UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT *

(Last Revisions or Amendments Completed Year 2002)

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ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

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MEETING IN ITS ONE-HUNDRED-AND-ELEVENTH YEAR
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WITH PREFATORY NOTE AND COMMENTS

October 15, 2002

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UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

(Amended 2000, 2002)

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UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

TABLE OF CONTENTS

PART 3
CONSTRUCTION

[SUBPART A. GENERAL]

[SUBPART B. INTERPRETATION]

PART 4
WARRANTIES

PART 5
TRANSFER OF INTERESTS AND RIGHTS

[SUBPART A. OWNERSHIP AND TRANSFERS]

[SUBPART B. FINANCING ARRANGEMENTS]

PART 6
PERFORMANCE

[SUBPART A. GENERAL]163

[SUBPART B. PERFORMANCE IN DELIVERY OF COPIES]

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

"A commercial contract code for computer information transactions"

Prefatory Note

Once land ownership and agrarian production were primary sources of wealth and income in our economy, and contracts for the exchange of horses and grain dominated the commercial landscape. Following the industrial revolution, manufactured goods assumed center stage. In the 1930s Llewellyn recognized that this change required revisions to the law of sales, so that its rules were relevant to the new economy. The result was UCC Article 2. Despite initially strong resistance, Article 2 won universal acceptance, for it reflected the reality of economic change and its implications for contract law.

Our economy has experienced another fundamental change, with information products and services now driving increased productivity and growth. Accompanying this change is a widely diverse and rich array of methods for distributing and tailoring digital information to the modern marketplace. Contracts underlie both the creation and distribution of such information. However, legal rules that are not relevant to commercial practice or that are uncertain in application inhibit contracting or raise transaction costs. UCITA was drafted in response to this fundamental economic change and need for clarity in the law.

Article 2 served as both a model and a point of departure for UCITA. Like Article 2, UCITA covers a variety of transactions, many of which take place solely between merchants. Article 2 governs sales of jet planes as well as toasters, not to mention the large-scale acquisition of jet and toaster parts. UCITA governs access by Fortune 500 businesses to sophisticated databases as well as distribution of software to the general public; it also covers custom software development and the acquisition of various rights in multimedia products.

Both UCITA and Article 2 are based upon the principle of freedom of contract: with limited exceptions, the terms and effect of a contract can be varied by agreement. Most provisions of both statutes are default rules, applicable only if the parties do not specify some other rule. Although one could try to fashion a contract code that regulates comprehensively rather than permitting such flexibility, it is hard to imagine such an approach being compatible with a vibrant market economy. Even if one succeeded in making the regulations stick, the effect would be to hinder rather than facilitate commerce. On the other hand, as noted, without certain default rules, contracting and thus legal rights remain unclear.

To be sure, not every term of a contract should be enforced. UCITA follows Article 2 in providing a standard of unconscionability for courts to employ in policing contract terms. UCITA goes beyond Article 2 in authorizing courts to strike down over-reaching language that conflicts with fundamental public policy. It also goes beyond Article 2 and other existing law in furthering licensee interests by prohibiting electronic self-help under this statute (Section 816) and by excluding enforcement of "no-reverse-engineering" clauses in some cases. See Section 118. Compare *Bowers v. Baystate Technologies, Inc*., 302 F.3d 1334 (Fed Cir. 2002).

UCITA provides that common law doctrines such as fraud and duress remain effective and that applicableconsumer protection law governs. UCITA does not alter competition or antitrust law. It does not change trade secret law, intellectual property law, or substantive consumer law. It deals only with contracts.

As Llewellyn recognized in drafting Article 2, contract law must be tailored to the type of transactions that it covers. Just as a body of law based on images of the sale of horses was not relevant a half century ago to sales of manufactured goods, so today a body of law based on images of the sale of manufactured goods ill fits licenses and other transactions in computer information. Rules based on an antiquated view of the transactional world do not give coherent guidance to courts or to transacting parties.

UCITA is the first uniform contract law designed to deal specifically with the new information economy. Transactions in computer information involve different expectations, different industry practices, and different policies from transactions in goods. For example, in a sale of goods, the buyer *owns* what it buys and has exclusive rights in that subject matter (e.g., the toaster that has been purchased). In contrast, someone that acquires a copy of computer information may or may not own that copy, but in any case rarely obtains all rights associated with the information. See *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999), *cert. den.* 528 U.S. 923 (1999). What rights are acquired or withheld depends on what the contract says. This point only is implicit in Article 2 for goods such as books; UCITA makes it explicit for the information economy where, unlike in the case of a book, the contract (license) is the product. See *Specht v. Netscape Communications Corp.*, – F.3d –, 2002 WL 31166784 n. 13 (Fed. Cir. 2002); *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989).

Licensing is one way in which computer information is tailored to the information marketplace. Courts have enforced contract terms that, among other things:

- preclude commercial use
- preclude making copies
- grant access
- allow use throughout a site
- preclude distribution of copies for a fee
- preclude modification
- allow distribution only in specific way
- permit commercial use
- permit making multiple copies
- limit access
- limit use to a specific computer
- allow distribution of copies
- allow modification
- limit use to internal operations

Such contract terms have helped to create the wondrous array of products and services that characterizes our modern economy. Whether specific terms are appropriate for a given transaction or set of parties is fundamentally a marketplace issue.

As noted, in computer information transactions, license terms often define the product. A software product may be provided in the same form in two transactions, but in one case the user is authorized to make 100,000 copies and in the other merely to use a single copy at home. The value of the transaction inheres not in the tangible medium (if, indeed, any is used), but rather in the license grant terms. UCITA does not require that computer information products and services be licensed; it covers sales as well. But UCITA provides a coherent contract law framework for analyzing a license, which has been the dominant contractual framework for commerce in computer information.

Up to this point, a complex mix of common law and Article 2 has governed computer information transactions. The common law is frequently difficult to ascertain, and it varies widely among states. In addition, differences in the legal norms that have developed in different areas of information practice are producing unpredictable results as those areas converge. Article 2, while uniform, does not properly apply to many issues involved in transactions in computer information, and when it applies, it often does not provide appropriate guidance because of differences in subject matter and transactional frameworks.

The need for a coherent, uniform body of law has never been greater. Revolutions in telecommunications and computer technology have made geography increasingly irrelevant to modern commerce. The Internet enables small firms as well as large ones to provide products and services throughout the country and around the world. Even as online systems have altered how many information transactions are performed, however, fundamental issues associated with contracting online remain unanswered. A modern contract law must give guidance on those issues. Failure to do so does not foster but rather impedes commerce in computer information.

The liberating promise of technology cannot be fully realized unless there is predictability in the legal rules that govern such transactions. This is the need that UCITA addresses. It clarifies and sets forth uniform legal principles applicable to computer information transactions. UCITA is a statute for our time.

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

PART 1
GENERAL PROVISIONS

[SUBPART A. SHORT TITLE AND DEFINITIONS]

SECTION 101. SHORT TITLE. This [Act] may be cited as the Uniform Computer Information Transactions Act.

SECTION 102. DEFINITIONS.

(a) [**General definitions.**] In this [Act]:

(1) "Access contract" means a contract to obtain by electronic means access to, or information from, an information processing system of another person, or the equivalent of such access.

(2) "Access material" means any information or material, such as a document, address, or access code, that is necessary to obtain authorized access to information or control or possession of a copy.

(3) "Aggrieved party" means a party entitled to a remedy for breach of contract.

(4) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances, including course of performance, course of dealing, and usage of trade as provided in this [Act].

(5) "Attribution procedure" means a procedure to verify that an electronic authentication, display, message, record, or performance is that of a particular person or to detect changes or errors in information. The term includes a procedure that requires the use of algorithms or other codes, identifying words or numbers, encryption, or callback or other acknowledgment.

(6) "Authenticate" means:

(A) to sign; or

(B) with the intent to sign a record, otherwise to execute or adopt an electronic symbol, sound, message, or process referring to, attached to, included in, or logically associated or linked with, that record.

(7) "Automated transaction" means a transaction in which a contract is formed in whole or part by electronic actions of one or both parties which are not previously reviewed by an individual in the ordinary course.

(8) "Cancellation" means the ending of a contract by a party because of breach of contract by another party.

(9) "Computer" means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions.

(10) "Computer information" means information in electronic form which is obtained from or through the use of a computer or which is in a form capable of being processed by a computer. The term includes a copy of the information and any documentation or packaging associated with the copy.

(11) "Computer information transaction" means an agreement or the performance of it to create, modify, transfer, or license computer information or informational rights in computer information. The term includes a support contract under Section 612. The term does not include a transaction merely because the parties' agreement provides that their communications about the transaction will be in the form of computer information.

(12) "Computer program" means a set of statements or instructions to be used directly or indirectly in a computer to bring about a certain result. The term does not include separately identifiable informational content.

(13) "Consequential damages" resulting from breach of contract includes (i) any loss resulting from general or particular requirements and needs of which the breaching party at the time of contracting had reason to know and which could not reasonably be prevented and (ii) any

injury to an individual or damage to property other than the subject matter of the transaction proximately resulting from breach of warranty. The term does not include direct damages or incidental damages.

(14) "Conspicuous", with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. A term in an electronic record intended to evoke a response by an electronic agent is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react to it without review of the record by an individual. Conspicuous terms include the following:

(A) with respect to a person:

(i) a heading in capitals in a size equal to or greater than, or in contrasting type, font, or color to, the surrounding text;

(ii) language in the body of a record or display in larger or other contrasting type, font, or color or set off from the surrounding text by symbols or other marks that draw attention to the language; and

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

(B) with respect to a person or an electronic agent, a term or reference to a term that is so placed in a record or display that the person or electronic agent cannot proceed without taking action with respect to the particular term or reference.

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

(16) "Consumer contract" means a contract between a merchant licensor and a

consumer.

(17) "Contract" means the total legal obligation resulting from the parties' agreement as affected by this [Act] and other applicable law.

(18) "Contract fee" means the price, fee, rent, or royalty payable in a contract under this [Act] or any part of the amount payable.

(19) "Contractual use term" means an enforceable term that defines or limits the use, disclosure of, or access to licensed information or informational rights, including a term that defines the scope of a license.

(20) "Copy" means the medium on which information is fixed on a temporary or permanent basis and from which it can be perceived, reproduced, used, or communicated, either directly or with the aid of a machine or device.

(21) "Course of dealing" means a sequence of previous conduct between the parties to a particular transaction which establishes a common basis of understanding for interpreting their expressions and other conduct.

(22) "Course of performance" means repeated performances, under a contract that involves repeated occasions for performance, which are accepted or acquiesced in without objection by a party having knowledge of the nature of the performance and an opportunity to object to it.

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

(24) "Delivery", with respect to a copy, means the voluntary physical or electronic transfer of possession or control.

(25) "Direct damages" means compensation for losses measured by Section 808(b)(1) or 809(a)(1). The term does not include consequential damages or incidental damages.

(26) "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(27) "Electronic agent" means a computer program, or electronic or other automated

means, used independently to initiate an action, or to respond to electronic messages or performances, on the person's behalf without review or action by an individual at the time of the action or response to the message or performance.

(28) "Electronic message" means a record or display that is stored, generated, or transmitted by electronic means for the purpose of communication to another person or electronic agent.

(29) "Financial accommodation contract" means an agreement under which a person extends a financial accommodation to a licensee and which does not create a security interest governed by [Article 9 of the Uniform Commercial Code]. The agreement may be in any form, including a license or lease.

(30) "Financial services transaction" means an agreement that provides for, or a transaction that is, or entails access to, use, transfer, clearance, settlement, or processing of:

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

(B) an instrument or other item;

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

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

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

(31) "Financier" means a person that provides a financial accommodation to a licensee under a financial accommodation contract and either (i) becomes a licensee for the purpose of transferring or sublicensing the license to the party to which the financial accommodation is provided or (ii) obtains a contractual right under the financial accommodation contract to preclude the licensee's use of the information or informational rights under a license

in the event of breach of the financial accommodation contract. The term does not include a person that selects, creates, or supplies the information that is the subject of the license, owns the informational rights in the information, or provides support for, modifications to, or maintenance of the information.

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

(33) "Goods" means all things that are movable at the time relevant to the computer information transaction. The term includes the unborn young of animals, growing crops, and other identified things to be severed from realty which are covered by [Section 2-107 of the Uniform Commercial Code]. The term does not include computer information, money, the subject matter of foreign exchange transactions, documents, letters of credit, letter-of-credit rights, instruments, investment property, accounts, chattel paper, deposit accounts, or general intangibles.

(34) "Incidental damages" resulting from breach of contract:

(A) means compensation for any commercially reasonable charges, expenses, or commissions reasonably incurred by an aggrieved party with respect to:

(i) inspection, receipt, transmission, transportation, care, or custody of identified copies or information that is the subject of the breach;

(ii) stopping delivery, shipment, or transmission;

(iii) effecting cover or retransfer of copies or information after the breach;

(iv) other efforts after the breach to minimize or avoid loss resulting from the breach; and

(v) matters otherwise incident to the breach; and

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

(35) "Information" means data, text, images, sounds, mask works, or computer programs, including collections and compilations of them.

(36) "Information processing system" means an electronic system for creating,

generating, sending, receiving, storing, displaying, or processing information.

(37) "Informational content" means information that is intended to be communicated to or perceived by an individual in the ordinary use of the information, or the equivalent of that information.

(38) "Informational rights" include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks, publicity rights, or any other law that gives a person, independently of contract, a right to control or preclude another person's use of or access to the information on the basis of the rights holder's interest in the information.

(39) "Insurance services transaction" means an agreement between an insurer and an insured which provides for, or a transaction that is, or entails access to, use, transfer, clearance, settlement, or processing of:

(A) an insurance policy, contract, or certificate; or

(B) a right to payment under an insurance policy, contract, or certificate.

(40) "Knowledge", with respect to a fact, means actual knowledge of the fact.

(41) "License" means a contract that authorizes access to, or use, distribution, performance, modification, or reproduction of, information or informational rights, but expressly limits the access or uses authorized or expressly grants fewer than all rights in the information, whether or not the transferee has title to a licensed copy. The term includes an access contract, a lease of a computer program, and a consignment of a copy. The term does not include a reservation or creation of a security interest to the extent the interest is governed by [Article 9 of the Uniform Commercial Code].

(42) "Licensee" means a person entitled by agreement to acquire or exercise rights in, or to have access to or use of, computer information under an agreement to which this [Act] applies. A licensor is not a licensee with respect to rights reserved to it under the agreement.

(43) "Licensor" means a person obligated by agreement to transfer or create rights in, or to give access to or use of, computer information or informational rights in it under an

agreement to which this [Act] applies. Between the provider of access and a provider of the informational content to be accessed, the provider of content is the licensor. In an exchange of information or informational rights, each party is a licensor with respect to the information, informational rights, or access it gives.

(44) "Mass-market license" means a standard form used in a mass-market transaction.

(45) "Mass-market transaction" means a transaction that is:

(A) a consumer contract; or

(B) any other transaction with an end-user licensee if:

(i) the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information;

(ii) the licensee acquires the information or informational rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and

(iii) the transaction is not:

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

(II) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee, other than minor customization using a capability of the information intended for that purpose;

(III) a site license; or

(IV) an access contract.

(46) "Merchant" means a person:

(A) that deals in information or informational rights of the kind involved in the transaction;

(B) that by the person's occupation holds itself out as having knowledge or skill

peculiar to the relevant aspect of the business practices or information involved in the transaction; or

(C) to which the knowledge or skill peculiar to the practices or information involved in the transaction 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.

(47) "Nonexclusive license" means a license that does not preclude the licensor from transferring to other licensees the same information, informational rights, or contractual rights within the same scope. The term includes a consignment of a copy.

(48) "Notice" of a fact means knowledge of the fact, receipt of notification of the fact, or reason to know the fact exists.

(49) "Notify", or "give notice", means to take such steps as may be reasonably required to inform the other person in the ordinary course, whether or not the other person actually comes to know of it.

(50) "Party" means a person that engages in a transaction or makes an agreement under this [Act].

(51) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental subdivision, instrumentality, or agency, public corporation, or any other legal or commercial entity.

(52) "Published informational content" means informational content prepared for or made available to recipients generally, or to a class of recipients, in substantially the same form. The term does not include informational content that is:

(A) customized for a particular recipient by one or more individuals acting as or on behalf of the licensor, using judgment or expertise; or

(B) provided in a special relationship of reliance between the provider and the recipient.

(53) "Receipt" means:

(A) with respect to a copy, taking delivery; or

(B) with respect to a notice:

(i) coming to a person's attention; or

(ii) being delivered to and available at a location or system designated by agreement for that purpose or, in the absence of an agreed location or system:

(I) being delivered at the person's residence, or the person's place of business through which the contract was made, or at any other place held out by the person as a place for receipt of communications of the kind; or

(II) in the case of an electronic notice, coming into existence in an information processing system or at an address in that system in a form capable of being processed by or perceived from a system of that type by a recipient, if the recipient uses, or otherwise has designated or holds out, that place or system for receipt of notices of the kind to be given and the sender does not know that the notice cannot be accessed from that place.

(54) "Receive" means to take receipt.

(55) "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.

(56) "Release" means an agreement by a party not to object to, or exercise any rights or pursue any remedies to limit, the use of information or informational rights which agreement does not require an affirmative act by the party to enable or support the other party's use of the information or informational rights. The term includes a waiver of informational rights.

(57) "Return", with respect to a record containing contractual terms that were rejected, refers only to the computer information and means:

(A) in the case of a licensee that rejects a record regarding a single information product transferred for a single contract fee, a right to reimbursement of the contract fee paid from the person to which it was paid or from another person that offers to reimburse that fee, on:

(i) submission of proof of purchase; and

(ii) proper redelivery of the computer information and all copies within a reasonable time after initial delivery of the information to the licensee;

(B) in the case of a licensee that rejects a record regarding an information product provided as part of multiple information products integrated into and transferred as a bundled whole but retaining their separate identity:

(i) a right to reimbursement of any portion of the aggregate contract fee identified by the licensor in the initial transaction as charged to the licensee for all bundled information products which was actually paid, on:

(I) rejection of the record before or during the initial use of the bundled product;

(II) proper redelivery of all computer information products in the bundled whole and all copies of them within a reasonable time after initial delivery of the information to the licensee; and

(III) submission of proof of purchase; or

(ii) a right to reimbursement of any separate contract fee identified by the licensor in the initial transaction as charged to the licensee for the separate information product to which the rejected record applies, on:

(I) submission of proof of purchase; and

(II) proper redelivery of that computer information product and all copies within a reasonable time after initial delivery of the information to the licensee; or

(C) in the case of a licensor that rejects a record proposed by the licensee, a right to proper redelivery of the computer information and all copies from the licensee, to stop delivery or access to the information by the licensee, and to reimbursement from the licensee of amounts paid by the licensor with respect to the rejected record, on reimbursement to the licensee of contract fees that it paid with respect to the rejected record, subject to recoupment and setoff.

(58) "Scope" means the terms of a license describing the:

(A) licensed copies, information, or informational rights involved;

(B) use or access authorized, prohibited, or controlled;

(C) geographic area, market, or location; or

(D) duration of the license.

(59) "Seasonable", with respect to an act, means taken within the time agreed or, if no time is agreed, within a reasonable time.

(60) "Send" means, with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed, to deposit a record in the mail or with a commercially reasonable carrier, to deliver a record for transmission to or re-creation in another location or information processing system, or to take the steps necessary to initiate transmission to or re-creation of a record in another location or information processing system. In addition, with respect to an electronic message, the message must be in a form capable of being processed by or perceived from a system of the type the recipient uses or otherwise has designated or held out as a place for the receipt of communications of the kind sent. Receipt within the time in which it would have arrived if properly sent, has the effect of a proper sending.

(61) "Standard form" means a record or a group of related records containing terms prepared for repeated use in transactions and so used in a transaction in which there was no negotiated change of terms by individuals except to set the price, quantity, method of payment, selection among standard options, or time or method of delivery.

(62) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(63) "Term", with respect to an agreement, means that portion of the agreement which relates to a particular matter.

(64) "Termination" means the ending of a contract by a party pursuant to a power created by agreement or law otherwise than because of breach of contract.

(65) "Transfer":

(A) with respect to a contractual interest, includes an assignment of the contract, but does not include an agreement merely to perform a contractual obligation or to exercise contractual rights through a delegate or sublicensee; and

(B) with respect to computer information, includes a sale, license, or lease of a copy of the computer information and a license or assignment of informational rights in computer information.

(66) "Usage of trade" means any practice or method of dealing that has such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question.

(b) [**Definitions incorporated from Uniform Commercial Code.**] The following definitions in [the Uniform Commercial Code (1998 Official Text)] apply to this [Act]:

(1) "Burden of establishing" [Section 1-201]

(2) "Document of title" [Section 1-201].

(3) "Financial asset" [Section 8-102(a)(9)].

(4) "Funds transfer" [Section 4A-104].

(5) "Identification" to the contract [Section 2-501].

(6) "Instrument" [Section 9-105(i) (1995 Official Text) or 9-102(a)(47) (1998 Official Text)].

(7) "Investment property" [Section 9-115(f) (1995 Official Text) or 9-102(a)(49) (1998 Official Text)].

(8) "Item" [Section 4-104].

(9) "Letter of credit" [Section 5-102].

(10) "Payment order" [Section 4A-103].

(11) "Sale" [Section 2-106].

Legislative note: If your State's definition differs from the 1998 Official Text, include the definition from the Official Text in subsection (a).

Comment

1. "Access contract." An access contract is an agreement that authorizes access to, or obtaining information from, an electronic facility, including a computer or Internet site, or that allows an equivalent form of access. The term does not include contracts that merely grant a right to enter a building or other physical location that contains information, or the mere purchase of a television, radio, or similar goods that merely create technological ability to access information.

An "access contract" is typified by "on-line" services. It also includes contracts for remote data processing, remote access to applications software or data stored on a third party computer, third party e-mail systems, and contracts for automatic updating from a remote facility to a database held by the licensee. The term does not cover interactions among computer programs within a person's own system – the access must be to another person's system or data. Thus, if a licensee of a spreadsheet program uses it to interact with the licensee's computers and data on the licensee's own network, that arrangement is not an access contract. However, a person can provide the equivalent of access, and thereby create an access contract, even though the information is only used on the licensee's system, such as where an on-line data provider elects to provide access to data in part by allowing its database to be loaded into the computer of a client. This performance retains all characteristics of an access contract and is within the definition. The same is true if a database loaded into the user's system is intermittently updated with data from remote systems. On the other hand, if a software publisher downloads licensed software into a licensee's system, the continuing right to use the software after it is downloaded is not an access contract.

An access provider may, or may not, provide contractual rights in the information accessed. Some transactions entail a three-party framework: in addition to the customer, one licensor provides access, while another (the content provider) licenses the information. This transaction involves two and, in some cases, three contracts. The first is between the content provider and the access provider. The second is between the access provider and the end user. The third arises if the content provider contracts directly with the end user; that too is an access contract. The contracts are independent of each other.

ATM cards, "smart cards," home banking products, and the like enable a customer to obtain information from an information processing system maintained by a financial institution, and would therefore reflect "access contracts" were they not excluded by section 103(d)(1) as a "financial services transaction" (excludes "related identifying, verifying, access-enabling, authorizing or monitoring information"). The parties may otherwise agree to use the contract formation provisions of this Act to enter into the initial customer relationship and thereafter to obtain an ATM card, smart card, or home banking software. They may further agree that the licensing aspects of their relationship will be governed by this Act. If so, the agreement is an "access contract." The agreement does not subject any transaction effected through use of an ATM card or home banking product to this Act, or alter the rules that would otherwise apply to such transaction.

2. "Agreement". This definition derives from Uniform Commercial Code § 1-201(3) (1998 Official Text). The term includes full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts of an agreement. The meaning of the agreement is determined by the language the parties use and their actions, interpreted in the light of commercial practice and other surrounding circumstances. See Section 116(c); Section 301 (parol evidence rule). Whether an agreement has legal effect is determined by this Act or other applicable law. Section 117(b).

3. "Attribution procedure." An "attribution procedure" is a procedure used to identify the person who sent an electronic message or to verify the integrity of its content. In general, an attribution procedure has substantive effect only if it was agreed to or adopted by the parties or established by applicable law. Agreement to or adoption of a procedure may occur directly between the two parties or through a third party. For example, the operator of a system that includes information provided by third parties may arrange with database providers and customers for use of a particular attribution procedure. Those arrangements establish an attribution procedure between the customers and the database providers. An attribution procedure may also be established by two parties in the expectation that a third party may rely on it. For example, a digital signature may be issued to an individual pursuant to an agreement between the issuer and the individual, but then accepted or relied on by another party in a

separate transaction. Use of the signature is an attribution procedure in that transaction. Similarly, a group of member companies may establish attribution procedures intended to bind members in dealing with one another. Such arrangements are attribution procedures under this Act. The substantive provisions on attribution are in Sections 108, 212 and 213.

4. "Authenticate." This term replaces "signature" and "signed." A similar change in terminology is made in Uniform Commercial Code Article 9 (1998 Official Text). In this Act, the term "sign" has the meaning used in Uniform Commercial Code § 1-201 (1998 Official Text), except that it is not limited to authenticating a *writing*. The definition is technologically neutral. This makes clear that qualifying electronic systems fulfill former paper-based requirements. This is consistent with the policies of the federal Electronic Signatures in Global and National Commerce Act that preclude discrimination against electronic records and signatures solely because they are electronic in character.

Any "signature" under other law is an authentication under this Act. In addition, authentication includes qualifying use of any identifier, such as a personal identification number (PIN) or a typed or otherwise signed name. It can include actions or sounds such as encryption, voice and biological identification, and other technologically enabled acts if done with proper intent. See *Parma Tile Mosaic & Marble Co. v. Short,* 87 N.Y.2d 524, 663 N.E.2d 633 (N.Y. 1996) (intent requirement not met). There is no requirement under this Act that the authenticated record be retained by a party, but that requirement may exist under other law.

An authentication may be on, logically associated with, or linked to the record. With digital technology, the analogy between signing a record electronically and signing a paper is not precise. "Logically associated" makes it clear that the association between an authentication and a record need not be physical in nature. However, the association must support the inference that the authenticating party intends to adopt or accept the associated or referenced record. "Referring to" or "linked to" captures the traditional concept of incorporating a record or term by reference, as well as use of an electronic connection, such as an Internet hyperlink.

An "authentication" may express various intended effects. What effects are intended are determined by the context and objective indicia associated with that context.

5. "Automated transaction." This term refers to contracts formed automatically and which are effective even though one or both parties operates through an electronic agent instead of a human being (an individual). The term is not inconsistent with a system in which, when an aspect of the transaction appears irregular, or when a message or transaction fails automated system edits, repair or review by an employee occurs. The transaction qualifies as an automated transaction if such review does not occur in the ordinary course when no system problems exist and there was no review in the particular case by an employee authorized to act on behalf of the employer in the particular case.

6. "Cancellation." This definition follows Uniform Commercial Code § 2-106(4) (1998 Official Text); no substantive change is intended by language variations. Cancellation is a remedy for breach. The effect of cancellation is stated in Section 802.

7. "Computer." The definition of "computer" draws on definitions in federal and state criminal law, tax law and other resources. The term does not include a traditional television set, radio or toaster even though such goods may contain a microprocessor. It might include new generations of machines that combine computation, word processing, Internet access, and traditional broadcast reception. The definition should be applied by the courts with common sense. In various states, unauthorized access to a computer is a crime, but while the definition of computer in those statutes is broad, courts exercise common sense in applying the definition, an approach that should also be true here. Thus, while an automobile might contain a computer or several computers, the automobile is not itself a computer. A microwave oven with timing operations controlled by software is not a computer, but ordinary goods enhanced by software.

On the other hand, a desktop computer that receives telephone calls, music, television images, or fax messages is still a computer.

8. "Computer information." This term covers information that is in electronic form and that is obtained from, accessible with, or usable by, a computer; it includes the information, the copy of it (e.g., a diskette containing the information), and its documentation (including non-electronic documentation). As defined, "electronic" includes digital information or information in another form having similar capabilities. This covers analog and future computational technologies, eliminating the possibility that the Act might be limited to current technology. The term does not include information merely because it could be scanned or entered into a computer; it is limited to electronic information in a form capable of being directly processed in a computer. "Computer information" does not generally include printed information or information in other non-electronic formats.

9. "Computer information transaction." This term helps to define the scope of this Act. Section 103. It requires an agreement involving computer information. The term includes transfers (e.g., licenses, assignments, or sales of copies) of computer programs or multimedia products, software and multimedia development contracts, access contracts, and contracts to obtain information for use in a program, access contract, or multimedia product. However, the mere fact that parties agree to communicate in digital form does not bring a transaction within this definition, nor does a decision by one party to use computer information when the contract does not require this.

This definition focuses on the essence or basic nature of the transaction. Thus, an agreement to use e-mail to communicate about a contract for the shipment of petroleum or to file an application in digital form does not bring the transaction within this definition. A contract for an airline ticket is not a computer information transaction simply because the ticket is in digital form. The subject matter of that agreement is not the computer information, but the service - air transportation. Similarly, this term does not cover professional services or alter standards of professional conduct, such as services rendered by a member of a regulated profession like a doctor or a lawyer. Merely because such professional services are rendered using computer information or the product is delivered in the form of computer information does not convert these professional services to a computer information transaction. See Comments to Section 103. Standards of professional behavior involving interaction with individual clients govern professional services, such as the giving of legal advice or the performance of an operation, and the standards are not affected by this Act. On the other hand, the term does include an agreement to develop a computer program, even if the person developing the program is also a member of a regulated profession.

A transaction is not for the "creation" of computer information in the sense intended here if the contracted-for activities are merely secretarial, ministerial, or clerical in nature. The computer information must be created (i.e., produced or developed) through some business, professional, artistic, imaginative, or similar effort. Of course, a transaction that otherwise qualifies and that occurs with respect to information already in the form of computer information is within the definition regardless of how the information was put into that form.

10. "Computer program." The first sentence follows copyright law. 17 U.S.C. § 101 (1998). The second sentence distinguishes between computer programs as operating instructions communicated to a computer and "informational content" communicated to human beings. This distinction parallels that used in discussions of formal programming languages between syntax (grammar) and semantics (meaning). As used in this Act, "computer program" refers to functional and operating aspects of a digital or similar system, whereas "informational content" refers to material that communicates to a person. In resolving an issue that turns on this distinction, the test lies in whether the issue concerns operations (program) or communicated content (informational content). The definition pertains solely to contract law issues. It does not

relate to the copyright law issue of distinguishing between a process and copyrightable expression. It is more like that in copyright law between a computer program as a "literary work" (code) and output as an "audiovisual work" (images, sounds). In copyright, that distinction relates to property rights and infringement issues. In this Act, the distinction relates to contract law issues such as liability risk and performance obligations.

11. "Consequential damages." This definition is from Uniform Commercial Code § 2-715(2)(1998 Official Text). Except for the clarification regarding "direct damages" and "incidental damages," no change is intended. For example, while the definition does not specifically exclude losses that could be avoided by mitigation through cover or otherwise, a duty to mitigate exists under Section 807. A party can recover compensation only for losses that it could not reasonably have avoided. Of course, the idea of avoidance through reasonable steps such as cover or otherwise must be assessed with due regard to how damages are being measured. For example, if recovery is based on a formula related to lost volume, the damages measure itself assumes that engaging in another transaction is not a substitute for the lost transaction and, thus, mitigation through a replacement transaction is not relevant. See discussion of substitute transactions in Sections 808 and 809.

Consequential damages do not include "direct" or "incidental" damages. Consequential loss includes loss of anticipated benefits as a result of not being able to exploit or rely on the expected contractual performance, such as lost profits of the injured party, lost third-party royalties that would have accrued from a licensee's proper performance, and lost income from wrongful gains realized by another party from misuse of confidential information. Consequential damages also include damage to reputation, loss of privacy, lost value of a trade secret from wrongful disclosure or use, and losses or damage to data or property caused by a breach.

Except as provided in Section 807 or as limited by agreement, consequential damages may be recovered by either party. The losses must be an ordinary and predictable result of the breach and must have been foreseeable. For purposes of damages computation, the term "reason to know" should be interpreted in a manner consistent with cases under Uniform Commercial Code Article 2. For an injured party to recover for economic losses resulting from its special circumstances, the party in breach must have had notice of those circumstances at the time of contracting. In contrast, losses from ordinary, general requirements can often be presumed to have been within the contemplation of the other party. To be foreseeable, the losses must not result from atypical risk taking by the aggrieved party, such as in a failure reasonably to maintain back-up systems for retrieval of data.

Damage to other property (i.e., not the property that is the subject of the contract itself) may be consequential damage. If injury follows use of a computer program without discovery of a defect causing the damage, the question of "proximate" cause includes whether it was reasonable for the injured party to use the information without inspection that would have revealed the defect. Proximate causation may not exist where damages result from misuse or from a use that violates clear warnings against the particular type of use.

12. "Conspicuous." This definition follows Uniform Commercial Code § 1-201(10) (1998 Official Text), but is updated for electronic commerce. Whether a term is conspicuous is determined by the court. Section 117. The definition of "conspicuous" does not change requirements of other law that specify the content, timing or location of disclosures or warnings. If such requirements exist, they govern. Sections 104 and 116. Section 104 specifically provides that a standard of conspicuousness in an applicable consumer protection law applies with respect to that law.

In contexts governed by this Act, a term is conspicuous if it is so positioned or presented that the attention of an ordinary person reasonably ought to have been called to it. Conspicuous terms are often contained in a record, but the concept includes oral or automated voice presentations that meet the standard. For electronic records, whether a term is conspicuous is gauged by the condition of the message as it would be received or first viewed by a person using a system that

the parties adopted for such records, a system that the sender knows the recipient is using or, in the absence of the foregoing, an ordinary system or method of receiving or reviewing such messages. For an electronic agent, presentation of the term must be capable of invoking a response from a reasonably configured electronic agent.

As in Uniform Commercial Code Section 1-201(10) (1998 Official Text), this Act describes several methods of making a term conspicuous. The illustrations are not exclusive. For cases outside their terms, the general standard governs.

The definition adapts the U.C.C. standard to cover electronic commerce. Paragraph (A)(ii) contemplates setting off a term or label by symbols so that conspicuous formatting can be reliably transferred electronically (font size, color and other attributes might not always be transferable). Paragraph (A)(iii) deals with hyperlinks and related Internet technologies. It contemplates a case in which a computer screen displays an image or term or a summary or reference to it, and the party using the screen, by taking an action with reference to it, is promptly transferred to a different display or location wherein the contract term is available. To be conspicuous, the image, term, summary or reference must be prominent and its use must readily enable review of the actual term. The access must be from the display and not require taking other actions such as a telephone call or driving to a store. When the term is accessed, it must be readily reviewable. The fact that an entire contract is prominently referenced does not automatically mean that a particular term in it is conspicuous.

Paragraph (B) is independent of paragraph (A). It recognizes a procedure by which, without taking action with respect to the term or reference, the party cannot proceed. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" in a manner that precludes the user from proceeding without assenting to or rejecting this term, suffices.

13. "Consumer" and **"consumer contract."** A "consumer" is an individual (human being) who obtains information primarily for personal, household, or family purposes. Whether an individual is a consumer with reference to a transaction is determined at the time of contracting and in light of the then-intended use of the information. For computer information, many contracts for personal use are not consumer contracts (e.g., stock broker personally using software to monitor client investments). The definition distinguishes profit-making, professional, or business use, from non-business or family use. Only when the contract is primarily for the latter is there a consumer contract. A license of software distributed for general personal use and acquired solely for tracking household finances is a consumer contract, but a transaction acquiring software for use in an investment management business is not a consumer transaction. The profit-making standard is followed in other areas of law. See, e.g., *Thoms v. Sundance Properties*, 726 F.2d 1417 (9th Cir. 1984); *In re Booth*, 858 F.2d 1051 (5th Cir. 1988); *In re Circle Five, Inc.,* 75 B.R. 686 (Bankr. D. Idaho 1987); Truth in Lending Act, 15 U.S.C. § 1603 (excludes extensions of credit "primarily for business, commercial, or agricultural purposes"). A purpose stated in the agreement ordinarily determines the purpose of the transaction for purposes of this definition.

14. "Contract." This definition is from Uniform Commercial Code § 1-201(11) (1998 Official Text).

15. "Contract fee." This term includes any monetary payment under a contract, including royalties. It does not include other forms of consideration exchanged in a transaction or their value.

16. "Contractual use term." This term includes any enforceable contractual term that defines or limits access to, use or disclosure of information or informational rights. Use terms ordinarily relate only to the copies and information provided under the contract or copies made of them. Unless otherwise agreed, a contractual use term does not govern the same information lawfully obtained from other sources. For this definition, the use restriction must come from a

contract and not simply from regulatory or property law. The term must be enforceable to be within the definition. Thus, if trade secret law bars enforcement of a particular term, that term is not a contractual use term under this Act to the extent it is unenforceable.

Terms establishing the scope of a license are contractual use terms. Under intellectual property law, however, with respect to determining whether an infringement occurs, not all contract terms are equal. See *Sun Microsystems v. Microsoft Corp.*, 188 F.3d 1115 (9th Cir. 1999). This Act does not alter the distinction with reference to infringement claims. In contract law, however, breach of any contractual use term breaches the contract. Whether there is also a right of action for infringement is determined by other law.

17. "Copy." This term refers to the medium containing the information. The medium can be tangible or electronic. The time during which information is fixed on the medium can be temporary if this fulfills the required performance. The copyright law question of when a copy occurs within computer memory or in a transient image does not relate to contract law issues and is not dealt with in this Act. *Stenograph L.L.C. v. Bossard Assoc., Inc.*, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

18. "Course of dealing." This term is from Uniform Commercial Code § 1-205 (1998 Official Text). It refers to a sequence of conduct between the parties prior to the agreement at issue.

19. "Course of performance." This term is from Uniform Commercial Code § 2-208 (1998 Official Text). It refers to conduct during performance of the agreement; conduct prior to the agreement may be a "course of dealing". Both terms are part of the commercial approach in this Act to interpreting contracts in a practical manner. The parties know best what their agreement meant; their conduct is often the best indication of that meaning. A course of performance is relevant to determine the meaning of the agreement. Uniform Commercial Code § 1-205, *comment* 2 (1998 Official Text).

