptance or cancel because of the breach unless the acceptance of the performance was on the reasonable assumption that the breach would be seasonably cured, but acceptance does not in itself preclude any other remedy provided by this article; and

(2) waives any remedy for the breach if the party fails within a reasonable time to object to the breach.

(c) Except with respect to a failure to meet a contractual requirement that performance be to the subjective satisfaction of a party, a party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on the unstated defect to justify refusal or to establish breach only if:

(1)

the other party was not aware of the defect and could have cured the defect if stated seasonably; or

(2)

between merchants, the other party after refusal has made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.

(d) Waiver of breach of contract in one performance does not waive the same or similar breach in future performances of like kind unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance is required in the future of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Committee Action: This section was considered in December, 1996 and June, 1997 without substantive changes.

Reporter's Notes:

1. A "waiver" is "the voluntary relinquishment" of a right. As with respect to cure, ideas of waiver in this Article must be considered in both directions. Conduct and words may constitute a waiver by either the licensor or the licensee. This section brings together rules from various portions of existing Article 2 dealing with waiver issues and recasts those rules to fit the broader number and variety of types of performance that are involved in Article 2B transactions. The section also applies principles from the Restatement.

2.

Subsection (a) stems from 2A-107. Waivers contained in a record are contractual modifications which, under current law and this Article, are enforceable without consideration. The Restatement is consistent with this view. **See** Restatement (Second) 277 ("a written renunciation signed and delivered by the obligee discharges without consideration a duty arising out of a breach of contract."). Subsection (a) does not preclude other ways of making an effective waiver, but that it merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a state, remains effective.

A similar concept exists under current Article 1, but requires both a signature and delivery of the record signifying waiver. The requirement of delivery seems unimportant and is not required for cases involving modifications under UCC rules. Developing Article 1 proposed revisions also eliminate that requirement. Depending on reconciliation between Article 2B and Article 1 revisions, this concept of waiver may be relocated into Article 1.

3. The language in (a) was modified as a result of discussions at the harmonization meeting dealing with Articles 1, 2, 2A, and 2B. In some cases, authentication will be needed to establish the written waiver, while in others, assent manifested to the waiver will be adequate.

4. Subsection (b) brings together rules from current Article 2-607(2) and (3)(a) and generalizes the language. In Article 2, the rules apply **only** to a

tender by the seller and acceptance of delivery by the buyer. Here, the effect also applies to acceptance of tendered performance by the licensee (e.g., a payment of royalties). The rule does not apply to cases where the party merely knows that performance under the license is not consistent with the contract unless that defective performance is tendered and accepted. This section on waiver is from current law in Article 2 and follows that rule. It is also consistent with the <u>Restatement (Second)</u> 246 which provides that retention of a performance with reason to know it was defective creates a promise to perform despite the breach. The following illustrates the rule here:

Illustration: Licensee has an obligation to pay royalties to the Licensor based on 2% of the sale price of products licensed for its manufacture and distribution. The royalty payments must be received on the first of each month. A 5% late fee is imposed for delays of more than five days and the license provides that delay of more than five days is a material breach. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts the tender it knows of the breach and cannot thereafter cancel the contract <u>for that</u>

breach. If it fails to object in a reasonable time to the late tender and the nonpayment of the late fee, it is also barred from recovering that amount.

5. Subsection (d) states a presumption consistent with common law that, unless the intent is express or the circumstances clearly indicate to the contrary, a waiver applies only to the specific performance defect waived. This principle does not, of course, alter estoppel concepts; a waiver by performance may create justifiable reliance as to future conduct in an appropriate case. Such common law principles continue to apply.

6. Subsection (e) comes from current UCC Article 2 setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see Restatement (Second) of Contracts ' 84, comment f.

SECTION 2B-621. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract

imposes on a party an obligation on each party that the other's ~~not to impair another party's~~ expectation of receiving due performance will not be impaired. ~~If~~ When reasonable grounds for insecurity arise with respect to the performance of either party~~,~~ the other party may demand in a record adequate assurance of due performance and, until ~~that~~ the demanding party receives such assurance may~~is received,~~ if commercially reasonable~~, may~~ suspend any performance, other than with respect to contractual use restrictions, for which the agreed return performance has not already been received.

(b) Between merchants~~,~~ the reasonableness of grounds for insecurity and the adequacy of ~~the~~ any assurance offered ~~is~~ shall be determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice ~~an~~ the aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand~~,~~ failure to provide ~~assurance of due performance that is adequate under the circumstances of the particular case~~ within a reasonable time~~,~~ not exceeding ~~30~~ thirty days~~,~~ such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

Committee Action: This section was considered in December without substantial substantive comment.
Uniform Law Source: **2-609.**
Reporter's Note: **This Section edited to correspond to existing law in Article 2.**

SECTION 2B-622. ANTICIPATORY REPUDIATION.

(a) ~~If~~ When

either party ~~to a contract~~ repudiates the contract with respect to a performance not yet due ~~and~~ the loss of ~~performance~~ which will substantially impair the value of the contract to the other, the aggrieved party may:

(1)

for a commercially reasonable time await performance by the repudiating party; or

(2)

~~for a commercially reasonable time or pursue~~resort to any remedy for breach ~~of contract~~ even if it has ~~urged the repudiating party to retract the repudiation or has~~

notified the repudiating party that it would await the latter's ~~agreed~~ performance and has urged retraction; and

(2) in either case, suspend its own performance or proceed in accordance with the provisions of this Article on the licensor's right to identify information to the contract notwithstanding breach or to cease work or to otherwise proceed under Section 2B-712.

(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 reasonably 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 edited to correspond to current law in Article 2.

SECTION 2B-623. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) ~~A~~ Until the repudiating party's ~~may retract a repudiation until its~~ next performance is due it can retract its repudiation unless ~~an~~ the aggrieved party ~~after the repudiation~~ has since canceled

~~the contract,~~or materially changed its position~~,~~ or otherwise indicated that ~~the~~ it considers the repudiation ~~is considered to be~~ final.

(b) ~~A r~~Retraction ~~under subsection (a)~~ may be by any method ~~that~~ which clearly indicates to the aggrieved party that the repudiating party intends to perform, ~~the contract. However, a retraction~~ but must ~~contain~~ include any assurance justifiably demanded under Section 2B-621.

(c) Retraction ~~under subsection (a)~~ reinstates ~~a~~ the 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 edited to correspond to existing law in Article 2.

[E. Loss and Impossibility]

SECTION 2B-624. RISK OF LOSS.

(a) Except as otherwise provided in this section, the risk of loss as to a copy passes to the licensee on receipt of the copy. In an access contract, risk of loss as to the information to be accessed remains with the licensor if the resource is in the possession or control of the licensor, but risk of loss as to a copy of information made by the licensee passes to the licensee when it receives the copy.

(b) If a contract requires or authorizes a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require delivery at a particular destination, the risk of loss passes to the licensee when the copy is delivered to the carrier even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the copy arrives there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered in a manner that enables the licensee to take delivery.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains on the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, or if a copy is to be delivered by making access available to a resource that contains the copy of the information, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing delivery or access or of access codes enabling delivery or

access.

Uniform Law Source: Section 2-509
Reporter's Notes:

1. In an information contract, in most cases, risk of loss issues relate to copies of the information and eventually deal with the obligation to pay for or provide additional copies or additional access to obtain new copies of the information. 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 sale of goods, buyer-seller environment, however, the issue may go in either or both directions as, in modern commerce, there are frequent transactions in which licensees provide copies of information to licensors. Basically, the premise of this section is that 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 as to the basic information that it controls and retains, 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 or nonperformance 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.