20. "Delivery." Delivery can occur by transfer of possession of a tangible copy or by electronic transfer. In electronic delivery, a copy of information may not *move* from one location to another, but delivery involves copying the information into another location or making it available in a system shared or accessible by the recipient. There are many ways to transfer possession or control. For example, in an electronic delivery, a transfer of possession or control occurs when information comes into existence in an information processing system or at an address in a form capable of being processed by or perceived from a system of that type if the recipient uses, or otherwise has designated or holds out, that place or system for receipt of copies of the kind.

21. "Direct damages." Direct damages are compensation for losses associated with the value of the contracted for performance itself as contrasted to loss of a benefit expected from use of the performance or its results. Direct damages are measured by Sections 808(b) and 809(a). They are capped by the contracted-for price or market value for the performance as appropriate. This Act rejects cases that treat as direct damages losses that relate to anticipated benefits from use such as *Chatlos Systems, Inc. v. National Cash Register Corp.,* 670 F.2d 1304 (3d Cir. 1982), cert. dism., *National Cash Register Corp. v. Chatlos Systems, Inc.*, 457 U.S. 1112 (1982). Those are consequential damages. Thus, if a computer program is purchased for $1,000 and, if merchantable, would yield profits or cost-savings in business of $10,000, but it is totally defective, "direct" damages are $1,000. If recoverable, the lost profits or expected cost-savings are consequential damages.

22. "Electronic." This term is technology neutral, and encompasses forms of information-processing technology that may be developed in the future.

23. "Electronic agent." This term refers to an automated means for making or performing contracts. The agent must act independently in a manner relevant to creating or performing a contract. Mere use of a telephone or e-mail system is not use of an electronic agent. The automated system must have been selected, programmed or otherwise intentionally used for that purpose by the person that is bound by its operations. The legal relationship between the person and the electronic agent is not equivalent to common law agency since the "agent" is not a human. However, parties that use electronic agents are ordinarily bound by the results of their operations.

24. "Electronic Message." A message is distinguished from a "record" by the fact that a message is intended for communication to another person or an electronic agent. Communication of a message may be by copying it into another location or making it available in a system shared by or accessible to the recipient. In effect, it is stored or generated for purposes of communicating to another.

25. "Financial accommodation contract." A financial accommodation contract is 1) a loan in whole or in part to acquire computer information or 2) a lease of a copy of software or other computer information. The recipient of the accommodation is the licensee. If a finance contract creates or provides for a security interest governed by Article 9 of the Uniform Commercial Code, the contract is not a "financial accommodation contract"; the interest is governed by Uniform Commercial Code Article 9 and not this Act. An agreement in which royalties for use are paid periodically is not a financial accommodation contract, but simply a royalty-bearing license (or assignment).

26. "Financial services transaction." This term includes a variety of financial system activities and transactions that are excluded from this Act under section 103(d). Many are governed by federal law or by the Uniform Commercial Code. The phrase "monetary value represented in electronic form" includes electronic currency. The term "financial services transaction" does not include contracts to acquire software for use in banking or other financial service activities even if the transactions that the software is used to process are financial services transactions that are excluded from the Act. Section 103(d). Nor does it apply to non-regulated information services, such as a virtual mall, provided on the financial institution's website.

27. "Financier." A financier is a creditor or a lessor dealing with the licensee under a financial accommodation contract. The financier may have any of several relationships to licensed computer information. In one the financier obtains rights as a licensee for purposes of transfer to the eventual licensee, which is the accommodated party. This is like a finance lease under Uniform Commercial Code Article 2A, but the focus is licensed computer information, rather than leased goods. A second kind of relationship arises where the party giving the accommodation does not obtain rights in the license as against the licensor, but obtains a contractual right to prevent the licensee's use of the information in the event of breach of the financial accommodation contract.

The licensor in the underlying license is not a financier for purposes of this Act. A licensor may obtain a security interest under Article 9 and would, with respect to that interest, have the rights of a secured party under Article 9.

28. "Good Faith." This definition adopts and expands on Uniform Commercial Code § 2-103(b) (1998 Official Text). It rejects pure "honesty in fact" as the sole standard of good faith. However, good faith is not a negligence or reasonable care standard. "Observance of reasonable commercial standards of fair dealing" is concerned with the fairness of the conduct rather than the care with which an act is performed. Both fair dealing and ordinary reasonable care are judged in light of reasonable commercial standards, but those standards in each case are directed

to different aspects of commercial conduct.

While good faith in performance is an element of all contracts covered by this Act, the obligation of good faith does not override express contract terms or the right to enforce them. *See Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting,* 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin,* 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wn.2d 563, 807 P.2d 356 (1991). The primary application of the concept is that, when a party has discretion under the contract, that discretion should be exercised in a good faith manner. *Davis v. Sears, Roebuck & Co.*, 873 F.2d 888 (6th Cir. 1989). Good faith does not require that a party act to benefit or avoid harm to the other at the cost of rights that it fairly has under the agreement.

29. "Goods." This definition clarifies that computer information, including computer programs, are not goods for purposes of this Act. The definition does not alter the definition of goods in any consumer protection law. Some but not all of the items or transactions treated as financial services transactions in this Act are also excluded from this definition of goods. No inference is intended that those not so excluded, such as payment orders or loans, are thereby treated as goods.

30. "Incidental damages." This term corresponds to Uniform Commercial Code Article 2 (1998 Official Text). Incidental damages are expenses incurred after breach. They include the cost of seeking or arranging for mitigation, but not the actual expenditure for the mitigation itself, which is covered in measuring direct or consequential damages.

31. "Information." This term embraces a wide range of subject matter, but as used in this Act it is limited to transactions within the scope of the Act. "Information" is not limited to subject matter in which informational property rights exist. It includes, for example, factual data if subject to a contractual relationship. As used here, "data" refers to facts whether or not organized or interpreted. "Mask work" is defined in federal law; it refers to a representational technology used in creation of semiconductor products.

32. "Information processing system." This term includes computers and other information processing systems. The term is used primarily in reference to sending and receiving notices.

33. "Informational content." This is information whose ordinary use involves communication of the information to a human being (individual). It is information that humans read, see, hear and otherwise experience. For example, if an electronic database includes images or text and a program enabling display of or access to them, the images are informational content while the search program is not. A Westlaw search program is not informational content, but the text of the cases is. The term applies even if the person creating the informational content does not intend to reveal it to others; this is because preparation involves an intent that the information be perceivable at least by its creator. Informational content need not actually be communicated; it merely must be information that in ordinary use is communicated to individuals. For example, stock quotes are informational content even if an investor uses an electronic agent to make orders and never reads the actual quotes themselves. However, the term does not include computer program instructions in object code that merely control interaction of a computer program with other programs or with a machine or device.

34. "Informational rights." This term includes "intellectual property" rights. It also includes rights created under any law that gives a person a right to control use of information independent of contract, such as may be developing in privacy law. As in traditional intellectual property law, the rights need not be exclusive as to all other persons and all uses. Other law determines whether such rights exist; this Act does not modify those laws. The term does not include mere tort claims such as the right to sue for defamation.

35. "Insurance services transaction." This term parallels that of "financial services transactions" with language changes to reflect the nature of insurance-related transactions. It identifies transactions that are subject to extensive regulation and separately developed law and excludes them because they are regulated. Section 103. It refers to an agreement between the insurer and insured relating to access to, use, transfer, clearance, settlement, or processing of the policy or contract, or payments or rights to payment under it. As with financial services transactions, the term does not include contracts to acquire software, nor does it apply to non-regulated information services, such as a virtual mall, provided on the insurance institution's website.

36. "Knowledge." This term is from Uniform Commercial Code § 1-201(25) (1998 Official Text). It does not include constructive notice or any duty to inquire.

37. "License." A license is an agreement the terms of which entail a limited or conditional transfer of information or a grant of limited or restricted contractual rights or permissions to use information. A contract "right" is an affirmative commitment that a licensee may engage in a specific use, while a contract "permission" means simply that the licensor will not object to the use. Either can be the basis of a license. No specific formality of language is required. For purposes of this Act, the term includes consignments of copies of information but does not otherwise alter the legal nature of a consignment. The definition is solely for purposes of this Act and does not alter treatment under other laws, such as tax law.

A transaction is not a license merely because as a matter of law a transferor retains informational property rights that restrict the transferee's ability to use the information. The term thus does not include an unrestricted sale of a copy of a copyrighted work; an unrestricted sale does not involve express contractual terms restricting use of the information. Similarly, a "copyright notice" in a book that merely states the restrictions on use that remain after a first sale under copyright law is not a license. On the other hand, a software agreement whose terms expressly govern use of the software is a license even if the agreement also gives the licensee ownership of the copy. A license exists if a *contract* grants greater rights or privileges than a first sale, if it restricts rights or privileges that might otherwise exist, or if it deals with other issues of scope of use.

Whether a contract is a license does not depend on who has title to a copy. Title to a copy is distinct from questions about the extent to which use of information is controlled by contract. *DSC v. Pulse Communications, Inc.,* 170 F.3d 1354 (Fed. Cir. 1999), cert. den. 528 U.S. 923 (1999) indicates how the issues can be treated. Restrictions in a license that are materially inconsistent with ownership of a delivered copy may result in the holder of the copy not being its owner.

Licenses are contracts. Whether the terms of a license are enforceable is determined under this Act and other applicable law, including copyright law. The requirements for an enforceable agreement must be met. The term does not include the myriad non-commercial, casual or other exchanges of information that occur in normal political or social discourse, even if there may be incidental restrictions on use of the information because they do not involve a contractual relationship or a computer information transaction.

38. "Licensor" and **"Licensee."** These definitions refer to the transferor and transferee in any contract covered by this Act, whether or not the contract is a license. In situations where each party supplies computer information to the other, each is a licensor as to the information it provides and a licensee as to the information it receives. Between a provider of access in an access contract and its customer, the provider is the licensor. Between the provider of access and a provider of the information to be accessed, the provider of the information is the licensor.

39. "Mass-market license" and **"mass-market transaction."** The term "mass market license" is new and the definition must be applied in light of its intended and limited function.

That function is to describe small dollar value, routine transactions involving information that is directed to the general public when the transaction occurs in a retail market available to and used by the general public. The term includes all consumer contracts and also some transactions between businesses if they are in a retail market. One purpose of the term is to avoid artificial distinctions among business and consumer transferees in an ordinary retail market. Mass-market transactions do not include commercial transactions between businesses using ordinary commercial methods, such as purchase orders, terms offered to businesses but not to consumers, or online and access systems focused on the business-business marketplace.

A "mass-market" transaction is characterized by 1) the *market* in which the transaction occurs, 2) the *terms* of the transaction, and 3) the *type* of information involved. The *market* is a retail market where information is made available in pre-packaged form under generally similar *terms* to the general public as a whole and in which the general public, including consumers, is a frequent participant. "Retail market" has its standard dictionary meaning, which refers to sales (or other transfers) of commodities in small quantities primarily to consumers. The prototypical retail context is a department store, grocery store, gas station, shopping center, or the like. It does not include contexts that center on business-business trade. Retail locations are open to, and in fact attract, the general public as a whole. The products are available to anyone who enters the retail location and pays the standard retail price. While retail merchants make transactions with other businesses, the predominant type of transaction involves consumers. Transactions in a retail market involve small quantities, non-negotiated terms, and transfers to end users rather than transferees who plan to resell or re-license the product. The phrase "in a quantity" is inherent in the idea of retail and emphasizes that the concept involves purchases of small quantities.

The computer information must be of a *type* aimed at the general public as a whole, including consumers. This does not include information earmarked for a business or professional audience and which is not ordinarily acquired by consumers, nor does it include information earmarked for members of an organization or persons with a separate relationship to the information provider. For example, software provided to and usable only by members of an association or customers of a particular institution, even if otherwise within this Act, are not mass-market transactions. In determining when the term applies, courts should be guided by the purpose of the definition which is to avoid artificial distinctions among business and consumer purchasers in an ordinary retail market. The covered transactions do not include specialty information for business or professional uses, information for specially targeted limited audiences, information distributed in non-retail transactions, or professional use information. The transactions involve computer information routinely acquired by consumers or that tend to appeal to a general public audience as a whole, including consumers. Generally, this is inconsistent with substantial customization of the information for a particular end user. Customization that is routine in mass markets or that is done by the licensee after acquiring the information does not take the transaction outside the concept of a mass-market transaction.

The transaction must be with an end user. An end user is a licensee that intends to use the information or informational rights in its own business or personal affairs. An end user is not engaged in reselling, distributing, sublicensing, commercial public performances of the information, or otherwise making the information commercially available to third parties, directly or indirectly.

All consumer transactions are mass-market. For non-consumer transactions, subsection (B)(iii) expressly excludes several transactions commonly not associated with routine retail transactions. It excludes any transaction intended for redistribution of the information by further license, loan or sale, or for public performance of a copyrighted work. Such transactions involve no attributes of a retail market. For purposes of this Act, public performance or display does not include use by a library patron of software acquired by the library in the mass market. In online contracts, consumer contracts are mass-market transactions, but business to business transactions are not. Business acquisition of software through online access and other non-retail transactions are outside of the definition. This gives electronic commerce room to develop without regulation

while preserving consumer interests.

40. "Merchant." This definition is from Uniform Commercial Code § 2-104 (1998 Official Text). The definition covers a person that holds itself out as experienced even if the person has not actually engaged in prior transactions of the type. The term "merchant" has roots in the "law merchant" concept of an expert or professional in business. This status may be based on specialized knowledge as to the information or general or specialized knowledge about business practices, or both. Which type of knowledge is sufficient for merchant status is determined by the nature of the issue to which the term applies. In this Act, as relevant to business practices, "merchant" refers primarily to general knowledge of business practices in any field, rather than to expertise in a specific field. Section 401(a) and (e) and Section 403, however, require a more focused expertise in the particular type of information.

When a party employs an agent, merchant status does not always depend on the principal's knowledge. An organization is charged with the expertise of its employees. Even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or personnel familiar with business practices.

41. "Non-exclusive license." In a nonexclusive license, the licensor does not foreclose itself from making additional licenses involving the same subject matter and same general scope. A nonexclusive license has been described as nothing more than a promise not to sue. It does not convey property rights in the information to the licensee.

42. "Notice." This definition is from Uniform Commercial Code § 1-201(25) (1998 Official Text). Notice exists when a person has knowledge or has received notification or has reason to know of a fact. When or if notice may cease to be effective is not governed by this Act, but by other law.

43. "Notify" or **"give notice."** This definition is from Uniform Commercial Code § 1-201(26) (1998 Official Text). This term is used when the essential event is the dispatch of notice, not its receipt. If receipt is the relevant standard, that is stated in the statute.

44. "Party." This definition is from Uniform Commercial Code § 1-201(29) (1998 Official Text). Reference to a "party" includes a person acting through an agent.

45. "Person." This term refers to individuals (human beings) and to business or other organizations, whether or not treated in law as formal entities. It is distinguished from the narrower term, "individual," which refers only to a natural human being, whether acting as a representative or on the individual's own behalf.

46. "Published informational content." This is the type of information most closely associated with free expression. In previous technology, this type of information refers to newspapers, books, phonorecords and the like (which are outside the scope of this Act). To be within this definition, the information must be informational content, that is, intended to communicate to a human being. Informational content is *published* content when created for or distributed to a group of recipients as a whole in generally the same form. The term includes interactive content and content made publicly available in a database, even if only portions of it are used by individual recipients who, for example, may search the database using a computer program. The information is still generally available; the end user selects from available information. That is like the reader of a newspaper who reads part, but not all, of the newspaper. The term also includes the informational product of automated systems that supply selected portions of a larger database to individual licensees based on programmed parameters.

Published informational content does not include content tailored by individuals (human beings) acting on behalf of the licensor to meet a specific recipient's needs, nor does it apply to

information provided in a special relationship of reliance. The phrase "special relationship of reliance" refers to transactions in which the provider knows that a particular licensee plans to rely on particular data provided by the licensor and that the licensee expects the licensor to tailor the information to the client's specific business or personal needs. That type of relationship arises only with respect to licensors who possess unique or specialized expertise or who are in a special position of confidence and trust with the particular licensee such that reliance is justified and the licensor has a duty to act with care. In a special relationship of reliance the information provider is specifically aware of and personally tailors information to the needs of the particular licensee as an integral part of the provider's primary business. A reliance relationship does not arise for information made generally available to a group in standard form, even if those who receive the information subscribe to the service because they believe it is relevant to their commercial or personal needs.

47. "Receive." This definition distinguishes between performances and notices. As to performances, it corresponds to Uniform Commercial Code § 2-103(1)(e) (1998 Official Text). With respect to notices, a notice is received when a message is delivered to a place designated or held out by the recipient for such notices even if the place is controlled by a third party. Arrival at an appropriate private post office box is receipt even if the addressee does not remove or read the message until later. Similarly, arrival at an appropriate electronic mail address is receipt by the addressee. The definition is met by arrival at a location *only* if the person holds out that location or system as a place for receiving notices of the kind. Parties often require that notice be to a particular address or person. If parties agree to send notice to a particular e-mail address, arrival at that location suffices; delivery to a different e-mail address does not.

The message must be capable of being processed by an ordinary system of the type involved. This refers to the type of system in its general, reasonably expected configuration and not to an atypical configuration known or knowable only to the party operating the system. Whether the message actually is processed is not relevant to receipt; similarly, a letter placed in a party's post office box is received even if not opened.

48. "Record." A record must be in, or capable of being retrieved in, perceivable form. Electronic text recorded in a computer memory that could be printed or displayed from that memory constitutes a record. Similarly, a tape recording of an oral conversation or a video taping of actions could be a record.

49. "Release." A release is a waiver or a nonexclusive permission not accompanied by other commercial attributes such as an ongoing obligation to pay or an obligation to provide the means to make use of the information. A release is a form of license. The term is used in this Act to identify transactions in which the sole purpose is to permit use and applies where agreements of the type are often made on a less formal basis than a commercial license. Some releases are enforceable as "quasi-contracts." This Act does not change that law.

50. "Return." In this Act, a "return" refers to acts that restore a party to its initial position if the party rejected contract terms in a record and, as a result, the transaction will not be carried forward. See sections 113, 208, and 209. A return requires redelivery to the licensor or its agent of any computer information already delivered that would have been covered by the rejected contract. When a licensee declines the contract, "return" entails reimbursement of any fees paid on re-delivery of all copies of the information and documentation. The information and documentation must be redelivered in their original condition. By consent of the licensor, the copies can be destroyed in accordance with its instructions. A right to a return under this Act applies only to computer information and does not affect goods, such as a computer that contains the software.

Return is not a remedy for breach. It is a right created by this Act or the agreement that arises if a party refuses contract terms but had previously committed to, or actually paid the contract

fee. A right of return allows the party a meaningful opportunity to decide to accept or reject the contract. If a party accepts contract terms, there is no right to a return, but if the computer information is defective, the aggrieved party may have a right to refuse the product and recover the contract fee and any other appropriate damages as a remedy for breach.

A return must be sought within a reasonable time. What is a reasonable time depends on the terms of the agreement or, if the agreement is silent, the commercial context. Section 117.

A right to a return may arise in "bundled" information products (products that include separate information products transferred as a whole for a single fee). Pricing in bundled transactions is not based on summing the fees that would be required for each product in an unbundled setting; often, bundled products include information products provided for no or a lesser charge, even though the information might have a different price in other transactions. In some cases, there is no fee attributable to any of the bundled information products included with other products, such as a computer.

If separate bundled products are separately priced, a return is for the contract fee for the information product as to which the contract terms were rejected. Otherwise, a return must be of the entire bundled product and reimbursement of the entire price, if any, attributed to that entire product. For a return for a separately stated price to occur, the contract price for the item must be separately stated in the sense that the agreement identified an amount for the particular information. A court cannot unbundle products and estimate appropriate prices in what is often a complex commercial arrangement premised on the economics of bundling multiple products. If no price is attributed in the agreement to the bundled information products, a return does not require reimbursement of a fee since none has been charged.

51. "Scope." This definition refers to contract terms that define the central elements of a license that relate to aspects of use of the information. Scope terms define the product. The same computer information has entirely different commercial characteristics and value depending on the scope of rights licensed. See *Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F.3d 1115 (9th Cir. 1999); *Graham v. James*, 144 F.3d 229 (2d Cir. 1998). A license that allows use of a word processing program in a single computer is not the same product as a license to make and distribute copies of that word processing software throughout a region. Neither license is the same product as a license that transfers a copy but limits use to three days at home. They are all different even though the program and the copy may be exactly the same and the differences can only be determined by reading the license.

53. "Standard form." The definition refers to forms, not standard terms. A form consists of record containing a group of terms prepared for frequent use as a contract. The definition does not cover a tailored contract comprised of "terms" selected from multiple prior agreements. The form must have been actually used without negotiation other than of the terms noted in the definition. If a standard form is offered but then negotiated or changed other than with respect to those ordinarily tailored terms, the resulting record of the contract is not a standard form. "Negotiated" for purposes of this definition means actually bargained for or about, or pointed out with an opportunity for meaningful bargaining, even if assented to without actual bargaining.

54. "Term." This definition is from Uniform Commercial Code § 1-201(42) (1998 Official Text). The word refers to a discernible element of an agreement. The word "clause" has the same meaning.

55. "Termination." This definition is from Uniform Commercial Code § 2-106 (1998 Official Text). The effect of terminating a contract is discussed in Sections 616-618.

56. "Transfer." This word, as used with respect to conveyances of contractual interests, refers to actual transfers of a contractual interest, as contrasted to agreements that merely employ another person to act on behalf of the transferor under a delegation or sublicense. Some of these

transfers might be described as an assignment of the contract.

57. "Usage of trade." This term is from Uniform Commercial Code § 1-205 (1998 Official Text). This Act treats usage of trade as a factor in determining the commercial meaning of the agreement. The language of an agreement is interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. A usage of trade must have the "regularity of observance" indicated in the text. It is not required that a usage be "ancient or immemorial," "universal" or the like. Full recognition is available for new uses and for uses currently observed by the majority of merchants, even though some do not. There is room also for appropriate recognition of usage agreed by merchants in trade codes.

58. Subsection b refers to various provisions of the Uniform Commercial Code that define additional terms used in this Act. Unless otherwise expressly indicated, the reference is to the Official Text as of 1998.

[SUBPART B. GENERAL SCOPE AND TERMS]

SECTION 103. SCOPE; EXCLUSIONS.

(a) [**Scope in general.**] This [Act] applies to computer information transactions.

(b) [**Mixed transactions.**] Except for subject matter excluded in subsection (d), if a computer information transaction includes subject matter other than computer information or subject matter excluded under subsection (d), the following rules apply:

(1) [**Computer information and goods.**] If a transaction includes computer information and goods, this [Act] applies to the part of the transaction involving computer information, informational rights in it, and creation or modification of it. However, if a copy of a computer program is contained in and sold or leased as part of goods, this [Act] applies to the copy and the computer program only if:

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

(B) giving the buyer or lessee of the goods access to or use of the program is ordinarily a material purpose of transactions in goods of the type sold or leased.

(2) [**Computer information and motion pictures.**] Subject to subsection (d)(3)(A), if a transaction includes an agreement for creating, or for obtaining rights to create, computer information and a motion picture, this [Act] does not apply to the agreement if the dominant character of the agreement is to create or obtain rights to create a motion picture. In all other

such agreements, this [Act] does not apply to the part of the agreement that involves a motion picture excluded under subsection (d)(3), but does apply to the computer information.

(3) [**All other cases.**] In all other cases, this [Act] applies to the entire transaction if the computer information and informational rights, or access to them, is the primary subject matter, but otherwise applies only to the part of the transaction involving computer information, informational rights in it, and creation or modification of it.

(c) [**Article 9 governs.**] To the extent of a conflict between this [Act] and [Article 9 of the Uniform Commercial Code], [Article 9] governs.

(d) [**Exclusions.**] This [Act] does not apply to:

(1) a financial services transaction;

(2) an insurance services transaction;

(3) an agreement to create, perform or perform in, include information in, acquire, use, distribute, modify, reproduce, have access to, adapt, make available, transmit, license, or display:

(A) a motion picture or audio or visual programming, other than in (i) a mass-market transaction or (ii) a submission of an idea or information or release of informational rights that may result in making a motion picture or similar information product; or

(B) a sound recording, musical work, or phonorecord as defined or used in Title 17 of the United States Code as of July 1, 1999, or an enhanced sound recording, other than in the submission of an idea or information or release of informational rights that may result in the creation of such material or a similar information product.

(4) a compulsory license;

(5) a contract of employment of an individual, other than an individual hired as an independent contractor to create or modify computer information, unless the independent contractor is a freelancer in the news reporting industry as that term is commonly understood in that industry;

(6) a contract that does not require that information be furnished as computer

information or a contract in which, under the agreement, the form of the information as computer information is otherwise insignificant with respect to the primary subject matter of the part of the transaction pertaining to the information;

(7) unless otherwise agreed between the parties in a record:

(A) telecommunications products or services provided pursuant to federal or state tariffs; or

(B) telecommunications products or services provided pursuant to agreements required or permitted to be filed by the service provider with a federal or state authority regulating those services or under pricing subject to approval by a federal or state regulatory authority; or

(8) subject matter within the scope of [Article 3, 4, 4A, 5, [6,] 7, or 8 of the Uniform Commercial Code].

(e) [**Definitions.**] In this section:

(1) "Audio or visual programming" means audio or visual programming that is provided by broadcast, satellite, or cable, as defined or used in the Communications Act of 1934 and related regulations as they existed on July 1, 1999, or by similar methods of delivery.

(2) "Enhanced sound recording" means a separately identifiable product or service the dominant character of which consists of recorded sounds, but which includes (i) statements or instructions whose purpose is to allow or control the perception, reproduction, or communication of those sounds or (ii) other information, as long as recorded sounds constitute the dominant character of the product or service.

(3) "Motion picture" means:

(A) "motion picture" as defined in Title 17 of the United States Code as of July 1, 1999; or

(B) a separately identifiable product or service the dominant character of which consists of a linear motion picture, but which includes (i) statements or instructions whose purpose is to allow or control the perception, reproduction, or communication of the motion

picture or (ii) other information, as long as the motion picture constitutes the dominant character of the product or service.

Definitional Cross References: Section 102: "Agreement"; "Consumer"; "Computer"; "Computer information"; "Computer information transaction"; "Consumer"; "Copy"; "Electronic"; "Financial services transaction"; "Good faith"; "Goods"; "Information"; "Insurance services transaction"; "License"; "Mass-market transaction"; "Party".

Comment

1. General Structure. This section states the scope of this Act. Subsection (a) states the affirmative scope. Subsections (b) and (c) establish rules for transactions where more than one subject matter is involved and not all of the subject matter is within subsection (a). Subsection (d) sets out exclusions from the Act.

2. Transactions in Computer Information. This Act deals with contracts and not property law. It applies to computer information transactions. In a computer information transaction, the transferee seeks the information and contractual rights to use it. Unlike a buyer of goods, a purchaser (e.g., buyer, lessee, or licensee) of computer information has little interest in the diskette or tape that originally contained the information after that information has been loaded into a computer, unless the information remains on that media and nowhere else. Indeed, in online transactions in computer information, there is often no tangible medium at all.

The scope of this Act turns initially on the definition of "*computer information transaction*." Section 102(11). "Computer information transactions" are agreements that deal with the creation, modification, access to, license, or distribution of computer information. Section 102(a)(11). "Computer information" is information in a form directly capable of being processed by, or obtained from, a computer and any copy, associated documentation, or packaging. Section 102(a)(10). As stated in subsections (b) and (c), if a transaction is a computer information transaction but also involves other subject matter, this Act ordinarily applies only to the aspects of the transaction that involve "computer information."

This Act deals with a variety of transactions central to the information economy where the contractual subject matter is computer information. However, the mere fact that communications about a transaction, such as an application for a loan or employment, are sent or recorded in digital form does not place the transaction within this Act. Thus, a contract for airplane transportation is not a computer information transaction even though the ticket is in digital form. The subject matter is not computer information, but the service - transportation. A contract to create and publish a print book does not become a computer information transaction simply because the author chooses or is required to deliver the work on a computer diskette. Similarly, an insurance policy prepared in digital form is not a computer information transaction; it is a contract for insurance coverage the terms of which are evidenced in digital form. A contract for a digital signature certificate is a contract for certification or identification services, not a contract whose subject matter is the computer information.

a. Contracts to Create or Develop Computer Information. This Act applies to contracts to develop, modify, or create software and other computer information, such as a computer database. Section 102(a)(11). Except as excluded in subsection (d), the Act covers all software development contracts, thus resolving conflicts in prior case law.

b. Computer Programs. This Act applies to transactions involving distribution of, or grant of a right to use, a computer program, whether they involve a license or an unrestricted sale of a copy of a program. Section 102(a)(11). The difference between a license and an unrestricted sale, however, is relevant within the Act. A license may involve either a more substantial retention of rights or a greater transfer of rights than an unrestricted sale of a copy. While most provisions of this Act apply to all transactions within its scope, some are limited solely to

licenses. The coverage of each section is explicit in the section.

c. Access and Internet Contracts. This Act applies to access contracts. Section 102(a)(1). This includes Internet and similar systems for access to or use of computer information on a remote system. It generally includes contracts under which data, text or images are provided to licensees by access to the provider's system or location on Internet.

d. Digital Multimedia Works. This Act applies to agreements to create or distribute multimedia works. Section 102(a)(11). Multimedia works are those that, through digital technology, combine multiple forms of authorship and multiple types of information into an integrated, often interactive work. Interactivity is a characteristic of software-based products. For a discussion of what is a multimedia work, see Copyright Office Circular (Multimedia Circular).

e. Data Processing Contracts. This Act covers contracts for data processing or data analysis of computer information. Section 102(a)(1)(11)(41).

3. Transactions Outside the Act. The scope of this Act is limited by the affirmative definitions of "computer information" and "computer information transaction," which exclude print and various other forms of information distribution, and by the exclusions in subsection (d). As a result, the Act leaves unaffected all transactions in the traditional core businesses of non-digital information industries. Whether a magazine, book or newspaper publisher can contractually limit or expand rights of use of information by purchasers of copies and what contract liability arises for print works is outside this Act, as are the following:

- Sales or leases of goods
- Contracts for personal services (except computer information development and support agreements)
- Casual exchanges of information
- Contracts where computer information is not required by the agreement
- Employment contracts
- Contracts where computer information is insignificant (de minimus)
- Computers, televisions, VCR's, DVD players, or similar goods
- Financial services transactions
- Insurance services transactions
- Contracts for print books, magazines, or newspapers
- Contracts for sound recordings and musical works
- Contracts for regulated telecommunications services and products
- Contracts for motion pictures, broadcast or cable programming (except as in Section 103(b)(d))

This Act applies to contracts and agreements regarding computer information.

4. Mixed Transactions. A computer information transaction may involve computer information and other subject matter. This presents a question of whether all or any part of the transaction is governed by this Act, common law, or an article of the Uniform Commercial Code. The circumstance that a contract is governed by more than one source of contract law is common in modern commerce. For example:

- A contract to produce a motion picture is governed by the common law of services, common law relating to information, labor law, copyright law, and other regulatory law.
- A contract to buy a toaster may be governed by Article 2, common law, consumer law, and various federal or state regulations.
- A contract to develop a multimedia product may be governed by common law of services, of information contracts and of licensing, copyright law, and other intellectual property law.

Indeed, virtually all contracts of all types involve "mixed" law. Thus, the issue is not whether multiple sources of contract law apply, but to what extent this Act applies in lieu of other law. Subsections (b) and (c) address that question based on the issue presented, the type of

transaction, and applicable commercial policies.

a. Computer Information and U.C.C. Subject Matter. If a transaction includes computer information and subject matter governed by an article of the Uniform Commercial Code, in the absence of contrary agreement, the general rule is that the rules of the Uniform Commercial Code apply to their subject matter and this Act applies to its subject matter. That rule is stated in subsection (b)(1), subsection (c), and subsection (d)(8). For example, under subsection (d)(8), Uniform Commercial Code Article 8, and not this Act, deals with investment securities, while Articles 4 and 4A, and not this Act, deal with payments, checks, and funds transfers. Under subsection (c), if there is a conflict between a provision of this Act and Article 9 of the Uniform Commercial Code, Article 9 prevails. This preserves uniformity in Article 9's application across a wide variety of personal property financing transactions.

b. Computer Information and Goods. Some transactions include goods and computer information. "Goods" is defined for purposes of this Act in Section 102. Generally, there is no overlap between goods and computer information since computer information and informational rights are not goods. See, e.g., *United States v. Stafford*, 136 F.3d 1109 (7th Cir. 1998), cert. den., *Allison v. United States,* 525 U.S. 849 (1998); *Specht v. Netscape Communications Corp.,* – F.3d –, 2002 WL 31166784 (Fed. Cir. 2002); *Fink v. DeClassis* 745 F.Supp. 509, 515 (N.D. Ill. 1990) (trademarks, tradenames, advertising, artwork, customer lists, goodwill and licenses are not "goods"). A diskette is a tangible object but the information on the diskette does not become goods simply because it is copied on tangible medium, any more than the information in a book is governed by the law of goods because the book binding and paper may be Article 2 goods. See, e.g., *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Grappo v. Alitalia Linee Aeree Italiane, S.p.A*., 56 F.3d 427 (2d Cir. 1995); *Gilmer v Buena Vista Home Video, Inc.*, 939 F. Supp. 665 (W.D. Ark. 1996); *Architectonics, Inc. v. Control Systems, Inc.*, 935 F. Supp. 425 (S.D.N.Y. 1996); *Cardozo v. True*, 342 So.2d 1053 (Fla. Dist.Ct.App.1977), cert. den., 353 So.2d 674 (Fla. 1977).

(1) General Rule. If a transaction involves goods and computer information (e.g., a computer and software), the general rule is that Article 2 or Article 2A applies to the aspect of the transaction pertaining to the sale or lease of goods, but this Act applies to the computer information and aspects of the agreement relating to the creation, modification, access to, or transfer of it. Section 103(b)(1). Each body of law governs as to its own subject matter. Some describe this as a "gravamen of the action" standard. The law applicable to an issue depends on whether the issue pertains to goods or to computer information. A similar distinction exists in copyright law between ownership of a copy and ownership of the copyright. See, e.g., 17 U.S.C. § 202; *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999), cert. den. 528 U.S. 923 (1999).

(2) Exceptions to General Rule: Copy and Documentation. There are exceptions to the general rule's gravamen test. Thus, this Act treats the medium that carries the computer information as part of the computer information and within this Act, whether the medium is a tangible object or electronic. This Act applies to the copy, documentation, and packaging of computer information; these are within the definition of computer information itself. Section 102. They are mere incidents of the transfer of the information.

(3) Exceptions to General Rule: Embedded Programs. If a computer program is embedded and contained in goods, the general rule ordinarily applies. This Act applies to the program, while goods law applies to the goods. In some cases, however, an embedded program is a mere part of the goods and this Act should not apply.

With respect to the materiality standard, this Act excludes a copy of the computer program if the copy is embedded in, inseparable from, and sold or leased as an indistinguishable part of goods.

The standards for determining when this exception to the general rule arise focus on the nature of the goods containing the copy and on the importance of the program and access to it in the transaction in those goods. Thus, for example, this Act does not apply to a copy of a program on a computer chip embedded as part of an automobile engine and sold or leased as an

indistinguishable part of the automobile containing the engine. On the other hand, this Act does apply to a copy of a program contained on a computer chip in a computer and transferred along with the computer. Uniform Commercial Code Article 9 (2000 Official Text) addresses a similar issue, but the rules there deal with issues about creating and perfecting security interests under that statute; they are not pertinent to general contract law and are not adopted here.

Subsection (b)(1) sets out the applicable standards under this Act.

First: This Act applies to the computer program and the copy of it if the goods in which the copy is embedded is a computer or a computer peripheral. As stated in Official Comment 7 to Section 102, "computer" should be given a common sense definition. Thus, a commercial choice to distribute a program in embedded form, rather than in a form that requires it to be loaded into a computer or peripheral does not affect the applicability of this Act. For example, software for a medical imaging device that relies on computer program capabilities is within this Act whether the program is embedded in the imaging device or loaded into it after purchase. On the other hand a chip in a toaster that controls the ordinary functions of an ordinary toaster is not a "computer" in a common sense application of the term. Of course, this Act does not apply to the computer, but only to the program (and copy) and other computer information.

Second: If a copy of a computer program is sold or leased as part of goods other than a computer or computer peripheral, this Act applies to the program (and the copy) if giving the buyer or lessee of the goods access to or use of the program is ordinarily a "material purpose" of this type of transaction. If not, this Act does not apply to the copy of the program. While this test may involve close decisions in individual cases, bright line tests are not possible and that result is inevitable as the digital information revolution continues to transform commerce. The blurred nature of the issue of determining whether the embedded program should be treated separately is recognized in other contexts. For example, in reference to tax law determinations, accounting standards refer to whether the program is a mere incident of the goods and recognize that determining when or whether this is true cannot involve a firm line, but rather a factual or contextual determination. See AICPA, Statement of Position 97-2 (1997). The issues for contract law differ from those involved in tax (or secured lending), but the nature of the distinction in each context is not one susceptible to bright line determination.

Materiality is judged on an objective sense, reflecting transactions of the type, rather than the subjective goals or intent of the particular parties. Furthermore, materiality focuses on ordinary transactions in *goods of the type*. Thus, the fact that a program is contained in and sold or leased as a part of goods that are a small part of a billion dollar transaction involving many other assets does not take it out of this Act if, as to the particular goods or system containing the program, access to the program is material.