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.

This section states the ordinary UCC formulation of force majeure and related impossibility themes.

[F. Termination]

SECTION 2B-626. TERMINATION; SURVIVAL OF

OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) Obligations that survive ~~The following survive~~ termination of a contract include:

(1) a right or remedy based on breach of contract or performance;

(2) a limitation on the use, manner, method, or location of the exercise of rights in the information;

(3)

an obligation of confidentiality or nondisclosure;

(4) an obligation to return or dispose of information, materials, documentation, copies, records, or the like to the other party or to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes by means of alternative dispute resolution procedures;

(7) a term limiting the time for

commencing an action or for providing notice;

(8) an indemnity term pertaining to future claims;

(9) a limitation of remedy or disclaimer of warranty and a warranty that expressly extends to future claims;

(10) an obligation to provide an accounting;

(11) any right, remedy, or obligation stated in the agreement as surviving~~; and~~

~~(12) other rights, remedies, or limitations if in the circumstances such~~

~~survival is necessary to achieve the purposes of the parties~~.

Committee Action:

a. This section was reviewed in December with no substantial substantive concerns.

b. The section was discussed again in June, 1997, with no substantive objections.

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 ordinary be treated as surviving in a commercial contract and the intent is to provide background support, reducing the need for specification in the contract with resulting risk of error. Of course, under the basic theme of contract flexibility, additional surviving terms can be added and the terms provided here can be made to be non-surviving.

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~~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 notification of termination to the other party.

(b) ~~Access to a facility under a~~An access contract ~~not involving information that the licensee provided to the licensor~~ may be terminated without notice unless the information to which the access pertains is owned by the licensee.

(c) ~~In cases not governed by subsection (b), a~~A term dispensing with notification required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for the nature and timing of notification 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. What is reasonable varies with the circumstances. 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. The no-notice rule of subsection (b) is especially important in

modern access contract situations where thousands of licensees may be involved and addresses may not be available. Of course, the concept of termination refers to events not associated with breach. Where the reason to end the access relates to the existence of a breach, the section on discontinuing access controls.

This section provides a limited exception to this common law rule to protect licensees in cases where the access contract involves information owned by the licensee. The language change in this draft was intended to clarify the circumstances under which this notice requirement occurs. Discussions with banks and other entities indicated that the prior reference to information "provided" by the licensee was too uncertain and could cover virtually all transactional settings. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

4. The language in the last part of (c) sets out a standard for measuring the validity of contract provisions relating to time, place and method of termination notice. Current Article 2 allows the dispensing with notice if the term is not unconscionable. Subsection (c) retains that concept. In addition, however, Article 2B refers to concepts set out

in Article 9-501 allowing standards to be set for notification. As in Article 9, that standard creates substantial room for effective exercise of contract freedom. The subsection invalidates waivers that are unconscionable, but allows specification of standards for notice subject to a standard of manifest unreasonableness.

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

(a) On termination of a license, a party in possession or control of information, materials, or copies which are the property of the other party or are subject to a contractual obligation to be returned, shall return all materials and copies or hold them for disposal on instructions of the party to whom the materials are to be returned. If information, materials, or copies are jointly owned, the party in possession or control shall make the information, materials, or copies available to the other joint owner.

(b) 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 license. Continued exercise of the terminated rights or other use is a breach of contract unless it is authorized by a contractual term that survives cancellation or which was designated in the contract as irrevocable.

(c) Each party is entitled to enforce its rights under subsection (a) and (b) by judicial process. To the extent necessary to enforce those rights, a court may order the party or an officer of the court to:

(1) take possession of copies or any other

materials to be returned;

(2) render unusable or eliminate the capability to exercise rights in the licensed information and any other materials to be returned without removal;

(3) destroy or prevent access to any record, data, or files containing the licensed information and any other materials to be returned under the control or in the possession of the other party; and

(4) require that the party in possession or control of the licensed information

and any other materials to be returned assemble and make them available to the other party at a place designated by that other party or destroy records containing the materials.

(d) In an appropriate case, the court may grant injunctive relief to enforce the rights under this section.

(e) A party may utilize electronic means to enforce termination under Section 2B-314. If termination is for reasons other than expiration of the license period or the happening of an agreed event, the party terminating the contract by electronic means shall reasonably notify the other party before using the electronic means either directly or through the electronic means.

Uniform Law Source: None.

Reporter's Notes:

1. This section only deals with licenses. Subsection (a) states the unexceptional principle that the expiration of the contract term justifies immediate termination of contract rights and performance.

2. Termination differs from cancellation in that cancellation applies only in cases of ending a contract for breach. Subsection (e) deals with electronic means to enforce contract rights, a phenomenon present in digital information products, but not generally available in more traditional types of commercial products. The provisions here involve use of electronics to enforce contract rights that are not characterized by enforcing a breach of the agreement. Enforcement in the event of breach is dealt with in 2B-715 and 716.

3. The ability to use electronic means to effectuate a termination does **not** allow use of those means to destroy or recapture records, but merely

enables the licensor to preclude further use of the information. Section 2B-314 requires notice in the contract, except in stated cases. The electronic means to enforce termination would include, for example, a calendar or a counter that monitors and then ends the ability to use a program after a given number of days, hours, or uses, whichever constitutes the applicable contract term.

Illustration 1: Sun licenses Crocker to use a word processing system for one use; the system operates through the Internet and the use of mini-program modules that are downloaded into the system as needed and remain in the system for brief periods. The license as to each applet terminates at the end of its brief use period. This section allows the use of electronic means to effectuate that termination.

PART 7

REMEDIES

[A. In General]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury.

(b) ~~Unless the contract contains a term liquidating damages, a~~ A court may deny or limit a remedy other than liquidated damages if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) If a party is in breach of contract, whether or not material, the other party has the rights and remedies provided in the agreement and this article, but the aggrieved party must continue to comply with contractual use restrictions. Unless the contract so provides, the aggrieved party also has the rights and remedies available to it under other law.

Uniform Law Source: **Section 2A-523.**

Reporter's Note:

1. The basic theme of contract remedies is set out in Article 1. The goal is to place an aggrieved party in the position that would occur if performance had occurred as agreed. This is stated in UCC Section 1-106(1) which 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." This Draft has been amended to not restate that basic principle here, relying instead on the principle that Article 1 rules apply unless expressly displaced.

2. Subsection (a) affirms 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.

3. Subsection (b) gives a court a limited 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. The limiting reference to "substantially" better position has been extensively debated in the Article 2 Drafting

Committee and, in the current draft, remains used as a reference point consistent with the idea of allows the parties, rather than the court, to elect among the remedies provided.

SECTION 2B-702. CANCELLATION.

(a) A party may cancel a contract if the other party's conduct constitutes a material breach of contract which 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 the following rules apply:

(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.

(3) The rights, duties, and remedies described in Section 2B-626(b) survive.

(d) A contractual term providing that a party'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~~ the contrary intention clearly appears, ~~language~~ expression of “cancellation”~~,~~ or “rescission” ~~, or avoidance or similar language is~~of the contract or the like shall not ~~a~~ be construed as 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.

Selected Issue:

1. Should rights granted by a licensee under authorized licenses to third parties survive cancellation?

2. Should the Draft alter current Article 2 and require notice before cancellation since

cancellation requires material breach or an event defined in the contract as sufficient to allow cancellation?

Reporter's Note:

Drafting committee was commended for creating a logical structure without repetition or conflict in the remedies sections !!!!!!!!!!!