The basic issue is whether the program and its capabilities are ordinarily important to the purpose in obtaining the goods. Courts should rely on the aspects of the ordinary commercial context. One issue involves between whom the pertinent part of a transaction occurs. Some transactions involve three parties and two agreements. If goods are sold by a vendor but the buyer must obtain a license from a publisher for use of the program, as to the license between the publisher and buyer, the computer information is clearly material. Beyond that, factors pertaining to whether access to or use of the program is material include the extent to which the computer program's capabilities are a material part of the appeal of the product, the extent to which negotiation focused on that capability, the extent to which the agreement made the program's capacity a separate focus, whether there are significant post-transaction obligations of program support, and the extent to which the program is or could be made available commercially separate and apart from the goods. Compare AICPA, Statement of Position 97-2 (1997). Materiality is ordinarily clear if the program is separately licensed as part of the transaction. A separately licensed program for a digital camera that enables the camera to link to a computer is within this Act. On the other hand, the mere fact that ordinary functions of ordinary goods rely on a program embedded in the goods does not indicate that program is governed by this Act. The braking functions of an automobile may be controlled by embedded programs, but in a retail transaction, the purpose is obtaining the automobile's functionality

rather than the program; this Act would not apply to a copy of brake software contained in and sold as part of a car. Upstream contracts to develop or supply the program to the manufacturer, however, are within this Act. A sale of an ordinary television that uses a computer program to preset channels is not in this Act.

c. Computer Information and Subject Matter not within the U.C.C. If a computer information transaction also involves subject matter not governed by the U.C.C. or this Act, the general rule is that this Act applies to its own subject matter, but not to aspects involving the other subject matter. As with respect to the treatment of goods, however, this general principle is tailored to reflect commercial and practical interests in some cases. Subsections (b)(2) and (3) state how to determine the applicability of this Act in such cases. However, this Act never applies to subject matter excluded under subsection (d) unless the parties agree to such coverage.

(1) Motion Picture Rights Contracts. Subsection (b)(2) provides the basic rule applied when the other subject matter involves a motion picture as defined in subsection (f). The rule in subsection (b)(2) must be read in connection with subsection (d)(3)(A).

Under subsection (b)(2), if the dominant character of an agreement is to create or to obtain rights to create a motion picture and that part of the agreement is excluded under subsection (d), this Act does not apply to any part of the agreement. Contracting practices in this part of the motion picture industry follow established, unique patterns. The rule here applies only to the extent that the motion picture aspect of the transaction is excluded under subsection (d)(3)(A). If an agreement is for rights to make a motion picture from the book Tractor Monster, but also includes rights to create a Tractor Monster computer game, this Act does not apply to the agreement at all if the dominant character of the agreement is one for creating or obtaining rights to create the motion picture.

As used here, "dominant character" does not mean merely a material or primary part. It requires more than in the "predominant purpose" test applied by some courts in relation to goods and services. The term refers to the fundamental character of the agreement. The motion picture rights must clearly be the focus of the agreement for both parties; it is not sufficient merely that their value or price ultimately exceeds the value of other aspects of the agreement. Whether motion picture rights are the dominant character is determined by an objective analysis of the circumstances of the transaction and transactions of the particular type. The dominance of motion picture rights must be clear and other rights secondary such that the transaction would not reasonably be viewed as other than as for motion picture rights.

When creating or obtaining rights to create a motion picture comprise the dominant character of the agreement, this Act does not apply. If the motion picture rights are not the dominant character of the agreement or if the contract does not involve creating or rights to create a motion picture, this Act applies to the computer information (e.g., the computer game) and other law applies to the motion picture to the extent excluded under subsection (d)(3)(A). If both computer information and motion picture rights are equally important, the dominant character rule does not apply because neither subject matter comprises the sole dominant character of the agreement; this Act applies to the computer information, while other law applies to the motion picture aspect excluded under subsection (d). Where there is a third subject matter involved (e.g., services or goods), other rules of this subsection apply with respect to the coverage by this Act of the other subject matter.

If a transaction includes several agreements among different parties related to a common goal, the character of each agreement is determined with respect to the particular agreement. For example, an agreement to use encryption or imaging software in a particular project is a software license and that agreement is not affected by the coexistence of a related but separate agreement for motion picture rights. Under general law, the parties can in all cases agree about whether the transaction is or is not governed entirely by this Act.

(2) Other Subject Matter. For other subject matter, the basic gravamen rule generally applies. That basic rule is restated in subsection (b)(3), which also provides for a limited exception to that rule.

If obtaining the computer information or informational rights in it is the primary

purpose of the transaction, this Act applies to the entire transaction, except for subject matter excluded by subsection (d). The test asks a court to consider whether the computer information or other subject matter (e.g., services) is the main focus. This adopts, for mixed information and services transactions, a variant of the predominant purpose test used under Article 2 with respect to goods and services. In this Act, however, the test only asks whether this Act should apply to other subject matter. In all cases, this Act will apply to the computer information. The primary purpose test requires less than the dominant character test in subsection (b)(2). In considering whether, under the primary purpose test, this Act should apply to the entire transaction, a court should consider the type of transaction envisioned by the parties. While cases under Article 2 provide guidance, it is appropriate to consider additional factors. Courts should consider the extent to which the transaction as a whole corresponds to the framework of information transactions, such as: 1) the nature of any underlying intellectual property rights involved, including differences in the rights provided for different types of works, 2) the extent to which clear allocation of liability risk is a concern, and 3) the extent to which coverage by this Act of the other subject matter in the transaction will correspond to reasonable expectations of the parties as to how the legal issues should be handled.

The same test applies throughout the various levels of use or distribution, but the results may differ at each level for the same information. For example, a courier company that licenses communications software from a software publisher is engaged in a transaction entirely within this Act. If the courier company provides the software to customers to access data on the location of their packages, the primary purpose may have to do with the services the courier provides. Even then, however, this Act applies to the software. If the software publisher enters into a license with the end user, as between the publisher and the end user, that license is entirely within this Act because the primary purpose of that agreement is the software.

The rules of subsection (b) do not apply if the agreement specifies to what extent this Act governs. If the parties elect coverage under this Act, that agreement generally governs as would an agreement that this Act should not apply at all. Agreement here, as elsewhere, can be found in the express terms of the contract as well as in the usage of trade or course of dealing between the parties, or as inferred from the commercial circumstances of the contracting.

5. Exclusions. Subsection (d) states several exclusions from this Act. They are based on a judgment that rules in this Act should not apply to the excluded subject matter unless the parties so agree, because the excluded transactions are different in type from those covered by this Act or are extensively covered by other contract law or regulations.

a. Core Financial and Insurance Functions. Subsection (d)(1) excludes core banking, payment and financial services activities because they are subject to regulation under federal and other state law. Subsection (d)(2) provides a parallel exclusion for insurance services transactions. Also, payment and similar functions are largely within the scope of the U.C.C. and thus outside UCITA.

Similar considerations apply for insurance services transactions in that they are subject to extensive regulation and separately developed law. In addition, these insurance transactions deal with insurance coverage and payment matters, rather than with computer information as the focus. The exclusion of insurance transactions refers to agreements between insurer and insured relating to access to, use, transfer, clearance, settlement, or processing of the policy or contract, or payments or rights to payment under it.

"Financial services transaction" is defined in Section 102. Financial services transactions are similar in many ways to computer information transactions in that they entail trade in symbols, albeit symbols of very different use and effect, and share some common legal issues: *e.g.*, authenticity, data integrity, and authority. See Section 102, *comment* 26. However, they will often be governed by very different rules in that, in many cases, the digital subject matter of a financial transaction *is* the value it represents. An appropriate book entry, for example, *is* a securities entitlement. UCC § 8-501(b)(1)(1998 Official Text). Also, core financial services practices are mature subjects of other bodies of law, such as UCC Articles 3, 4, 4A, 5, 7, 8 and

UCC Article 9. For all of these reasons it was deemed essential to exclude financial services transactions from the scope of this Act and to define financial services transaction broadly.

The exclusion under subsection (d)(1) does not exclude banks as entities. Many financial services regulations (e.g., Regulation E of the Board of Governors of the Federal Reserve System) do not apply solely to banks but to any holder of a qualifying account. To the extent that non-banks engage in the activities covered by the exclusion, those activities are excluded from this Act. On the other hand, banks engage as licensors and as licensees in many computer information transactions; those transactions, if not covered by this exclusion, are within this Act. Examples include licensing computer software and contracts providing on-line shopping and access to third-party databases. Where a bank provides software to a customer to be used in part in online access, this Act would govern the software license except to the extent the issue involves questions excluded by this subsection or dealt with in an article of the U.C.C., such as Article 4A, or in preemptive federal law.

b. Telecommunication Services. Subsection (d)(7) excludes regulated telecommunications products and services, and such products and services that are subject to filing or approval procedures as stated in subsection (d)(7)(B). The latter refers to interconnection and similar agreements that are subject to regulatory overview. Overall, the exclusion reflects the existence of extensive state and federal regulations. These telecommunications services would most likely not be included within the definition of a computer information transaction, but the exclusion makes that result clear. The exclusion does not apply to contracts to acquire software for use in telecommunications, nor does it apply to non-regulated information services.

c. Core Entertainment, Cable and Broadcast. Subsection (d)(3) excludes many agreements relating to motion pictures and broadcast and cable programming, in addition to agreements relating to musical works, sound recordings and enhanced sound recordings. The exclusion covers contracts regarding the traditional core activities of these information industries or, in the case of enhanced sound recordings, a enhanced version of a traditional activity. It is intended to be comprehensive as to the excluded activities. The exclusion leaves contract issues to other law with respect to the excluded subject matter.

Business practices in reference to these excluded transactions differ substantially from practices involving computer information. However, this is not an industry exclusion. To the extent that motion picture, broadcast and other covered companies engage in software licensing or other forms of computer information transactions that are not excluded, this Act applies. Also, the exclusion does not apply to contract issues pertaining to submission of information or ideas, or to releases of informational property rights. Here, practices are similar and it is often impractical to distinguish between an idea or a release in terms of whether it is associated with one or another type of informational work. Coverage of all such transactions reflects these factors.

Also, the exclusion does not apply to mass-market transactions involving audio-visual programming or motion pictures. The information industries are rapidly converging and, for those engaged in computer information based transactions, the convergence is most pronounced in the mass market. Limiting the exclusion with respect to such transactions reduces the circumstances in which potentially artificial distinctions are drawn between digital information products.

The exclusions in subsection (d)(3) include agreements to create, perform or include information in the excluded subject matter. To be within the exclusion, both parties must know that the agreement is for a particular work that entails such subject matter. For example, a license generally authorizing use of digital graphics for multiple purposes is not within the exclusion simply because a particular licensee uses the graphics in a motion picture. To be in the exclusion, the agreement must be to include the digital graphics in the motion picture, sound recording or other excluded subject matter. A license for editing or effects software that can be used for multiple purposes, is covered by this Act and not excluded by subsection (d)(3) even if one of its uses is in the creation of a motion picture. Similarly, a software license for use of

encryption software generally in products that are motion pictures or sound recordings is not excluded.

The terms "motion picture," "sound recording," "musical work," and "phonorecord" have the meanings associated with those terms in the Copyright Act as of the indicated date and also the meaning set out in subsections (e) and (f). That interpretation applies as of that date for all purposes and with reference to all sources as of that date, including final decisions of courts. The exclusion includes creation or distribution of these works in digital form. The Copyright Act and registration system makes distinctions among and between various types of works, such as audiovisual works, literary works, computer programs, motion pictures, and sound recordings. These distinctions are followed here. The exclusion additionally employs a slightly expanded definition of "motion picture," and a new term, "enhanced sound recording," to cover digital products that have elements beyond ordinary sound recordings or motion pictures (e.g., a program to allow use of the work), but which do not change the fundamental nature of the work as a sound recording or linear motion picture. In each case, the intent is that including instructions or other information does not affect the exclusion so long as the product's dominant character remains a sound recording or linear motion picture.

The term "enhanced sound recording" encompasses products such as enhanced music CDs, audio DVDs and the products commonly known as music videos. A music video qualifies as an enhanced sound recording because its dominant character consists of recorded sounds, even though it also includes visual depiction of a performance or series of performances of a nondramatic musical work or works. For purposes of this section, a music video is to be distinguished from a motion picture featuring music, a motion picture of a musical play, opera, concert or variety show, or a documentary concerning a recording artist or other music-related subject. A music video is also to be distinguished from audio or visual programming featuring music videos, which is treated under subsection (d)(3)(A).

Multimedia works are within this Act. For purposes of this Act, the term "motion picture" focuses on linear works and does not include an interactive computer game, multimedia product, or similar work, nor does it include audio-visual effects within interactive works. The term does not refer to images or visual motion within another work or within software, such as the animated help feature of a word processing program or images or motion in an interactive computer encyclopedia.

Subsection (d)(3) excludes contracts for audio and visual programming distributed by broadcast, cable, or satellite regardless of whether transmitted in digital or another form, including transmissions analogous to broadcast made through the Internet. See Subsection 103(f) (defining this type of programming). The federal Communications Act and associated regulations define terms associated with this exclusion and the intent is to adopt that terminology as of the indicated date, but not subsequent changes. The terms broadcast and cable programming do not include interactive computer services or similar information services that entail a service, a system, or access software that provides or enables access by multiple users to a computer system or the information provided through or from it. See Washington Revised Code § 19.190.010; *America Online, Inc. v. Greatdeals.Net*, 49 F.Supp.2d 851 (E.D. Va. 1999) ("any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems offered by libraries or educational institutions."). Agreements for access to Internet and similar information services are not covered by the exclusion. Similarly, the term "programming" does not refer to software or computer programs as they may be programmed by a licensor.

d. Compulsory Licenses. Subsection (d)(4) excludes compulsory licenses pursuant to the Copyright Act and similar statutes. These transactions are not voluntary contractual relationships and the contract principles which underlie this Act are not appropriate.

e. Employment Contracts. This Act does not deal with employee contracts. Subsection (d)(5). A vast network of labor law and other regulatory rules apply to the relationship between an employee and employer; this Act leaves that law unchanged. As the

second clause of subsection (d)(5) makes clear, however, this Act does apply to computer information contracts involving independent contractors other than freelancers in the news reporting industry as that term is commonly understood in the news reporting industry. Freelancers play an important role in reporting news, including news gathering, dissemination, comment, and feature or general interest reporting and traditionally their relationship with publishers has been governed by applicable state and federal law. Subjecting them to a new set of rules may inject uncertainty into the marketplace, particularly concerning whether the Act applies to a particular transaction. Subsection (d)(5) is designed to exempt the transactions involving these freelancers and their publishers so as not do disturb industry practices in this regard.

f. Voluntary Use of Computer Information. Under Subsection (d)(6) an agreement is not brought into this Act merely because one party elects to use computer information to transmit information to the other, when not required to do so. An author that contracts to submit an article to a publisher for publication in a print journal and elects to send the text by E-mail, does not thereby bring the contract into this Act. A developer allowed by agreement to deliver information in any form it chooses, including print, is not within this Act merely because it elects to use digital systems,

g. Form is Insignificant. There may be cases in which the form of the information as computer information is such a minor part of the transaction that the Act should not apply at all. Subsection (d)(6) provides a court with the basis to reach this judgment if the *form* of the information as computer information is insignificant. This is a narrow exception, applicable only if the form of the information, as compared to the information itself, is trivial. The exception does not ask a court to compare the cost or value of the computer information to the cost or value of the overall transaction.

What must be insignificant is that the information is in the form of computer information as contrasted to another form, such as in written form. If the information could not be provided in any other form under the agreement and still fulfill the purpose of the agreement with respect to it, the form can never be insignificant, such as where the computer information is a computer operating system. This is true even if the software is provided in a transaction for goods that in cost far exceed the value of the software. To function as an operating system under the agreement, the form can never be insignificant. Similarly, if a party acquires a billion dollar robotics system involving robots and computers along with software that operates each, the fact that the price of the software is small as compared to the billion dollar total deal does not exclude coverage of this Act over the software aspect of the agreement. Rather, the form of the information as computer information in this transaction is essential to the agreement because the software must be in a form to operate the computer and robots.

SECTION 104. CONSUMER PROTECTION LAW GOVERNS.

(a) [**Consumer protection law defined.**] In this section, "consumer protection law" means a consumer protection statute, rule, or regulation, or other state executive or legislative action that has the effect of law and any applicable judicial or administrative decisions interpreting those statutes, rules, regulations, or actions.

(b) [**Applicable consumer laws prevail.**] Except as otherwise provided in this section, this [Act] does not limit, modify, or supersede a consumer protection law.

(c) [**Standard of conspicuousness.**] If a consumer protection law requires a term to be conspicuous, the standard of conspicuousness under the consumer protection law applies. However, a provision in the consumer protection law requiring a term to be conspicuous does not preclude the term from being presented electronically.

(d) [**Required writing or signature.**] Subject to Section 905, if a consumer protection law requires a writing or a signature, a record or an authentication suffices.

(e) [**Required assent.**] If a consumer protection law addresses assent, consent, or manifestation of assent, the standard of assent, consent, or manifestation of assent under the consumer protection law applies and, subject to Section 905, may be accomplished electronically.

(f) [**Determination of applicability of consumer protection law.**] The applicability of a consumer protection law is determined by that law as it would have applied in the absence of this [Act].

[(g) [**Applicable consumer protection statutes.**] Among the consumer protection laws of this State which apply to the subject matter of this [Act] are: [Insert statutes that, on review by the legislature and amendment as appropriate, are determined to be applicable to the subject matter of this [Act] such as a state's unfair and deceptive practices act with amendments as appropriate.]]

Legislative Note: This Section makes clear that this [Act] does not change a "consumer protection law". Some consumer protection statutes apply to goods and services and may not apply to computer information which is an intangible under current law. Accordingly, states must review their consumer protection statutes to determine if they should be applied to computer information and, if so, what amendments are required to adapt them to that subject matter. In most cases, the state's unfair and deceptive practices act should apply, but some modification may be required. For example, if a state's "unfair acts and practices" statute requires the origin of the product to be specified on the "label or package," such a provision needs consideration before being applied to electronic information that has no "label" or "package." It may also be appropriate to consider such issues as whether the provision should apply to computer information for which no charge is made, or how the provision can be applied to products having multiple "origins" such as software written by an unaffiliated community of programmers. A consumer protection statute applicable to health club contracts may not apply but a consumer protection statute requiring that a vendor's refund policy be posted on the "premises" might apply if amended to allow compliance in an Internet or other electronic environment. Amendments of consumer protection laws must be consistent with the federal Electronic Signatures in Global and Electronic Commerce Act which requires technological

neutrality and that the amended statute reference the federal act.

Definitional Cross-References: Section 102: "Authentication"; "Conspicuous"; "Consumer"; "Electronic"; "Record"; "State"; "Term". Section 112, "Manifestation of assent".

Comment

1. Scope of the Section. This section describes the relationship of this Act to a state's consumer protection law. The rule is that this Act does not alter the scope, applicability, or substantive effect of consumer protection laws.

2. Consumer Law Controls. This Act does not alter the scope, applicability, or substantive effect of consumer protection laws. In cases of conflict, the consumer protection law controls. However, consistent with the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et. seq., this section permits commerce in electronic form including in consumer cases.

This Act deals with general contract law. It does not promulgate a consumer protection code, although the Act does contain numerous consumer protections. This Act leaves further consumer protection concepts to the consumer protection law of the particular State. This approach is consistent with the approach of other general uniform law, including UCC Article 2 and Article 9, which defer to consumer protection laws. Historically, consumer protection statutes have varied State-by-State. Except for the limited e-commerce rules in this section, a State's consumer protection statutes trump this Act whenever a conflict arises. For example, consumer protection statutes regulating advertising, mandating disclosure of the licensor's main business office, requiring disclosure of a term in specified manner, typeface or the like, or providing for treble damages for particular acts, are not altered by this Act and their provisions over-ride any inconsistent rule contained in this Act.

A "consumer protection law" reflects the judgment of the State's legislature expressed through statutes, or of the State's regulatory agencies or executives expressed through regulations or equivalent actions, that a consumer should receive special protection. A statute or a provision thereof can be fairly described as a consumer protection statute only if it contains protections or rights specifically earmarked for or primarily intended to apply to consumers and that gives consumers greater protection than other parties in similar transactions. The term includes judicial or regulatory interpretations of such laws. While this Act defers to such determinations, the term does not include common law rules that are judicial in derivation.

3. Standard of Conspicuousness. Some consumer protection laws require that particular terms be displayed in a conspicuous manner. Subsection (c) makes clear that, as to such laws, the general principle that this Act defers to consumer protection law includes deference to how those laws interpret or define "conspicuousness" with reference to that requirement; the second sentence of subsection (c) provides a limited exception needed for electronic commerce. In cases where a conspicuousness requirement arises solely from this Act or where there is no standard in or pertaining to the consumer protection law, the definition of conspicuous under this Act controls.

4. Records and Authentication. Subsection (d) confirms an electronic commerce principle that is widely accepted nationally: electronic signatures and records suffice to meet requirements of a writing or a signature in most laws, including most consumer protection laws. The reference to Section 905 is intended to bring in applicable federal procedural requirements for obtaining a consumer's consent to substitute electronic disclosures for those required by law to be delivered in writing and to make it clear that this Act does not alter the provisions of other law on use of electronics for certain forms of notices if they apply to transactions covered by this Act. See 15 U.S.C. §§ 7001(c), 7003(b).

5. Assent. Subsection (e) confirms that the basic principle making consumer protection laws controlling applies to cases where those laws establish requirements of assent and the like. That principle is subject to the rule that assent can be made electronically. In turn, when the limitations spelled out in federal law for consumer "written" disclosure laws and some notice rules apply, the UCITA rule is subject to the applicable federal rule.

6. Applicability of Consumer Protection Law. The effect of the principle that consumer protection laws trump this Act depends on how those laws define their scope. Subsection (f) makes clear that this Act does not alter the scope of any consumer protection law, including any law giving regulatory jurisdiction to a particular state agency. Thus, a consumer protection law applicable to "services" applies to any service transactions within the scope of this Act to the same extent and without any change as it would have applied without enactment of this Act. If courts or regulators interpreted that statute to cover online services before enactment of this Act, that interpretation remains effective as to such services in this Act. If no prior interpretations were made on that issue, or if the issue of scope of the consumer protection law does arise, then that issue should be resolved by considering the policies, language and content of that consumer protection law, not this Act. The same analysis applies to a consumer protection statute that applies to "goods." The meaning of that scope requires analysis of that statute and its policies; this Act does not alter that analysis.

Subsection (f) also recognizes that many consumer protection laws do not by their terms cover transactions within this Act. It would be inappropriate and beyond the prerogative of this or any Act to amend all of those laws automatically to apply to the subject matter of this Act, because many deal with particular circumstances that are not relevant to computer information transactions. Subsection (f) invites legislatures to undertake an analysis that must occur with or without enactment of this Act – an analysis to determine whether or which consumer protection laws in a state should be amended expressly to apply to the subject matter covered here and whether and what other changes need to be made to the consumer protection laws given that coverage. If a State elects to undertake this analysis, subsection (f) signals that any list included is not exclusive.

SECTION 105. RELATION TO FEDERAL LAW; FUNDAMENTAL PUBLIC POLICY; LAWFUL PUBLIC COMMENT; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

(a) [**Federal preemption.**] A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption.

(b) [**Fundamental public policy controls.**] If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a result contrary to public policy, in each case to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of the term.

(c) [**Lawful public comment not prohibited.**] In a transaction in which a copy of computer information in its final form is made generally available, a term of a contract is unenforceable to the extent that the term prohibits an end-user licensee from engaging in otherwise lawful public discussion relating to the computer information. However, this subsection does not preclude enforcement of a term that establishes or enforces rights under trade secret, trademark, defamation, commercial disparagement, or other laws. This subsection does not alter the applicability of subsection (b) to any term not rendered unenforceable under this subsection.

(d) [**Intellectual property notices.**] This [Act] does not apply to an intellectual property notice that is based solely on intellectual property rights and is not part of a contract. The effect of such a notice is determined by law other than this [Act].

[(e) [**Conflicting laws that prevail.**] The following laws govern in the case of a conflict between this [Act] and the other law: [List laws establishing a digital signature and similar form of attribution procedure.]]

Uniform Law Source: None.

Definitional Cross References: Section 102: "Agreement"; "Computer information" "Contract"; "Information"; "Informational Rights"; "Term".

Comment

1. General Principle and Scope of the Section. Subsections (a) and (b) clarify that this Act does not alter intellectual property or other fundamental information laws. Subsection (c) provides for invalidation of certain contract terms. Subsection (d) clarifies the treatment of non-contractual notices.

The transition from print to digital media has created new demands for information. Because digital information is so easily copied, increased attention has been focused on the formulation of rights in information in order to encourage its creation and on the development of contracting methods that enable effective development and efficient marketing of information assets. Here, as in other parts of the economy, the fundamental policy of contract law is to enforce contractual agreements. At the same time, there remains a fundamental public interest in assuring that information in the public domain is free for all to use from the public domain and in providing access to information for public purposes such as education, research, and fair comment. While the digital environment increases the risk of unfair copying, the enforcement of contracts that permit owners to limit use of information and the development of technological measures have given the owners of information considerable means of enforcing exclusivity in the information they produce or collect. This is true not only against those in contractual privity with the owners, but also in some contexts against the world-at-large.

Balancing the rights of owners of information against the claims of those who want access is

complex and has been the subject of considerable controversy and negotiation at both the federal level and internationally. The extent to which the resolution of these issues at the federal level ought to preempt state law is beyond the scope of this Act, the central purpose of which is to facilitate private transactions in information. Moreover, it is clear that limitations on the information property rights of owners that may exist in a copyright regime, where rights are good against third parties, may be inappropriate in a contractual setting where courts should be reluctant to set aside terms of a contract. Subsections (a) and (b) strike the balance between fundamental interests in contract freedom and fundamental public policies such as those regarding innovation, competition, and free expression. The use of these general principles will enable the courts to react to changing practices and technology; more specific prohibitions would lack flexibility and would inevitably fail to cover all relevant contingencies.

2. Federal Law: Preemption. Subsection (a) states a rule that would apply in any event under federal law. If federal law invalidates a state contract law rule or contract term, federal law controls. See, e.g., *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996) (patent license not transferable); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984) (copyright license not transferable); *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989) and *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corporation*, 284 F3d 1323 (2002) (UCC bona fide purchaser doctrine not appropriate for non-exclusive licensees).

A contract term that varies the effect of a rule whose effect between the parties cannot be varied by agreement under the Copyright Act is unenforceable. Subsection (a) refers to preemption, but other doctrines grounded in federal law may preclude enforcement of some contract terms in some cases. Except for rules that directly regulate specific contract terms, no general preemption of contracting arises under copyright or patent law. See *National Car Rental System, Inc. v. Computer Associates Int'l, Inc.*, 991 F.2d 426 (8th Cir. 1993); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), cert. den., 510 U.S. 861 (1993). Case law will continue to develop in this area. As state law, this Act does not define whether or when federal preemption may occur.

3. Public Policy Invalidation. Contract terms may be unenforceable because of federal preemption under subsection (a) of this section or because they are unconscionable under Section 111. In addition, subsection (b) sets out the legal principle that terms may be unenforceable if they violate a fundamental public policy that clearly overrides the policy favoring enforcement of private transactions as between the parties. The principle that courts may invalidate a term of a contract on public policy grounds is recognized at common law and in the *Restatement (Second) of Contracts* § 178 et. seq. See, e.g., *Livingston v. Tapscott*, 585 So. 2d 839 (Ala. 1991); *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 293 N.W.2d 843 (Neb. 1980).

Fundamental state policies are most commonly stated by the legislature. In the absence of a legislative declaration of a particular policy, courts should be reluctant to override a contract term. In evaluating a claim that a term violates fundamental public policy, courts should consider various factors, including the extent to which enforcement or invalidation of the term will adversely affect the interests of each party to the transaction or the public, the interest in protecting expectations arising from the contract, the purpose of the challenged term, the extent to which enforcement or invalidation will adversely affect other fundamental public interests, the strength and consistency of judicial decisions applying similar policies in similar contexts, the nature of any express legislative or regulatory policies, and the values of certainty of enforcement and uniformity in interpreting contractual provisions. Where parties have negotiated terms in their agreement, courts should be even more reluctant to set aside terms of the agreement. In applying these factors, courts should consider the position taken in the *Restatement (Second) of Contracts* § 178, comment b ("Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in enforcement of the particular term."). In light of the national and international integration of the digital economy,

courts should be reluctant to invalidate terms based on purely local policies.

The offsetting public policies most likely to apply to transactions within this Act are those relating to innovation, competition, fair comment and fair use. Innovation policy recognizes the need for a balance between protecting property interests in information to encourage its creation and the importance of a rich public domain upon which most innovation ultimately depends. Competition policy prevents unreasonable restraints on publicly available information in order to protect competition. Rights of free expression may include the right of persons to comment, whether positively or negatively, on the character or quality of information in the marketplace. Free expression and the public interest in supporting public domain use of published information also underlie fair use as a restraint on information property rights. Fair use doctrine is established by Congress in the Copyright Act. Its application and the policy of fair use is one for consideration and determination there. However, to the extent that Congress has established policies on fair use, those can taken into consideration under this section.

In practice, enforcing private contracts is most often consistent with these policies, largely because contracts reflect a purchased allocation of risks and benefits and define the commercial marketplace in which much information is disseminated and acquired. Thus, a wide variety of contract terms restricting the use of information by one of the contracting parties present no significant concerns. For example, contract restrictions on libelous or obscene language in an on-line chat room promote interests in free expression and association. Such restrictions are enforced to a much broader degree if they arise out of contractual arrangements than if they are imposed by governmental regulation. However, there remains the possibility that contractual terms, particularly those arising from a context without negotiation, may be impermissible if they violate fundamental public policy.

Contracting parties may have greater freedom contractually to restrict the use of confidential information than information that is otherwise publicly available. While a term that prohibits a person from criticizing the quality of software may raise public policy concerns if included in a shrink-wrap license for software distributed in the mass market, a similar provision included in an agreement between a developer and a company applicable to experimental or early version software not yet perfected for the marketplace would not raise similar concerns. Trade secret law allows information to be transferred subject to considerable contractual limitations on disclosure which facilitates the exploitation and commercial application of new technology. On the other hand, trade secret law does not prohibit reverse engineering of lawfully acquired goods available on the open market. Striking the appropriate balance depends on a variety of contextual factors that can only be assessed on a case-by-case basis with an eye to national policies.

A term or contract that results from an agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b). This Act and general contract law also recognize the commercial necessity of enforcing standard-form agreements mass-market transactions. The terms of such forms may not be available to the licensee prior to the payment of the price and typically are not subject to affirmative negotiations. In such circumstances, courts must be more vigilant in assuring that limitations on use of the informational subject matter of the license do not offend over-riding fundamental public policy.

Even in mass-market transactions, however, limitations in a license, such as terms that prohibit the licensee from making multiple copies, or that prohibit the licensee or others from using the information for commercial purposes, or that limit the number of users authorized to access the information, or that prohibit the modification of software or informational content without the licensor's permission are typically enforceable. See, e.g., *Storm Impact, Inc. v. Software of the Month Club*, 13 F.Supp.2d 782 (N.D. Ill. 1998) ("no commercial use" restriction in an on-line contract). On the other hand, terms in a mass-market license that prohibit persons from observing the visible operations or visible characteristics of software and using the observations to develop non-infringing commercial products, that prohibit quotation of limited material for purposes of education or criticism, or that preclude a non-profit library licensee from making an archival (back-up) copy would ordinarily be invalid in the absence of a showing of

significant commercial need.

Under the general principle in subsection (b), courts also may look to federal copyright and patent laws for guidance on what types of limitations on the rights of owners of information ordinarily seem appropriate, recognizing, however, that private parties ordinarily have sound commercial reasons for contracting for limitations on use and that enforcing private ordering arrangements in itself reflects a fundamental public policy enacted throughout the Uniform Commercial Code and common law.

In part because of the transformations caused by digital information, many areas of public information policy are in flux and subject to extensive debate. In several instances these debates are conducted within the domain of copyright or patent laws, such as whether copying a copyrighted work for purposes of reverse engineering is an infringement. This Act does not address these issues of national intellectual property policy, but how they are resolved may be instructive to courts in applying this subsection. One national statement of policy on the relationship between reverse engineering, security testing, and copyright in digital information can be found at 17 U.S.C. § 1201 (1999). It recognizes a policy not to prohibit some forms of reverse engineering and also to protect security testing where it is needed to protect the integrity and security of computers, computer systems or computer networks. 17 U.S.C. § 1201(j)(1999) ("the term "security testing" means accessing a computer, computer system, or computer network, solely for the purpose of good faith testing, investigating, or correcting, a security flaw or vulnerability, with the authorization of the owner or operator of such computer, computer system, or computer network . . . [It] is not a violation . . . for a person to develop, produce, distribute or employ technological means for the sole purpose of performing the acts of security testing"). This policy may or may not outweigh a contract term to the contrary. See Section 118 for provisions dealing with reverse engineering for purposes of interoperability and Official Comment 3 to that section.With reference to contract law policies that regulate the bargain of the parties, this Act makes express public policy choices. Contract law issues such as contract formation, creation and disclaimer of warranties, measuring and limiting damages, basic contractual obligations, contractual background rules, the effect of contractual choice, risk of loss, and the like, including the right of parties to alter the effect of the terms of this Act by their agreement should not be invalidated under subsection (b) of this section. This subsection deals with policies that implicate the broader public interest and the balance between enforcing private transactions and the need to protect the public domain of information.

The court, if it finds a particular term unenforceable under this section, may enforce the remainder of the contract if it is possible to do so. In considering this issue the court should consider the factors described in *Restatement (Second) of Contracts* § 184.

4. Terms Prohibiting Public Comment. The rule in this subsection invalidates certain contractual terms that prohibit public comment about the performance of computer information, if the copy of the information has been made generally available to the public in its final form, such as when a licensor releases to the retail market a word processing program. Such terms are invalid unless the term is supported by other law, such as the law of trade secrets, trademark, unfair competition and the like. The term is also enforceable to the extent the term precludes otherwise unlawful comment.

Under this provision there are cases where a party can validly, by contract, agree not to comment about, use, or disclose information except as provided by agreement. Nondisclosure and no-discussion terms may be important for trade secrecy, trademark, unfair competition and other law. Enforcing such terms is central to establishing and retaining valuable rights and provides a foundation for much of modern practice involving technology. This subsection does not disturb such contracting practices, including practices that contractually restrict disclosure or comment. It does not apply unless the information is made generally available; thus, it would not apply to ordinary trade secret and limited distribution transactions.

The policy behind this subsection is this: if the person that owns or controls rights in the information decides that it is ready for general distribution to the public, the decision to place it

in the general stream of commerce places it into an arena in which persons who use the product have a strong public interest in public discussion about it. This subsection recognizes that those public interests outweigh interests in enforcing the contract term in appropriate cases. It thus applies only if there was an authorized distribution in final form. "Final form" does not include distribution of pre-test or so-called "beta" or other test versions, such as where the intent of the distribution is to collect information to make further improvements and nondisclosure rules are important to obtaining feedback without exposing the potential product to premature public discussion and criticism. Once generally released in final form, however, a product does not lose that character simply because further versions of it may be developed and released in the future. A product is in final form for purposes of this section when it has been generally released in the marketplace. "End-user licensee" reflects the intent of this subsection not to disturb relationships between manufacturers and distributors where application of such a rule could have unintended consequences. In cases where the license involves a company or other legal entity, the term includes the named entity and any individuals authorized to use the computer information under that license.

5. Non-Contractual, Intellectual Property Notices. Subsection (d) clarifies that this Act does not apply to copyright or other intellectual property notices that are not a contract. This Act applies to agreements and contracts. Thus, the Act does not apply if an academic physicist in Houston creates program code and makes it freely available to other academics or individuals as a way of contributing to the development of so-called "free software" or "open source" software. Non-contractual conduct is not covered by this Act.

A closer question exists if a party makes software available subject to limits on its use which may or may not be interpreted as involving contractual obligations. This Act does not take a position on whether or not intellectual property notices in any particular context are contractual in nature. This Act does not apply to non-contractual relationships. The effect of an intellectual property notice that is not part of a contract is governed by other law and this Act takes no position on what that law is or its effect.

6. Digital And Electronic Signature Statutes. Subsection (e) allows States with existing laws regarding digital signature, electronic signatures, and other similar statutes, which attribute acts or performances of a party in computer information transactions, to list any provisions of such statutes that the State desires to have prevail over this Act in the case of a conflict. For example, many such statutes do not provide a consumer defense of the type provided in Section 213 of this Act. If a State wishes to afford consumers the protections of Section 213, it should not list its other statute or should otherwise craft an appropriate exception. It is not necessary to list the Uniform Electronic Transactions Act because, by its terms, that Act does not apply if UCITA applies.

SECTION 106. RULES OF CONSTRUCTION.

(a) [**Liberal construction and application.**] This [Act] must be liberally construed and applied to promote its underlying purposes and policies to:

(1) support and facilitate the realization of the full potential of computer information transactions;

(2) clarify the law governing computer information transactions;

(3) enable expanding commercial practice in computer information transactions by commercial usage and agreement of the parties;

(4) promote uniformity of the law with respect to the subject matter of this [Act] among States that enact it; and

(5) permit the continued expansion of commercial practices in the excluded transactions through custom, usage, and agreement of the parties.

(b) [**Construction of mandatory language.**] Except as otherwise provided in Section 113(a), the use of mandatory language or the absence of a phrase such as "unless otherwise agreed" in a provision of this [Act] does not preclude the parties from varying the effect of the provision by agreement.

(c) [**No negative inference.**] The fact that a provision of this [Act] imposes a condition for a result does not by itself mean that the absence of that condition yields a different result.

(d) [**When special formalities required.**] To be enforceable, a term need not be conspicuous, negotiated, or expressly assented or agreed to, unless this [Act] expressly so requires.

(e) [**Headings.**] Section headings are part of this [Act], but subsection headings and paragraph headings are not.

Uniform Law Source: Uniform Commercial Code § 1-102(1)(2)(4).

Definitional Cross References: Section 102: "Agreement"; "Computer information transaction"; "Conspicuous"; "Contract"; "Electronic"; "Party"; "Term".

Comment

1. Scope of the Section. This section brings together rules regarding construction of this Act.

2. Purpose of the Act. This Act must be construed in light of its purposes. As stated in paragraph (1), these are not regulatory, but are intended to facilitate and support commercial practice and to support its evolution through agreement and trade practices. To construe an Act in light of its purposes does not mean that general purposes supplant specific provisions. However, in cases of uncertainty, the meaning of this Act should be construed by reference to the stated purposes and the themes developed in the Act, as opposed to inconsistent or extraneous contract law policies that contradict those of this Act.

3. Mandatory Language. This Act ordinarily does not use phrases such as "unless

otherwise agreed" and frequently uses mandatory language such as "shall" or "must." However, neither drafting style alters the basic rule that the agreement controls in all cases, except as indicated in Section 115(b). Paragraph (2) rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995) (absence of language allowing variance by agreement indicates provision is mandatory). The agreement, including trade usage and the like, also controls the meaning of language parties use in their contract. For example, an agreement may state that a party may "terminate" for breach. The Uniform Commercial Code and this Act define "termination" as ending a contract without breach. The proper interpretation of the agreement is based on its context and whether use of the term corresponds to a cancellation or termination under this Act.

4. Negative Inference. Paragraph (3) resolves issues about the existence of a negative pregnant. In this Act, the statement of an affirmative result that occurs when certain conditions are met does not necessarily indicate that a different result occurs if the conditions are not met. Thus, if a provision states: "If the originator of a message requests acknowledgment, the following rules apply: ---", this does not indicate what rule governs in the absence of a request. Similarly, a provision that states that particular language or procedure yields a specific result does not indicate what result occurs with different language or procedures. It merely states the affirmative proposition. If a different interpretation is intended, that different interpretation is made explicit in the section.

5. Headings. Subsection (e) follows the UCC rule that sections headings are part of the Act, but subsection headings are not.

SECTION 107. LEGAL RECOGNITION OF ELECTRONIC RECORD AND AUTHENTICATION; USE OF ELECTRONIC AGENTS.

(a) [**Equivalency principle.**] A record or authentication may not be denied legal effect or enforceability solely because it is in electronic form.

(b) [**Use of electronics not required.**] This [Act] does not require that a record or authentication be generated, stored, sent, received, or otherwise processed by electronic means or in electronic form.

(c) [**Party autonomy preserved.**] In any transaction, a person may establish requirements regarding the type of authentication or record acceptable to it.

(d) [**Party bound by electronic agent.**] A person that uses an electronic agent that it has selected for making an authentication, performance, or agreement, including manifestation of assent, is bound by the operations of the electronic agent, even if no individual was aware of or reviewed the agent's operations or the results of the operations.

Definitional Cross References: Section 102: "Agreement"; "Authentication"; "Electronic";

"Electronic agent"; "Person"; "Record"; "Receive"; "Sent". Section 112: "Manifestation of assent".

Comment

1. Scope of Section. This section states that statutes pertaining to subject matter within this Act requiring a "writing" or "signature" must be interpreted and applied as allowing a "record" or "authentication." The rules apply only to transactions within this Act, whether by agreement or otherwise.

2. Equivalence of Electronics. Under subsection (a), the fact that a message, record or authentication is electronic does not alter its legal impact. This establishes an equivalence between electronic and other records. The rule refers to the form of the authentication or record, not to its content. See Section 104(4). Subsection (a) does not address how to prove attribution or authentication, nor does it alter evidence law relating to when an original copy of a record is required or what, in a digital world, constitutes an original.

3. Requiring Electronics. Nothing in this Act requires parties to use electronic processes. Subsection (b). In some cases, parties may wish to require use of paper documents; this Act does not alter that choice. It merely establishes a legal framework for electronic commerce in which electronics and paper records are equivalent in law. Parties may decide to use, or not to use, that framework.

4. Establishing requirements. Subsection (c) makes clear that parties can set their own requirements regarding the acceptability of records or authentication. This does not authorize one party unilaterally to change requirements previously established by agreement. Also, subsection (c) does not require that the parties establish requirements regarding electronics – it simply clarifies that they may if they so choose. A person can insist on conformance with requirements that are offered or agreed. Thus, while typing one's name with the requisite intent may be an authentication under this Act, parties can require a different form of authentication, such as a digital signature using encryption. Nothing in this Act disturbs their ability to so contract. Ordinary standards of waiver, estoppel and the like, along with general rules of offer and acceptance, provide standards for dealing with issues that might arise in this context.

5. Electronic Agents. Operations of an electronic agent generally bind the party that used the electronic agent for that purpose. Subsection (d). This rule is limited to situations where the party selects the agent, and includes cases where the party consciously elects to employ the agent on its own behalf, whether that agent was created by it, licensed from another, or otherwise adopted for this purpose. The term "selects" does not require a choice from among several electronic agents, but merely a conscious decision to use a particular agent.

The concept here embodies principles like those in agency law, but it does not depend on agency law. The electronic agent must be operating within its intended purpose. For human agents, this is often described as acting within the scope of authority. Here, the focus is on whether the agent was used for the relevant purpose. For a similar concept in a different context, see *Playboy Enterprises, Inc. v. Webbworld, Inc.,* 991 F. Supp. 543 (N.D. Tex. 1997), *aff'd,* 168 F.3d 486 (5th Cir. 1999). Cases of fraud, manipulation and the like are discussed in Section 206.

SECTION 108. PROOF AND EFFECT OF AUTHENTICATION.

(a) [**Proving authentication.**] Authentication may be proven in any manner, including a

showing that a party made use of information or access that could have been available only if it engaged in conduct or operations that authenticated the record or term.

(b) [**Commercially reasonable attribution procedure.**] Compliance with a commercially reasonable attribution procedure agreed to or adopted by the parties or established by law for authenticating a record authenticates the record as a matter of law.

Definitional Cross References: Section 102: "Attribution procedure"; "Authenticate"; "Information"; "Party"; "Record".

Comment

1. Scope of the Section. This section deals with two issues pertaining to proof of an authentication. It does not address to whom the authentication is attributed.

2. Method of Proof. Proof of authentication can occur in any manner. In electronic commerce, one important means of proving authentication is by showing that a process existed that required an authentication in order to proceed.

3. Authentication Procedure. Under Subsection (b), compliance with an effective or commercially reasonable attribution procedure for authentication confirms that an authentication was intended and occurred. Compliance with such a procedure does not necessarily resolve the issue of to whom the authentication is attributed, but may have weight on that question. See Section 212.

Unless established by law, the procedure must be agreed to or adopted by the parties. This is not limited to instances in which the contracting parties have communicated directly concerning use of an authentication procedure. It includes instances in which one of the contracting parties contracted with a third party offering a digital signature or other procedure with the intent to be bound thereby whenever the signature is affixed to a record and to situations in which a group composed of member companies has adopted attribution procedures to use with other members or assenting third parties.

SECTION 109. CHOICE OF LAW.

(a) [**Contractual choice and limitations.**] The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) in the absence of the agreement.

(b) [**Absence of enforceable choice.**] In the absence of an enforceable agreement on choice of law, the following rules determine which jurisdiction's law governs in all respects for purposes of contract law:

(1) [**Access contracts and electronic delivery.**] An access contract or a contract

providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor was located when the agreement was entered into.

(2) [**Consumer tangible copies.**] A consumer contract that requires delivery of a copy on a tangible medium is governed by the law of the jurisdiction in which the copy is or should have been delivered to the consumer.

(3) [**All other cases.**] In all other cases, the contract is governed by the law of the jurisdiction having the most significant relationship to the transaction.

(c) [**Effect of foreign law.**] In cases governed by subsection (b), if the jurisdiction whose law governs is outside the United States, the law of that jurisdiction governs only if it provides substantially similar protections and rights to a party not located in that jurisdiction as are provided under this [Act]. Otherwise, the law of the State that has the most significant relationship to the transaction governs.

(d) [**Location of party.**] For purposes of this section, a party is located at its place of business if it has one place of business, at its chief executive office if it has more than one place of business, or at its place of incorporation or primary registration if it does not have a physical place of business. Otherwise, a party is located at its primary residence.

Uniform Law Source: Restatement (Second) of Conflicts 188. Revised.

Definitional Cross References: Section 102: "Access contract"; "Agreement"; "Consumer"; "Consumer contract"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Licensor"; "Party"; "State"; "Term".

Comment

1. Scope of Section. This section deals with agreed terms selecting applicable law and with what law applies to a transaction in the absence of agreed terms. Subsection (a) enforces the agreement except with respect to mandatory consumer protection rules. Subsections (b) and (c) provides clarity on what law applies in the absence of an enforceable contract term.

2. Contractual Choice of Law. Contract terms that select the law applicable to the contract are routine in commercial agreements. The information economy accentuates their importance because it allows remote parties to enter and perform contracts spanning multiple jurisdictions and in circumstances that do not depend on physical location of either party or the information. Subsection (a) enables small companies to actively engage in multinational business; if the agreement could not designate applicable law, even the smallest business would be subject to the law of all fifty states and all countries in the world. That would impose large costs and uncertainty on an otherwise efficient system of commerce; it would create barriers to entry.

a. General Rule. This Act enforces agreed choices of law. This follows most decisions dealing with information-related contracts. See *Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir. 1984); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993). *Restatement (Second) of Conflict of Laws* § 188 has a similar rule. Subsection (a) does not follow U.C.C. § 1-105 (1998 Official Text) which requires that the selected state have a "reasonable relationship" to the transaction. In a global information economy, limitations of that type are inappropriate, especially in cyberspace where physical locations are often irrelevant or not knowable. Parties may appropriately wish to select a neutral forum because neither is familiar with the law of the other's jurisdiction. In such a case, the chosen state's law may have no relationship at all to the transaction. *See* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997. This rule is consistent with international norms. *See Inter-American Convention on the Law Applicable to International Contracts* art. 7 (Mexico City 1994); *Convention on the Law Applicable to Contracts for the International Sale of Goods* art. 7(1) (The Hague 1986).

b. Limitations. Agreed choices of law are subject to limitations such as in the doctrine of unconscionability and the treatment of overriding fundamental public policy of the forum state. Section 105(b); *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App.4th 881, 72 Cal. Rptr.2d 73 (Cal. App. 1998). Compare *Lowry Computer Products, Inc. v. Head*, 984 F. Supp. 1111 (E.D. Mich. 1997).

Subsection (a) further provides that, in a consumer contract, the agreed choice of law cannot override an otherwise applicable rule that could not be altered by agreement under the law of the state whose law would apply in the absence of the contractual choice. The policy of freedom of contract should not permit overriding the consumer rule if a state, having addressed the cost and benefits, determines that the consumer rule is not variable by contract.

3. Choice of Law: No Contract term. Subsection (b) states what choice-of-law rules govern in the absence of a contract term. These rules apply to all contract-related issues and replace common law. Contracts in computer information can be created and performed remotely, a factor emphasizing the need for tailored, understandable rules that enhance certainty and thus facilitate commerce. As to common law, see *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992) ("[C]hoice-of-law theory today is in considerable disarray. [It] is marked by eclecticism and even eccentricity.").

Subsection (b)(1) specifies that, in an access contract or a contract involving electronic delivery of information, in the absence of an agreed choice of law, the agreement is governed by the law of the jurisdiction in which the licensor is located. Any other rule would require that the information provider (small or large) comply with the law of all states and all countries, since it may not be known or knowable where the contract is formed or the information sent. The rule adopted here enhances certainty in a context where an on-line vendor, large or small, makes Internet access available to the entire world. "Located" is defined in subsection (d) and does not depend on the location of the computer that contains the information.

Subsection (b)(2) applies to consumer transactions that involve delivery of tangible (physical) copies. In the absence of agreed terms, the law where the copy is or was to be delivered governs. Thus, if a consumer is to receive delivery of a tangible copy in Chicago, the transaction is subject to the law of Illinois unless the agreement indicates otherwise. This is consistent with current U.S. law and is followed in many European countries. It adopts, for the consumer, the location that is most likely to be consistent with the consumer's expectations. It avoids surprise to the provider because the tangible copy is to be delivered into a known state.

The rules in subsection (b) deal only with contract law. They do not affect tax, copyright, or other fields of law. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992); *Itar-tass Russian News Agency v. Russian Kurier, Inc.,* 153 F.3d 82 (2d Cir. 1998); *Allarcom Pay Television, Ltd. v. General Instrument Corp.*, 69 F.3d 381 (9th Cir. 1995).

4. Most Significant Relationship. In the absence of an agreement and except for the rules

in subsections (b)(1) and (b)(2), subsection (b)(3) adopts a "most significant relationship" test. The *Restatement (Second) of Conflicts of Law* uses a similar test; cases interpreting that rule are applicable here. Applying this test requires consideration of factors including the: (a) place of contracting, (b) place of negotiation, (c) place of performance, (d) location of the subject matter of the contract, (e) domicile, residence, nationality, place of incorporation and place of business of one or both parties, (f) needs of the interstate and international systems, (g) relative interests of the forum and other interested states in the determination of the particular issue, (h) protection of justified expectations of the parties, and (i) promotion of certainty, predictability and uniformity of result.

5. Foreign Countries. Subsection (c) does not apply if an enforceable contract term designates what law applies. It deals with cases where the default rules in subsection (b) select the law of a foreign country whose law is substantively inappropriate because it fails to give a party protections substantially similar to those available under this Act. The reference is solely to contract law, including this Act and general contract and related equity law of the jurisdiction. Subsection (c) allows a court to use a different choice of law rule than in (b), but courts should alter the basic rule only in extreme cases. It does not suffice merely that the foreign law is different. The differences must be substantial and adverse.

SECTION 110. CONTRACTUAL CHOICE OF FORUM.

(a) [**Limitations on contractual choice.**] The parties in their agreement may choose an exclusive judicial or arbitral forum unless the choice is unreasonable or unjust.

(b) [**When forum exclusive.**] A judicial forum specified in an agreement is not exclusive unless the agreement expressly so provides.

(c) [**Decision for court.**] The enforceability of an agreed choice of exclusive forum is a question for determination by a court of competent jurisdiction in the state in which the action is brought.

Definitional Cross References: Section 102: "Agreement"; "Party"; "Term".

Comment

1. Scope of the Section. This section deals with agreements choosing an exclusive judicial or arbitral forum.

2. General Rule. Choice of forum agreements are generally enforceable. This rule adopts the approach of *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972), and cases following that decision, which form the majority position on this issue in this country, and which treat choice of forum terms as presumptively valid. The *Restatement (Second) of Conflicts of Law* has a similar rule.

3. Limitations. A choice of an exclusive forum is not enforceable if it is unreasonable or unjust; the term also is not enforceable if it is unconscionable under Section 111. The "unreasonable or unjust" standard follows *Breman* and its progeny and adopts the reasoning of

those cases, also applying the standard to choice of arbitral forums. The agreed term is unenforceable if it has no valid commercial purpose and has a severe and unfair impact on the other party. In such cases, the choice is both unreasonable and unjust. This may preclude enforcement of forum agreements that choose an unreasonable forum solely to defeat the other party's ability to contest disputes. Terms may be unreasonable in that they have no commercial purpose or justification other than to defeat the rights of the other party and their impact may be unjust if the term unfairly harms the other party for no sustainable reason. On the other hand, an agreed choice of forum based on a valid commercial purpose is not invalid simply because it adversely affects one party, even if bargaining power was unequal. The burden of establishing that the clause fails lies with the party asserting its invalidity. *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972); *Pelleport Investors, Inc. v. Budco Quality Theaters, Inc.*, 741 F.2d 273 (9th Cir. 1984); *Restatement (Second) of Conflicts of Law* § 80, comment c (1989 rev.). A party that challenges a choice of forum clause by filing in a forum other than the designated forum does not breach the contract by doing so.

Agreed choices of forum are important in electronic commerce. Court decisions on jurisdiction in the Internet demonstrate the uncertainty about when merely doing business on the Internet exposes a party to jurisdiction in all States and all countries. That uncertainty affects all businesses, but it has greatest impact on small enterprises. Choice of forum agreements serve a significant commercial purpose by allowing parties to control the uncertainty and the cost it creates. See, e.g., *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998); *Caspi v. Microsoft Network, L.L.C.*, 323 N.J.Super. 118, 732 A.2d 528 (N.J. A.D. 1999), *cert. den.*, 162 N.J. 199, 743 A.2d 851 (1999). The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991) in a different multi-jurisdictional context is relevant to determining reasonableness in Internet contracting:

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

In electronic commerce, a contractual choice of forum will often be justified on the basis of the risk and uncertainty that would otherwise exist. Choice of a forum at a party's location is ordinarily reasonable.

4. Non-exclusive Forum. Subsection (b) provides that a choice of forum term is nonexclusive unless the agreement expressly provides otherwise. Requiring express exclusivity terms provides notice and follows what, in most cases, is the expectation of the parties. The enforceability of a non-exclusive forum selection clause is not addressed in this Act. Absent unconscionability or other overriding restriction, these clauses present less reason for restricting contract choices than do the clauses dealt with in this section.

5. Forum for Decision. Subsection (c) clarifies the general rule that the enforceability of the forum selection clause will be determined by the forum in which the action is brought. The subsection refers to a decision by a court. In this Act, that term includes an arbitral forum. Thus, this section does not resolve the issue of whether the determination is to be made by a court or an arbitral panel. The forum must be of competent jurisdiction. The subsection does not disturb existing law that determines whether a challenge to a forum selection should be heard by an arbitrator or by a judicial officer. If the action is brought by a consumer in his jurisdiction or if

enforcement of a judgment is challenged by the consumer in its jurisdiction,then the consumer's jurisdiction will decide the questions of enforceability of the forum selection clause.

6. Federal Arbitration Act. The federal Arbitration Act provides preemptive federal standards regarding the treatment of arbitration clauses and the enforceability of arbitration remedies. This Act does not alter those preemptive standards.

SECTION 111. UNCONSCIONABLE CONTRACT OR TERM.

(a) [**General rule.**] If a court as a matter of law finds a contract or a term thereof to have been unconscionable at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable term, or limit the application of the unconscionable term so as to avoid an unconscionable result.

(b) [**Evidence.**] If it is claimed or appears to the court that a contract or term thereof may be unconscionable, the parties must be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

Uniform Law Source: Uniform Commercial Code § 2-302 (1998 Official Text).

Definitional Cross References: Section 102: "Contract"; "Court"; "Term".

Comment

1. Scope of the Section. This section adopts the unconscionability doctrine of Uniform Commercial Code § 2-302 (1998 Official Text).

2. Basic Policy and Effect. This section and Section 117 allow courts to rule directly on the unconscionability of the contract or a particular term. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the terms involved are so one-sided as to be unconscionable under the circumstances existing at the time the contract was made. The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power. See *Intel Corp. v. Integraph,* 195 F.3d 1346 (Fed. Cir. 1999). Since its adoption in Article 2 of the U.C.C., the doctrine of unconscionability has received continuing attention from the courts and enables courts to police explicitly against the contracts or clauses which they find to be unconscionable. *See, Brower v. Gateway 2000, Inc.,* 676 N.Y.S.2d 569 (N.Y.A.D. 1998). In this Act, the concept requiring an "opportunity to review" establishes a requirement that is not clearly present in common law and that resolves many procedural issues preventing unfair surprise. Section 113, *cmt.* 2.

3. Electronic commerce. This Act confirms the enforceability of automated contracting involving "electronic agents," but in some cases automation may produce unexpected, potentially oppressive results due to errors in programs, problems in communication, or other unforeseen circumstances in the automation process. Common law concepts of mistake may apply, as may Sections 206 and 213. In addition, in appropriate cases, unconscionability doctrine may

invalidate a term because a procedural breakdown in automated contract formation produces unexpected and oppressive results in the terms of the agreement.

4. Remedy. The court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single term or group of terms that are so tainted, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

5. Decision of the court. Unconscionability is a decision to be made by the court. The commercial evidence allowed under subsection (b) is for the court's consideration, not for the jury. Only the terms of the agreement that result from the court's action are submitted to the general triers of fact for resolution of a matter in dispute.

SECTION 112. MANIFESTING ASSENT.

(a) [**How person manifests assent.**] A person manifests assent to a record or term if the person, acting with knowledge of, or after having an opportunity to review the record or term or a copy of it:

(1) authenticates the record or term with intent to adopt or accept it; or

(2) intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term.

(b) [**How electronic agent manifests assent.**] An electronic agent manifests assent to a record or term if, after having an opportunity to review it, the electronic agent:

(1) authenticates the record or term; or

(2) engages in operations that in the circumstances indicate acceptance of the record or term.

(c) [**Assent to specific term.**] If this [Act] or other law requires assent to a specific term, a manifestation of assent must relate specifically to the term.

(d) [**Proof of assent.**] Conduct or operations manifesting assent may be proved in any manner, including a showing that a person or an electronic agent obtained or used the information or informational rights and that a procedure existed by which a person or an electronic agent must have engaged in the conduct or operations in order to do so. Proof of compliance with subsection

(a)(2) is sufficient if there is conduct that assents and subsequent conduct that reaffirms assent by electronic means.

(e) [**Agreement for future transactions.**] The effect of this section may be modified by an agreement setting out standards applicable to future transactions between the parties.

(f) [**Online services, network access, and telecommunications services.**] Providers of online services, network access, and telecommunications services, or the operators of facilities thereof, do not manifest assent to a contractual relationship simply by their provision of those services to other parties, including, without limitation, transmission, routing, or providing connections; linking; caching; hosting; information location tools; and storage of materials, at the request or initiation of a person other than the service provider.

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

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Copy"; "Electronic"; "Electronic agent"; "Delivery"; "Information"; "Informational Rights"; "Knowledge"; "Mass-market license"; "Person"; "Record"; "Return"; "Term". Section 117: "Reason to know".

Comment

1. Scope of Section. This section provides standards for "manifestation of assent." Section 113 deals with the related, important concept of an "opportunity to review". In this Act, having an opportunity to review a record is a precondition to manifesting assent.

2. General Theme. The term "manifesting assent" comes from *Restatement (Second) of Contracts* § 19. This section corresponds to *Restatement* § 19, but more fully explicates the concept. Codification establishes uniformity that is lacking in common law.

Restatement (Second) of Contracts §19(1) provides: "The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act." This section adopts that view. Conduct can convey assent as clearly as words. This rule is important in electronic commerce, where most interactions involve conduct rather than words. Subsection (b) adapts that principle to electronic agent contracting.

"Manifesting assent" has several roles: 1) a method by which a party agrees to a contract; 2) a method by which a party adopts terms of a record as the terms of a contract; and 3) if required by this Act, a means of assenting to a particular term. In most cases, the same act accomplishes the results under 1 and 2.

Manifesting assent does not require any specific formality of language or conduct. In this Act, however, to manifest assent to a record or term requires meeting three conditions:

- **First**, the person must have knowledge of the record or term or an opportunity to review it before assenting. An opportunity to review requires that the record be available in a manner that ought to call it to the attention of a reasonable person and that readily permits review. Section 113 may also require a right of return if the opportunity to review comes after a person becomes obligated to pay or begins performance.

- **Second**, having had an opportunity to review, the person must manifest assent. The person may authenticate the record or term, express assent verbally, or intentionally engage in conduct with reason to know that the conduct indicates assent. *Restatement (Second) of Contracts* § 19. As in the *Restatement* this can include a failure to action if the circumstances so indicate.
- **Third**, the conduct, statement, or authentication must be attributable in law to the person. General agency law and Section 212 provide standards for attribution.

3. Manifesting Assent.

a. Assent by Statements or Authentication. A person can assent to a record or term by stating or otherwise indicating its assent or by "authenticating" the record or term. Authentication occurs if a party signs a record or does an electronic equivalent. Section 102 (a)(6).

b. Assent by Conduct. Assent occurs if a person acts or fails to act having reason to know its behavior will be viewed by the other party as indicating assent. Whether this occurs depends on the circumstances. As in common law, proof of assent does not require proof of a person's subjective intent or purpose, but focuses on objective indicia, including whether there was an act or a failure to act voluntarily engaged in with reason to know that an inference of assent would be drawn. Actions objectively indicating assent are assent. This follows modern contract law doctrines of objective assent. Doctrines of mistake, fraud, and duress apply in appropriate cases.

Assent does not require that a party be able to negotiate or modify terms, but the assenting behavior must be intentional (voluntary). This same rule prevails in all other contract law. Intentional conduct is satisfied if the alternative of refusing to act exists, even if refusing leaves no alternative source for the computer information. On the other hand, conduct is not assent if it is conduct which the assenting party cannot avoid doing, such as blinking one's eyes. Courts use common sense in applying this standard in common law and will do so under this Act. Actions in a context of a mutual reservation of the right to defer agreement to a contract do not manifest assent; neither party has any reason to believe that its conduct will suggest assent to the other party.

Knowledge that conduct or inaction is assent satisfies this rule. Also, conduct is assent if a person has "reason to know" the conduct will lead the other party to believe that there was assent. Factors that relate to this issue include: the ordinary expectations of similar persons in similar contexts; language on a display, package, or otherwise made available to the party; the fact that the party can decline and return the information, but decides to use it; information communicated before the conduct occurred; and standards and practices of the business, trade or industry of which the person has reason to know.

The "reason to know" standard is not met if the computer information is sent to a recipient unsolicited under terms that purport to create a binding contract by failure to object to the unsolicited sending. In such cases, it is not reasonable for the sending party to infer assent from silence; the threshold for manifesting assent is not met.

c. Assent by Electronic Agents. Assent may occur through automated systems ("electronic agents"). Either or both parties (including consumers) may use electronic agents. For electronic agents, assent cannot be based on knowledge or reason to know, since computer programs are capable of neither and the automated nature of the interaction may mean that no individual is aware of it. Subsection (b) focuses on the electronic agent's acts, not knowledge or reason to know. Assent occurs if the agent's operations were an authentication or if, in the circumstances, the operations indicate assent. In this Act, manifesting assent requires a prior opportunity to review. For an electronic agent, this opportunity occurs only if the record or term was presented in such a way that a reasonably configured electronic agent could react to it. See Section 113(b). The capability of an automated system to react and an assessment of the implications of its actions are the only appropriate measures of assent.

d. Assent to Particular Terms. This Act distinguishes between assent to a record

and, when required by this Act or other law, assent to a particular term in a record. Assent to a record encompasses all terms of the record. Section 208. Assent to a particular term, if required, requires acts that specifically relate to that term. This is like a requirement that a party "initial" a clause to make it effective. One act, however, may assent to both the record and the term if the circumstances, including the language of the record, clearly indicate that this is true, such as where assent is clearly indicated as being to the record and to a term the nature of which is made clear to the assenting party.

4. Terms of Agreement. Manifestation of assent to a record is not the only way in which parties establish the terms of their agreement. This Act does not alter recognition in law of other methods of agreeing to terms. For example, a product description can become part of an agreement without manifestation of assent to a record repeating that description; the product description defines the bargain itself. A party that licenses a database of names of "consumer attorneys" need only provide a database of consumer attorneys since this is the bargain; the provider is not required to obtain assent to a record stating that deal. Similarly, the licensee can rely on the fact that the database must contain consumer attorneys, not other lawyers. If a product is clearly identified on the package or in representations to the licensee as for consumer use only, that term is effective without language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent or agreement to terms defining it, hidden conditions might not be part of the agreement.

Often, copyright or other intellectual property notices restrict use of a product without needing assent to contract terms. For example, a video rental may place a notice on screen that limits the customer's use such as by precluding commercial public performances. Enforceability of such notices does not depend on obtaining a manifestation of assent.

5. Proof of Assent. Many different acts can establish assent to a contract or a contract term. It is not possible to state them in a statute. In electronic commerce, one important method is by showing that a procedure existed that required an authentication or other assent in order to proceed in an automated system. This is recognized in subsection (d).

Subsection (d) also encourages use of double assent procedures as a reconfirmation showing intentional assent ("intentionally engages in conduct . . . with reason to know"). It makes clear that if the assenting party has an opportunity to confirm or deny assent before proceeding to obtain or use information, confirmation meets the requirement of subsection (a)(2). This does not alter the effectiveness of a single indication of assent. When properly set out with an opportunity to review terms and to make clear that an act such as clicking assent on-screen is assent, a single indication of assent suffices. See *Caspi v. Microsoft Network, L.L.C.*, 323 N.J.Super. 118, 732 A.2d 528 (N.J. A.D. 1999), *cert. den.*, 162 N.J. 199, 743 A.2d 851 (1999); *Register.com, Inc., v. Verio, Inc.* 126 F.Supp.2d 238 (SD NY 2000).

> **Illustration 1:** The registration screen for NY Online prominently states: "Please read the License. It contains important terms about your use and our obligations. If you agree to the license, indicate this by clicking the "I agree" button. If you do not agree, click "I decline"." The on-screen buttons are clearly identified. The underlined text is a hypertext link that, if selected, promptly displays the license. A party that indicates "I agree" assents to the license and adopts its terms.
>
> **Illustration 2:** The first screen of an online stock-quote service requires that the potential licensee enter its name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. Somewhere below the place to enter the information, but hidden in small print, is the statement: "Terms and conditions of service; disclaimers." The customer's attention is not called to this sentence, nor is the customer asked to react to it. Even though using the service creates a contract, there may be no assent to the terms of service and disclaimer, since there is no act indicating assent to those terms. If there is no assent

to those terms, the court would determine contract terms on other grounds, including the rules of this Act and usage of trade.

Illustration 3: The purchasing screen of an on-line software provider provides the terms of the license, a space to indicate the software purchased, and two on-screen buttons indicating "I agree" and "I decline" respectively. A user that completes the order and indicates "I agree" causes the system to move to a second screen. This second screen summarizes the order and asks the user to click, either confirming its order, or canceling it. This satisfies subsection (a)(2) on intentional conduct and reason to know. It also satisfies the error correction procedure in Section 213.

6. Authority to Act. The person manifesting assent must be one that can bind the party seeking the benefits or being charged with the obligations or restrictions of the agreement. In general, this Act treats this issue as a question of attribution: are the assent-producing acts attributable to this particular person? A person that desires to enforce terms against another must establish that it dealt with an individual or agent that had authority to bind the person or, at least, establish that the person to be bound accepted the benefits of the contract or otherwise ratified the acts. If the individual who assented did not have authority and the conduct was not ratified or otherwise adopted, there may be no assent as to the party "represented," but only as to the individual who acted. If this occurs, both the purported principal and the relying party may be at risk: the relying party (e.g., licensor) risks loss of its terms with respect to the party it intended to have bound, while the purported principal ("licensee" using information not obtained by a proper agent) risks that use of the computer information infringes a copyright or patent, since the principal does not have the benefit of the license. There must be an adequate connection between the individual who had the opportunity to review and the one whose acts constitute assent. Of course, a party with authority can delegate that authority to another and such delegation may be either express or implicit. Thus, a CEO may authorize her secretary to agree to a license when the CEO instructs the secretary to sign up for legal materials online or to install a newly acquired program that is subject to an on-screen license.

Questions of this sort arise under agency law as augmented in this Act, such as by the provision on electronic agents in Section 211 or rules in this Act on attribution. Other law governs questions of ordinary agency law, estoppel and the like.

7. Modification of Rules. Subsection (e) recognizes that parties, by prior agreement, may define what constitutes assent with respect to future conduct in ongoing relationships. Compare Section 113(e). The parties may call for more or less formality than set out in this Act. This is important for cases where multiple transfers in electronic commerce occur pursuant to prior agreement. Assent in such cases can just as well be found in the original agreement as in the subsequent conduct.

8. Third Party Service Providers. Assent requires conduct by the party to be bound or its agents. If the party is enabled to reach a system because of services provided by a third party communications or service provider, the service provider typically does not intend or enter into in a contractual relationship with the provider of the information. While the customer's acts may constitute assent by the customer, they do not bind the service provider since the service provider's actions are in the nature of transmissions and enabling access, not assent to a contractual relationship.

Subsection (f) makes clear that service providers - providers of online services, network access, or the operation of facilities thereof - do not manifest assent to a contractual relationship simply from their provision of such services, including but not limited to transmission, routing, providing connections, or linking or storage of material at the request or initiation of a person other than the service provider. If, for example, a telecommunications company provided the routing for a user to reach a particular online location, the fact that the user of the service might assent to a contract at that location does not mean that the service provider has done so. The

conduct of the customer does not bind the service provider.

Of course, in some on-line systems the service provider has direct contractual relationships with the content providers or may desire access to and use the information on its own behalf, and therefore may assent to terms in order to obtain access. In the absence of these circumstances, however, the mere fact that the third-party service provider enables the customer to reach the information site does not constitute assent to the terms at that site.

SECTION 113. OPPORTUNITY TO REVIEW.

(a) [**Manner of availability generally.**] A person has an opportunity to review a record or term only if it is made available in a manner that ought to call it to the attention of a reasonable person and permit review.

(b) [**Manner of availability by electronic agent.**] An electronic agent has an opportunity to review a record or term only if it is made available in a manner that would enable a reasonably configured electronic agent to react to the record or term.

(c) [**When right of return required.**] If a record or term is available for review only after a person becomes obligated to pay or begins its performance, the person has an opportunity to review only if it has a right to a return if it rejects the record. However, a right to a return is not required if:

(1) the record proposes a modification of contract or provides particulars of performance under Section 305; or

(2) the primary performance is other than delivery or acceptance of a copy, the agreement is not a mass-market transaction, and the parties at the time of contracting had reason to know that a record or term would be presented after performance, use, or access to the information began.

(d) [**Right of return created.**] The right to a return under this section may arise by law or agreement.

(e) [**Agreement for future transactions.**] The effect of this section may be modified by an agreement setting out standards applicable to future transactions between the parties.

Definitional Cross References: Section 102: "Agreement"; "Copy"; "Information"; "Mass-market transaction"; "Record"; "Term".

Comment

1. Scope of this Section. This section sets out the basic standards for when a party has been given an opportunity to review the terms of a record. Unless there is an opportunity to review the record, under Section 112 the party cannot manifest assent to it.

2. Opportunity to Review. A manifestation of assent to a record or term under this Act cannot occur unless there was an opportunity to review the record or term. Common law does not clearly establish this requirement, but the requirement of an opportunity to review terms reasonably made available reflects simple fairness and establishes concepts that curtail procedural aspects of unconscionability. Section 111. For a person, an opportunity to review requires that a record be made available in a manner that ought to call it to the attention of a reasonable person and permit review. See *Specht v. Netscape Communications Corp.*, – F.3d –, 2002 WL 31166784 n. 13 (Fed. Cir. 2002). This requirement is met if the person knows of the record or has reason to know that the record or term exists in a form and location that in the circumstances permit review of it or a copy of it. For an electronic agent, an opportunity to review exists only if the record is one to which a reasonably configured electronic agent could respond. Terms made available for review during an over-the-counter transaction or otherwise in a manner required under federal law give an opportunity to review.

a. Declining to Use the Opportunity to Review. An opportunity to review does not require that the person use that opportunity. The condition is met even if the person does not read or actually review the record. This is not changed because the party desires to complete the transaction rapidly, is under pressure to do so, or because the party has other demands on its attention, unless the one party actively manipulates circumstances to induce the other party not to review the record. Such manipulation may vitiate the alleged opportunity to review.

b. Permits Review. How a record is made available for review may differ for electronic and paper records. In both, however, a record is not available for review if access to it is so time-consuming or cumbersome, or if its presentation is so obscure or oblique, as to make it difficult to review. It must be presented in a way as to reasonably permit review. In an electronic system, a record promptly accessible through an electronic link ordinarily qualifies. Actions that comply with federal or other applicable consumer laws that require making contract terms or disclosure available, or that provide standards for doing so, satisfy this requirement.

c. Right to Return. If terms in a record are not available until after there is an initial commitment to the transaction, subsection (c) indicates that ordinarily there is no opportunity to review unless the party can return the product (or for a vendor that refuses the other party's terms, recover the product) and receive appropriate reimbursement of payments if it rejects the terms. The return right creates a situation where meaningful assent can occur. The right exists only for the first licensee. If the right to a return is created only by agreement or by an offer from the one party, rather than by law, the right must be communicated to the other person so that the person ought to become aware of it.

Computer information is frequently distributed without charge for the purpose of enabling the recipient to enter into transactions with the licensor. The "beginning of performance" under subsection (c) in such cases is typically not payment, but selection of a password or other attribution procedure or the initiation of a transaction. In such situations, with respect to a right of return, the licensor's obligation is satisfied if it provides instructions on request for destruction or return of the information and, when applicable under Section 209, reimburses the other party for costs, if any. Although the party refusing terms has a reasonable time within which to contact the licensor and destroy the information, it must do so before it uses the information to select a security procedure or initiate a transaction.

There is no distinction between software distributed at a nominal price and software that is competitively priced. Therefore, if a financial or other institution distributes software at a nominal price that enables a customer to manage its personal finances or to engage in transactions with the distributor of the software, it must offer the right of return in the same manner as a company that distributes such at a market price.

The return right provides incentive for a licensor to make the terms of the license available up-front if commercially practicable since this avoids the right of return in this section and in Sections 209 and 613. An additional incentive, under Sections 208 and 209, is that, when presentation of terms is deferred, the terms cannot become part of the contract unless the other party had reason to know that terms would be presented later. A decision to delay presentation of terms without an important commercial reason to do so may result in substantial costs and uncertainty.

Failure to provide a right to return when required does not invalidate the agreement, but creates a risk that the terms will not be assented to by the party to which they were presented. If there is no manifestation of assent to a record, the terms of the agreement are determined by considering all the circumstances, including the expectations of the parties, applicable usage of trade and course of dealing, and the property rights, if any, involved in the transaction. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment. An agreement with payment and other agreed terms that reflect a right to use information for consumer purposes only cannot be transformed into an unlimited right of commercial use by a failure of assent.

3. Modifications and Layered Contracting. The right to a return provisions do not apply to proposals to modify an agreement or to cases where the agreement gives a party the right to specify particulars of performance. If the contract allows one party unilaterally to alter terms, no further agreement is required for the changed terms to be effective if the term is not unconscionable or otherwise made invalid. If that contractual right does not exist, however, and one party proposes in a record modifications of the contract (that can become effective only on the other person's agreement to them), there must be an opportunity to review the terms before a manifestation of assent pursuant to Section 112.

Similarly, the return right does not apply where parties begin performance in the expectation that a record containing contract terms will be presented and adopted later and the performance is more than merely tendering and accepting an existing copy of computer information. Subsection (c). This is common in software development and other complex contracts; this Act does not disturb that commercial practice.

4. Modification of Rules. Subsection (e) allows parties, by prior agreement, to define what constitutes assent with respect to future conduct in ongoing relationships. The parties may call for more or less formality than set out in this Act. This is important for cases where multiple transfers in electronic commerce occur pursuant to prior agreement. Assent in such cases can just as well be found in the original agreement as in the subsequent conduct.

SECTION 114. PRETRANSACTION DISCLOSURES IN INTERNET-TYPE TRANSACTIONS.

(a) [**Scope of section.**] This section applies to a licensor that makes its computer information available to a licensee by electronic means from its Internet or similar electronic site.

(b) [**Sufficient opportunity to review.**] In such a case, the licensor affords an opportunity to review the terms of a standard form license which opportunity satisfies Section 113 with respect to a licensee that acquires the information from that site, if the licensor:

(1) makes the standard terms of the license readily available for review by the licensee

before the information is delivered or the licensee becomes obligated to pay, whichever occurs first, by:

(A) displaying prominently and in close proximity to a description of the computer information, or to instructions or steps for acquiring it, the standard terms or a reference to an electronic location from which they can be readily obtained; or

(B) disclosing the availability of the standard terms in a prominent place on the site from which the computer information is offered and promptly furnishing a copy of the standard terms on request before the transfer of the computer information; and

(2) does not take affirmative acts to prevent printing or storage of the standard terms for archival or review purposes by the licensee.