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 in two different ways. First, it is important to the injured party because it ends the party’s duty to continue to perform executory obligations under the agreement. Thus, for example, cancellation in a

continuous access contract would end the access provider's obligation to continue to make access available. Second, in licenses that involve intellectual property rights, cancellation ends the contractual permission to utilize the information in ways that would otherwise infringe the licensor's intellectual property rights. This creates the possibility of intellectual property remedies for infringement that co-exist with contractual remedies for breach. This is true because, at least in most cases, cancellation of a license coupled with continued use (e.g., copying) by the licensee infringes the property rights of the transferor. In practice, in licensing, contract damages are often not sought because a licensor relies on the 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). Damages for copyright infringement include "actual damages suffered by [the copyright owner] as a result of the infringement **and** any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages...." 17 U.S.C. ' 504(b). There is also a statutory damages provision.

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 **also** affects judicial jurisdiction issues if the information is covered by federal intellectual rights. An 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.

4. Of course, the fact that a material breach occurred does not require the injured party to cancel. It may continue to perform and collect damages under other remedial provisions. Under the section dealing with cure, the ability to cure a material breach is

subject to the injured party's right to cancel. Thus, there is no obligation to wait for a possible cure. Cancellation may be immediate. However, if cure precedes cancellation, cure precludes cancellation.

5 Cancellation is effective when the injured party notifies the other party. In a single delivery in the mass market, refusal of delivery itself provides the required notice. More generally, since the right to cancel arises in the event of a **material** breach, the equities favor flexibility for the injured party.

Yet, the draft does not allow cancellation without any effort to notify the breaching party. "Notifies" is defined in Article 1 (1-201(26)) as taking steps reasonably required to inform the other party of the fact, but does not require **receipt** of the notice. An obligation to ensure receipt would be inconsistent with the balance of rights here and other law, such as in Article 9. Since cancellation requires a material breach, however, the Committee should consider whether a precondition of notice should be imposed at all or whether cancellation without notice is appropriate. That requirement apparently does not exist in current Article 2.

6. Subsection (d) clarifies the enforceability of contract terms that provide that a licensee's right cannot be canceled, even for material breach. This type of remedy limitation is especially common in transactions where the licensee contemplates distribution of the information product

developed or licensed by the other party and makes a significant investment in developing the information product based on the license. The non-cancellation term has as much or more importance in information industries as does the refund and replacement term in transactions involving the sale of goods.

7. Subsection (e) is from current Article 2.

SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may add to, limit, or provide a substitute for the measure of damages recoverable for breach of contract or limit a party's other remedies, such as by precluding the party's right to cancel or limiting the remedies to return of all copies of the information and refund of the contract fee, or repair and replacement of copies of the information.

(b) Resort to a modified or limited remedy is optional unless the remedy is expressly agreed to be exclusive in which case it is the sole remedy. An exclusive remedy precludes resort to any other remedies under this article. However, if an exclusive remedy requires performance by the party that breached the contract and the performance of that party in providing the agreed remedy fails to give the other party the remedy, the aggrieved party is entitled to specific enforcement of the agreed remedy or, to the extent that the performance failed to provide the agreed remedy and subject to subsection (c), to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of separate terms disclaiming or limiting consequential or incidental damages [unless those terms are expressly made subject to] [if those terms are expressly made independent of] 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).**

COMMITTEE ACTIONS:

a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

b. Considered in June 1997 with consideration of whether failure of exclusive remedy should assume failure of consequential damages limiting clause unless the clauses are expressly indicated to be independent.

REPORTER'S NOTE:

Subsection (c) proposes a resolution of a heavily litigated issue about the relationship between exclusive remedy and consequential damage limiting clauses. See Reporter's Note 4. During the June meeting of the Drafting Committee, this approach was discussed extensively with the Committee asking the Reporter to consider whether this approach should be retained or whether there should be a presumption that the two clauses are dependent unless the contract expressly provides that they are independent clauses. The alternative formulation has not been fully considered by the Reporter or the Committee. It would state something along the following lines as a substitute for current subsection (c): "Failure or unconscionability of an agreed remedy precludes enforcement of terms limiting or excluding consequential or incidental damages unless those terms are expressly described as independent of the other agreed remedy."

General Notes:

1. Subsection (a) validates the ability of parties to contractually limit remedies. It generally conforms to current law. Subsection (a) also lists an additional remedy (non-cancellation) relevant in information transactions, but not in sale of goods law. The list is subsection (a) is not an exclusive statement of appropriate option, but provides guidance on what options are clearly acceptable, if performed by the party seeking to enforce the limited remedy.

This Draft follows current Article 2 in providing that exclusion or limitation of **consequential damages** is permitted unless the clause doing so is unconscionable. In information contracts, unlike in reference to transactions involving the sale of goods, there does not exist a body of law applying contract breach principles to create liability for personal injury for the information provider. In fact, in dealing with informational content, most cases do not provide for personal injury recovery, even under tort theories. Where the subject matter involves computer software, as compared to informational content, there is a similar lack of case law creating liability for personal injury claims. Additionally, most cases where personal injury risk is clearest in reference to computer software (e.g., embedded software operating automobile brake systems) are not within the scope of Article 2B (see 2B-103). Under these circumstances, the draft does not adopt the sales law presumption that exclusion of loss for personal injury in **consumer** cases is prima facie unconscionable. 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. On the other hand, the Draft does provide that personal injury in appropriate cases does fall within the definition of consequential damages. **The Draft simply takes no position on the issue of the conscionability of excluder clauses.**

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), however, reflects modern case law and clarifies the test for failure of a remedy under

current Article 2. Current Article 2 provides that a contractual limit is eliminated 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 clearly describe 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 in this subsection is that, if a party agrees to specified performance as an exclusive remedy in lieu of other remedies, its failure or inability to perform its that agreement on remedies both vitiates the exclusive nature of the remedy limitation or allows specific performance at the aggrieved party's option.

3. This Draft follows current law under Article 2 in that it does not restrict the ability of the parties to control their remedies by contract through a statutory concept that there must be a so-called "minimum adequate remedy". Under current law, that phrase appears only in comments to Section 2-719. In some reported cases, those comments have been used as a basis to challenge contractual remedy limitations, but the challenges have been effective in only a few cases and typically only if the remedy limitation essentially denies any remedy to the party. That being said, the standards for what constitutes a "minimum adequate remedy" are not clearly delineated either in current comments the Article 2 of in the

reported cases. See, e.g., **Cognitest** case.

The Comments to current Article 2-719 tie the idea of a minimum adequate remedy to two legal analyses, both of which are present under this Draft. In one respect, they seem to refer to an idea of a failure of mutuality or consideration and resulting questions about the enforceability of the entire contract. (e.g., "If the parties intend to conclude a contract for sale … they must accept the legal consequence that there be at least a fair quantum of remedy …"). Alternatively, the concept is connected in the comments to the idea of unconscionability, a standard against which all contract clauses are tested in this Article. (e.g., "Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion …").

Since these generally applicable and more widely accepted themes remain present in reference to all contract, the decision to not elevate the commentary to statutory law avoids creating a new and undefined basis for invalidating important contract terms without substantively altering the rights of the parties under current law.

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 unless the contract expressly so provides. See Section 2B-701(e)

4.

Subsection (c) provides a basis for resolving an issue that yields inconsistent results in reported decisions under Article 2. That situation involves an interpretation problem where a contract contains both a limited, exclusive remedy and a contractual exclusion of consequential damages. Cases split on whether in such situations a failure of the exclusive remedy also invalidates the consequential damages exclusion. Most states holding that the failure of one remedy does not necessarily exclude enforceability of the other limitation. This is essentially a contract interpretation issue in that it asks whether the one contract clause is dependent (or independent) of the other clause.