(c) [**Other methods of giving opportunity to review.**] Failure to provide an opportunity to review under this section does not preclude a person from providing a person an opportunity to review by other means pursuant to Section 113 or law other than this [Act].

Definitional Cross References: Section 102: "Computer information"; "Copy"; "Electronic"; "Information"; "License"; "Licensee"; "Licensor"; "Standard form". Section 113: "Opportunity to review".

Comment

1. Scope of Section. This section deals with pre-transaction disclosures of contract terms in Internet transactions where the contract is formed on-line for an electronic delivery of information.

2. Relation to Other Assent Rules. This section provides guidance for Internet commerce and an incentive for use of particular types of disclosures of terms and acts as an incentive-creating, safe harbor rule. The section does not foreclose use of other procedures. Failure to comply with this section does not bear on whether a license is enforceable or whether the procedures used adequately establish an opportunity to review. Whether an opportunity to review has occurred is determined under the general standards in Section 113.

3. Disclosure and Downloading. The disclosure rules in this section are modeled the federal Magnuson-Moss Warranty Act. They combine actual disclosure with availability of terms. It is sufficient that standard terms be available on request. Terms might be made available by hyperlink on the particular site or through providing a potential licensee with an address (electronic or otherwise) from which the terms can be obtained. The terms to be made available are the standard terms of a license of the type involved. Supplying the terms can meet the requirements for providing an opportunity to review if the provisions of this section are met.

The terms or a reference to them must be in a prominent place in the site or in close proximity to the computer information or instructions for obtaining it. The intent of the close proximity standard is that the terms or the reference to them would be called to the attention of an ordinary reasonable person.

Given all other conditions being satisfied, this section is met if the licensor does not take affirmative steps to preclude printing or storage of the terms of the agreement. This does not require that the licensor adopt technologies that enable downloading or printing, although many technologies allow this. It does require that there be nothing affirmatively done to preclude use of one of those alternatives. For example, a licensor that uses a technology which would otherwise enable copying the contract terms and modifies it specifically to preclude copying does not qualify under the provisions of this section. However, one method of compliance is sufficient: if the terms include sensitive information that is more susceptible to unauthorized distribution if made available in electronic form, the licensor may preclude electronic copies. As long as it does not also preclude the ability to print a paper copy, this section is still satisfied. If the licensor links the person to another location under the control of a third party, knowing that affirmative steps will be taken at that location to prevent downloading or printing, there is no compliance with this section.

SECTION 115. VARIATION BY AGREEMENT.

(a) [**Variation by agreement generally.**] Except as otherwise provided in subsection (b), the effect of any provision of this [Act], including an allocation of risk or imposition of a burden, may be varied by agreement of the parties.

(b) [**Rules not variable by agreement.**] The following rules are not variable by agreement:

(1) [**Obligations of good faith, diligence, reasonableness, and care imposed by this act.**] Obligations of good faith, diligence, reasonableness, and care imposed by this [Act] may not be disclaimed by agreement, but the parties by agreement may determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.

(2) [**Unconscionability and fundamental public policy.**] The limitations on enforceability imposed by unconscionability under Section 111 and fundamental public policy under Section 105(b) may not be varied by agreement.

(3) [**Other nonvariable rules.**] Limitations on enforceability of, or agreement to, a contract, term, or right expressly stated in the sections listed in the following subparagraphs may not be varied by agreement except to the extent provided in each section:

(A) the limitations on agreed choice of law in Section 109(a);

(B) the limitations on agreed choice of forum in Section 110;

(C) the requirements for manifesting assent and opportunity for review in Section 112;

(D) the limitations on enforceability in Section 201;

(E) the limitations on a mass-market license in Section 209;

(F) the consumer defense arising from an electronic error in Section 213;

(G) the requirements for an enforceable term in Sections 303(b), 307(g), 406(b) and (c), and 804(a);

(H) the requirements of Section 304(b)(2);

(I) the limitations on a financier in Sections 507 through 511;

(J) the restrictions on altering the period of limitations in Section 805(a) and (b); and

(K) the limitations on self-help repossession in Sections 815(b) and 816.

Uniform Law Source: Uniform Commercial Code §§ 1-102(3); 1-203; 1-205(3); 2-303.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Conspicuous"; "Financier"; "Party"; "Return"; "Term". Section 112: "Manifesting assent"; Section 113: "Opportunity to Review."

Comment

1. Scope of Section. Subsection (a) sets out basic principles on the effect and meaning of an agreement. It follows Uniform Commercial Code (1998 Official Text). Subsection (b) delineates rules that cannot be varied by agreement when they are otherwise applicable.

2. Contract Choice. The fundamental policy of this Act is freedom of contract. Subsection (a). See also Uniform Commercial Code § 1-102(3), Official Comment 2 (1998 Official Text). With few exceptions, the parties' agreement controls; the effect of provisions of this Act may be varied by agreement unless the provision is expressly non-variable. This reflects fundamental contract law theory in a free market economy. The absence of the phrase "unless otherwise agreed" or similar language in any provision of this Act does not change this principle.

"Agreement" that varies the effect of a provision of this Act does not require express terms in a record; "agreement" refers to the bargain of the parties in fact and can be found in express terms as well as in course of dealing, course of performance, and usage of trade. To be enforceable, an agreement must satisfy Section 201. Of course, the agreement must be between the parties to which the provision applies. Several provisions of this Act allow a financier to finance a licensee subject to restrictions that protect rights of the licensor. An agreement between the licensee and financier cannot alter the licensor's rights. An agreement between the financier and the licensor cannot alter rights of the licensee.

Subsection (b) lists rules that override express agreement to the contrary. In each case, the policy is that the provision enacts rules that should not be altered except as indicated in those sections. Beyond this list, all other rules can be varied by agreement. Paragraph (b)(1) follows U.C.C. § 1-102(3) (1998 Official Text) and precludes complete waivers of good faith and other stated requirements, but allows parties by agreement to establish standards for performance of the obligation. Paragraph (b)(2) recognizes that unconscionability doctrine and the doctrine in Section 105(b) trump contrary agreement.

Listed exceptions to the rule that agreements govern should be sparingly applied. For example, subparagraph (b)(3)(C) prohibits variation of certain aspects of manifest assent and opportunity to

review. That is designed to protect persons who are asked to manifest assent. However, parties can agree to *greater* protections and, in appropriate cases, to *lesser* assent standards with respect to future transactions. Section 112(e).

3. Gap-filler Rules. With exceptions stated here, all rules in this Act are "default" or "gap-filler" rules that apply only in the absence of contrary agreement. This is especially important for converging industries and richly diverse commercial practice. Agreed terms that alter default rules do not require specific reference to the default rule and ordinarily do not require use of specific language, presentation or assent, unless expressly so required by this Act. In some situations, this Act expressly imposes a requirement such as that a term be conspicuous or that there be assent to the term. Such requirements exist only if expressly set forth in this Act or in consumer protection statutes. Section 104.

SECTION 116. SUPPLEMENTAL PRINCIPLES; GOOD FAITH; COMMERCIAL PRACTICE.

(a) [**Supplemental principles.**] Unless displaced by this [Act], principles of law and equity, including the law merchant and the common law of this State relative to capacity to contract, principal and agent, estoppel, duress, coercion, mistake, and other validating or invalidating cause, supplement this [Act]. Among the laws supplementing and not displaced by this [Act] are trade secret laws, unfair competition laws, and the law of fraud, misrepresentation, and unfair and deceptive practices, including pplication of such laws as they may deal with failure to disclose defects.

(b) [**Good faith.**] Every contract or duty within the scope of this [Act] imposes an obligation of good faith in its performance or enforcement.

(c) [**Commercial practice.**] Any usage of trade in the vocation or trade in which the parties are engaged or of which the parties are or should be aware and any course of dealing or course of performance between the parties are relevant to determining the existence or meaning of an agreement.

Uniform Law Source: Uniform Commercial Code " 1-102(3); 1-104; 1-203; 1-205(3); 2-303.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Course of Dealing"; Course of Performance"; "Court"; "Good faith"; "Usage of Trade".

Comment

1. Scope of Section. This section generally follows Uniform Commercial Code (1998 Official Text).

2. Supplemental Rules. Under subsection (a), common law rules to apply to transactions under this Act unless displaced by a provision or policy of this Act. The displacing effect of this Act with respect to common law is found not only in particular provisions of the Act, but also more generally in the policies adopted in the Act. Ordinarily, the appropriate source of supplemental law should be common law, rather than statutes addressing subject matter different from that in this Act. Supplementation does not mean that a common law rule overrides rules or policies in this Act, such as a policy that requires, or does not require, a particular formality or express agreement for a particular contractual result.

The list in subsection (a) is illustrative; no listing could be exhaustive. There are many broadly applicable competition, tax, regulatory, and property laws with which this Act does not deal since it is concerned with contract law. As made clear in subsection (a), trade secret law and unfair competition law are not displaced by this Act, but supplement it pursuant to the first sentence of the subsection. Thus, if trade secret or competition law renders enforcement of a contract or a contract term invalid under that law, this Act does not alter that result. A similar rule is adopted for consumer protection statutes in Section 105.

The last sentence in subsection (a) makes clear several important bodies of statutory or common law that are not displaced by the Act. Thus, trade secret laws, unfair competition laws, and the law of fraud, misrepresentation, and unfair and deceptive practices remain fully in effect and are not displaced. To the extent applicable under that body of law, concepts of fraud and unfair or deceptive practices provide a forum for analysis of the effect of material nondisclosures of known material defects in transactions under this Act. When there is a duty to disclose, the same remedies for undisclosed known defects that apply under other laws, including laws relating to goods and services if applicable, are not disturbed and continue to apply to information products. In addition, express warranties under Section 402 and implied warranties under Sections 403 to 405 of this Act may also apply and afford remedies.

This Act does not deal with computer viruses or alter existing criminal, tort, or other law on that subject. In most States, intentional introduction of a computer virus into a computer system of another person is a criminal act. See Raymond Nimmer, *Information Law* § 9.04 (1997). Any remedy in contract, however, must be based on an agreement. Absent agreement, no basis for allocating risk under contract principles exists and this Act leaves the issue to other law.

3. Good Faith. Subsection (b) follows Uniform Commercial Code § 1-203 (1998 Official Text), but this Act adopts a broader definition of "good faith." See U.C.C. § 2-103(1)(b) (1998 Official Text); U.C.C. § 3-103(a)(4) (1998 Official Text). Good faith is relevant to the performance of all contracts within the scope of this Act. Good faith is defined in Section 102.

While good faith in performance is an element of all contracts under this Act, the obligation of good faith does not override express contract terms or the right to enforce them. See *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin*, 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wn.2d 563, 807 P.2d 356 (1991). A lack of good faith is not shown simply by the fact that the party insisted on compliance with contract terms. Neither the idea of honesty nor the idea of fair dealing alters the rule that the obligation of good faith does not override or create new contractual obligations. *Ohio Casualty Company v. Bank One*, 1997 WL 428515 (N.D. Ill. 1997).

This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, a failure to perform or enforce in good faith a specific duty or obligation under the contract is a breach of that contract. The doctrine of good faith directs a court to interpret contracts within the commercial context in which they are created, performed, and enforced, rather than creating a separate duty of fairness and reasonableness which can be independently breached. See PEB Commentary No.10.

4. Usage of Trade, etc. There are two ideas in subsection (c).

First, terms of an *agreement* must be defined in light of the commercial context in which the transaction occurs. This principle derives from U.C.C. § 1-205 (1998 Official Text). The terms of an agreement can be as easily found in express contractual language as in the commercial context, such as usage of trade, course of dealing and course of performance.

Second, these commercial factors also provide the background and give meaning to language used. The meaning of the terms of an agreement must be interpreted in light of practical considerations that reflect common commercial understanding. Abstract concepts about what an agreement should mean are not as important as are grounded interpretations of what an agreement does mean in context. Section 302.

SECTION 117. DECISION FOR COURT; LEGAL CONSEQUENCES; REASONABLE TIME; REASON TO KNOW.

(a) [**Decision for court.**] Questions to be determined by the court include (i) whether a term is conspicuous, (ii) whether a term is enforceable under Section 105(a), (b), or (c), 110, 111, or 209(a), and (iii) whether an attribution procedure is commercially reasonable or effective under Section 108, 212, or 213.

(b) [**Legal consequences.**] Whether an agreement has legal consequences is determined by this [Act].

(c) [**Reasonable time.**] Whenever this [Act] requires any action to be taken within a reasonable time, the following rules apply:

(1) [**Nature of circumstances controls.**] What is a reasonable time for taking the action depends on the nature, purpose, and circumstances of the action.

(2) [**Manifestly unreasonable term precluded.**] Any time that is not manifestly unreasonable may be fixed by agreement.

(d) [**Reason to know.**] A person has reason to know a fact if the person has knowledge of the fact or, from all the facts and circumstances known to the person without investigation, the person should be aware that the fact exists.

Comment

1. Issues as a Matter for the Court. As to unconscionability and conspicuousness, subsection (a) follows Uniform Commercial Code § 1-201(10) and 2-302 (1998 Official Text) and common law on what issues are reserved for decision by a court. In addition, the section lists other issues that are also made questions for the court. The list is not exclusive. There may be further issues that are

questions for the court based on the terms of the relevant section or applicable case law or procedural rules.

2. Legal Effect. Subsection (b) derives from Uniform Commercial Code Article 1, moving this rule from the definition of "agreement" to a separate substantive section, with no substantive change in law.

3. Reasonable Time. Subsection (c) derives from Uniform Commercial Code § 1-204 (1998 Official Text). Reasonable time, when used in this Act, is gauged by the commercial context. As in the U.C.C., nothing is stronger evidence of a reasonable time than the fixing of such time by an agreement between the parties. However, a court may disregard a contractual term which fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not manifestly unreasonable as judged at the time of contracting. The agreement that fixes the time need not be part of the main agreement, but may be separate. By virtue of the definition of "agreement," the circumstances of the transaction, including course of dealing, course of performance, and usage of trade may be material.

4. Reason to Know. This concept is consistent with *Restatement (2d) Contracts* § 19, comment b. A person has reason to know a fact if the person has information from which a reasonable person would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. The person is charged with commercial knowledge of any factors in a particular transaction that in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing and widespread business practice. If a person has specialized knowledge or superior intelligence, reason to know is determined in light of whether a reasonable person with that knowledge or intelligence would draw the inference that the fact does or will exist. There is also reason to know if, from all the circumstances, a person exercising reasonable caution regarding the matter in question would infer that there is such a substantial chance that the fact does or will exist that the person would predicate its actions on the assumption of its existence.

"Reason to know" must be distinguished from knowledge. Knowledge means an actual conscious belief in or awareness of a fact. Reason to know need not entail a conscious belief in or awareness of the existence of the fact or its probable existence in the future. Of course, a person that has knowledge of a fact also has reason to know of its existence. Reason to know is also to be distinguished from "should know." "Should know" imports a duty to ascertain facts; the term "reason to know" does not entail or assume an obligation to investigate, but is determined solely by the information available to the party. The latter term is used where the person would not be acting adequately in protecting its own interests if it did not act in light of the facts of which it had reason to know.

SECTION 118. TERMS RELATING TO INTEROPERABILITY AND REVERSE ENGINEERING.

(a) [**Interoperability defined.**] In this section, "interoperability" means the ability of computer programs to exchange information and of such programs mutually to use the information that has been exchanged.

(b) [**Contractual term unenforceable.**] Notwithstanding the terms of a contract subject to this [Act], a licensee that lawfully obtained the right to use a copy of a computer program may identify, analyze, and use those elements of the program necessary to achieve interoperability of an independently created computer program with other programs, including adapting or modifying the licensee's computer program, if:

(1) the elements have not previously been readily available to the licensee;

(2) the identification, analysis, or use is performed solely for the purpose of enabling such interoperability; and

(3) the identification, analysis, or use is not prohibited by law other than this [Act].

(c) [**Applicability of Section 105.**] Identification, analysis, or use of elements of a computer program for a purpose other than described in this section is governed by Section 105(b), if applicable.

Uniform Law Source: None.

Definitional Cross-References: Section 102: "Computer program"; "Copy"; "Information"; "Licensee".

Comment

1. Scope of the Section. This section provides that contract terms cannot preclude a licensee from undertaking certain steps to analyze a copy of a computer program for purposes of achieving interoperability, as defined herein. The section was added to the Act in the 2002 Amendments.

2. Reverse Engineering. This section deals with a sensitive issue in technology industries and with a practice typically described as "reverse engineering" here and in the Digital Millennium Copyright Act (DMCA). That practice involves close examination of a product that has been purchased in order to discern technological or other information that is discoverable from that product. Where that technology is not protected by copyright, patent or similar law, and the product is sold on the open market, under trade secret law reverse engineering is recognized as a proper means of acquiring information.

3. Fundamental Public Policy Aspects. A public policy that supports allowing reverse engineering of products distributed on the open market has been recognized in several sources. For example, the Supreme Court has described the ability to reverse engineer products sold on the public market as a fundamental part of intellectual property policy. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 US 141 (1989). Similarly, while the DMCA prohibits circumvention of technological devices that control access to a copyrighted work, it recognizes a policy not to prohibit some reverse engineering where it is needed to obtain interoperability of computer programs. 17 U.S.C. § 1201 (f) (1999) ("a person who has lawfully obtained the right to use a copy of a computer program may circumvent a technological measure . . . for the sole purpose of identifying and analyzing those elements of the program that are necessary to achieve interoperability of an

independently created computer program with other programs, and that have not previously been readily available to the person engaging in the circumvention, to the extent any such acts of identification and analysis do not constitute infringement under this title."). The DMCA rule does not exempt conduct that constitutes copyright infringement and this section does not do so either. Case law with respect to copyright infringement, however, holds that certain forms of reverse engineering are fair use at least in cases where the party engaging in the reverse engineering owns the copy that it examines. See *Sega Enters. Ltd. v. Accolade, Inc.*, 977 F.2d 1510 (9th Cir. 1992); *Atari Games Corp. v. Nintendo of Am.,* 975 F.2d 832 (Fed. Cir. 1992). Compare *Triad Sys. Corp. v. Southeastern Express Co.*, 64 F.3d 1330 (9th Cir. 1995).

In cases where a contract term is involved and enforceability of that term is the issue, these fair use decisions are only indirectly relevant. Neither DMCA, nor the copyright case law, however, deals with the enforceability of contract terms on reverse engineering. The existence of a contract introduces additional fundamental public policy concerns about the general enforceability of agreements and these policies may support enforcement of the term. See *Bowers v. Baystate Technologies, Inc*., 302 F.3d 1334 (Fed Cir, 2002). This section states one context in which the balance of interests favors invalidating the contract term. Similarly a European Union Software Directive permits reverse engineering despite a contrary contract clause if the reverse engineering is needed for interoperability, is permitted under other law (e.g., trade secret, copyright, etc.), and involves obtaining interoperability information that is not otherwise readily available.

4. Impact of this Section. This section makes ineffective contract terms that would prevent reverse engineering in certain situations. It is the first time in the United States that a law has extended the underlying policy discussed here to invalidate a contract term. Compare *Bowers v. Baystate Technologies, Inc*., 302 F.3d 1334 (Fed Cir, 2002). In cases of reverse engineering for purposes other than those covered in this section, subsection (c) makes clear that the general Section 105(b) rule provides the appropriate framework for analysis. See U.S. Copyright Office, Exemption to Prohibition on Circumvention of Copyright Systems for Access Control Technologies, 65 Fed. Reg. 64,556, 64,569 (Oct. 27, 2000) (discussing reverse engineering under DMCA).

5. Protected Conduct. The scope of protection under this section is patterned after the DMCA. 17 U.S.C. § 1201(f), as quoted above. In the circumstances outlined in this section and the DMCA, reverse engineering for purposes of interoperability by a person with a lawful right to use the copy being examined cannot be prohibited by contract. This protection, of course, does not extend to a thief or other person without a lawful right to use the copy.

a. The reverse engineering must be for interoperability as described in subsection (a). Because of the interactive nature of modern digital systems, the capability of competitors creating interoperable products serves an important public policy in the development and evolution of computer and communications systems. The public policy support for reverse engineering is most powerful in this context because of the nature of the environment in which computer information is used.

b. Additionally, under paragraph (b)(1), the reverse engineering must be necessary in the sense that the information is not otherwise readily available. In determining whether information is readily available, a court should examine interpretations of that phrase under the DMCA.

c. This section does not apply if the conduct involved is precluded by other law. Thus, for example, if the licensee's conduct would be a copyright or patent infringement or a misappropriation under trade secret law, then this section does not invalidate the contract term. Cases on the copyright implications of reverse engineering should be consulted where the copy of the computer information contains a work protected under copyright law.

PART 2

FORMATION AND TERMS

[SUBPART A. FORMATION OF CONTRACT]

SECTION 201. FORMAL REQUIREMENTS.

(a) [**General rule.**] Except as otherwise provided in this section, a contract requiring payment of a contract fee of $5,000 or more is not enforceable by way of action or defense unless:

(1) the party against which enforcement is sought authenticated a record sufficient to indicate that a contract has been formed and which reasonably identifies the copy or subject matter to which the contract refers; or

(2) the agreement is a license for an agreed duration of one year or less or which may be terminated at will by the party against which the contract is asserted.

(b) [**Sufficiency of record.**] A record is sufficient under subsection (a) even if it omits or incorrectly states a term, but the contract is not enforceable under that subsection beyond the number of copies or subject matter shown in the record.

(c) [**Exceptions.**] A contract that does not satisfy the requirements of subsection (a) is nevertheless enforceable under that subsection if:

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

(2) the party against which enforcement is sought admits in court, by pleading or by testimony or otherwise under oath, facts sufficient to indicate a contract has been made, but the agreement is not enforceable under this paragraph beyond the number of copies or the subject matter admitted.

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

after the confirming record is received.

(e) [**Agreement for future transactions.**] An agreement that the requirements of this section need not be satisfied as to future transactions is effective if evidenced in a record authenticated by the person against which enforcement is sought.

(f) [**Other laws inapplicable.**] A transaction within the scope of this [Act] is not subject to a statute of frauds contained in another law of this State.

Uniform Law Source: Uniform Commercial Code: Section 2A-201 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Information"; "License"; "Merchant"; "Notice"; "Party"; "Receive"; "Record"; "Term". Section 117: "Reason to know".

Comment

1. Scope of the Section. This section requires an authenticated record for enforceability of certain agreements. The section blends Uniform Commercial Code concepts with common law approaches. Failure to comply with the requirements of this section does not make the contract void, it merely precludes a party from relying on it as a defense or to bring a cause of action. Under subsection (e), EDI trading partner and similar authenticated records satisfy this section. The rules in this section also apply to agreements brought within this Act by an agreement.

2. Relationship to Federal Law. Federal intellectual property law may require formalities for enforceability of a contract. These federal rules are not affected by this Act. Section 204(a) of the Copyright Act, for example, requires a signed writing for "transfers of copyright ownership," which include assignments and certain other transactions. See *Konigsberg International v. Rice* 16 F.3d 355, 357 (9th Cir. 1994); *Library Publications, Inc. v. Medical Economics, Co.*, 548 F. Supp 1231 (E.D. Penn 1982). In general, state law controls regarding non-exclusive licenses. See, e.g., *Advent Systems, Ltd. v. Unisys Corp.* 925 F.2d 670 (3rd Cir 1991); *World Championship Wrestling, Inc. v. GJS Intern., Inc.,* 13 F.Supp.2d 725 (N.D. Ill. 1998). *Friedman v. Select Information Systems, Inc.*, 221 U.S.P.Q. 848 (N.D. Cal. 1983). Compare *Lulirama, Ltd. v. Axcess Broadcast Services* 128 F.3d 872, 879 (5th Cir. 1997); *I.A.E., Inc. v. Shaver*, 74 F.3d 768, 775 (7th Cir. 1996). If federal law applies, the requirements of that law must be met. *See, e.g., Radio Television Espanola S.A. v. New World Entertainment*, 183 F.3d. 922 (9th Cir. 1999).

3. Basic Rule. Subject to stated exceptions, under subsection (a) an agreement requiring payment of a contract fee of $5,000 or more is not enforceable by way of action or defense unless there is an authenticated record indicating that a contract was formed and reasonably describing the subject matter or copy. The payments must be *required* under the agreement assuming that full performance occurs. A royalty provision that might (or might not) ultimately yield millions of dollars of revenue is not within this rule unless the agreement calls for a minimum payment of $5,000 or more. Similarly, an option that might trigger an additional payment is not relevant unless the payment is mandatory.

a. Over One Year Rule. For a license, a record is required only if the threshold dollar amount is met and the license grants rights for an agreed term of more than one year. This reflects the common law statute of frauds, which centers on the duration of the contract, and the

fact that for licenses the duration of rights is a significant, independent measure of value. A license for a perpetual duration exceeds one year as would any license that designates a term longer than one year, even if the license permits termination by a party for a reason before that time. However, an option to extend the duration of the license does not bring the contract within the statute unless the option is mandatory. A license that is subject to termination at will does not exceed a one year duration. This rule refers to the term of the license, not to associated agreements. Thus, a license for a perpetual term is within this section even if it is accompanied by a support agreement that can be terminated at will.

b. Record Required. A record, when required, must 1) indicate that a contract was formed, 2) reasonably identify the copy or subject matter involved, and 3) have been authenticated by the party against whom the contract is asserted. No other formalities are required.

This section does not require that the record be retained or that it contain all material terms of the contract or even that it be designated as a contract. All that is required is that the record afford a basis for believing that offered oral evidence rests on a real agreement. A memorandum that fulfills the conditions suffices. But the record must indicate that a contract was formed, not merely that a contract was being negotiated.

Merely because a record satisfies this section does not establish that a contract exists. Nor does it establish the terms of the contract, which must be determined under other sections of this Act. Fulfilling this section merely removes the formal barrier of this section and allows a party to assert the existence of a contract as a basis for a cause of action or a defense. For the contract to actually exist, contract formation rules must be met. For example, while a record need not describe all of the scope of a license to meet this section, there is no contract if there is a material dispute about scope. Section 202. Satisfying the statute of frauds is merely a gateway to being able to have a court consider whether or not there is a contract.

c. Authenticated. Under the general rule, and subject to exceptions provided in this section, the record must be authenticated by the party to be bound. See Section 108 regarding proof of authentication.

d. Subject Matter or Copy. The record must describe the "copy" or "subject matter" covered. "Subject matter" refers to the topic of the agreement; that is, the computer information to which the agreement relates, e.g., the name of a information product, the type of program to be developed, the database to which access is given, or other identifying descriptions. This does not require a description of the detailed scope of a license or of all terms important to the contract. For example, in a license to use a digital photograph, a reference to a "photograph of Greenacre" suffices even if the record does not describe the rights granted. There is no requirement that the record describe the contract fee.

"Copy" refers to the particular copy (e.g., "the copy demonstrated on June 1") or to a copy of identified computer information. The description must identify the copy in a manner that distinguishes it from other copies or from copies of other information. A record is adequate for this purpose if it refers to "one copy of Word Perfection." However, a record that refers to "one copy" without designating what computer information is on the copy is inadequate.

Subsection (b) adapts a rule from Uniform Commercial Code § 2-201 (1998 Official Text). The required description of a copy or subject matter cannot be defeated for purposes of the statute of frauds by showing that it was incorrect. However, the contract is not enforceable beyond the number of copies or subject matter shown in the authenticated record. Both terms are limitations on enforcement. Thus, a record which refers to "one copy of Word Essence" cannot be enforced beyond one copy of that program. A record that refers to "access to Whisedata" cannot be enforced beyond access to that database and does not support an enforceable right to any copies of it. A term that states "one copy," but does not say of what, fails this section entirely. A term that states "Wordperfection" may allow proof of a contract for enforceable rights in that work, but does not allow enforcement of any contract rights in or to any copies of the work.

4. Exceptions to the Basic Rule. There are four exceptions to the basic rule based on transactional circumstances that render the protective policies of this section moot.

a. Partial Performance. Under subsection (c)(1), the requirements of subsection (a) are not imposed if there was a tender of performance by one party and acceptance or access by the other. Here, the acts by both parties adequately establish that a contract *may* exist; the authenticated record of subsection (a) is unnecessary. Partial performance satisfies the statute of frauds in full, rather than solely with respect to the performance itself. Parol evidence rules and ordinary contract interpretation principles protect against unfounded claims of extensive contract obligations based on a tender and acceptance of limited performance.

The exception requires both tender and acceptance or access. Mere possession of a copy does not satisfy this exception, which depends on there being an authorized source that delivered the copy. Similarly, the performance tendered and accepted must be sufficient to show that a contract exists and cannot consist of minor acts of ambiguous nature. Thus, mere access to information at an Internet web site does not satisfy the statute of frauds when there is no indication that a contract exists or that the access resulted in assent to contract terms. Section 112.

Performance under this subsection merely allows the party to attempt to prove the existence of a contract. It does not prove that a contract exists or what terms govern. These must be established under other provisions of this Act. For example, in an alleged contract to develop and deliver three modules of a new computer program, tender and acceptance of one module satisfies the formalities required by the section, but whether there was actually a contract covering three modules must be proven by the party claiming that it exists.

b. Judicial Admissions. An authenticated record is not needed if the party charged with the contract obligations admits in proceedings that a contract exists. The admission confirms the existence of the contract to the extent of the subject matter admitted. Consistent with U.C.C. Article 2 (1998 Official Text), however, the admission satisfies the section only to the extent of the subject matter or copies admitted.

c. Confirming Memoranda. Subsection (d) generally follows U.C.C. § 2-201 (1998 Official Text). Between merchants, failure to respond to a record that confirms may satisfy this section with respect to both parties. The ten day rule in U.C.C. Article 2 is replaced in this Act by a "reasonable time" to better accommodate varying commercial practices. The rule in subsection (d) validates practice in many industries where the volume or nature of the transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum places the other party on notice that a contract has been formed. It must object to the existence of a contract if one, in fact, does not exist or otherwise lose protection of this section. Failure to object does not establish that a contract exists or what are the terms, but merely removes the formal barrier in subsection (a). The burden of persuading a trier of fact that a contract was actually made is not affected by this rule.

5. Other Agreements. Subsection (e) confirms the enforceability of trading partner or similar agreements that alter the requirements of this section with respect to covered transactions. The parties can agree in an authenticated record to conduct business without additional authenticated records. That agreement satisfies the policy of requiring minimal indication that a contract was formed. The purpose of this section is to prevent fraud, not to inhibit development of reasonable commercial practices between parties.

6. Other Laws. Subsection (f) clarifies that the formalities required by this section supplant formalities required under other state laws for transactions within this Act. This rule applies only with respect to state law. Federal law may require more stringent formalities. For example, the Copyright Act requires that an exclusive copyright license be in a writing and makes non-exclusive licenses that are not in a writing subject to subsequent transfers of the copyright.

SECTION 202. FORMATION IN GENERAL.

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

(b) [**Sufficiency of agreement.**] If the parties so intend, an agreement sufficient to constitute a contract may be found even if the time of its making is undetermined, one or more terms are left open or to be agreed on, the records of the parties do not otherwise establish a contract, or one party reserves the right to modify terms.

(c) [**Open terms.**] Even if one or more terms are left open or to be agreed upon, 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) [**Material disagreement precludes formation.**] In the absence of conduct or performance by both parties to the contrary, a contract is not formed if there is a material disagreement about a material term, including a term concerning scope. For purposes of this subsection, the material disagreement must exist at the time of attempted contracting and may not involve a later dispute about the meaning of agreed terms.

(e) [**Contract conditional on later agreement.**] If a term is to be adopted by later agreement and the parties intend not to be bound unless the term is so adopted, a contract is not formed if the parties do not agree to the term. In that case, each party shall deliver to the other party, or with the consent of the other party destroy, all copies of information, access materials, and other materials received or made, and each party is entitled to a return with respect to any contract fee paid for which performance has not been received, has not been accepted, or has been redelivered without any benefit being retained. The parties remain bound by any restriction in a contractual use term with respect to information or copies received or made from copies received pursuant to the agreement, but the contractual use term does not apply to information or copies properly received or obtained from another source.

Uniform Law Source: Uniform Commercial Code: Sections 2-204; 2-305(4); 2A-204 (1998

Official Text).

Definitional Cross References: Section 102: “Agreement”; “Contract”; “Contract fee”; “Contractual use term”; “Deliver”; “Electronic agent”; “Information”; “Licensee”; “Licensor”; “Party”; “Record”; “Receive”; “Scope”; “Term”.

Comment

1. Scope of Section. This Act separates the issue of whether a contract is formed from issues of what the terms of the contract are or whether those terms are enforceable. This section deals with contract formation. It is subject to the specific rules on offer and acceptance in subsequent sections. Sections 208, 209, and 210 deal with establishing the terms of a contact by an agreed record or by conduct. Often, of course, the same acts that form a contract define its terms.

2. Manner of Formation. Subsection (a) follows Uniform Commercial Code § 2-204 (1998 Official Text), the *Restatement (Second) of Contracts* ' 19, and common law in most States. A contract can be formed in any manner sufficient to show agreement: orally, in writing, by conduct or inaction or otherwise. Of course, no contract is formed without an intent to contract. This section does not impose a contractual relationship where none was intended. In determining whether or not conduct or words establish a contract, courts must look to the entire circumstances, including applicable usage of trade or course of dealing.

Subsection (a) recognizes that an agreement can be formed by operations of electronic agents. This is important for electronic commerce and gives force to choices by a party to use an electronic agent for formation of a contract. The agent’s operations bind the person who deployed the agent for that purpose.

3. Time of Formation. Subsection (b) follows U.C.C. § 2-204 (1998 Official Text). If the intent to do so exists, a contract can be formed even though the exact time of its formation is not known or there are terms left open or deferred for later delineation by one party. This rule exists in both the U.C.C. and common law. It focuses on the commercial context and on whether there was an intent to contract, rather than on whether the form or format of an exchange complies with abstract concepts of when a contract should be recognized in law.

4. Open Terms and Layered or Rolling Transactions. Under subsection (c), if the parties intend to be bound, the agreement is binding despite missing or otherwise open terms, so long as any reasonable basis exists for granting a remedy in the event of breach. This rule does not apply if the parties do not intend to be bound unless or until the remaining terms are agreed or reduced to writing. See, e.g., *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2d Cir. 1998) (applying New York law). There is a difference between preliminary negotiations and actions or statements made with intent to be bound, even though terms are left open. If the parties did not intend to be bound unless terms were later agreed to and there was no later agreement, subsection (e) gives guidance for unwinding the relationship. In law, when a contract is formed and how terms are added over time turns on the intent of the parties. In determining that intent, the more terms left open, the less likely it is that the parties intended to be bound at the outset.

This subsection lays a foundation for the layered contracting that typifies many areas of commerce and is recognized in Uniform Commercial Code § 2-204 (1998 Official Text), as well as in the common law and practice of most States. This foundation is further developed in Sections 208, 209, 304, and 305. Many contract terms are intended, expressly or by usage of trade or the like, to be defined over time, rather than on the occurrence of one specific event. Contract formation is often a process, rather than a single event. A rule that a contract must arise at a single point in time and that this single event defines all the terms of the contract is

inconsistent with commercial practice. Contracts are often formed over time; terms are often developed during performance, rather than before performance occurs. Often, parties expect to adopt records later and that expectation itself is the agreement. Rather than modifying an existing agreement, these terms are part of the agreement itself. Treating later terms as proposed modifications is appropriate only if the deal has previously been, in the commercial understanding of both parties, fully closed with no reason to know that new terms would be provided.

During the time in which terms in a layered contract are developed or to be proposed, it is not appropriate to the apply default rules of this Act. The default rules apply only if the agreement of the parties does not deal with the subject matter of the rule. In layered contracting, the agreement is that there are no terms on the undecided issues until they are made express by the parties. Applying a default rule would be applying the rule despite contrary agreement, rather than when no such agreement exists.

5. Disagreement on Material Terms: Scope. The existence of a contract requires a determination of intent to contract, objectively measured. In some cases, the circumstances clearly indicate that no intent to contract exists. Subsection (d) sets out one such context. A material disagreement about an important (material) term indicates that there is no intent to enter a contract. The "scope" of a license is one such term. It goes to the fundamentals of the transaction, i.e., what the licensor intends to transfer and what the licensee expects to receive. Disagreements about this fundamental issue indicate fundamental failure to agree on a contract. The reference in subsection (d) to disagreement relates to this type of failure to agree and does not refer to a later dispute about the meaning of an agreed term, a point made clear in the second sentence of subsection (d).

6. Failure to Agree. Subsection (e) follows Uniform Commercial Code § 2-305(4) (1998 Official Text). While many cases involve layered contracting, the parties may intend not to be bound unless they agree to terms later. See Section 208, Official Comment 4. Subsection (e) deals with cases where that later agreement does not occur. The basic rule is that parties are returned to the status that would have existed in the absence of initial agreement. There is an obligation to return copies or information received during the preliminary period. Any contractual use terms in the proposed final deal do not apply because no contract was formed. If, however, the parties agreed to restrictions on the information or copies as part of the process of negotiation or discussion, the restrictions continue as to that information or those copies. The restrictions must be agreed to independent of agreement on the entire proposed contract. This often occurs with terms on nondisclosure of confidential material exchanged in preliminary discussions.

The continued effect of such terms assumes an agreement in fact. Thus, a negotiation involving two mutually conditional points only one of which is "agreed to" may not create a contractual use term if the two are mutually condition and no agreement is reached on the second. In any event, the terms do not extend to authorized copies obtained from *other* sources. For example, a preliminary agreement restricting use of data compression software is binding as to the copies delivered, but it does not preclude the licensee from making an agreement with another authorized source for a copy of the same software. Of course, in addition to contract terms, intellectual property rights may limit a party's use of information.

SECTION 203. OFFER AND ACCEPTANCE IN GENERAL. Unless otherwise unambiguously indicated by the language or the circumstances, the following rules apply:

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

(2) [**Acceptance by shipment or promise to ship.**] An order or other offer to acquire a copy for prompt or current delivery invites acceptance by either a prompt promise to ship or a prompt or current shipment of a conforming or nonconforming copy. However, a shipment of a nonconforming copy is not an acceptance if the licensor seasonably notifies the licensee that the shipment is offered only as an accommodation to the licensee.

(3) [**Acceptance by beginning performance.**] If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance or performance within a reasonable time may treat the offer as having lapsed before acceptance.

(4) [**Electronic acceptance.**] If an offer in an electronic message evokes an electronic message accepting the offer, a contract is formed:

(A) when an electronic acceptance is received; or

(B) if the response consists of beginning performance, full performance, or giving access to information, when the performance is received or the access is enabled and necessary access materials are received.

Uniform Law Source: Restatement (Second) of Contracts § 19; Uniform Commercial Code §§ 2A-206; 2-206 (1998 Official Text).

Definitional Cross References: Section 102: "Access Materials"; "Copy"; "Contract"; "Delivery"; "Electronic"; "Electronic message"; "Licensee"; "Licensor"; "Information"; "Notifies"; "Party"; "Receive"; "Term".

Comment

1. Scope of Section. This section states general rules on offer and acceptance. Sections 204 and 205 concern acceptances that vary the offer and conditional offers or acceptances; when applicable, those sections control over this section to the extent of a conflict.

2. Reasonable Methods of Acceptance. A party has a right to control the terms under which its offer can be accepted, if it does so expressly. In many cases, this occurs by insistence on agreement to all terms or on following a stated method for acceptance. If an offeror does not limit the method of acceptance, any reasonable manner of acceptance suffices. This rule reflects ordinary practice and follows *Restatement (Second) of Contracts* § 19 and Uniform Commercial Code § 2-206 (1998 Official Text).

3. Shipment or Promise to Ship. Paragraph (2) follows Uniform Commercial Code § 2-

206(1)(b) (1998 Official Text). Either a shipment or a prompt promise to ship the copy is a proper means of acceptance of an offer looking to current shipment of a copy, unless the offer otherwise states. The second sentence recognizes that, in some cases, it is useful commercially to accommodate a request for a copy with a shipment that may not fully conform. In such cases, there is no acceptance of the offer if the shipping party notifies the licensee that the shipment is offered only as an accommodation. Paragraph (2) has more limited application in this Act than Article 2. It applies only to contracts that call solely for a return performance by shipment of a copy. It does not apply to a license of information since the terms of the license are not set by shipment itself.

4. Beginning of Performance. The beginning of performance by an offeree can be an acceptance if it unambiguously indicates an intent to be bound. Paragraph (3) follows Uniform Commercial Code § 2-206 (1998 Official Text) in limiting that effect to prevent abuse. Beginning performance as acceptance, even if a reasonable means of acceptance, requires notice to the offeror that there has been acceptance. If notice is not given in a reasonable time, the offeror can treat its offer as having lapsed before acceptance.

5. Electronic Responses. Paragraph (4) adopts a time of receipt rule for an electronic acceptance or an electronic performance. The performance may entail making access available to the other party. In this case, acceptance by performance occurs when the access is enabled or access materials are received.

SECTION 204. ACCEPTANCE WITH VARYING TERMS.

(a) [**When acceptance materially alters offer.**] An acceptance materially alters an offer if it contains a term that materially conflicts with or varies a term of the offer or that adds a material term not contained in the offer.

(b) [**When contract formed by varying acceptance.**] Except as otherwise provided in Section 205, a definite and seasonable expression of acceptance operates as an acceptance, even if the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially alters the offer.

(c) [**Effect of acceptance materially altering offer.**] If an acceptance materially alters the offer, the following rules apply:

(1) [**When contract formed.**] A contract is not formed unless:

(A) a party agrees, such as by manifesting assent, to the other party's offer or acceptance; or

(B) all the other circumstances, including the conduct of the parties, establish a

contract.

(2) [**Contract formed by conduct.**] If a contract is formed by the conduct of both parties, the terms of the contract are determined under Section 210.

(d) [**Effect of acceptance not materially altering offer.**] If an acceptance varies from but does not materially alter the offer, a contract is formed based on the terms of the offer. In addition, the following rules apply:

(1) [**Conflicting terms.**] Terms in the acceptance which conflict with terms in the offer are not part of the contract.

(2) [**Additional terms.**] An additional nonmaterial term in the acceptance is a proposal for an additional term. Between merchants, the proposed additional term becomes part of the contract unless the offeror gives notice of objection before, or within a reasonable time after, it receives the proposed terms.

Uniform Law Source: Uniform Commercial Code: Section 2-207.

Definitional Cross References: Section 102: "Contract"; "Delivery"; "Merchant"; "Give notice"; "Party"; "Receive"; "Seasonable"; "Term". Section 112: "Manifest assent". Section 117: "Reasonable time."

Comment

1. Scope of Section. This section deals with contract formation when the acceptance contains terms that vary the offer, but neither the offer nor the acceptance is expressly conditional on acceptance of all of its own terms. Conditional offers and acceptances are covered in Section 205.

2. Basic Rule. Subsection (a) follows Uniform Commercial Code § 2-207(1) (1998 Official Text). If neither the offer nor the acceptance is expressly conditioned on acceptance of its own terms, a definite expression of acceptance may form a contract even if it contains terms that do not fully match the offer. The common law "mirror image" rule was rejected in Article 2 and is not now followed as common law in many states.

If a purported acceptance varies from the offer, however, it forms a contract only if the accepting party indicated an intent to form the contract and enough similarity exists between the acceptance and the offer to conclude that acceptance occurred. An acceptance with varying terms must be a *definite* expression of *acceptance.* Anything less is a counter-offer or, perhaps, mere negotiation. Also, a response is not an acceptance if it materially alters the offer. One does not accept by proposing materially different terms. The conditions for treating a response that contains varying terms as an acceptance are seldom met except in cases of standard form purchase orders or invoices. In most other cases, a response with varying terms is a counter-offer, not an acceptance.

3. Material Alteration. A material alteration of an offer by a purported acceptance

precludes contract formation based on the purported acceptance. If a contract is formed in such cases, it must be based on other factors, such as conduct that establishes a contract, another acceptance conforming to the terms of an offer, or other circumstances that clearly show that one party accepted the terms of the other.

What is a material alteration depends on the commercial context. A nonmaterial alteration refers to an acceptance that adds further minor suggestions or proposals. A material change is one that would result in surprise, hardship or fundamental change if incorporated without express agreement by the other party, or one that would significantly alter the bargain proposed by the offeror. The issue must be judged by what degree of acceptable variation parties might reasonably expect in light of applicable usage of trade and course of dealing. Any change in an offer that is expressly conditional on acceptance of all of its terms is a material change.

4. Immaterial Alteration. If a definite acceptance does not fully conform to the terms of the offer but does not materially vary it, the acceptance creates a contract. In deciding what are the terms of the contract, Section 210 does not apply, because the contract is formed by offer and acceptance, not conduct. Under subsection (d), the terms are based on the terms of the offer and other terms as indicated. Conflicting terms in the acceptance are excluded. A conflicting term is one that covers the same subject matter of another term, but in a different way. Subsection (d) allows for inclusion of non-material *additional* terms in a transaction between merchants unless the offeror timely objects to those terms. An additional term is one that covers a subject not addressed in the offer.

SECTION 205. CONDITIONAL OFFER OR ACCEPTANCE.

(a) [**When offer or acceptance conditional.**] An offer or acceptance is conditional if it is conditioned on agreement by the other party to all the terms of the offer or acceptance.

(b) [**Effect of conditional offer or acceptance.**] Except as otherwise provided in subsection (c), a conditional offer or acceptance precludes formation of a contract unless the other party agrees to its terms, such as by manifesting assent.

(c) [**Conditional offer or acceptance in standard form.**] If the offer and acceptance are in standard forms and at least one form is conditional, the following rules apply:

(1) [**Acts consistent with conditions.**] Conditional language in a standard term precludes formation of a contract based on the offer or acceptance if the actions of the party proposing the form are consistent with the conditional language, such as by refusing to perform, refusing to permit performance, or refusing to accept the benefits of the agreement, until its proposed terms are accepted.

(2) [**Agreement to conditions.**] A party that agrees, such as by manifesting assent,

to a conditional offer that is effective under paragraph (1) adopts the terms of the offer under Section 208 or 209, except for a term that conflicts with an expressly agreed term regarding price or quantity.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Party"; "Standard form"; "Term". Section 112: "Manifestation of assent".

Comment

1. Scope of Section. This section deals with conditional offers or acceptances. In a conflict between this section and general rules on formation, this section controls as to these issues.

2. Basic Rule. Subsection (a) states the basic principle that a person can insist on preconditions for acceptance of its offer without being forced into a different relationship because the conditions are ignored. The most common conditional offer or acceptance limits the other party to acceptance of all of its terms. No principled view of contract law precludes a party from insisting on such conditions and precluding a contract on other terms. The language of condition need not be in a record or stated in any specific form of language.

3. Standard Forms. The rule does not change merely because the conditions are in a standard form. Conditional forms state the terms under which a party is willing to enter a transaction. The mere fact that the conditions are not tailored to each individual deal does not lessen their effect. Standardization is an ordinary and efficient means of doing business.

4. Battle of Standard Forms. Subsection (b) deals with a situation where both parties use standard forms for offer and acceptance *and* one or both are conditioned on acceptance of all terms in the form. In that case, if the forms disagree, there is no contract based on the standard forms. However, the parties often act as if a contract exists and that behavior may form a contract.

Under subsection (b), the conditional language in a standard form is enforced only if a party proposing the form acts in a manner consistent with the language in its form. If the party whose form is conditional on acceptance of its terms ignores that condition by its own conduct, the condition is not enforced and a contract is created under the section on varying terms. If, on the other hand, the party's behavior is consistent with its conditional terms, such as by refusing to perform fully, refusing to permit performance, or refusing to accept the benefits of the contract, until the terms are accepted, there is no contract by the exchange of forms unless one party accepted the other party's terms. If the other party accepts the terms, under paragraph (b)(2) the contract is formed based on those terms, except to the extent they might conflict with expressly agreed terms on price or quantity.

Illustration 1. Licensee sends a standard purchase order form that states that its order is conditional on the Licensor's assent to the terms of the form. Licensor ships with an invoice conditioning the contract on assent to its terms, but takes no steps to enforce that condition. Purchaser accepts the shipment. Neither party acted consistent with the language of condition. A contract exists but neither condition is enforced. Section 204, 208, or 210 applies.

Illustration 2. In Illustration 1, in response to the purchase order, Licensor refuses to ship unless Licensee agrees to the Licensor's terms. Until that occurs, there is no contract. Licensor's terms govern when agreed to by the Licensee. The same result occurs if Licensor ships, but includes in the information a code that prevents use unless the Licensee assents to the Licensor's terms.

Illustration 3. In Illustration 1, Licensor ships pursuant to a conditional form, but when the shipment arrives, Licensee refuses it. In a telephone conversation, Licensor agrees to Licensee's terms. Until that agreement, there is no contract; Licensee acted in a manner consistent with its conditional language. Licensee's terms govern.

SECTION 206. OFFER AND ACCEPTANCE: ELECTRONIC AGENTS.

(a) [**Formation by interaction of electronic agents.**] A contract may be formed by the interaction of electronic agents. If the interaction results in the electronic agents' engaging in operations that under the circumstances indicate acceptance of an offer, a contract is formed, but a court may grant appropriate relief if the operations resulted from fraud, electronic mistake, or the like.

(b) [**Formation by interaction of individual and electronic agent.**] A contract may be formed by the interaction of an electronic agent and an individual acting on the individual's own behalf or for another person. A contract is formed if the individual takes an action or makes a statement that the individual can refuse to take or say and that the individual has reason to know will:

(1) cause the electronic agent to perform, provide benefits, or allow the use or access that is the subject of the contract, or send instructions to do so; or

(2) indicate acceptance, regardless of other expressions or actions by the individual to which the individual has reason to know the electronic agent cannot react.

(c) [**Terms of the contract.**] The terms of a contract formed under subsection (b) are determined under Section 208 or 209 but do not include a term provided by the individual if the individual had reason to know that the electronic agent could not react to the term.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Electronic agent"; "Information"; "Party"; "Person"; "Term". Section 117: "Reason to know".

Comment

1. Scope of the Section. This section deals with contracts formed by interaction between electronic agents, or between an individual (acting on the individual's own behalf or for another person such as a company) and an electronic agent.

2. Interaction of Electronic Agents. Interaction of electronic agents creates a contract if the parties use the agents for that purpose and the operations of the electronic agents indicate that a contract exists. Conduct, even automated, can create a contract. Whether a contract is formed focuses on the operations of the agents. The issue is whether those operations indicate that a contract is formed, such as by sending and receiving the benefits of the contract, initiating orders, or indicating in records that a contract exists. The terms of the contract are determined under Section 208 and 209 as applicable. However, a contract is formed only by operations taken with respect to a legally significant event. An electronic agent may accept an offer, but acceptance of a message that is not an offer (such as an advertisement) does not form a contract.

3. Electronic Mistake and Fraud. Under subsection (a), restrictions analogous to common law concepts of fraud and mistake are made applicable to this automated context to prevent abuse or clearly unexpected results. Of course, parties may allocate risk of mistake or fraud in an agreement.

Assent does not occur if the operations are induced by mistake, fraud or the like, such as where a party or its electronic agent manipulates the programming or response of the other electronic agent in a manner akin to fraud. Such acts vitiate the assent that would occur through normal operations of the agent. Similarly, the inference is vitiated if, because of aberrant programming or through an unexpected interaction of the two agents, operations indicating existence of a contract occur in circumstances that are not within the reasonable contemplation of the parties. Such circumstances are analogous to mutual mistake. Courts applying these concepts should refer to mistake or fraud doctrine, even though an electronic agent cannot actually be said to have been misled or mistaken.

4. Interaction of Human and Electronic Agent. Contracts may be formed by interaction of an individual (human being) and an electronic agent. Subsection (b) does not define all cases where this can occur or the results of all interactions, such as where the individual is not aware that he is dealing with an electronic agent. The section describes one setting with two elements: 1) an electronic agent programmed to make contracts, and 2) an individual, having the ability not to do so, engaging in conduct or making a statement with reason to know that this will cause the electronic agent to provide the benefits of the contract or otherwise indicate acceptance. If the individual is dealing with an electronic agent, it may be that not all statements or actions by the individual can be reacted to by the electronic agent. A contract is formed if the human makes statements or engages in conduct that indicate assent. Statements purporting to alter or vitiate agreement to which the electronic agent cannot react are ineffective.

Illustration. Officer dials the telephone information system using the company credit card. A computerized voice states: "If you would like us to dial your number, press "1"; there will be an additional charge of $1.00. If you would like to dial yourself, press "2." Officer states into the phone that the company will not pay the $1.00 additional charge, but will pay .50. Having stated these conditions, Officer strikes "1." The computer dials the number. User's "counter offer" is ineffective, because Officer has reason to know that the program cannot react to the counter offer. The charge to dial the number includes the additional $1.00.

SECTION 207. FORMATION: RELEASES OF INFORMATIONAL RIGHTS.

(a) [**Consideration not required.**] A release is effective without consideration if it is:

(1) in a record to which the releasing party agrees, such as by manifesting assent, and

which identifies the informational rights released; or

(2) enforceable under estoppel, implied license, or other law.

(b) [**Duration.**] A release continues for the duration of the informational rights released if the release does not specify its duration and does not require affirmative performance after the grant of the release by:

(1) the party granting the release; or

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

Definitional Cross References: Section 102: "Agreement"; "Informational rights"; "License"; "Party"; "Record"; "Release". Section 112: "Manifesting assent."

Comment

1. Scope of Section. This section deals with the enforceability and duration of a release. A release is a promise that the releasing party will not object to, or exercise any remedies to limit, the use of computer information or informational rights, but does not contain significant, affirmative obligations by the releasing party.

2. Basic Rule. A release is enforceable without consideration if it is in a record to which the releasing party agrees, by manifesting assent or otherwise. This includes all means of assent and all forms of creating a record, such as by filmed assent. The rule clarifies the enforceability of releases in a record, but it does not alter other law making releases enforceable, whether or not supported by consideration, such as the law of estoppel or waiver.

> **Illustration:** In Internet "chat room" and "list service" systems, participation often requires permission by the participant to allow use of comments or materials submitted. If the relationship granting that permission is supported by assent and consideration (e.g., one party grants the right to use the service in return for the release), the release is enforceable under ordinary contract law principles of offer and acceptance. This section makes clear that the release is enforceable without consideration.

3. Duration. The duration of a release is determined by its terms. If there is no stated duration, the common law regarding duration of contracts applies. However, subsection (b) states a different rule for releases where there is no significant involvement by a party to support the other's use of the information or rights. In these cases, the release is for the duration of the released rights. Of course, a release is effective only according to its own substantive terms; a release for use of an image at an Internet site does not release rights for other uses of that image.

[SUBPART B. TERMS OF RECORDS]

SECTION 208. ADOPTING TERMS OF RECORDS. Except as otherwise provided in

Section 209, the following rules apply:

(1) [**Adoption of terms.**] A party adopts the terms of a record, including a standard form, as the terms of the contract if the party agrees to the record, such as by manifesting assent.

(2) [**Later terms.**] The terms of a record may be adopted after beginning performance or use if the parties had reason to know that their agreement would be represented in whole or part by a later record to be agreed on and there would not be an opportunity to review the record or a copy of it before performance or use begins. If the parties fail to agree to the later terms and did not intend to form a contract unless they so agreed, Section 202(e) applies.

(3) [**Effect of terms.**] If a party adopts the terms of a record, the terms become part of the contract without regard to the party's knowledge or understanding of individual terms in the record, except for a term that is unenforceable because it fails to satisfy another requirement of this [Act].

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Party"; "Record"; "Standard form"; "Term". Section 112: "Manifest assent"; Section 113: "Opportunity to review." Section 117: "Reason to know".

Comment

1. Scope of Section. This Act deals separately with when a contract is formed and what are its terms, although the same conduct often does both. This section states when a party adopts a record as the contract. Section 209 limits terms in mass-market licenses. Section 210 deals with when records do not create terms, but a contract exists by conduct. Trade use, course of dealing, and course of performance are also relevant as are the supplementary rules of this Act for topics on which the other sources of terms do not control.

2. Adopting Terms. A party that assents to a record adopts the record as the terms of the contract whether or not the record is a standard form. There is no difference between a customized record or terms of a standard form. Standard forms are common and provide efficiencies for both parties; they are used by both licensees and licensors. Treating them as of lesser effect than other records would place commercial contract law in conflict with commercial practice.

A party is bound by the terms of a record only if it agrees to it, by manifesting assent or otherwise. Assent can be by authenticating the record or by other conduct indicating assent. However, a party cannot assent unless it had an opportunity to review the record before reacting. Section 113. See *Specht v. Netscape Communications Corp.*, – F.3d –, 2002 WL 31166784 n. 13 (Fed. Cir. 2002).

3. Later Terms: Layered Contracting. Subsection (b) reflects the reality of layered contracting. While some contracts are formed and their terms defined at a single point in time, many transactions involve a rolling or layered process. The commercial expectation is that terms will follow or be developed after performance begins. This Act rejects cases that narrowly treat

contracting as a single event despite ordinary practice. It adopts a rule in cases that recognize that contracts are often formed over time. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. 2000).

a. Reason to Know. Contract terms proposed for later agreement to complete the initial contract are part of the initial contracting process if the parties had reason to know that later terms would be proposed. "Reason to know" means that, realistically considered, later presentation of terms should not be a surprise. It does not require specific notice or specific language, although such factors may be important because notice suffices. "Reason to know" can also be inferred from the circumstances, including ordinary business practices or marketing approaches of which a party is or should be aware and from which a reasonable person would infer that terms will follow. The time over which the record can be proposed must be reasonable as shaped by the expectations of the parties, the context and their agreement. Compare Section 209. At some point, the deal is closed, but when this is true requires analysis focused on the context and circumstances. If the parties considered terms of the deal to be closed, subsequently proposed terms are proposed modifications.

b. Specification of Terms. Subsection (b) deals with cases that differ from those under Section 305, which governs agreements that give *one party* a right to specify terms. In cases under Section 305, the party receiving terms is not asked to assent; the agreement gives the other party the right to specify terms. Since no assent is required, the terms must be proposed in good faith and in accord with reasonable commercial standards. Those conditions are not appropriate when the party receiving terms can simply refuse them.

4. Later Terms: Roadmap. The following gives guidance on how to handle cases with later terms. Unless the parties' agreement is that one party has the right to specify terms without the other party being required to assent to the terms (see, e.g., Sections 304 and 305), as a general rule the later terms do not become part of the contract unless the party receiving them agrees to the terms such as by manifesting assent after having an opportunity to review often including a right to return, as described in sections 102(a)(57), 112, 113, 208, and 209. This Act applies in the following way:

- If the parties did not have reason to know that terms would be proposed later for assent and a contract was formed before the terms were available for review and assent, the later terms are treated as proposed modifications that may be accepted or rejected under rules applicable to contract modifications including Section 303.
- If the parties agree that one party could specify later terms, but no further assent is required, Sections 304 and 305 apply.
- In a mass-market license, if the parties had reason to know that terms would be proposed later for assent and the later terms are agreed on, there is a contract including those terms; but if the later terms are rejected, there is no contract under Section 209(b) and the parties' obligations are determined by this Act, including Sections 208, 209 and 202(e) as applicable.
- In all other cases:
    - If the parties had reason to know that terms would be proposed later for assent and did not intend to have a contract unless the later terms were agreed to by manifesting assent or otherwise and the later terms are agreed on, there is a contract including those terms; but if the later terms are rejected, there is no contract and the parties' obligations are determined by this Act, including Sections 208, 209 and 202(e) as applicable.
    - If the parties had reason to know that terms would be proposed later for assent and intended to have a contract even if the later terms were rejected and the terms are agreed on they become part of the contract; but if the terms are rejected, the rejected terms are left open pursuant to this Act, including Section 306, unless covered by other agreement of the parties.

5. Mass-Market Contracts. Subsection (b) applies in the mass market. However, Section 209 places limits on when proposal of the terms must occur and precludes altering terms expressly agreed by the parties.

6. Right to a Return. In some cases, if assent is sought after the person has paid or delivered or become obligated to pay or deliver, the manifestation of assent is not effective unless the person has a right to a return if it refuses the proposed terms. Section 112; 113. This rule applies in mass market transactions and to other cases where the licensor's performance is mere delivery of a copy, but does not apply in more complex commercial contexts where general principles of equity govern because of the complexity. Section 202(e) provides guidance where the parties did not intend to have a contract in the absence of agreeing to terms.

7. Adoption of Terms. Assent to a record adopts all terms of the record; there is no requirement that the party read, understand or separately assent to each term. Of course, enforceability of terms is subject to doctrines set out in this Act regarding unconscionability, public policy, good faith, and the like. But this Act rejects *Restatement (Second) of Contracts* § 211(3). Absent unconscionability, fraud or similar conduct, parties are bound by the terms to which they assent after having had an opportunity to review.

SECTION 209. MASS-MARKET LICENSE.

(a) [**Limitation on terms.**] Adoption of the terms of a mass-market license under Section 208 is effective only if the party agrees to the license, such as by manifesting assent, before or during the party's initial performance or use of or access to the information. A term is not part of the license if:

(1) the term is unconscionable or is unenforceable under Section 105(a) or (b);

(2) subject to Section 301, the term conflicts with a term to which the parties to the license have expressly agreed;

(3) under Section 113, the licensee does not have an opportunity to review the term before agreeing to it; or

(4) the term is not available to the licensee after assent to the license in one or more of the following forms:

(A) an immediately available nonelectronic record that the licensee may keep;

(B) an immediately available electronic record that can be printed or stored by the

licensee for archival and review purposes; or

(C) in a copy available at no additional cost on a seasonable request in a record by a licensee that was unable to print or store the license for archival and review purposes.

(b) [**Right of return and reimbursement.**] If a mass-market license or a copy of the license is not available in a manner permitting an opportunity to review by the licensee before the licensee becomes obligated to pay and the licensee does not agree, such as by manifesting assent, to the license after having an opportunity to review, the licensee is entitled to a return under Section 113 and, in addition, to:

(1) reimbursement of any reasonable expenses incurred in complying with the licensor's instructions for returning or destroying the computer information or, in the absence of instructions, expenses incurred for return postage or similar reasonable expense in returning the computer information; and

(2) compensation for any reasonable and foreseeable costs of restoring the licensee's information processing system to reverse changes in the system caused by the installation, if:

(A) the installation occurs because information must be installed to enable review of the license; and

(B) the installation alters the system or information in it but does not restore the system or information after removal of the installed information because the licensee rejected the license.

(c) [**Licensor's opportunity to review.**] In a mass-market transaction, if the licensor does not have an opportunity to review a record containing proposed terms from the licensee before the licensor delivers or becomes obligated to deliver the information, and if the licensor does not agree, such as by manifesting assent, to those terms after having that opportunity, the licensor is entitled to a return.

(d) **[Notice of refund.]** In a case governed by subsection (b), notice must be given in the license or otherwise that a refund may be obtained from the person to which the payment was made or other person designated in the notice if the licensee refuses the terms.

Definitional Cross References: Section 102: "Contract"; "Information"; "Information processing system"; "Informational Rights"; "License"; "Licensor"; "Mass-market license"; "Mass-market transaction"; "Notice"; "Party" "Return"; "Term". Section 112: "Manifest assent"; Section 113: "Opportunity to review".

Comment

1. Scope of Section. Mass-market licenses are typically standard forms where the licensee either takes or leaves the license. Thus, significant protections are provided in this section. This section must be read in connection with Sections 208, 112 and 113. In addition, trade use, course of dealing, and course of performance are relevant, as are the supplementary terms of this Act on issues not resolved by express terms or practical construction. Sections 116(c), 302. Many mass-market licenses are available for review and agreed to at the outset of a transaction; but some licenses are presented later. This section deals with both and relies also on the rules in Section 208. Many mass-market transactions involve three parties and two contracts. That circumstance is addressed here and in Section 613.

2. General Rules for Enforceability. Several limiting concepts govern where assent to a record is relevant to establishing the terms of a mass-market license:

a. **Unconscionability and Fundamental Public Policy.** Even if a party agrees to a mass market license, paragraph (a)(1) makes clear a court may invalidate unconscionable terms or terms against fundamental public policy under rules that apply to all contracts under this Act. Unconscionability doctrine invalidates terms that are bizarre or oppressive and hidden in boilerplate language. See Section 111. For example, a term in a mass-market license for $50 software providing that any default causes a default in all other licenses between the parties may be unconscionable, if there was no reason for the licensee to anticipate that breach of the small license would breach an unrelated larger license between the parties. Similarly, a clause in a mass-market license that grants a license-back of a licensee's trademarks or trade secrets without any discussion of the issue would ordinarily be unconscionable. This section rejects the additional test in *Restatement (Second) of Contracts* § 211(3).

b. **Conflict with Expressly Agreed Terms.** Paragraph (a)(2) provides that standard terms in a mass-market license cannot alter terms expressly agreed to between the parties to the license. A term is expressly agreed if the parties discuss and come to agreement regarding the issue and the term becomes part of the bargain. For example, if a librarian acquires software for children from a licensor under an express agreement that the software may be used in its library network, a term in the license that limits use to a single user computer system conflicts with and is overridden by the agreement for a network license. Similarly, in a consumer contract where the vendor promises a "90 day right to a refund" and the parties agree to that, the mass-market license cannot alter that term between those parties. Of course, there must be an agreement and this rule is subject to traditional parol evidence concepts. This rule is consistent with Section 613 where the terms of a publisher's license do not alter the agreement between the end user and the retailer unless expressly adopted by them.

c. Assent and Agreement. Under this Act, a party adopts the terms of a mass market license only if it agrees to the record, by manifesting assent or otherwise. A party cannot do so unless it had an opportunity to review the record ***before*** it agrees. Section 112. Paragraph (a)(3) makes clear that, under Section 113, the record must be available for review and called to the person's attention in a manner such that a reasonable person ought to have noticed it before assenting. See Section 113. The opportunity to review the terms must come before assent to them.

Adopting terms of a record under this section for a mass-market license is pursuant to Section 208, and is subject to the limits stated in that section. If the terms of the record are proposed after a party commences performance, they are effective only if the party had reason to know that terms would be proposed and agrees or manifests assent to the terms once proposed.

For mass-market licenses, however, even if reason to know exists at the outset, under this section the terms must be made available no later than during the initial performance or use of the information and the person has a statutory right to a return if it refuses the license.

d. Ability to Retain Terms. Paragraph (a)(4) provides additional licensee protection not present in other law. The person presenting terms of a mass-market license must make it possible for the licensee to retain a copy of the agreed license, or to obtain a copy if the contract was presented in a context in which it originally could not have been retained (e.g., presentation at a kiosk with no printing or copying capability). The ability to retain the license terms enables the licensee to have information about its obligations on an ongoing basis. Paragraph (a)(4) provides for a right that typically is not mandated in other general contract law (such as UCC Article 2). It outlines three options in which this capability to retain the agreed record can be achieved:

- presentation in a form the licensee can keep such as on paper or diskette or in the licensed computer program;
- presentation in retainable or printable electronic form such as an electronic presentation on a web site which the licensee can print, download, copy or email to a storage device of the licensee, or in the computer program itself; or
- provision of a copy on timely request from a licensee who is unable to print or store its own copy because the presentation does not allow that to occur.

This paragraph is satisfied if a copy *can* be kept, printed or stored etc. after the licensee consents to the license, or obtained on request, whether the licensee *in fact* keeps or prints it at all or at that time, or uses a device that could do so. This is consistent with commentary to the federal Electronic Signatures in Global and National Commerce Act. See 146 Cong. Rec. S5281–06, at S5285, 106th Cong., 2d Sess. (June 16, 2000) (statement of Sen. Abraham).

3. Relevance of a License. The enforceability of a license is important to both the licensor and the licensee. License terms define the product by, for example, distinguishing between a right to use for a single user or with multiple users on a network, or between a right to consumer use or a right to commercial use. Often, the license benefits the licensee, giving it rights that would not be present in the absence of a license or rights that could not be exercised without permission of the owner of informational rights. See, e.g., *Green Book International Corp. v. Inunity Corp.*, 2 F. Supp.2d 112_(D. Mass. 1998). The license allows the licensee to avoid infringement.

The terms of mass-market contracts can be established in many ways. An oral agreement may suffice as would an agreement to terms in a record. Product descriptions may define the bargain without reference to any record containing contractual terms. Parties may leave terms open and agree that the terms may be specified later by a party.

4. Terms Prior to Payment. If a mass-market license is presented before the price is paid, this Act follows general law that enforces a standard form contract if the party assents to it. The fact that license terms are non-negotiable does not invalidate them under general contract law or this Act. A conclusion that a contract is a contract of adhesion may, however, require courts to take a closer look at *terms* to prevent unconscionability. See, e.g., *Klos v. Polske Linie Lotnicze*, 133 F.3d 164 (2d Cir. 1998); *Fireman's Fund Insurance v. M.V. DSR Atlantic*, 131 F.3d 1336 (9th Cir. 1998); *Chan v. Adventurer Cruises, Inc.*, 123 F.3d 1287 (9th Cir. 1997). This Act's concepts of manifest assent and opportunity to review also address concerns relevant to such a review.

5. Terms after Initial Agreement. Mass market licenses may be presented after initial general agreement from the licensee. In some distribution channels this allows a more efficient mode of contracting between end users and remote parties; this is especially important where the remote party controls copyright or similar rights in the information. Enforceability of the license

is important to both parties. Under federal law, a mere sale of a copy of a copyrighted work does not give the copy owner a number of rights that it may desire. The limitations in subsection (b) impose significant costs that create incentives for licensors to present terms at the outset when practicable for the distribution channel employed.

Most courts under current law enforce contract terms that are presented and assented to after initial agreement. See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Hill vs. Gateway 2000 Inc.*, 105 F.3d 1147 (7th Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y.A.D. 1998); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 998 P.2d 305 (Wash. 1999); *I.Lan Systems, Inc. v. Netscout Service Level Corp.*, 183 F.Supp.2d 328, 46 UCC Rep.Serv.2d 287 (U.S. Dis. Mass., 2002) ("*Step-Saver* once was the leading case on shrinkwrap agreements. Today that distinction goes to . . . *ProCD*. . . 'Money now, terms later' is a practical way to form contracts, especially with purchasers of software").

Subsection (b) imposes some added limitations. It allows such terms to be enforceable only if there is agreement, or if there is a manifestation of assent after a chance to review terms and only pursuant to the rule that a party that rejects terms for information must be given a cost free right to say no. This does not mean that the licensee can reject the license and use or copy the information. The right to a return creates a situation equivalent to that which would have existed if the licensee had a chance to review the terms and rejected the license at the preliminary agreement. It does not apply if the licensee agrees to the license. However, a mass-market licensee who agrees to the license but receives a nonconforming product has a right to reject the copy and obtain a refund of the contract fee as a remedy for breach of the contract. See Section 704(b).

a. Timing of Assent. Agreement to the mass-market record must occur no later than during the initial use of the information. This limits the time during which layered contracting may occur in the mass market and reflects customary practices in software and other industries. Of course, any applicable federal law that establishes a right to rescind a contract and return a product is not altered by this Act. Section 105. Also, assent to the record does not alter the licensee's right to refuse a defective product that constitutes a breach of contract. Assent to contract terms is different from acceptance of a copy. "Acceptance" of the copy ordinarily requires a right to inspect it. See Section 608. For mass-market transactions, this Act follows U.C.C. Article 2 on this issue.

b. Cost Free Return. Under subsection (b), if terms are not available for review until after an initial agreement, the party being asked to assent must have a right to reject the terms return the information product. Possible liability for the expense of reinstating a customer's system after review, creates an incentive to make the license or a copy available for review before the initial obligation is created. This Act refers to a return right, rather than a right to a refund, because, under developing technologies, the right may apply to either the licensee or the licensor, whichever is asked to assent to the record. See Section 102(57) (defining the right of return).

The return right under this section includes, but expands on the return right described in Section 113. In this section, the return right is cost free in that it requires reimbursement for reasonable costs of making the return and, if installation of the information was required to review the license, the reasonable costs in returning the system to its initial condition. The fact that this section states an affirmative right in mass market licenses does not affect whether under an agreement or other law, a similar right exists in other contexts.

The expenses incurred in return relate only to the subject matter of the rejected license (the computer information) and do not include goods delivered in the same transaction. Rights regarding the goods are governed by Uniform Commercial Code Article 2 or 2A. The expenses must be reasonable and foreseeable. The costs of return do not include attorney fees or the cost of using an unreasonably expensive means of return or lost income or the like unless such expenses are required to comply with instructions of the licensor. The reimbursement right refers to ordinary expenses, such as the cost of postage.

Similarly, if expenses are incurred because the information must be installed to review the license, expenses of reversing changes caused by the installation that are chargeable to the licensor must be reasonable and foreseeable. The reference here is to actual, out-of-pocket expenses and not to compensation for lost time or lost opportunity or for consequential damages. The expenses must be foreseeable. A licensor may be reasonably charged with ordinary requirements of a licensee that are consistent with others in the same general position, but is not responsible for losses caused by the particular circumstances of the licensee of which it had no notice. A twenty-dollar mass market license should not expose the provider to significant loss unless the method of presenting the license can be said ordinarily to cause such loss. Similarly, it is ordinarily not reasonable to provide recovery of disproportionate expenses associated with eliminating minor and inconsequential changes in a system that do not affect its functionality. On the other hand, the provider is responsible for actual reasonable expenses that are foreseeable from the method used to obtain assent.

c. Notice of the Right to Return. Subsection (d) provides that notice must be given indicating the person from whom the refund and return can be obtained. The notice may be given in the license or otherwise at a time making it possible for the person refusing the license terms to obtain a return within any reasonable time stated for it or, if no time is stated, a reasonable time. See Section 102(57) (defining the right of return). The purpose is to allow the licensee to assert its rights within the period for a return if it chooses to refuse the license. The section does not require the notice to include address or telephone information because, in mass-market distribution, the identity of the eventual retailer or other person from which a copy was obtained cannot be known in advance. In such cases, the person can be described, for example, as "the store from which you obtained this copy." See also Section 613 (describing when a right of return is due from a dealer) and Section 102(57).

SECTION 210. TERMS OF CONTRACT FORMED BY CONDUCT.

(a) [**Source of contractual terms.**] Except as otherwise provided in subsection (b) and subject to Section 301, if a contract is formed by conduct of the parties, the terms of the contract are determined by consideration of the terms and conditions to which the parties expressly agreed, course of performance, course of dealing, usage of trade, the nature of the parties' conduct, the records exchanged, the information or informational rights involved, and all other relevant circumstances. If a court cannot determine the terms of the contract from the foregoing factors, the supplementary principles of this [Act] apply.

(b) [**Effect of agreed record.**] This section does not apply if the parties authenticate a record of the contract or a party agrees, such as by manifesting assent, to the record containing the terms of the other party.

Uniform Law Source: Uniform Commercial Code: Section 2-207 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Contract"; "Court"; "Course of Dealing"; "Course of Performance"; "Information"; "Informational Rights"; "Party"; "Record"; "Term"; "Usage of Trade". Section 112: "Manifesting assent."

Comment

1. Scope of Section. This section deals with contracts formed by conduct, rather than by offer and acceptance or agreement to a record. Contracts formed by conduct arise in various settings. One involves a "battle of forms" in which, under Sections 204 and 205, the exchanged records did not result in an effective offer and acceptance, but both parties engaged in conduct indicating that a contract was formed. If agreed records or an oral offer-acceptance form a contract, this section does not apply simply because agreed records do not cover all relevant terms. In such cases, terms are determined under the general rules of this Act, including appropriate weight for usage of trade, course of performance, and course of dealing. See, e.g., Sections 116(c); 301; 302.

2. Interpret based on Context. This section requires a court to determine contractual terms by considering all commercial circumstances, including the nature of conduct, the informational rights involved, applicable trade usage or course of dealing, and any terms that were expressly agreed without condition or because of an assumption about what would be the agreed performance due from the other party which conditions or assumptions were not met. No hierarchy is established except for that under Section 302. Given the fluid nature of the context, usage of trade and course of dealing have special importance. If a court cannot determine the contract terms from the foregoing, then, the supplemental rules contained in this Act may serve as gap-fillers to supply the terms. Consideration of all factors requires a practical interpretation of the relationship. *Restatement (Second) of Contracts* § 202(1) (2) (1981); 2 *Farnsworth, Contracts* § 7.10 (1990). Formalistic rules cannot account for the contextual nuances that exist in the rich environment of transactional practice. This section rejects the so-called "knock-out" rule where terms in records are thrown out and not considered, and are instead replaced by default rules of this Act; that rule is too rigid for information transactions where contract terms often define the product and scope of the grant.