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 limiting or excluding 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 the amount to which the other party is entitled under terms liquidating damages in accordance with subsection (a).

(c) A party's right under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under 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 other party 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.

b. At the June 1997 meeting, the Drafting Committee by consensus agreed to delete a restitution formula contained in current Article 2, but which has had limited or non-existent use.

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. In essence, if two commercial parties negotiate the clause, it is essentially per se reasonable. The comments will describe this approach.

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 accrues and may extend it to a term of not longer than eight years.

(b) A right of action accrues when the act or omission occurs or should have occurred constituting the breach, even if the aggrieved party did not know of the breach. Except as provided in subsection (c), breach of warranty occurs when the activation of rights occurs. However, if a warranty explicitly extends to future conduct, breach of warranty occurs when the conduct that constitutes the breach of warranty occurs or should have occurred, but not later than the date the warranty expires.

(c) A right of action for breach of warranty under Section 2B-401, an express warranty covering similar subject matter as Section 2B-401, a warranty against third party claims for libel, defamation or the like, or for a breach of contract involving disclosure or misuse of confidential information accrues on the earlier of when the act or omission constituting the breach is or should have been discovered by the aggrieved party. A right of action for a failure to provide an indemnity accrues on the earlier of when the act or omission that constitutes a breach of the obligation to indemnify is or should have been discovered by the indemnified party.

(d) This section does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; 2-725. Revised.

Reporter's Note:

1. This section combines a discovery rule with a rule of repose. The discovery rule extends the limitations period for one additional year if applicable.

2. The cause of action as a general rule in this draft when the <u>conduct constituting</u> a breach occurs. In ordinary warranties, including all implied warranties, the warranty is met or breached on delivery of a product or service, even if the performance problem may not appear until later. Performance, in the sense of ongoing operation of a program, is not the measure of when the breach occurs. Performance in the sense of completion of one's required conduct in the transaction is the measure.

3. This draft follows Article 2A and Article 2 and adopts a four year limit for the contract action, but allows extension by one year if the breach could not have been discovered earlier. Article 2A uses a "discovery" rule. In a license, this can create an extended period of exposure to suit because of the long term nature of the contract and because many defects in software and similar intangibles do not become manifest until particular conditions arise. Additionally, of course, breaches occur during the contract performance and do not relate to circumstances present at the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause of action arises, except in cases where warranty extends to future performance and the breach cannot be discerned until that performance occurs. In most warranty cases, the breach of warranty arises on delivery. See <u>Intermedics, Inc. v. Ventritex, Inc</u>., No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) (cause of action for contract breach related to

the misappropriation would not entail a continuing breach); Computer Associates International, Inc. v. Altai, Inc., (Tex. 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute of limitations in trade secret misappropriation claim). A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

4. Subsection (a) applies the basic principle of contract freedom and holds that parties can contract for a longer period of limitations than under the statute. 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 eight 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. REMEDIES FOR FRAUD. [new]

Remedies For material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission nor a claim for rescission of the contract nor reject or return of the information shall bar or be deemed inconsistent with a claim for damages or other remedy.

Reporter's Note: Adds a section present in existing law and relevant in Article 2B.

[B. Damages]

SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) If there is a breach of contract, an aggrieved party may recover as [direct] [general] damages, compensation the loss resulting in the ordinary course from the breach as measured in any reasonable manner, together with the present value of any incidental and consequential damages, less the present value of expenses avoided as a result of the breach of contract.

(b) The remedy for breach of contract relating to disclosure or misuse of information in which the aggrieved party has a right of confidentiality or which it holds as a trade secret may include compensation for the benefit received by the party in breach as a result of the breach. A remedy under the agreement or this article for breach of confidentiality or misuse of a trade secret is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.

(c) Except as otherwise provided in the agreement or this article, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(d) In a case involving published informational content, neither party is entitled to consequential damages unless the agreement expressly so provides.

Committee Votes:

a. Voted 7-6 in March, 1996 to allow consequential damages only in cases where the parties agreed to provide for that remedy.

b. Voted 14-0 in September, 1996, to return to consequential damages rule of common law, but to consider specific types of circumstances in which consequential damages should be allowed only if agreed to by the parties.

c. Voted 5-7 in December, 1996, to reject a motion to reverse the consequential damages presumption in the case of a battle of forms.

d. Consensus to retain the exception for consequential damages in reference to published informational content. (December, 1996)

e. Reviewed without substantive change or comments in June, 1997. Subsection (a) subsequently edited without substantive change in response to harmonization meeting in June.

Reporter's Notes:

1. Subsection (a) defines a broad approach to remedies intended to cover the myriad of contexts that are potentially encountered within this Article. Unlike in current Article 2, reliance on formula-driven damage computation is often not appropriate in Article 2B. Breach does not always or even primarily entail defects in delivered products or failures to pay by a recipient (e.g., buyer). The Article covers a wide range of performances and this section allows a court and a party to resort to general, common sense approaches to damage computation for such occurrences. Comments to the eventual Act will provide illustrations of approaches to the

computation of damages derived from reported license breach cases.

2. Article 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 entitle to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain by the aggrieved party resulting from its avoidance of cost or harm." UNIDROIT art. 7.4.2.

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 received, while consequential loss refers to foreseeable losses resulting from the inability to use the performance.

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 availab le 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. Finally, with few exceptions, modern law recognizes the liability limit even under tort law and the exclusion would merely decline to change the law on this issue. The Restatement of Torts, for example, limits exposure for negligent error in data to cases involving an intended recipient and even then to "pecuniary loss" which courts typically interpret as direct damages.

Illustration 3: Dow Jones distributes general stock market and financial transaction information through sales of newspapers and in an on-line format for a fee of $5 per hour or $1 per copy. Dow, the financial officer of Dupond, reviews information in the online system and relied on an error to trade 1 million shares of Acme at a price that caused a $10 million loss. If Dupond was in a situation of special reliance on Dow Jones, the consequential loss would be recoverable. If this is published content, Dupond cannot recover for the consequential loss.

Illustration 4: Disney licenses a motion picture to Vision Theaters. Vision shows the movie to audiences under a ticket contract that qualifies as an access contract (e.g., on-line). One member of the audience who pays five dollars hates the movie and spends a sleepless week because the movie was more violent than expected. That audience member should have no recovery at all, but if it can show that there was a breach, the individual could not recover consequential loss because this is published content. If liability for a violent movie exists, it exists only under tort law.

SECTION 2B-708. LICENSOR'S DAMAGES.

(a) Except as otherwise provided

in subsection (b), for a material breach of contract by a licensee, the licensor may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, the value of accrued and unpaid contract fees or other consideration for any performance rendered by the licensor for which the licensor has not received the contractual consideration, plus:

(A) the

present value of the total unaccrued contract fees or other consideration required for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;

(B) the present value of the profit and general overhead which the licensor would have received on acceptance and full payment for the performance that was to be delivered to the licensee under the contract and was not accepted to or delivered to the licensee because of an improper refusal or a repudiation of the contract; or

(C) damages calculated pursuant to Section 2B-707; and

(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 in subsection (a) must be reduced by due allowance for the proceeds of any actual substitute transaction or the market value of the substitute transaction made possible because of the breach, less the costs of the substitute transaction.

(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 never occurred, the date of the breach of contract;

(2) if the licensor cancels and discontinues the right to possession or use, the date the licensee no longer had the actual ability to use the information; or

(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 three measures described in (a). Each is subject to subsection (b). 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.