3. Battle of Forms and Conduct. Some information transactions involve an exchange of inconsistent standard forms coupled with conduct of both parties indicating the existence of a contract. One of two results may occur. The first is that a contract is formed by one or both forms and conduct is irrelevant either because the forms do not materially disagree or because a conditional offer or acceptance of one party was agreed to or otherwise adopted by the other. When this occurs, the contract is not within this section. The second possibility is that the records and conduct related to them do not establish a contract (e.g., they materially disagree). See Sections 204 and 205. Such cases are within this section if the conduct of the parties nevertheless creates an enforceable contract. Subsection (a) directs the court to review the entire circumstances regardless of which form was first received or last sent, but including factors such as the terms of the exchanged records and established trade usage, course of dealing, and course of performance.

4. Scope of License. In information transactions, contract terms relating to the scope of the grant define the product being licensed and lie at the core of the agreement. See Comments to Section 102(a)(58). The subject matter (e.g., a copy of software) has entirely different value depending on what rights are granted, but that often cannot be determined from the copy itself (the copy may be license of a single-user or for network use). That being true, it is especially important to give special deference to scope issues in a manner that protects valuable informational rights.

Under subsection (a), the information or informational rights involved are relevant factors.

Where there is a significant disagreement about an important element of scope, a court should be careful not to make a determination that creates rights or imposes obligations beyond those actually agreed to by the parties, because that in effect would transfer away valuable property of one party based on a judicial determination made on unclear facts. That risk argues for rejecting any expansive interpretation of ambiguous conduct. Absent clear agreement to the contrary, if a contract is formed by conduct, the court should consider the following principles:

(1) The court should avoid creating a scope that requires the licensor to have or to acquire rights it did not own or have a right to license at the time of contracting, or that exceed the rights the licensor then had. Thus, if the licensor only had the right to grant a license for the Southwest United States, the court should avoid interpreting conduct as indicating a scope that includes rights for the East Coast or forcing the licensor into an infringement.

(2) The court should avoid expanding the licensee's rights beyond the actual agreement of the parties. A court needs to understand and effectuate the importance of this issue from the licensor's standpoint, protecting important property rights which it holds. Thus, the mere fact that the licensee may have used the licensed rights in the East Coast should not lead a court to conclude that the bargain must therefore have included those rights. Such an interpretation could encourage infringement as a means of expanding rights.

(3) The court should avoid making the licensee liable for infringement because of conduct exceeding the scope, if the conduct occurred at a time when the licensee reasonably and in good faith believed that it was acting within the agreed scope. Good faith conduct can be protected in appropriate cases by applying equitable principles without creating a grant that may not have been intended by the licensor.

[SUBPART C. ELECTRONIC CONTRACTS: GENERALLY]

SECTION 211. EFFICACY AND COMMERCIAL REASONABLENESS OF ATTRIBUTION PROCEDURE.

(a) [**Decision for court.**] The efficacy, including the commercial reasonableness, of an attribution procedure is determined by the court.

(b) [**Applicable standards.**] In making the determination under subsection (a), the following rules apply:

(1) [**Procedures established by law.**] An attribution procedure established by law is effective for transactions within the coverage of the statute or rule.

(2) [**Basis and time for determination.**] Except as otherwise provided in paragraph (1), commercial reasonableness and effectiveness is determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agreed to or adopted the procedure.

(3) [**Devices and methods.**] An attribution procedure may use any security device or

method that is commercially reasonable under the circumstances.

Uniform Law Source: Uniform Commercial Code: Sections 4A-201; 202 (1998 Official Text).

Definitional Cross References: Section 102: "Attribution procedure."

Comment

1. Scope of Section. This section provides standards for determining the efficacy of an attribution procedure or whether it is commercially reasonable.

2. Decision of the Court. Issues of whether a particular procedure is commercially reasonable or otherwise about its efficacy in a particular context are decisions made by the court. This Act does not require a commercially reasonable attribution procedure or adopt any one type of procedure as reasonable or otherwise efficacious. Other law may do so, as may the agreement of the parties.

3. Nature of an Attribution Procedure. Evolving technology and commercial practice make it impractical to predict future developments and unwise to preclude developments by a narrow statutory mandate describing what type of procedure is appropriate. This Act relies on the parties to select or use an appropriate procedure. If an attribution procedure is established by agreement or adopted by both parties, assent is the predicate for allowing the procedure to affect substantive rights subject to normal restrictions on enforcement of contract terms, such as the doctrine of unconscionability. A procedure of which one party is not aware does not qualify as having been agreed to or adopted by the parties as an attribution procedure. However, parties dealing for the first time may adopt a procedure at that time, there is no requirement of agreement in advance. Similarly, a procedure may be established by one party in connection with a third person (such as in the issuance of a digital signature, or the creation of an attribution procedure to be used among a group of member companies) and adopted in a particular transaction such as where another party accepts and relies on the issued digital signature.

In some cases, statutes or regulations define a particular attribution procedure as appropriate or as applicable to a given context. These laws, such as digital signature statutes, establish by law a procedure that qualifies as an attribution procedure in this Act and that, under paragraph (1) are per se effective or commercially reasonable within the scope of coverage of the statute or regulation.

4. Efficacy and Commercial Reasonableness. The general idea of efficacy or commercial reasonableness is that the procedure be a reasonably effective method in the commercial context reasonably suited to the task for which it is used. This does not require the procedure to be state of the art, the most reasonable procedure, or an infallible procedure. The decision must take into account the choices of the parties as well as the effectiveness and cost relative to the value of the transactions. How one gauges efficacy or commercial reasonableness depends on a variety of factors, including the agreement, the choices of the parties, technology, the types of transactions affected by the procedure, sophistication of the parties, volume of similar transactions engaged in, availability of feasible alternatives, cost and difficulty of utilizing alternative procedures, and procedures in general use for similar types of transactions. The commercial reasonableness concept is similar to that in Uniform Commercial Code § 4A-202(c) (1998 Official Text). In most cases, the efficacy of a procedure is related to whether it is a commercially reasonable procedure. The quality of an attribution procedure may reasonably be tailored to the particular transaction and the degree of risk involved. Additionally, if a procedure results from a negotiated agreement of the parties or decisions of informed commercial entities entering a relationship, it should receive deference. This flows from the principle of contractually assumed risk and the principle that the parties' agreement should ordinarily be enforced. The same principle may

apply in non-negotiated situations. If two parties generally aware of the risks of a particular procedure, agree to use the procedure for a particular transaction, they have in effect concluded that the procedure is sufficiently effective or commercially reasonable in their context to accept the risks.

SECTION 212. DETERMINING ATTRIBUTION.

(a) [**When attribution established.**] An electronic authentication, display, message, record, or performance is attributed to a person if it was the act of the person or its electronic agent, or if the person is bound by it under agency or other law. The party relying on attribution of an electronic authentication, display, message, record, or performance to another person has the burden of establishing attribution.

(b) [**Proving attribution.**] The act of a person may be shown in any manner, including a showing of the efficacy of an attribution procedure that was agreed to or adopted by the parties or established by law.

(c) [**Context determines effect.**] The effect of an electronic act attributed to a person under subsection (a) is determined from the context at the time of its creation, execution, or adoption, including the parties' agreement, if any, or otherwise as provided by law.

(d) [**Failure to use procedure.**] If an attribution procedure exists to detect errors or changes in an electronic authentication, display, message, record, or performance, and was agreed to or adopted by the parties or established by law, and one party conformed to the procedure but the other party did not, and the nonconforming party would have detected the change or error had that party also conformed, the effect of noncompliance is determined by the agreement but, in the absence of agreement, the conforming party may avoid the effect of the error or change.

Definitional Cross References: Section 102(a): "agreement"; "attribution procedure"; "authentication"; "electronic"; "electronic agent"; "party"; "person"; "record".

Comment

1. Scope of Section. This section deals with when an electronic authentication, message, record or performance is attributed to a particular person and with the consequences of failure to follow a procedure intended to detect errors. Attribution to a person means that the electronic

event is treated in law as having come from that person.

2. Nature of Attribution. Subsection (a) clarifies that the party seeking to attribute the source of an electronic authentication, message, record or performance to a particular party bears the burden of doing so. "Burden of establishing" means "the burden of persuading the trier of fact that the existence of a fact (e.g., attribution) is more probable than its non-existence." In effect, a party (either the licensor or the licensee) that desires to attribute an order or a shipment or license to a particular party bears the burden and the risk of being able to do so.

Attribution might involve reliance on agency law principles. In addition, the reference in subsection (a) to "other law" makes clear that the concept covers circumstances in which a person is bound by the act of another even though the acting person might not qualify as an agent. For example, if a woman gives her on-line account password to her brother so that he may use the account, his acts will be attributed to her even though he is not necessarily her agent. If he steals the password, she is not bound by his actions unless other law requires her to bear the consequences of his actions (e.g., by contract or under some state electronic signature statutes her liability may be allocated to her, or a cause of action for negligence might exist in some circumstances).

3. Nature of Proof. Subsection (b) states the principle that the efficacy and other characteristics of an attribution procedure used by the parties are part of proof of attribution. The role of an attribution procedure agreed to or used by the parties varies depending on the character of the procedure. Compliance with a commercially reasonable attribution procedure that has a level of effectiveness suitable to that context may be treated by the court as carrying the burden of establishing attribution referred to in subsection (a), subject to rebuttal by appropriate evidence, such as by a showing that the party in fact had no role in causing or permitting the electronic authentication, message, record or performance to occur. For example, if the parties agree to an attribution procedure, the party seeking to rely on attribution to the other has the burden of establishing the agreement, the fact that it was followed in good faith and other relevant attributes of the procedure. Having done that, under general law, the burden may pass to the other party to establish that neither he nor a person with authority to act were responsible for the message or performance. On the other hand, a procedure with very limited effectiveness not reasonably suited to the context might have no effect at all in the evidentiary mix. Of course, this all depends on existing law regarding the burden of establishing a fact; this Act does not change that law.

4. Role of Agreement. This section is subject to contrary agreement. An agreement here may have the effect of creating an attribution procedure that later plays a role in proving to whom the message is attributed. The agreement, however, may also deal with the effect of the procedure itself, and thereby override the rules in this section. For example, an agreement between a law firm and West Publishing may provide that the law firm is responsible for the costs associated with any use for database access of the identification code issued to it. The identification code is an attribution procedure. Absent agreement on its effect, the effect of its use would be controlled under this section. In the hypothetical case, however, the agreement itself specifies the effect of use of the code and that agreement controls. No special language is necessary to achieve this result: the agreement is enforceable under the same standards as any other term of an agreement. Thus, it must not be unconscionable or violate a fundamental public policy. See Sections 105 and 111.

5. Failure to Use. Subsection (d) deals in a limited way with the effect of a failure by one party to conform to an attribution procedure. If the sender complies, but the recipient does not, the sender is entitled to its rights or damages under any agreement between the parties regarding the attribution procedure and its effects; in the absence of an agreement, the complying party (sender) may choose not to be bound by an error that would have been detected through

compliance by the other party (recipient).

SECTION 213. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) [**Electronic error defined.**] In this section, "electronic error" means an error in an electronic message created by a consumer using an information processing system if a reasonable method to detect and correct or avoid the error was not provided.

(b) [**When consumer not bound.**] In an automated transaction, a consumer is not bound by an electronic message that the consumer did not intend and which was caused by an electronic error, if the consumer:

(1) promptly on learning of the error:

(A) notifies the other party of the error; and

(B) causes delivery to the other party or, pursuant to reasonable instructions received from the other party, delivers to another person or destroys all copies of the information; and

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

(c) [**When other law applies.**] If subsection (b) does not apply, the effect of an electronic error is determined by other law.

Definitional Cross References: Section 102: "Automated transaction"; "Consumer"; "Consumer contract"; "Copy"; "Delivery"; "Electronic"; "Electronic message"; "Good Faith"; "Information"; "Information processing system"; "Informational Rights"; "Notifies"; "Party"; "Person"; "Receive".

Comment

1. Scope of Section. This section creates a statutory electronic error correction procedure for consumers that supplements common law concepts of mistake. The section does not displace the common law of mistake or alter law concerning transactions that do not involve a consumer. It does not apply to transactions excluded from this Act. The procedure created here establishes a rule that avoids the complexity and uncertainty of relying solely on common law principles about mistake in an automated world. In common law in many states, a party making a unilateral mistake is responsible for its consequences. This section creates a consumer protection that avoids such decisions.

2. Electronic Errors: Defined. An "electronic error" contemplates a situation in which a

consumer's conduct results in an error in an electronic message. This section allows the consumer, by prompt action, to avoid the effect of the mistake. The defense does not apply if the electronic system with which the consumer is working provides a reasonable means to correct or avoid errors. Thus, a consumer's mistake in erroneously entering "11" as the number of copies desired may be an error, but does not come within this section if the automated ordering system with which the consumer interacts requires confirmation of the quantity or reasonably allows the consumer to correct any error before sending the order. The rule thus provides an incentive to establish error-correction procedures in automated contracting systems and provides protection to the consumer where such procedures are not present.

What is a reasonable procedure for correcting errors depends on the commercial context, including the extent to which the transaction entails immediate reactions. For example, in a transaction which occurs over a several day period, it may be reasonable to require a verification of a bid or order before it is placed, while in an on-line, real time auction, reconfirmation may not be possible. A reasonable procedure may entail no more than requiring two separate indications confirming that the bid should be entered or, where the formatting allows correction, requesting that the consumer check and correct the bid before the "Bid Now" button is pressed. As elsewhere, the idea of a reasonable procedure here does not require use of the most effective procedure, of special detection software or even the most reasonable, it requires that, all things taken into account, the procedure is commercially reasonable.

3. Avoiding the Effect of Error. If an electronic error occurs, a consumer can avoid responsibility for the unintended message if the consumer acts promptly. However, the message must not have been intended. Error avoidance is not a right to rescind a contract because of second thoughts.

To avoid the effects of an electronic error, the consumer must act promptly on learning of the error or of the other party's reliance. The consumer must notify the other party of the error and deliver back, at the consumer's cost, any copies of information received in the same condition as received. Return of copies is not required if the other party reasonably instructs the consumer to destroy the copies. However, the consumer must act promptly in a manner that returns the other party to the position that would have been true if the error had not occurred. *Compare* European Union *Distance Contract Directive* (no rescission right for consumer if software is not returned unopened).

This defense builds on equity principles that permit a party to avoid the consequences of its error if the error causes no detrimental effect to another party and does not give a benefit to the person making the mistake. The defense does not apply if the consumer used the information or otherwise received a benefit from it or the error. Since there may be unavoidable detrimental effects on the party who received an erroneous message (e.g., costs of filling erroneous orders), courts must apply this rule with care. The basic assumption is that the defense works when there is no detrimental effect on the person who did not make the error, but that assumption is particularly suspect in cases where the nature of the information product makes for high costs to the provider or risk of fraud worked by the consumer.

Illustration 1: Consumer intends to order one game from Jones' web site. Consumer types 11. Jones electronically delivers 11 games or causes their shipment with an overnight courier. The next morning, Consumer notices the mistake. He immediately sends an e-mail to Jones describing the problem, offering to immediately return the copies at Consumer's expense; he does not use the games. Under this section, there is no obligation for 11 copies.

Illustration 2: Same facts as in Illustration 1, except that Consumer did intend to order 11 copies and merely changed his mind. The section does not apply.

Illustration 3: Same as in Illustration 1, but Jones' system asks Consumer to confirm an order of 11 copies. Consumer confirms. There was no "electronic error." The procedure reasonably allowed for correction of the error. The conditions for application of this section are not met.

4. Transactions Not Within the Section. This section does not alter law in transactions that do not involve consumers or where consumers use electronic agents. The diversity of commercial transactions make a simple rule such as that stated here inappropriate because of the different patterns of risk and the greater ability of commercial parties to develop tailored solutions to the problem of errors. A court addressing electronic errors in these other contexts should apply general common law. The existence of the defense in this section for a consumer does not affect remedies under the general law of mistake, including in cases where the consumer does not qualify for the defense.

5. Relation to other Law. This section does not alter other consumer protection laws. In addition, it does not alter credit card or other rules regarding the responsibility of a consumer or a merchant to parties who provide payment or credit services relating to the transaction. Financial services transactions are excluded from this Act. Thus if an error by a consumer causes an order for ten copies, rather than one copy, as between the consumer and the licensor, this section applies. However, if the transaction were made with a credit card, the consumer's responsibility to the card issuer under the credit card remains governed by law applicable to that transaction and by the card issuer's disputed charge resolution procedures.

SECTION 214. ELECTRONIC MESSAGE: WHEN EFFECTIVE; EFFECT OF ACKNOWLEDGMENT.

(a) [**Electronic record effective when received.**] Receipt of an electronic message is effective when received even if no individual is aware of its receipt.

(b) [**Effect of acknowledgement.**] Receipt of an electronic acknowledgment of an electronic message establishes that the message was received but by itself does not establish that the content sent corresponds to the content received.

Definitional Cross References: Section 102: "Electronic"; "Electronic message"; "Information"; "Receive".

Comment

1. Scope of the Section. This section deals with the timing of effectiveness of electronic messages and with the impact of an acknowledgment. It does not deal with questions of to whom the message is attributed or with whether the content of the message is effective.

2. Time of Receipt Rule. Subsection (a) adopts a time of receipt rule; rejecting the mailbox rule for electronic messages and resolving uncertainty about what common law rule would otherwise govern. See Section 102 (definition of "receipt"). This time-of-receipt rule reflects both the relatively instantaneous nature of electronic messaging and places the risk on the sending party if receipt does not occur. As used in this Section, "effectiveness" of a notice parallels the usage in Uniform Commercial Code § 1-201(27) (1998 Official Text). The receipt of the message is "effective" *when* received, but the receipt being effective does not create a presumption that the message contains no errors, that its content is adequate or that it was sent by any particular person. Whether the message formed a contract is determined by ordinary offer and acceptance rules and whether an existing contract has been modified is determined by

ordinary rules on modification. Neither effect happens simply because receipt of a message is effective without more.

The message is "effective" when received, not when read or reviewed by the recipient, just as written notice is received even if not read or acknowledged. This applies traditional common law theories to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention. A rule that demands human assent would add an inefficient and error prone element or inappropriately cede control to one party.

3. Effect of Acknowledgment. Acknowledgment is not acceptance, although an acceptance can also be treated as an acknowledgment. Acknowledgment proves receipt but does not create any presumption about the identity of the person sending the acknowledgment. That can be established by an attribution procedure agreed to or adopted by the parties or established by law, but this section does not create any presumptions. Questions about the accuracy or the general content of the received message also are not treated here. Of course, by agreement the parties address all of these issues.

[SUBPART D. IDEA AND INFORMATION SUBMISSIONS]

SECTION 215. IDEA OR INFORMATION SUBMISSION.

(a) [**Submissions without prior agreement.**] The following rules apply to a submission of an idea or information for the creation, development, or enhancement of computer information which is not made pursuant to an existing agreement requiring the submission:

(1) [**Receipt does not form agreement.**] A contract is not formed and is not implied from the mere receipt of an unsolicited submission.

(2) [**Engaging in business is not invitation.**] Engaging in a business, trade, or industry that by custom or practice regularly acquires ideas is not in itself an express or implied solicitation of the information.

(3) [**Effect of procedures.**] If the recipient seasonably notifies the person making the submission that the recipient maintains a procedure to receive and review submissions, a contract is formed only if:

(A) the submission is made and a contract accepted pursuant to that procedure; or

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

(b) [**Enforceability of agreement.**] An agreement to disclose an idea creates a contract enforceable against the receiving party only if the idea as disclosed is confidential, concrete, and

novel to the business, trade, or industry or the party receiving the disclosure otherwise expressly agreed.

Definitional References: Section 102: "Agreement"; "Information"; "Informational rights"; "License"; "Party"; "Record"; "Release".

Comment

1. Idea Submissions: General Premise. This section deals in a limited way with an important issue in information industries: submissions of ideas. It section leaves undisturbed doctrines dealing with equitable remedies, but clarifies contract law. Subsection (a) pertains to unsolicited submissions and to the effect of express submission procedures. Subsection (b) pertains to standards for enforcement of idea submission agreements, whether express or implied.

2. Idea Submissions: No Prior Agreement. Subsection (a) deals with submissions not pursuant to a prior agreement. Subsection (a)(1) states an obvious contract law principle. If the submission was not solicited, mere receipt of the submission does not create a contract. The receiving party may have an obligation to return copies in some cases, but unilateral action of one party cannot impose obligations in contract on the recipient. Of course, simply because an idea or information is solicited does not mean that there is an agreement or a contract with respect to that submission. The absence of a contract is clear where, for example, a party merely maintains a website inviting clients and licensees to contact it but not indicating an obligation to pay or otherwise compensate for ideas received.

As indicated in subsection (a)(2), this is true even if the industry in which the recipient functions ordinarily relies on ideas. Contracts only arise by agreement by the parties.

For purposes of this section, an idea is not solicited simply because the recipient maintains a general interactive customer contact and information site at which clients and licensees may supply information, complaints or suggestions about its products. An idea or information is solicited if the recipient has specifically requested information from another party on a particular topic with some undertaking to pay for such solicited submission.

Subsection (a)(3) acknowledges the common practice of establishing a method for receiving and reacting to submissions as a means of controlling risk and giving guidance. Under this subsection, these procedures have impact in contract law if the submitting party is notified that they exist. Undisclosed procedures are not relevant to a contract analysis. If the submitting party is notified of the procedure, decisions about acceptance or rejection of the submission are funneled through that procedure or, in the case of acceptance, an express decision to accept. This protects both parties. The submitter and the recipient receive the benefit of a more specific set of choices about taking on a contract or rejecting it.

3. Idea Disclosure. Subsection (b) deals with the classic circumstance in which implied in fact contracts might arise. An agreement to disclose an idea carries with it, in the absence of contrary terms, the assumption that the idea has value or uniqueness. That value exists if the idea is concrete, confidential and novel. If, for example, there is an agreement for a party to submit an idea for enhancing the success of audiovisual works in return for a fee, the agreement is not an enforceable contract if the idea is "draw more attractive images." This rule adopts majority view and cases such as *Oasis Music Inc. v. 100 USA, Inc.*, 614 N.Y.S.2d 878 (N.Y. 1994); *Smith v. Rerion Corp.,* 541 P.2d 663 (Nev. 1975); *Burgess v. Coca-Cola Co.*, 55 U.S.P.Q.2d 1506 (Ga. App. 2000)**.** The recipient cannot recover payments it already made. Rather, the default rule is that the provider of the non-novel submission cannot enforce any future obligations as to the submitted idea. The basic principle is that a non-novel idea is not adequate consideration for a contract and that a proponent of an idea implicitly represents that the idea has value. This is not met in a case of an idea that is not concrete, confidential and novel. Of course, however, if the

receiving party expressly agreed that it would pay regardless of the nature of the idea, the default rule stated in subsection (b) is over-ridden by that express agreement.

This principle does not require that the idea rise to the level of novelty as that term is used in patent law. Cases on combination secrets and other situations in trade secret law where information has sufficient uniqueness or secrecy to qualify as a trade secret should inform decisions under this standard.

Nothing in this section precludes enforcement of an agreement for idea submission that does not hinge on the uniqueness of the proposed submission. In deciding whether such agreement exists, a court must consider the fundamental notion that a party does not implicitly contract away its rights, without a fee, to use information which is not novel, confidential and concrete merely because it contracted for "disclosure" of such material.

4. Trade Secret and Other Confidential Disclosures. The rule stated in subsection (b) applies to idea submissions. It does not apply to ordinary commercial cases involving confidential disclosures of trade secret or other information. The formation and enforcement of such contracts is under general contract formation law and, when applicable, trade secret law. The *Restatement (Third) of Unfair Competition* suggests that, for purposes of tort claims (e.g., misappropriation law), the doctrines that have developed in many states relating to idea submissions should be brought within trade secret law. This Act does not deal with that issue. It expressly preserves trade secret and similar law, leaving unaffected any controversy that this *Restatement* suggestion might engender. The rules here deal only with contract law and follow the widely accepted majority rule with respect to idea submissions.

PART 3

CONSTRUCTION

[SUBPART A. GENERAL]

SECTION 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 terms included therein may not be contradicted by evidence of any previous agreement or of a contemporaneous oral agreement but may be explained or supplemented by:

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

(2) evidence of consistent additional terms, unless the court finds the record to have been intended as a complete and exclusive statement of the terms of the agreement.

Uniform Law Source: Uniform Commercial Code: Sections 2A-202; 2-202 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Course of dealing"; "Course of performance"; "Court"; "Party"; "Record"; "Term"; "Usage of Trade."

Comment

1. Scope of Section. This section adopts the parol evidence rule from Uniform Commercial Code § 2-202 (1998 Official Text).

2. Record as Final Expression. The basic principle is that an agreed record of the contract is the best and primary source determining the terms of the agreement of the parties. This section excludes evidence of other alleged terms or agreements that contradict the terms of a record intended as a final expression of the agreement with respect to the terms covered in the record or with respect to terms on which confirmatory records agree. The record need not be intended as the only statement of the agreement on all terms, but to have this rule apply it must be intended as final on the terms covered.

An alleged term or agreement is contradictory if its substance cannot reasonably coexist with the substance of the terms of the record. Thus, an alleged term that calls for completion of a software project on July 1 contradicts a term of a record calling for completion on June 10. The two terms cannot reasonably coexist as part of the same agreement. On the other hand, an alleged term that specifies the processing capacity of the software does not contradict the terms of a record that does not make reference to that issue. Of course, the fact that the term does not contradict the record means only that evidence of it can be admitted. It does not indicate whether the alleged term was actually agreed by the parties.

This rule does not preclude proof of subsequent modifications of the agreement. What is excluded is evidence of prior or contemporaneous agreements that are not in the record. Subsequent modification may be shown by appropriate evidence. Terms of the original record may restrict what subsequent modification may be proven or effective, such as by requiring that

all modifications be in an authenticated record. Section 303.

3. Practical Construction. Paragraph (1), however, makes admissible evidence of course of dealing, usage of trade, and course of performance to explain or supplement the terms of any record stating the agreement of the parties. This does not depend on a prior determination that the language of the record is ambiguous. Instead, these sources of interpretation are allowed in order to reach an accurate understanding of the parties' intent as to their agreement. Records of an agreement are to be read on the assumption that the course of prior dealings between the parties and the usage of trade were taken for granted when the record was drafted. Unless negated by the record, they are an element of the meaning of the words used. Similarly, the course of actual performance by the parties may be the best indication of what the parties intended the record to mean.

4. Consistent Additional Terms. Under paragraph (2), consistent additional terms not in the record may be proved unless the court finds that the record was intended by both parties as a complete and exclusive statement of all the terms. This rejects the view that any record that is final on some terms should be, without more, treated as final on all terms of the agreement. On the other hand, if alleged additional terms are such that given the circumstances of the transaction, if agreed upon, they would certainly have been included in the record of the agreement, evidence about the alleged terms must be kept from the trier of fact under this standard.

In many cases, evidence of the parties' intent about the exclusive nature of the record of their agreement will be provided in the record itself. Particularly in commercial agreements, it is common to include a merger clause stating that the record is intended by both parties as a complete and exclusive expression of the terms of the contract. Under the UNIDROIT Principles of International Commercial Law, merger clauses are conclusive on the issue of intent. As a practical matter, a merger clause in a negotiated commercial contract creates a strong, nearly conclusive presumption that both parties intended the record to be the exclusive statement of their agreement. The merger clause does not preclude a court from using course of dealing, usage of trade or course of performance to understand the meaning of contract terms, but does place a difficult burden on the party seeking to establish that additional terms exist. Even in a commercial case, however, the presumption can be shown to be inappropriate if the record itself refers to terms contained in or documented by material extraneous to the purportedly exclusive record. Of course, records that contain a merger clause but refer to other documents may still reflect an intent to be exclusive if the statement of what represents the aggregate exclusive statement of agreement includes all documents intended to be aggregated, including the referenced external documents.

5. Language. This section rejects the premise that the language used in a record necessarily has the meaning attributable to such language by rules of construction existing in the law rather than the meaning that arises out of the commercial context in which it was used. See Section 302.

SECTION 302. PRACTICAL CONSTRUCTION.

(a) [**Consistent construction required.**] The express terms of an agreement and any course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. However, if that construction is unreasonable:

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

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

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

(b) [**Applicable usage of trade.**] An applicable usage of trade in the place where any part of performance is to occur must be used in interpreting the agreement as to that part of the performance.

(c) [**Admissibility: notice to other party.**] Evidence of a relevant course of performance, course of dealing, or usage of trade offered by one party in a proceeding is not admissible unless and until the party offering the evidence has given the other party notice that the court finds sufficient to prevent unfair surprise.

(d) [**Question of fact.**] The existence and scope of a usage of trade must be proved as a question of fact.

Uniform Law Source: Uniform Commercial Code: Section 2A-207; Section 2-208; Section 1-205 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Course of dealing"; "Course of performance"; "Knowledge"; "Party"; "Term"; "Usage of trade".

Comment

1. Scope of the Section. This section is based on Uniform Commercial Code §§ 1-205; 2-208 (1998 Official Text), and provides that in interpreting an agreement a court should refer to relevant indicia of the context in which the parties formed and performed their agreement.

2. Construction based on Performance. This section adopts the premise that the parties themselves know best what they meant by the words of their agreement and that their actions under that agreement are an important indication of that meaning. Behavior, of course, is subordinate to express contract terms. However, course of performance as well as usage of trade and course of dealing provide factors useful in determining the meaning of the "agreement."

3. Nature of Course of Performance. A course of performance requires repeated performance by one party known to the other, an opportunity for the other to object, and a pattern of acceptance or acquiescence by that other party. Since it provides a basis for understanding the parties' agreement, the events creating it must have mutual elements. Unilateral conduct unknown to the other party, such as use of information beyond the terms of a license, cannot establish a course of performance. Similarly, a single act does not fall within this concept, although a single event may affect the parties' rights in other respects.

4. Relationship to Waiver. A pattern of conduct may provide insight into the meaning of the agreement or represent a waiver of a term. The preference in this Act is in favor of a "waiver" (if the elements of waiver are present) whenever this construction is reasonable because this interpretation preserves the flexible character of commercial contracts and prevents surprise or other hardship. This is true because a waiver can be retracted as to future performance. See Sections 702; 303 Comment 5. In contrast, treating a pattern of conduct as providing a binding interpretation of the agreement results in specifying a meaning that cannot be unilaterally retracted by a party.

5. Order of Interpretation. Subsection (a) sets out the order of preference among express terms, course of performance, course of dealing, and usage of trade. Express terms of an agreement always govern. Course of performance and course of dealing are the next preferred, respectively, because each relates to the behavior of the particular parties. These all supersede the default rules of this Act.

6. Place of Performance. Subsection (b) indicates that, as applied to a performance, any applicable usage of trade is determined as meaning what it may fairly be expected to mean to parties in a given locality and involved in the particular type of commercial transaction in that locality. However, the alleged usage of trade must meet the definition of that term, including in reference to its being understood by all parties to the contract as to that place. See Uniform Commercial Code § 1-205, comment 4 (1998 Official Text).

SECTION 303. MODIFICATION AND RESCISSION.

(a) [**Consideration not required.**] An agreement modifying a contract subject to this [Act] needs no consideration to be binding.

(b) [**No oral modification terms.**] An authenticated record that precludes modification or rescission except by an authenticated record may not otherwise be modified or rescinded. In a standard form supplied by a merchant to a consumer, a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.

(c) [**When record required.**] A modification of a contract and the contract as modified must satisfy the requirements of Sections 201(a) and 307(f) if the contract as modified is within those provisions.

(d) [**Waiver.**] Subject to Section 702, an attempt at modification or rescission which does not satisfy subsection (b) or (c) may operate as a waiver.

Uniform Law Source: Uniform Commercial Code: Sections 2A-208; 2-209 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Consumer"; "Contract"; "Merchant"; "Record"; "Standard form"; "Term".

Comment

1. Scope of the Section. This section deals with modifications of contracts and agreed limits on the ability to modify. It is subject to Section 304 on changes made pursuant to contract terms allowing changes. The section generally follows Uniform Commercial Code § 2-209 (1998 Official Text), but makes various changes and moves provisions on the relationship between attempted modification and waiver to Section 702. On the relationship between this and terms presented for later agreement, see Section 208, Official Comment 4.

2. Role of Contract Modifications. Subsection (a) makes modifications of contracts effective without regard to any lack of consideration. The modification must be in an agreement and there must be assent by both parties. As in Uniform Commercial Code § 2-209 (1998 Official Text), there is no requirement that a modification be proposed in good faith. A court should not be asked to accept or invalidate an agreed modification based on its view of the fairness of the commercial motivations of the party proposing the modification or whether the agreement is fair. The fact that there must be agreement protects against overreaching and abuse, allowing courts to apply ordinary concepts related to fraud or duress when appropriate.

3. Contract Terms Prohibiting Oral Modification. Under subsection (b), a contract term that bars modification or rescission of an agreement except in an authenticated record is enforceable. See Uniform Commercial Code § 2-209 (1998 Official Text). This type of contract term has great importance in commercial relationships especially in contracts involving ongoing performances. Contractually preventing modifications that are not in an authenticated record plays an important role in preventing false allegations of oral modifications, difficulties of establishing terms, and avoiding circumvention of express agreements by alleged modifications. For example, a term that provides "no modification without a signed writing" precludes modification of an agreement by a later mass-market license not signed by the licensee. *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*, 1997 WL 258886, 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997). Such terms permit parties to make their own statute of frauds that controls their risk of oral or other unsigned modifications. The language of the contract term controls, but the presumption should be that electronic records and signatures are included within contractual terms that generally refer to signatures or writings. However, if a term of a contract limits modifications to a "written signature on paper," an electronic record or an electronic authentication is not sufficient.

Subsection (b) adopts the policy of Uniform Commercial Code § 2-209 (1998 Official Text) that in consumer transactions such terms are enforceable only if the consumer assents specifically to the term. U.C.C. Article 2 requires a consumer to sign the term. This Act substitutes the requirement of manifesting assent to better fit electronic commerce. The limitation in subsection (b) does not apply to a transaction that is not a consumer transaction.

4. Statute of Frauds. Under subsection (c), the contract as allegedly modified and the modification itself must satisfy the statute of frauds and Section 307(f) to be enforceable. This prevents unfounded claims of oral modification that alter the contract in a way that derogates Section 201(a) or Section 307(f). Thus, the alleged modification cannot, without an authenticated record, transform a $6,000 two-year license of computer information into a perpetual license, nor can it alter the subject matter of a license for a multi-media product to include an entirely different subject matter. On the other hand, a modification that changes the delivery date without altering the term or subject matter, need not be in an authenticated record if the original agreement was in such a record. In that case, the original record suffices under Sections 201 and 307 as to the modified contract.

Partial performance under the original agreement validates the original agreement, but if the modification alters subject matter, duration, scope, price or other significant terms, that partial performance does not validate the modified contract. If the contract as modified does not satisfy

the statute of frauds, the original agreement that did satisfy Section 201 constitutes the contract.

The modifications must also satisfy any other applicable rules limiting the effectiveness of agreed terms. Thus, disclaimers of warranties must meet the disclaimer rules and modifications of scope must comply with Section 307.

5. Waiver. A party whose conduct is inconsistent with a contract term may place itself in a position from which it may no longer assert that term until it gives notice to the other party that it intends to do so. That principle of waiver is discussed in Section 702 and applies to contract terms requiring a signed record for modification. But waiver occurs only if the conduct induced the other party reasonably and in good faith to rely and that reliance precludes changing the position as to past conduct or as to future conduct unless steps are taken to cut off reasonable reliance on the waiver as to the future. See *Autotrol Corp. v. Continental Water Systems*, 918 F.2d 689, 692 (7th Cir. 1990); *Wisconsin Knife Works v. National Metal Crafters*, 781 F.2d 1280 (7th Cir. 1986). Reasonableness of such behavior, of course, must be considered in light of the circumstances, including the fact of a "no waiver" clause. Courts should be slow to find waiver of anti-waiver provisions in general and "no-oral modification" clauses in particular. See 1 *White & Summers, Uniform Commercial Code* 1-6, pp. 41-42 (4th Ed. 1995). With "no-oral modification" clauses, it is more likely that the conduct constitutes a waiver of the substantive term for a particular performance, rather than of the "no-oral-modification" clause itself which would open up the entire contract based on behavior affecting one part. That interpretation is consistent with Section 302, preferring a waiver analysis over a modification analysis in close cases.

SECTION 304. CONTINUING CONTRACTUAL TERMS.

(a) [**Terms apply to all performances.**] Terms of an agreement involving successive performances apply to all performances, even if the terms are not displayed or otherwise brought to the attention of a party with respect to each successive performance, unless the terms are modified in accordance with this [Act] or the contract.

(b) [**Agreed procedure for changes.**] If a contract provides that terms may be changed as to future performances by compliance with a described procedure, a change proposed in good faith pursuant to that procedure becomes part of the contract if the procedure:

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

(2) in a mass-market transaction, permits the other party to terminate the contract as to future performance if the change alters a material term and the party in good faith determines that the modification is unacceptable.

(c) [**Agreed standards for notice.**] The parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light

of the commercial circumstances.

(d) [**When other law applies.**] The enforceability of changes made pursuant to a procedure that does not comply with subsection (b) is determined by the other provisions of this [Act] or other law.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Good faith"; "Mass-market transaction"; "Notice"; "Notify"; "Party"; "Term"; "Termination".

Comment

1. Scope of the Section. This section deals with contracts involving ongoing performances by one or both parties. It clarifies enforceability of agreed methods that allow changes in terms, but does not alter law or agreements outside this Act which place restrictions on the ability to change terms.

2. Continuing Terms. Subsection (a) states two important principles.

First, contract terms cover all performances under the contract whenever the agreement extends to subsequent performances. A warranty disclaimer in a contract for ongoing use of a website applies to all subsequent uses of the site pursuant to that contract. Of course, if each separate access involves a separate access contract, the terms of the first agreement do not cover the second, absent express agreement that it does so.