3. The measure used here reflects the subject matter. Unlike for goods, information can be replicated many times over with little cost or none. Thus, the remedies do not relate to resale or re-license of the particular diskette or copy. Instead,

the approach taken here allows a court to consider cost savings and alternative transactions made possible by the breach. The reference to alternative transactions is in subsection (b). This due allowance approach is appropriate in this setting because of the nature of the subject matter and the variety of circumstances that can be encountered. Similar language is employed in the **Restatement.** In addition, of course, the injured licensor is also subject to an obligation to mitigate damages.

Illustration 1: Chambers agrees to supply a master disk of its software to Wilson Distributing and agrees to allow Wilson to distribute 10,000 copies of the software in a wholesale market place. This is a nonexclusive license. The cost of the license is $1 million. The cost of the disk is $5. Wilson fails to pay, but instead repudiates the contract. Under (a)(1)(A), Chambers recovers $1 million less the $5. Chambers recovery is also to be reduced by dues allowance for (1) any alternative transaction made possible by this breach (e.g., another transaction in a market created by the lack of the 10,000 products, and (2) by any failure to mitigate under 2B-707.

Illustration 2: Same

as in Illustration 1, except that the contract also requires Chambers to deliver manuals, boxes and other distribution materials for Wilson to distribute the software. The cost of 10,000 of these materials is approximately $800,000. In computing damages, the $800,000 cost savings is deducted from the $1 million. In considering what "due allowance" should be made for any alternative transactions, a court should take into account that this expense adjustment already reflects some accommodation to the alternative transaction, but if a second deal had the same terms, the issue would be whether the second transaction was made possible by the breach. **Illustration 3:** Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, Chambers makes an identical license with Second Distributor for a fee of $900,0

00. This transaction was possible because the first was canceled. Chambers recovery is $100,000 less any net cost savings that are not accounted for in the second transaction.

4. This draft retains the lost profits concept that had been developed in parallel to Article 2. See Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996) (discussing of the application of the alternative transaction concept in reference to a lost profits claim relating to a license breach).

Illustration 4: Compart licenses robotics software designed to operate aircraft engine plants making a particular type of engine. There are five such plants in the world. One is operated by Boeing. Boeing decides to sell the plant to Douglas and, since the license is not transferable, it repudiates the license at the time of sale. Douglas enters into a separate license with Compart. The second transaction was made possible because of the breach by Boeing. The profit and contract fees it generates off-set any profit or fees lost in the Boeing breach.

Illustration 5: Parkins grants

an exclusive license to Telemart to distribute products comprised of copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches the license and Parkins cancels. It sues for damages. Its recovery is the present value of the remaining contract fees with due allowance for alternative transactions made available by virtue of the breach and subject to a duty to mitigate. Here, since the breached license was exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution of the encyclopedia.

5. The damages rules follow common law and give both the licensor and the licensee a right to consequential damages. The **Restatement** uses a licensing illustration in describing its general damages approach in an illustration that, under this Article, deals with consequential damages, rather than the direct damages measure of the formulae in subsection (a) and (b).

"A" contracts to publish a novel that "B" has written. "A" repudiates the contract and B is unable to get his novel published

> elsewhere. Subject to the limitations stated [elsewhere], B's damages include the loss of royalties that he would have received had the novel been published together with the value to him of the resulting enhancement of his reputation.

Restatement (Second) of Contracts ' 347, illustration 1. The UN Sales Convention applies the same damages approach to the buyer as to the seller. UN Convention art. 74.

Recovery of consequential (or any other damages), of course, is limited by the principle that the loss must be proven with reasonable certainty. See ' 352. The Restatement example, although apt for purposes of this Article, fails to reflect a number of cases that reject claims of recovery for losr potential profits as being too speculative. This Article does not disturb the basic rule requiring adequate proof of loss.

The formulae in

subsection (a) relate to direct (general) damages. The consideration referred to in that section does not, therefore, include what gains the licensor hoped to recover from full performance by the licensee which might yield a broader profit for the licensor. It refers to consideration agreed to be paid and independent of the market success or other unpredictable resulting gains from the success.

Illustration 6. I receive a promise to be paid $10,000 for an item that cost $1,000 and receive a further commitment of 3 % royalties for any sales of copies of that item. Assume that the licensee repudiates the entire contract. As direct damages under (a), I receive $10,000 less any expenses saved.

The potential loss of royalty profits is treated as potential consequential loss. It can be recovered only if proven with the degree of certainty required under general contract law cases in the applicable jurisdiction.

6. If the breach relates to use or disclosure restrictions, consequential damages are appropriate. This is consistent with current law. See Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) (On breach of license, under California law, "Universal was entitled to recover the profits it lost as a result of [defendant's] breach ... The court correctly undertook to determine (1) which of the sales that [defendant] made after the agreement was terminated would have been made by Universal if [defendant] had not violated that provision and (2) the profit Universal would have made on those sales."); United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) (Premature

publication under book publishing license entitled licensor to lost profits caused by the effect of early publication on the sales of hard copies).

7. The Section provides that, for consequential damages, present values are measured as of the date of the entry of the judgment. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. As to the direct damages, a distinction will often be required between when a fee is accrued and when a fee is not accrued. The provisions of subsection (c) provide guidance on this issue, making computation of accrued and unaccrued fees occur on the same date.

Illustration 7: A five year license requires that the Sony pay a $5 royalty to Smith, the licensor, for each copy of the Power Rangers video game that it produces for the retail market from a master copy given to it by the licenso

r. Payments are made on a monthly basis. After non-payment for three months, Smith notifies Sony that it is canceling the license. Assume that $50,000 of royalty fees would accrue each month of the ten year contract. Under (c)(2), the date for distinguishing accrued and unaccrued fees arises when Sony no longer had possession or the ability to continue use of the information. Assume that it returned the master disk at the end of month 3. The sum of accrued and unpaid fees is $150,000, while the unaccrued fees total (assuming this can be proven or reliably estimated) $50,000 times the remaining 57 months of the license. The present value of that amount would be determined as of the end of the third month. If Sony's performance also breached quality requirements in the license, Smith may be able to recover consequential loss to the value of the images as computed on the date of judgment.

8. The licensor may have remedies under other law. The primary alternative is intellectual property law. Default by the licensee introduces the possibility of an infringement claim if (a) the breach results in cancellation (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the default consists of acting outside the scope of the license and in violation of the intellectual property right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir.1982); Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) ("[Under] federal and state law a material breach of a [copyright] licensing agreement gives rise to a right of rescission which allows the non-breaching party to terminate the agreement. After the agreement is terminated, any further distribution would constitute copyright infringement."); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

9. Remedies for copyright infringement include both monetary recovery and a right of action against the infringing works and the infringer's future conduct. The two remedies are not mutually exclusive and

are simultaneously available. 17 USC ' 504. Loss is measured in terms of wasted advantage, lost profit or the like. See Data General Corp. v. Grumman Systems Support Corp., Civ. A. No. 88-0033-S, 1993 WL 153739 (D. Mass. May 11, 1993); Harris Market Research v. Marshall Marketing & Comm., Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing fees due under sublicenses were admissible on the issue of damages under theory of breach of license agreement); Engineering Dynamics, Inc. v. Structural Software, Inc., 785 F. Supp. 576 (E.D. La. 1991) (infringing user manual; damage award adjusted to reflect the fact that losses suffered by copyright owner stemmed from factors other than actions attributable to improper use of the manual); Deltak, Inc. v. Advanced Systems, Inc., 767 F.2d 357 (7th Cir. 1985) (damages measure value of the infringing use; in case in which no directly attributable profit could be discerned, each infringing copy "had a value of use equal to the acquisition cost saved by the infringement instead of purchase which [defendant] was then free to put to other uses.")

10. Infringement of a patent entitles the patent holder to damages computed so as to place the patentee in the position that it would have been in had the infringement not occurred. 35 U.S.C. ' 284 (damages "adequate to compensate for the infringement.") The Patent Act also authorizes a court to award treble damages in the event of a willful infringement. Actual damages are assessed in terms of loss suffered by the patent holder with the measure of "loss" frequently gauged in

terms of loss of profits in reference to the patented invention. Zegers v. Zegers, Inc., 458 F.2d 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132 (1972); Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959).

11. Trade secret law is grounded in state law relating to the enforcement of confidential relationships relating to information. There are three sources of trade secret law: the Restatement (First) of Torts ' 757, the Restatement (Third) of Unfair Competition, and the Uniform Trade Secrets Act (UTSA). While the first Restatement has dominated this field, the majority of all states have now adopted the UTSA. Restatement: in addition to injunctive and other relief, the trade secret owner may recover "damages for past harm ... or be granted an accounting of the wrongdoer's profits" and provides that the owner of the trade secret can have two or more of these remedies in the same action. Restatement (First) of Torts ' 757 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may recover damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust enrichment caused by the misappropriation that is not taken into account in computing damages for actual loss."

12. Licensors often opt for intellectual property remedies, rather than contract remedies under current law because the recovery is often greater and the standards for damages are more clearly defined. Federal

intellectual property remedies do not preempt or displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general principle is that all remedies are cumulative, except that double recovery is not permitted. See Harris Market Research v. Marshall Marketing & Communications, Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing and processing fees due under sublicense admissible on the issue of damages under either the theory of copyright infringement or of breach of license agreement); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (award of damages for a breach of license contract and copyright infringement by unauthorized display was not an award of double damages).

SECTION 2B-709. LICENSEE'S DAMAGES.

(a) Subject to subsection (b), on material breach of contract by a licensor, the licensee may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [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 of performance not provided minus the contract fee or other consideration for that performance;

(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 contract fee or other contractual consideration required for the performance; 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) by expenses avoided as a result of the breach; and

(2) if further performance is not anticipated under the agreement, by any unpaid contract fees for performance by the licensor which has been received by the licensee.

(c) Market value is determined

as of the place for performance. Due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contractual terms, performance, and information that were similar in terms, quality, and character to the 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.

Reporter's Notes:

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 the seller's plus: (1) the "loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable" or (2) "the measure of damages for breach of warranty [which is] the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." UCC ' 2-714. Section 2A-519(3) provides that the measure of damages for accepted goods is: "loss resulting in the ordinary course of events from the lessor's default as determined in any manner which is reasonable" plus incidental and consequential damages less expenses saved. Article 2A provides that for breach of warranty the measure of damages is the present value of the difference between the value of the goods as warranted and their value as accepted.

4. As a general rule, the "value of the goods as warranted" focuses on the market value of the property if it were consistent with the represented quality it was to have. This should most often equal the purchase price, but it is not always so limited by courts. See <u>Chatlos Systems, Inc. v. National Cash Register Corp.</u>, 670 F.2d 1304 (3rd Cir. 1980) (allows value measure that encompassed the value that the buyer would have obtained from a perfect computer system with specific capabilities, including advantages in inventory control, profits

and the like, in excess of the contracted price). This draft reverses that approach. The additional value loss (e.g., lost benefits) are consequential damages and covered by treatment of that type of damage in the contract and under the article. This draft allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality. Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F.Supp. 364 (E.D. Mich.).

5. Courts apply a flexible approach to licensee damages outside the UCC. If the damages are proven with reasonable certainty, they can include lost profits in this context. In Western Geographic Co. of America v. Bolt Associates, 584 F.2d 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits that the licensor earned from licensing following breach. In Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984) a company was entitled to recover lost profits when a California distributor of motion pictures breached licensing agreement where California distributor knew that the owner was attempting to obtain films for redistribution in Europe and should have known that owner and company intended to resell films. In Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir. 1989) the court approved a lost profit recovery based on a failure of a licensor to make available to the licensee various films for showing in European markets. In Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir. 1989) a licensee brought action for

breach of contract and for wrongful termination of license related to trademarks and manufacturing know how. The contract breach consisted in part of actions taken by the licensor in violation of the territorial exclusivity provisions of the license. The court approved an award of lost profits for breach of contract based on estimates of lost sales, but reversed on the basis of how the profits were computed requiring computation of profits based on a marginal cost approach. Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

SECTION 2B-710. RECOUPMENT.

(a) A ~~If a~~ party on ~~is in breach of contract, the other party, after~~ notifying the party in breach of its intention to do so, may deduct all or any part of the damages resulting from any breach of the contract from any part of the payments -still due ~~and owing to the~~

~~party in breach~~ under the same contract.

(b) If a nonmaterial breach of contract has not been cured, after notifying the other party of its intention to do so, an aggrieved party may exercise its rights under subsection (a) ~~but may exercise those rights~~ only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Section 2-717. Revised.
Committee Action
a. Discussed in June, 1997; requirement of prior notification suggested.
Reporter's Note: Subsection (a) was edited to conform to the language of existing 2-

717.

1. Subsection (a) adopts language from Article 2 and Article 2A. It recognizes that the injured party can employ self-help by diminishing the amount that it pays under the contract. Unlike in the sale of goods, the obligations of the parties here often run continuously and in complex ways back and forth.

2. Subsection (b) applies that principle to the case of nonmaterial breaches, recognizing the different interests that are involved in ongoing performance contracts and minor breaches. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach. Importantly, this Article creates an obligation to cure nonmaterial breaches where the cost of that cure is not disproportionate to the harm.

[C. Performance Remedies]

SECTION 2B-711. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance of any obligation, other than the obligation to pay for information or services already received, if:

(1) the agreement expressly provides for that remedy and an order for specific performance will not constitute an undue administrative burden for the court; or

(2) the contract was not for personal services, but the agreed performance is unique and monetary compensation would be inadequate.

(b) A decree for specific performance may contain any terms and conditions the court considers just but must provide adequate safeguards consistent with the terms of the contract to protect the confidential information and intellectual property rights of the party ordered to perform.

(c) An aggrieved party has a right to recover information that was to be transferred to and thereafter owned by it if the information exists in a form capable of being transferred and, after reasonable efforts, the aggrieved party is unable to effect reasonable cover or the circumstances indicate that an effort to obtain cover would be unavailing.

Uniform Law Source:
2A-521. Section 2-716. Revised.
Committee Action:

a. Discussed without substantive changes in June, 1997.

Issue: Should subsection a(2) be amended to conform to existing Article 2?

Reporter's Notes:

1. This section explicitly affirms the right of parties to contract for specific performance, so long as a court can administer that remedy. Literature clearly supports that this contractual option promotes freedom and flexibility of contract. This premise is consistent with the overall approach in this Article to favor and support freedom of contract. The principle excludes the obligation to pay a fee, however, since this is essentially equivalent to a monetary judgment and not relevant to the principle of contract remedy choice. [Comments will discuss how this works with respect to development contracts; it depends on the type of commitment made in the contract.]

2. The second principle in subsection (a) outlines a common basis for specific performance (the unique nature of the performance). That principle cannot apply to a "personal services contract" in light of traditional concerns about not imposing judicial obligations requiring work or services by an individual. Article 2 does not deal with this latter issue, since it is not involved in transactions that might fall within this category. Excluding specific performance of the price element of a contract avoids creating a surrogate form of contempt proceeding. Of course, if there is a specific performance order requiring transfer of property under court

order, a reciprocal obligation to pay any relevant fees is an appropriate condition of the specific performance decree.

3. Article 2 allows specific performance "where the goods are unique or in other proper circumstances." UCC " 2-716(1). The comments state: "without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with specific performance of contracts of sale." UCC ' 2-716, comment 1. There are few cases ordering specific performance in a sale of goods. In most cases, a court concludes that adequate substitutes are available and that any differences in quality or cost can be compensated for by an award of damages. Article 2A has a similar specific performance section. ' 2A-521.

4. In common law, despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance in the form of allowing the licensee continued use of the property. Courts often rule that a monetary award fits the circumstances, unless the need for continued access is compelling. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985); Johnson & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co., 715 F. Supp. 110 (D. Del. 1989). Very few cases award specific performance in information-related contracts.

5. The Restatement (Second) of

Contracts distinguishes between specific performance awards and injunctive relief. Restatement (Second) of Contracts ' 357. Specific performance relates to ordering activity consistent with the contract. The most common use concerns injunctions against acts that the defendant promise to forebear or mandatory injunctions demanding performance of a duty that is central to preserving the licensor's position. The Restatement states: "The most significant is the rule that specific performance or an injunction will not be granted if damages are an adequate remedy [to protect the expectation interest of the injured party]." Restatement (Second) of Contracts ' 357, Introductory note. Non-uniform case law deals with under what circumstances a damage award is or will be considered to be inadequate. The Restatement catalogues the following circumstances under which damages may be inadequate:

> (a) the difficulty of providing damages with reasonable certainty,
>
> (b) the difficulty of procuring a suitable substitute performance by means of money ...,
>
> (c) the likelihood that an award of damages could not be collected.

Restatement (Second) of Contracts ' 360. The most frequently discussed illustrations of when these conditions are sufficiently met are cases in which the subject matter of the contract is unique.

6. Subsection (b) recognizes judicial discretion, but provides an important protection for confidential information that is relevant for both the licensor and the licensee. The section casts the balance in favor of a party not being required to specifically perform in cases where that performance would jeopardize interests in confidential information of the party. Confidentiality and intellectual property interests must be adequately dealt with in any specific performance award. Article 2A allows the court to order conditions that it deems just, but does not deal with confidentiality issues.

7. Subsection (c) creates an important right for a licensee It adapts language from Article 2 and Article 2A to give the licensee a right to force completion of a contractual transfer if, at the time of breach, the information is capable of being identified and the contract contemplated that the licensee would own the information product had the transaction been fully performed. It applies in cases where the contract calls for a transfer of the intangibles, not merely rights to use. This occurs, for example, in cases of software development where the software is at least partially developed, but not yet delivered to the transferee. See, e.g., In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (uses Article 2 title rules to resolve rights in incomplete software in a bankruptcy proceeding).

SECTION 2B-712.

LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, ~~the~~ an aggrieved licensor may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization ~~may~~ either complete the information and identify the information to the contract or cease work on the information or re-license or dispose of it or proceed in any other reasonable manner. In ~~either~~ any case, the licensor may recover damages or pursue other remedies.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised. Edited to more closely correspond to existing Article 2.

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 that has not cancelled 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 for breach of contract of contract.

(3) The licensor's rights other than being subject to the licensee’s remedies for breach remain in effect as if the licensor had not been in breach.

Reporter's Note: This section makes clear the consequences of a licensee's decision to accept flawed performance by the licensor and pursue remedies that do not involve a cancellation of the contract obligate the licensee to continued performance of the intangibles contract itself. A licensee faced with breach by the licensor can elect to continue the contract and claim damages for the breach. This section clarifies that, if this choice is made, the licensee is bound by the contract terms. However, it retains rights of action with respect to the prior, defective performance.

SECTION 2B-714. RIGHT TO DISCONTINUE.

In an access contract, in the event of a material breach of contract or if the agreement so provides, a party may discontinue access by the party in breach or instruct any third person that is assisting the performance of the contract to discontinue its performance.

Reporter's Notes:

1. This section deals with the right of a party in an access contract to stop

performance under two significant circumstances. It was read without comment or objections at the 1997 Annual Meeting. The ability to act quickly in an access contract is potentially critical to party's ability to avoid continuing liability risk, as might occur where the basis of the breach includes use of the access system to distribute infringing, libelous, or otherwise damaging material. More generally, it corresponds to current common law principles regarding access to facilities – treating these as arrangements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides. The right to discontinue is recognized in licenses whose basic nature entails a contractual permission to access or use a resource owned or controlled by the licensor. In such cases, the contract will be treated as preemptively subject to termination a will (even without a breach). See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned facilities). This right operates independently of Sections 2B-715 and 716.

In cases where the information available for access is information of the breaching party, the breaching party's rights to recover the information are protected under other provisions of this Article.

2. This section does not create a right to retake transfers already made, but merely to stop future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This subsection

derives in part from Section 2A-525(1). It does not create special rules for insolvency. Cases of insolvency will be handled either in the definition by contract of material breach or in the rules dealing with insecurity about future performance. This grants lesser rights to the transferor than do either Article 2 or 2A. Both give a right to stop shipment in the event of discovered insolvency.

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

(a) On cancellation of a license, the aggrieved party has

(1) a right to possession of all copies of the information in the possession or control of the party in breach whether delivered to or made by the party in breach and any other materials that by contract were to be returned by the

party in breach; and

(2) a right to prevent the continued exercise of rights in the licensed information by the party in breach.

(b) A court may enjoin the party in breach from continued use of the information and may order that the aggrieved party or an officer of the court take the steps described in Section 2B-628(b). If the agreement so provides, a court may require the party in breach to assemble all copies of the information and any other materials relating thereto and make them available to the aggrieved party at a place designated by that party which is reasonably convenient to both parties.

(c) The aggrieved party has a right to an expedited hearing on a request for prejudgment relief to enforce or protect its rights under this section.

(d) The right to possession under subsections (a) and (b) is 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.

Uniform Law Source: Section 2A-525; Section 9-503; Section 2A-525(1);. Sections 2A-526; 2-705. Revised.

Reporter's Notes:

1. **This section deals only with judicial action.** The section recognizes that the right to judicial assistance can go in either direction. The right to obtain possession and to control use of information in the hands of the other party in commercial practice may run either to the benefit of the licensor or the licensee. This is true because in many commercial settings, the licensee provides information important to it to the licensor for purposes of processing, analysis and otherwise. While in a simple software license, the information flows from licensor to licensee, that is not true in other situations and the principle which gives the injured party a right to recover and control use of its information should not be restricted to a licensor.

The major change, intended to reduce the need to resort to remedies under the self-help provisions, is in new subsection (c) which provides for a right to an expedited hearing to enforce rights or possession and restriction of use. No effort has been made to define the contours of what that hearing timing may entail. Based on the recommendation of several Commissioners, the Committee should consider whether that right should be presented in a more elaborated manner to encourage resort to judicial, rather than self-help remedies. The following language, based on a modern replevin statute, might be considered as a model:

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A party in an action to enforce its rights under this section has a right to recover or prevent continued use of the information at the commencement of suit under the following terms:

(a) the party files a verified petition that:

(1) describes the information;

(2) states that the party is entitled to possession or preventing use the information and the facts supporting that right; and

(3) requests that the court issue an order for the immediate delivery of the information or prevention of its use information through electronic or other means.

(b) on the filing of such petition, the court shall serve on the other party a summons notifying it that an order is sought and that may object to issuance by a written objection filed with the court and delivered to the plaintiff's attorney within five days of service.

(c) If no written objection is filed in the five-day period, no hearing is necessary and the court shall issue the order.

(d) If a written objection is filed in the five-day period, the court shall, at the request of either party, set the matter for prompt hearing. At the hearing the court shall determine whether the order for prejudgment relief should issue based on the probable merit of petition and the posting of an appropriate bond.

(e) The court may order the defendant not to conceal, damage, copy or destroy the property or a part thereof other than in the ordinary use of the information pending hearing on plaintiff's petition.

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2. The right under 2B-715 flows from the conditional nature of the transaction. It arises only in the case of a license and only in the event of cancellation. The section differentiates between the right to obtain possession and the right to prevent on-going use of the information. The right to possession is contingent on there being no commingling in the ordinary course of the license such that the information cannot be identified or reasonably separated from the property of the party in breach. This deals, for example, with cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible and the reason it is impossible lies in the expected performance of the parties under the contract.

If, however, an image, trademark, name or similar material is incorporated and inseparable from other property of the party in breach, that fact does not in the case of a material breach and cancellation, preclude the injured party from preventing further use of the information by the party in breach. Thus, ~~for example,~~ a ~~limited~~ license of the "Mickey Mouse" character which results in placing that image on hats produced by the party in breach does not prevent the other party from barring continued use of the image on the hats in commerce.

SECTION 2B-716. LICENSOR'S SELF-HELP.

Alternative A

(a) ~~Subject to subsection (b), a~~A licensor may exercise its rights under Section 2B-715 without judicial process if this can be done without a breach of the peace and the licensor complies with subsection (b) or Section 2B-714.

(b) If the licensed information is used to process other information held by the licensee or to operate the licensee's business, the licensor may not use electronic means to exercise its rights under (a) unless:

(1) possession of a copy is obtained by the licensor without a breach of the peace and the electronic means are used with respect to that copy; or

(2) the licensor gives notice in a record not less than five business days prior to utilizing the electronic means, to an officer, director, partner or managing agent of the licensee or to another person

or office designated by the parties in the license; a term in the license to which the licensee manifested assent authorizes use of electronic means; and use does not result in a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

(c) A licensee has a right to an expedited hearing to contest ~~on~~ the licensor's right to proceed under subsection (b).

(d) Actions that violate this section constitute a breach of contract by the licensor unless the actions are ~~allowed~~ authorized by other ~~applicable~~ law.

(e) The licensee cannot waive the protections of this section prior to breach.

Alternative B

SECTION 2B-716. LICENSOR'S SELF-HELP.

(a) Subject to subsection (b), a licensor may exercise its rights under Section 2B-715 without judicial process if this can be done without a breach of the peace.

(b) This article does not authorize a party to proceed without judicial process by electronic means, but a party may do so as allowed by other law.

Uniform Law Source: Section 9-503. Revised.

Committee Action:

a. Considered and substantially revised in January 1996.

b. Considered in June, 1997.

c. Motion to delete the section and adopt alternative A was withdrawn. Sept. 1997

Reporter's Notes:

1. This section deals with self-help repossession and the controversial remedy of “electronic self-help.” During the September Meeting, it was decided to pursue the further refinement of Alternative A in seeking a consensus position on the electronic self-help issue. Alternative A focuses on ensuring notice to the licensee and granting a right to judicial access on an expedited basis as the primary protections. This Draft builds on the prior Draft, adopting several recommendations made by a representative of a group of large company licensees. The additional elements are: 1)

requiring the notice in a record, 2) designating a minimum time for reasonable notice, 3) requiring assent to a contract term allowing use of electronics, and 4) designating senior personnel as the recipient of the notice. The issues addressed here are relevant not only to Article 2B, but also to Article 2A and Article 9.

Consideration of this Alternative should also include some attention to a suggestion contained in the notes to 2B-715 which outline a potential judicial remedy patterned after modern replevin statutes.

2. Subsection (a) deals with traditional self-help and a clarifying cross-reference to the right to discontinue an access contract. The basic self-help right is constrained by the standard of "breach of the peace." This is the only restriction contained in Articles 9 and 2A. No reason appears to apply a different standard here for traditional repossession activities, especially since Article 2B requires a material breach to exercise self-help, while the other articles do not.

3. The

basic principle in this section is that self-help remedies are appropriate. The primary concerns about self-help focus on the leverage it creates in business and other settings in which the information (typically computer software) is used in business or other processing activities that may be critical to the licensee. The prefatory language in (b) limits the additional protections to these circumstances. Thus, for example, there are no particular restrictions (other than the idea of breach of peace and the conditions in 2B-715) where electronic means are used to disable use of licensed informational content, such as digital copies of motion pictures.

The language of (b)(1) makes clear that ordinary methods currently used to enforce rights through physical repossession are not invalidated simply because a machine may be involved. Thus, for example, an access card that is repossessed by an ATM or similar device refusing to return the card is subject to the general rule of breach of the peace, rather than to the more elaborate protections established for electronic self-help.

3. Subsection (b)(2) outlines a series of restrictions on electronic means in all other cases of operation software where the licensee's risk is high. **E**lectronic self-help remedy under this proposal is restricted by several limitations. The most important combine contractual consent and prior notice before implementing the right. The prior notice must be no less than five days. The Committee should consider the adequacy or appropriateness of this term as contrasted to a more general standard of "reasonable time" which would allow different approaches depending on the type of information involved. The notice becomes important because the licensee is given a right to an expedited hearing to contest the electronic shut off. In addition, the self-help remedy cannot be implemented unless there is no foreseeable risk of injury to person or property.

This Alternative leaves the Licensor's rights under this

Article significantly more constrained in reference to electronic remedies than is the case under Article 2A or Article 9. In each case, the sole restrictive measure on the right to repossession and to disable use of equipment is that the action not breach the peace. Neither article requires prior notice or contractual consent.

4. Alternative B: This proposal acknowledges the right to physical action to repossess, akin to that granted in Article 2A and 9, but leaves issues about the ability to use electronic self-help to be resolved by other law, including those statutes. The rationale is simply that, in current circumstances, the issue involves a too hotly contested question to be resolved here. Recognizing physical self-help remedies is consistent with the other aspects of the UCC and with the desirable result of coordinating law in cases where mixed packages of rights and property are involved in a particular transaction.

5. 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." Several cases disallowed use of this device where no prior authorization or notice was given. See *Franks & Son, Inc. v. Information Solutions*, Computer Industry Litigation Rep. 8927-25 (ND Okla. 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of inclusion); *Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc.*, 157 App. Div. 2d 689, 549 NYS2d 789 (1990).

6. Current law includes rights of self-help repossession under both Article 9 (security interests) and Article 2A (leases). In each area, self-help is allowed except if it causes a breach of the peace. Each recognizes the right to self-help by "rendering unusable" goods used in business or trade. That can be done physically or electronically in the digital world. It is already being done electronically with automobile rentals and other limited term or limited use contracts. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC § 2A-525, Comment 3. 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). Article 2A does not regulate or limit the ability of the parties to contractually define damages and procedural issues relating to self-help repossession or disablement of leased equipment.

·THIS COLUMN SUMMARIZES THE IMPACT OF THE CHANGES BASED ON EXISTING UCC AND COMMON LAW AND AN ASSUMPTION THAT: INCREASED OBLIGATIONS ON THE VENDOR, REDUCED CONTRACT FLEXIBILITY, AND INCREASED NOTICE DUTIES ARE BENEFICIAL TO THE CONSUMER NOTWITHSTANDING OTHER EFFECTS ON THE MARKETPLACE. (NC no change; + increased protection; - reduced protection) DIfferent assumptions of a broader analsysis would convert many question markets or negatives to a different result.