Second, contract terms can be changed pursuant to procedures established by the contract. The procedures might relate to actions of a third party (e.g., changes in applicable government regulation), to an external standard (e.g., a price index), or to changes implemented by a party pursuant to an agreed procedure. Performance under a contractual right to change terms is subject to the duty of good faith. The affirmative principle is that, in a commercial agreement, if parties agree to a procedure by which terms can be altered, they are bound by that agreement and changes made pursuant to that agreed procedure are binding unless the proposal violates standards of good faith, including commercial fair dealing.

3. Changes in Terms. Subsection (b) sets out procedures that, if established by agreement and followed in fact, make a contractual change of terms effective. It creates incentives for contracts that provide more protection to the party that is not changing the terms than are required in common law. If parties agree that changes can be made pursuant to a specified procedure and the provisions of this subsection are met, the changes made in good faith pursuant to that procedure are effective; this section excludes any argument in such cases that the contract containing such a procedure fails for lack of mutuality. If subsection (b) is not met, however, neither the contract nor the changes are rendered unenforceable by this Act, but the parties do not benefit from the rule in this subsection.

The subsection addresses important practices in online and other contracts, such as outsourcing agreements, where there is a need to efficiently modify terms over time. It does not alter agreements or consent orders which limit or expand the ability to make changes in an ongoing contract. This subsection deals only with agreed terms that permit changes to be made. It does not create a unilateral right to change terms if the parties have not agreed to an applicable procedure.

Contract terms allowing procedures for changes are the converse of contractual provisions restricting modification other than in an authenticated record. They are analogous to cases in which an agreement leaves the particulars of performance to be specified by one party. They are enforceable under Section 305 and under U.C.C. Article 2. The need for enforceability of such changes is especially important in electronic commerce because this area of commerce is subject

to evolving and unpredictable rules and circumstances that may require adjustment of performance, risk allocation, and other characteristics of a relationship. The requirement that the change be made in good faith requires that the change occur in a manner consistent with commercial standards of fair dealing; this prevents the party making the change from taking undue advantage.

a. Relationship to Other Rules. To be effective under this section, the procedures described in subsection (b) must be pursuant to a contract term authorizing a procedure for changes. The terms of an ongoing contract may, of course, be altered in other ways, such as by an agreed modification. Similarly, principles of waiver can affect what are the effective terms of the agreement.

b. Contracts Generally. Under subsection (b)(1), a change becomes part of the contract if it meets the following conditions:

- it is proposed in good faith, which includes meeting standards of commercial fair dealing;
- it is proposed pursuant to an agreed procedure;
- the procedure reasonably notifies the other party of the change.

However, since this Act preserves substantive consumer statutes (Section 105), if a consumer statute specifies a method for notice of changes, this Act does not displace that rule.

Subsection (b)(1) requires that the procedure reasonably notify the other party of the change. What constitutes reasonable notification depends on the commercial circumstances and general commercial standards of practice with respect to that circumstance. Posting at an agreed location designated for that purpose would ordinarily suffice as commercially reasonable notification. While there is no requirement that individual changes be separately singled out for special affirmative notice, such may be appropriate under this standard for material changes such as a change in price. Often, reasonable notification requires action before the change is effective, but in some emergency situations, notice that coincides with the change or follows it is sufficient (e.g., blocking access to a virus infected site or a change in access codes to prevent third party intrusions). A procedure for posting changes in a designated, accessible location will ordinarily suffice. The overall context of the contract must be considered.

This section does not require that there be a right to withdraw from the contract in commercial, non-mass-market transactions. This is because, in cases such as outsourcing agreements or other ongoing commercial relationships, the blanket requirement of a withdrawal right cannot meet the varied and important commercial circumstances that might arise. For example, in some cases, the services provider makes extensive financial commitments in based on a multiyear contract term and requiring that a withdrawal right exist in those situations would seriously disrupt commercial expectations.

c. Mass-Market Transactions. In mass-market transactions, subsection (b)(2) authorizes an agreed procedure only if standards of good faith and reasonable notification are met and the consumer or other mass-market licensee has a right in good faith to withdraw from the contract with respect to future performances. The termination right must be exercised in good faith and for a material change adverse to the licensee. Price changes are material in all cases. Other changes may be material, such as a significant change in the agreed hours during which the on-line system is available. Of course, a reduction in price or other generally beneficial change does not require a right to terminate.

The right to withdraw must be without penalty, but the licensee must, of course, perform the contract prior to the date of withdrawal (e.g., pay all sums due). In many licenses that entail continuing performance, the contract may be subject to termination at will. Subsection (b) does not alter that rule or the rights of either party under it.

4. Changes in Content. This section deals with changes in contract terms and does not cover changes in content available under an access contract. In an access contract, the access right is to materials as changed by the licensor over time unless the agreement otherwise expressly provides. A decision to add, modify, or delete a database or a part of a database does

not modify the contract, but merely constitutes the performance of the licensor and is not within this subsection.

SECTION 305. TERMS TO BE SPECIFIED. An agreement that is otherwise sufficiently definite to be a contract is not invalid because it leaves particulars of performance to be specified by one of the parties. If particulars of performance are to be specified by a party, the following rules apply:

(1) [**Limitations on specification.**] Specification must be made in good faith and within limits set by commercial reasonableness.

(2) [**Effect of delay.**] If a specification 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.

Uniform Law Source: Uniform Commercial Code Section 2-311 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Good faith"; "Seasonable"; "Party."

Comment

1.Scope of Section. This section follows Uniform Commercial Code § 2-311 (1998 Official Text). It deals with contracts in which one party reserves or is granted the right to specify terms after the agreement. On the relationship between this and terms presented for later agreement, see Section 208, *Official Comment* 4.

2. Enforceability. This section is an express recognition of one form of layered contracting in which terms are established after the initial agreement, rather than at the time of initial agreement. If the initial agreement is sufficiently definite to form a contract, this section allows parties to leave particulars of performance to be filled in by a party without running the risk of having the contract invalidated for indefiniteness. The party empowered to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise; the range of permissible specifications is limited by what is commercially reasonable.

The agreement that permits one party to specify terms may be found in a course of dealing, usage of trade, implication from the circumstances or in explicit language used by the parties. Thus, acquisition of information through a telephone order where there is reason to know that terms to be provided by the other party will indicate details of the contractual arrangement may fall within this section. Supplied under this section, the details supplied are bounded by trade use

and commercial expectations (as well as by the terms actually agreed by the parties). They do not, however, require that the other party agree to the terms since, by definition, the original agreement constitutes assent to the later terms under the limitations described here.

3. Conditions. Paragraph (2) applies when specification by one party is necessary to or materially affects the other party's performance, but is not seasonably made. The section excuses the other party's resulting delay in performance. The hampered party may perform in any reasonable manner, suspend its performance, or treat the other person's failure as a breach of contract. These rights are in addition to all other remedies available under the contract or this Act. This includes the right to demand reasonable assurances of performance because the delay caused insecurity. The request for assurances may also be premised on the obligation of good faith established in this section, which obligation may imply the need for a reasonable indication of the time and manner of performance for which the other party is to hold itself ready.

SECTION 306. PERFORMANCE UNDER OPEN TERMS. A performance obligation of a party that cannot be determined from the agreement or from other provisions of this [Act] requires the party to perform in a manner and in a time that is reasonable in light of the commercial circumstances existing at the time of agreement.

Definitional Cross References: Section 102: "Agreement"; "Party".

Comment

1. Scope of Section. This section provides a general interpretation rule for issues not covered by the agreement or other sections of this Act. It follows Article 2 of the Uniform Commercial Code (1998 Official Text).

2. Commercial Context. Interpretation of contracts must be based on the commercial context. If the agreement or this Act does not provide content for a term left open by the parties, a court must adopt a standard that is reasonable in light of the commercial circumstances. This rule applies only if there is no contract term. Agreement may be found in express language or in usage of trade or course of dealing. This section does not allow a court to add or alter agreed terms. See Section 210, Comment No. 4.

What is reasonable in context depends on the nature, purpose and circumstances of the action to be taken or avoided and on the entire commercial context of the agreement. If the reasonableness standard applies, a party is not required to fix, at peril of breach, a performance that is in fact reasonable in the unforeseeable judgment of a later trier of fact. Under general requirements of good faith, effective communication by one party to the other of a proposed time limit or other interpretation of a reasonable performance calls for a response so that a failure to reply in a timely manner creates an inference of acquiescence to the proposal. If the recipient of the proposal objects or if no proposal is made, a demand for assurance on the ground of insecurity may be made pending further negotiation. Only if a party insists on undue delay or unreasonable performance or rejects the other party's commercially reasonable proposal does a question of breach arise.

3. Lack of Contract. This section does not apply if the parties do not intend an agreement. If a term is left open because there was no agreement on the term and the intent of the parties precludes a contract unless or until that agreement occurs, Section 202(e) applies.

[SUBPART B. INTERPRETATION]

SECTION 307. INTERPRETATION AND REQUIREMENTS FOR GRANT.

(a) [**Terms of grant.**] A license grants:

(1) the contractual rights that are expressly described; and

(2) a contractual right to use any informational rights within the licensor's control at the time of contracting which are necessary in the ordinary course to exercise the expressly described rights.

(b) [**When breach occurs.**] If a license expressly limits use of the information or informational rights, use in any other manner is a breach of contract. In all other cases, a license contains an implied limitation that the licensee will not use the information or informational rights otherwise than as described in subsection (a). However, use inconsistent with this implied limitation is not a breach if it is permitted under applicable law in the absence of the implied limitation.

(c) [**Improvements not included.**] A party is not entitled to any rights in new versions of, or improvements or modifications to, information made by the other party. A licensor's agreement to provide new versions, improvements, or modifications requires that the licensor provide them as developed and made generally commercially available from time to time by the licensor.

(d) [**Design information.**] Neither party is entitled to receive copies of source code, schematics, master copy, design material, or other information used by the other party in creating, developing, or implementing the information.

(e) [**Other rules of interpretation.**] Terms concerning scope must be construed under ordinary principles of contract interpretation in light of the informational rights and the commercial context. In addition, the following rules apply:

(1) [**Grant of "all rights" interpreted.**] A grant of "all possible rights and for all

media" or "all rights and for all media now known or later developed", or a grant in similar terms, includes all rights then existing or later created by law and all uses, media, and methods of distribution or exhibition, whether then existing or developed in the future and whether or not anticipated at the time of the grant.

(2) [**Grant of "exclusive license" interpreted.**] A grant of an "exclusive license", or a grant in similar terms, means that:

(A) for the duration of the license, the licensor will not exercise, and will not grant to any other person, rights in the same information or informational rights within the scope of the exclusive grant; and

(B) the licensor affirms that it has not previously granted those rights in a contract in effect when the licensee's rights may be exercised.

(f) [**When record required.**] The rules in this section may be varied only by a record that is sufficient to indicate that a contract has been made and which is:

(1) authenticated by the party against which enforcement is sought; or

(2) prepared and delivered by one party and adopted by the other under Section 208 or 209.

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Person"; "Receive"; "Record"; "Scope"; "Term".

Comment

1. Scope of Section. This section deals with interpretation of a license, establishing the basic premise that a license should be interpreted in a commercially reasonable manner and providing several specific interpretation rules that reflect commercial practice.

2. License Grant. Subsection (a) provides that as a matter of interpretation a license gives the contractual rights expressly granted and, in appropriate cases, limited implied rights to the extent necessary to use the expressly granted rights in the information. A license of software expressly allowing the licensee to create visual presentations for use in public speaking incorporates a right to publicly display images from the software in such presentations because that right is necessary to the expressly granted right. On the other hand, under both copyright law and this section, a contract granting a right to publish a work as part of a particular compilation does not convey any implied right to reproduce that work in another medium or form. See *Tasini v. The New York Times Co., Inc.*, – U.S. – (2001). Also, the implied rights apply only to rights within the control of the licensor at the time of the contracting. For example, a license to use a photograph in a digital product implies a right to transform that photograph into digital form

assuming that this right was within the licensor's control at the time the contract was made.

This subsection does not create an implied license, but merely states a reasonable commercial interpretation of a contract. It can be over-ridden by the agreement. Also, the implied rights pertain only to information and material provided to the licensee. They do not require that the licensor transfer additional materials (such as source code) unless that transfer was agreed by the parties. The rights must be necessary and not merely convenient to enable the express grant. They do not include rights merely because the licensee desired them, merely because the rights pertain to uses made possible by possession of a copy, or merely common or even helpful rights, unless such rights are necessary to utilize the expressly granted rights. Express terms creating greater rights or lesser rights, of course, override this subsection.

Subsection (a) expresses a contract law interpretive rule. Some cases hold that federal policy requires interpretation of a license against the licensee and in a manner that withholds any use not expressly granted. *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989). The better view is that expressed in cases such as *Bourne v. Walt Disney Co.*, 68 F.3d 621 (2d Cir. 1995), which treat interpretation as an ordinary commercial contract question. Of course, to the extent a mandatory federal policy precludes different state law, that policy overrides subsection (a). Section 105(a).

3. Exceeding the Grant. Subsection (b) resolves the interpretation of a license that gives the licensee a right "to do X" when the licensee does an act that exceeds or differs from "X." When the contract limit is express, as in stating a right "only to do X", actions different from the expressly limited grant are a breach. This refers to the grant as interpreted, including consideration of course of dealing and usage of trade. When the license is less explicit, subsection (b) provides that there is an implied limitation that the licensee will not use the information other than as described in the contract and subsection (a). Uses outside these terms are a breach. This rejects case law that requires express limiting language for this result, such as requiring a license to state that the licensee may "*only* do X". If the word "only" or its equivalent does not appear, some patent cases hold that uses not covered by the grant infringe the patent, but may not breach the license. As a matter of contract law, a rule that hinges on the use or failure to use the word "only" provides a trap that is avoided in subsection (b) by adopting the ordinary understanding that an affirmative grant implicitly excludes uses that exceed or are not otherwise within the grant.

The implied limitation, however, does not yield a breach if the use would have been permitted by law in the absence of the limitation. Thus, scholarly use of a quotation from licensed material not subject to trade secrecy restraints, if a fair use under federal law, would not conflict with the implied limitation. However, a licensee that does something that is not included in that grant and that is not protected such as by fair use breaches the contract. A license for use in Peoria implies the lack of a right to do so in Detroit, just as a contractual right to use information for 100 users implies a lack of a right to use it for 101 or more.

4. Improvements and Design Material. Under subsections (c) and (d), unless the contract clearly indicates otherwise, neither party has a right to receive subsequent modifications or improvements made by the other, or a right of access to design and confidential material. Arrangements for such material as modifications, improvements, source code or designs entail separate relationships handled by express contract terms. In the absence of express terms, the contract gives no rights to such material to either party. This contract law principle does not, of course, supplant intellectual property rules on derivative works. Section 105(a).

5. Grant Clauses. Subsection (e) states that ordinary commercial contract principles apply to interpreting a license grant. As a state law rule, of course, it is subject to contrary federal policy which, some courts hold, requires interpretation of a grant in favor of the licensor. See Comment No. 2 above.

Subsections (e)(1) and (e)(2) provide guidance on important license terms. Subsection (e)(1)

establishes a uniform rule on when a grant covers future technologies and rights. Use of statutory or similar language that creates a broad scope without qualification should be sufficient to cover any and all rights as well as present and future media (such as print, television, on-line and other modes of distribution). This is subject to other rules in this Act, 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. The interpretation rule does not encourage or discourage use of such broad grants, but merely gives guidance on what language achieves what result when agreed by the parties.

Subsection (e)(2) clarifies that an exclusive license that does not otherwise deal with the issue, conveys exclusive rights that include restrictions on the licensor. The licensor may not license or itself use the information within the scope of the exclusive license, and affirms that it has not granted any other subsisting license covering the same scope and will not grant any future license covering the same scope that takes effect during the duration of the exclusive license. This Act does not change the definition of what is an "exclusive license" for copyright law recordation purposes, it merely deals with the interpretation given to a contract that provides that it is an exclusive license.

SECTION 308. AGREEMENT FOR PERFORMANCE TO PARTY'S SATISFACTION.

(a) [**Reasonable person standard as general rule.**] Except as otherwise provided in subsection (b), an agreement that provides that the performance of one party is to be to the satisfaction or approval of the other party requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied.

(b) [**When subjective satisfaction standard applies.**] Performance must be to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by stating that approval is in the "sole discretion" of the party, or words of similar import; or

(2) the agreement is for informational content to be evaluated in reference to subjective characteristics such as aesthetics, appeal, or suitability to taste.

Uniform Law Source: Restatement § 228.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Informational content"; "Party"; "Person"; "Term".

Comment

1. Scope of Section. This section deals only with cases where the agreement provides that the acceptability of a required performance is to be judged based on the satisfaction of the party

receiving the performance (e.g., where the parties agreed to a "to the satisfaction" clause). This often occurs in licenses where a work is to appeal to aesthetic sensibilities or taste.

2. Basic Rule. Subsection (a) follows the *Restatement (Second) of Contracts* § 228. Contract terms that define acceptability in terms of "to the satisfaction" of a party are ordinarily interpreted as requiring an objective or reasonable person standard. Refusal is not allowed if the tender would be acceptable to a reasonable person. This rule is supplemented by the general obligation of good faith that applies to all contracts.

3. Subjective Standard. As subsection (b) indicates, there are cases where a subjective standard of satisfaction is appropriate. The most obvious is when the contract so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard. Of course, the agreement may expressly reject a subjective standard and that agreement would control.

Subsection (b)(2) presumes a subjective standard if the contract involves informational content evaluated on aesthetics, appeal, or the like. See *Locke v. Warner Brothers, Inc.*, 66 Cal. Rptr.2d 921 (Cal. App. 1997) (Under California law the applicable standard is that it is to be to the "honest satisfaction" of the party). As the subsection makes clear, this refers to cases where evaluation reflects subjective criteria and judgment. A reasonable person standard in such cases is nonsensical since the nature of the required evaluation presumes the exercise of personal judgment.

PART 4

WARRANTIES

SECTION 401. WARRANTY AND OBLIGATIONS CONCERNING NONINTERFERENCE AND NONINFRINGEMENT.

(a) [**Warranty of noninfringement.**] A licensor of information that is a merchant regularly dealing in information of the kind warrants that the information will be delivered free of the rightful claim of any third person by way of infringement or misappropriation, but a licensee that furnishes detailed specifications to the licensor and the method required for meeting the specifications holds the licensor harmless against any such claim that arises out of compliance with either the required specification or the required method except for a claim that results from the failure of the licensor to adopt, or notify the licensee of, a noninfringing alternative of which the licensor had reason to know.

(b) [**Warranty of noninterference and exclusivity.**] A licensor warrants:

(1) for the duration of the license, that no person holds a rightful claim to, or interest in, the information which arose from an act or omission of the licensor, other than a claim by way of infringement or misappropriation, which will interfere with the licensee's enjoyment of its interest; and

(2) as to rights granted exclusively to the licensee, that within the scope of the license:

(A) to the knowledge of the licensor, any licensed patent rights are valid and exclusive to the extent exclusivity and validity are recognized by the law under which the patent rights were created; and

(B) in all other cases, the licensed informational rights are valid and exclusive for the information as a whole to the extent exclusivity and validity are recognized by the law applicable to the licensed rights in a jurisdiction to which the license applies.

(c) [**Exceptions and limitations.**] The warranties in this section are subject to the

following rules:

(1) [**Governmental mandates.**] If the licensed informational rights are subject to a right of privileged use, collective administration, or compulsory licensing, the warranty is not made with respect to those rights.

(2) [**Territorial assumptions.**] The obligations under subsections (a) and (b)(2) apply solely to informational rights arising under the laws of the United States or a State, unless the contract expressly provides that the warranty obligations extend to rights under the laws of other countries. Language is sufficient for this purpose if it states "The licensor warrants 'exclusivity', 'noninfringement', 'in specified countries', 'worldwide'", or words of similar import. In that case, the warranty extends to the specified country or, in the case of a reference to "worldwide" or the like, to all countries within the description, but only to the extent the rights are recognized under a treaty or international convention to which the country and the United States are signatories.

(3) [**Patent licenses.**] The warranties under subsections (a) and (b)(2) are not made by a license that merely permits use, or covenants not to claim infringement because of the use, of rights under a licensed patent.

(d) [**Disclaimer or modification permitted.**] Except as otherwise provided in subsection (e), a warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it may have. An obligation to hold harmless under subsection (a) may be disclaimed or modified only by specific language or by circumstances giving the licensor reason to know that the licensee does not provide a hold-harmless obligation to the licensor. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states:

(1) as to a licensor's obligation, "There is no warranty against interference with your enjoyment of the information or against infringement", or words of similar import; or

(2) as to a licensee's obligation, "There is no obligation to hold you harmless from any actions taken in compliance with the specifications or methods furnished by me under this contract", or words of similar import.

(e) [**Quitclaims.**] Between merchants, a grant of a "quitclaim", or a grant in similar terms, grants the information or informational rights without an implied warranty as to infringement or misappropriation or as to the rights actually possessed or transferred by the licensor.

Uniform Law Source: Uniform Commercial Code: Sections 2A-211; 2-312 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Automated transaction"; "Conspicuous"; "Contract"; "Information"; "Informational rights"; "Knowledge;" "License"; "Licensee"; "Licensor"; "Merchant"; "Notify," "Person"; "Record"; "Scope"; "Term," "Transfer." Section 117: "Reason to know".

Comment

1. Scope of the Section. This section deals with warranties on non-infringement, exclusivity, and non-interference. These warranties are not implied warranties and cannot be disclaimed except as stated in this section.

2. Non-Infringement Warranty. Subsection (a) derives from Uniform Commercial Code § 2-312 (1998 Official Text). Language changes, such as use of the word "will" as compared to "shall", are for purposes of style and no change in substance is intended.

a. Party Making the Warranty. When the computer information is part of the normal business subject matter with which the licensor deals and is provided in the normal course of its business, it is the licensor's obligation to see that no third party claim of infringement of an intellectual property right or of misappropriation will affect the delivered information. As in Article 2, however, a transfer by a person other than a dealer in information of the kind raises no implication of such a warranty.

b. Delivered Free of Infringement. Subsection (a) requires delivery free of rightful claim of infringement or misappropriation. The mere assertion of a claim does not breach this warranty; the claim must be valid. As in Uniform Commercial Code Section 2-312 (1998 Official Text), the warranty refers to circumstances and claims existing as the information exists at delivery. This does not cover future events, such as a subsequently issued patent, or extend to use of the information, such as infringement claims resulting from a licensee's decision to use multi-functional software in a manner that is an infringing use, or to combine the licensed information with other information where the composite infringes a third party right. *Chemtron, Inc. v. Aqua Products, Inc.*, 830 F. Supp. 314 (E.D. Va. 1993) and *Motorola v. Varo, Inc.*, 656 F.Supp. 716 (N.D. Tex. 1986) frame the issue correctly. For example, in a license of a spreadsheet program, the warranty is that the program itself does not infringe another person's rights, not that uses of the program that may involve employing the program's capability to create particular functions will not infringe the rights of another. See, e.g., *Matthew Bender & Co., Inc.. v. West Pub. Co.*, 158 F.3d 693 (2d Cir. 1998) (no infringement even if program could be used to recreate copyrighted work). Under Section 805, the limitations period for breach begins when breach was or should have been discovered, rather than on tender of delivery of the

information.

c. Patent License. Subsection (c)(3) makes the subsection (a) warranty inapplicable to patent licenses. This refers to a party licensing a patent per se. Most such patent licenses are not within this Act, but if the license is within this Act, subsection (c) adopts the prevailing rule in patent licensing: a patent license does not warrant that the licensee can use the licensed technology, but merely affirms that the licensor will not sue for use of its rights. On the other hand, if a party licenses *computer information*, the subsection (a) warranty is breached if the information as delivered infringes a third party patent. If a licensor gives a license to the *patent* itself, subsection (a) does not apply.

d. Specifications and Hold Harmless. No warranty from the licensor is implied when the licensee orders computer information to be assembled, prepared, designed or manufactured on the licensee's detailed specifications and methods; in such cases liability runs from the licensee to the licensor. There is an implicit representation by the licensee that the licensor will be safe in following the detailed specifications and method that the licensee requires. *See Bonneau Co. v. AG Industries, inc.,* 116 F.3d 155 (5th Cir. 1997) (rule under Article 2).

The circumstances for this rule do not arise merely because the licensee assists and advises in developing the computer information and even suggests alternative approaches to development. In such cases, the licensor remains in control. More generally, the licensee is entitled to rely on the technical expertise and judgments of the licensor. That is reversed only when the agreement makes clear that the licensee has undertaken to specify what must be done and how it must be done in detail sufficient to eliminate the licensor's choices. When this occurs, there is a tacit assurance from the licensee that there will be no infringement claim resulting from relying on that mandate. For this rule to apply, then, the specifications and method must be specific or detailed, rather than general, and compliance must be required by contract. The "hold harmless" obligation does not exist if infringement is caused by or arises out of optional choices of the licensor that may result in infringement.

A licensor presented with required specifications and methods has an obligation to adopt, or notify the licensee of, non-infringing alternatives of which it has reason to know. The "hold harmless" obligation is eliminated if the licensor had reason to know of a non-infringing alternative and failed either to choose it or notify the licensee of it, such as when an experienced designer of banking systems knows that alteration of a specification would allow use of an alternative that will avoid infringement of a financial systems patent. Only a non-infringing alternative of which the licensor has reason to know is required; the section does not impose a duty of investigation. Reason to know for this purpose must exist at the time that the contract is performed. Since we are dealing with contractually required performance, however, it is enough that the licensee be notified of the non-infringing alternative—the licensor cannot unilaterally rewrite or ignore the contractual requirements.

e. Non-Infringement and Passive Transmission. The warranty in subsection (a) is only made by licensors of information. It does not apply to persons who provide communications or transmission services even if such service falls within this Act. Those service providers do not, for purpose of contract law, engage in activities that reasonably create the inference that they assure the absence of infringing information. That obligation could be expressly undertaken by the contract but is not created by this Act. This Act takes no position and has no effect on what constitutes copyright infringement in such situations. Whether a party is a licensor of information for contract law depends on its position with respect to affirmatively providing the information as part of its ordinary business. This has no bearing on whether a passive transmission provider is liable for infringement to the owner of intellectual property rights.

3. Interference Warranty. The warranty of quiet possession was abolished in Uniform Commercial Code Article 2 for sales of goods but reestablished in Uniform Commercial Code Article 2A for leases of goods. Paragraph (b)(1) follows Article 2A. It creates a warranty that no act or omission of the licensor will result in a third party holding a claim (other than

infringement) that interferes with enjoyment by the licensee of its contractual interest. "Enjoyment" refers to authorized exercise of contract rights in use of the information. The warranty is limited to interfering claims or interests that arise from the licensor's acts or omissions. As in Article 2A, this limitation enables the licensor to assess risks. Infringement and misappropriation claims are excluded because they are dealt with in subsection (a). The warranty reflects that the nature of a license results in a need of the licensee for protection greater than that afforded to a buyer of goods. The warranty represents a tacit commitment by the licensor that it will not act during the duration of the contract in a manner that detracts from the contractual grant. Under Section 805, the limitations period for breach begins when delivery of the information is tendered, not when breach was or should have been discovered. This follows U.C.C. Article 2-312 (1998 Official Text, Comment 2) (breach of warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to future performance).

4. Exclusivity. Subsection (b)(2) deals with exclusive licenses. When a license purports to be exclusive, it engenders two implied assurances that are not relevant for non-exclusive licenses. The first concerns the validity of the intellectual property rights. An exclusive licensor warrants that the rights conveyed are not in the public domain. If this condition is not met, the licensor cannot convey exclusive rights. The second involves whether a portion of the rights covered by the license are vested in another person because co-authors or co inventors were involved, or a prior license exists. In an exclusive license, the licensor implicitly warrants that this is not true. The reasoning on both points is similar: if the implied circumstances are not present, the meaning of "exclusivity" is altered. A similar concern does not exist for non-exclusive licenses because such a condition does not alter the licensee's ability to use the licensed rights as described.

A special rule governs patents. When the exclusivity warranty applies at all, it is restricted to the licensor's knowledge. The warranty is inapplicable to patent licenses excluded under subsection (c)(3).

Exclusivity and validity are warranted only to the extent recognized in law applicable to the rights in question. Thus, the licensor of a trade secret warrants that it has not granted rights to another person, but does not warrant that no other person independently has the information. A trade secret gives no rights against independent discovery. If no right of publicity is recognized in a particular jurisdiction, then the licensor does not warrant exclusivity there with respect to such rights. Subsection (c)(1) reinforces this theme. If under applicable law, the rights are subject to compulsory licensing, public access or use, the warranty is limited by the terms of those rights. For example, a licensor of rights in information which must be licensed to any and all parties for a specified fee, does not warrant exclusivity. If an exclusive right is limited in law by a privilege granted to public use, such as "fair use," the licensor does not warrant against such use.

5. International Issues. Intellectual property rights extend only within the territory of the jurisdiction that creates them, although some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) provides that implied exclusivity and infringement warranties extend only within this country and a country specifically mentioned in the warranty. This latter extension refers to statements made with express reference to the warranty, such as "Licensor warrants non-infringement worldwide." Other references in a license may not be intended to create a warranty. A grant of a license for worldwide use may be no more than a permission to use the information worldwide without lawsuit by the licensor, rather than a warranty that worldwide use will not infringe others rights. In the case of a "worldwide warranty," the obligation extends only to countries that have intellectual property rights treaties with the United States. In the absence of such relationships, rights created under United States law cannot create rights in the other country and, thus, it is assumed that the parties did not intend it to extend there.

6. Disclaimer. Subsection (d) derives from U.C.C. § 2-312 (1998 Official Text) and goes further to provide illustrative language for disclaimer of the licensee's hold harmless obligation. The infringement and other warranties in this section are not implied warranties and cannot be disclaimed except as provided in this Section. Under subsection (d), this requires specific language or circumstances indicating that the warranties are not given; illustrative language is provided for clarity. Subsection (d) limits the conditions under which the warranty can be disclaimed or modified; it does not limit or preclude disclaimer or modification of a hold harmless obligation that might arise under subsection (a).

Subsection (e) recognizes an alternative form of disclaimer in commercial cases. Reference to a grant of a "quitclaim" in this context is relatively common is some areas of business and indicates that the licensor is not undertaking any assurance about the nature or scope of the rights it holds or conveys.

SECTION 402. EXPRESS WARRANTY.

(a) [**How created.**] Except as otherwise provided in subsection (c), an express warranty by a licensor is created as follows:

(1) [**Affirmation of fact or promise.**] An affirmation of fact or promise made by the licensor to its licensee, including by advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information to be furnished under the agreement will conform to the affirmation or promise.

(2) [**Description.**] Any description of the information which is made part of the basis of the bargain creates an express warranty that the information will conform to the description.

(3) [**Sample, model, or demonstration.**] 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 conform to the performance of the sample, model, or demonstration, taking into account differences that would appear to a reasonable person in the position of the licensee between the sample, model, or demonstration and the information as it will be used.

(b) [**Puffing and language limitations.**] It is not necessary to the creation of an express warranty that the licensor use formal words, such as "warranty" or "guaranty", or state a specific intention to make a warranty. However, an express warranty is not created by:

(1) an affirmation or prediction merely of the value of the information or

informational rights;

(2) a display or description of a portion of the information to illustrate the aesthetics, appeal, suitability to taste, subjective quality, or the like of informational content; or

(3) a statement purporting to be merely opinion or commendation of the information or informational rights.

(c) [**Law applicable to published informational content.**] An express warranty or similar express contractual obligation, if any, exists with respect to published informational content covered by this [Act] to the same extent that it would exist if the published informational content had been published in a form that placed it outside this [Act]. However, if the warranty or similar express contractual obligation is breached, the remedies of the aggrieved party are those under this [Act] and the agreement.

Uniform Law Source: Uniform Commercial Code: Section 2A-210; 2-313 (1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Party"; "Person;" "Published informational content".

Comment

1. Scope and Basis of Section. This section follows Article 2 of the Uniform Commercial Code (1998 Official Text), except with respect to published informational content, where it preserves current common law. "Express" warranties rest on "dickered" aspects of the individual bargain and go to the essence of that bargain. "Implied" warranties, on the other hand, rest on inferences from a common factual situation or set of conditions so that no particular language is necessary to create them. They exist unless disclaimed.

2. Basis of the Bargain. Subsection (a) generally adopts the "basis of the bargain" test from U.C.C. §§ 2-313; 2A-210 (1998 Official Text). This allows courts and parties to draw on extensive case law distinguishing express warranties from puffing and from other unenforceable statements, representations or promises. The concept of the "basis of the bargain" standard is that express affirmations or promises are express warranties if they are within the matrix of elements that constitute the bargain of the parties, but that they are not express warranties if they are not part of the basis for the contract. This does not require that a licensee prove actual reliance on a specific statement in deciding to enter into the contract, but does require proof that the statement played a role in the bargain. The issue is whether statements of the licensor to the licensee have in the circumstances and in objective judgment become part of the basic deal. However, an express warranty concerns a bargain; this does not convert all statements a licensor makes about information into an express warranty.

As in Article 2 of the Uniform Commercial Code (1998 Official Text), no specific intent to make a warranty is necessary if the indicated representations, promises or affirmations are part of the basis of the bargain. In practice, affirmations of fact describing the information and made by

the licensor about it during the bargaining are ordinarily part of the bargain unless they are mere puffing, predictions, or otherwise not an enforceable commitment. No specific reliance on the specific statement need be shown in order to weave it into the fabric of the agreement. Of course, when statements are made by an agent, the effect of the representations to bind the principal are governed by ordinary standards about the scope and effect of agency.

If language is used after the closing of the deal (as when the licensee on taking delivery asks for and receives an additional assurance), the assurance may become a modification of the contract. An agreed modification requires no consideration to be binding. Section 303. Alternatively, under the layered contracting recognized in Section 208 and 209, in appropriate cases the assurance may be a further elaboration of terms of the contract if the parties, at the outset, had reason to know this would occur.

3. Advertising as an Express Warranty. Paragraph (a)(1) expands current Article 2. It clarifies that advertising by the licensor may create an express warranty if it otherwise meets the standards for an express warranty under this section. A warranty exists only if the advertising statement becomes part of the bargain and a bargain between the person making the statement and the person acquiring the product actually occurs. Under this Act, and particularly Section 613, a contract may exist between the end user and a dealer who makes the statement, or, or as well as, separately between the end user and a publisher who makes the statement; neither is responsible for the other's statement, however. The affirmation of fact in advertising must be known by the licensee, and must influence and in fact become part of the basis of the bargain between the licensee and warrantor and under which the licensee acquired the computer information. If this does not occur, there is no express warranty. Also, statements made in advertising that are puffing or mere expressions of opinion do not create an express warranty. In appropriate cases, there may be liability for false advertising, but that does not arise under contract law. This section does not create a false advertising claim under the guise of contract law.

4. Descriptions. Paragraph (a)(2) is a specific application of when a description becomes an express warranty. The description need not be by words. Technical specifications, blueprints and the like can afford more exact descriptions than mere language and, if made part of the basis of the bargain, become express warranties. Of course, all descriptions by merchants must be read in light of applicable trade usage and in light of concepts about merchantability that may resolve any doubts about the meaning of the description. The description requires a commercially reasonable interpretation.

5. Samples and Models. Samples, models and demonstrations are treated no differently than statements. However, in mercantile experience, the mere exhibition of a "sample", a "model" or a "demonstration" does not of itself show whether it is intended to "suggest" or to "be" the character of the subject-matter of the contract. That distinction is recognized in reported cases and in this Act.

The effect of representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the demonstration, model, or sample. Showing a sample of a keg of raw beans consisting of a cup-full of beans communicates one inference (most beans will be similar), while demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files (the inference is not that actual use will be identical to use of the sample). This difference also applies to beta models of software, which are used on a test or a demonstration basis and may contain elements that are not carried forward into the ultimate product. Ordinarily the parties understand that what is being demonstrated on a small scale or tested on a beta model is not necessarily representative of actual performance or of the eventual product. As with any other purported express warranty, any model or demonstration must be interpreted in a reasonable fashion that reflects the circumstances of the test or

demonstration. See *NMP Corp. v. Parametric Technology Corp.*, 958 F. Supp. 1536 (S.D. Okla. 1997). The 2002 amendments deleted a redundancy created by the word "reasonably" without there being any substantive change.

6. Puffing and Expressions of Opinion. Subsection (b) makes it clear that puffing or mere statements of opinion do not form an express warranty. The law distinguishes between an actionable representation and puffing is well-developed. The distinction requires a determination based on the circumstances of the particular transaction. The policy that requires this distinction to be made is that in common experience some statements and predictions cannot fairly be viewed as entering into the bargain. To hold each party to every statement made would contradict common experience and stifle discourse about products and proposals. Of course, whether or not a statement is an express warranty does not affect whether the statement established a cause of action under the law of fraud or misrepresentation.

Paragraph (b)(2) identifies a common setting where the issue about how to treat a statement arises. It refers to statements or demonstrations pertaining to aesthetics and the appeal (including market appeal) of informational content as a form of puffing or opinion that does not create an express warranty. Aesthetics, as used here, refers to questions of the artistic character, tastefulness or beauty of informational content, not to statements pertaining to how a person uses the informational content or its essential nature. For example, a statement that a clip art program contains useable images of "working people" may create an express warranty that the subject matter of the program includes working people and that the images are usable. Neither the statement, nor a selected display of part of the program creates an express warranty that they are tasteful or artistically pleasing.

7. Relation to Disclaimers. Express warranty rules focus on determining what the licensor agreed to provide. Descriptions of an information product, if made part of the bargain, are express warranties. If an express warranty is made, the obligations created ordinarily cannot be easily deleted. A general contract term disclaiming "all warranties, express or implied" is not given literal effect as to express warranties under Section 406(a). This does not mean that parties cannot make their own bargain, including a bargain that does not include a purported express warranty. But to do so requires that the particular description or promise not become part of the bargain. In determining what was the actual agreement, consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation. For example, a license of a "word-processing program" that contains a general disclaimer of all warranties is nevertheless a contract for a product that satisfies the basic description of a "word-processing program."

8. Published Informational Content. Subsection (c) preserves current law for published informational content. This section does not change express warranty rules for such content and does not preclude the imposition of any obligation under other law or the creation of an express contractual obligation. Despite it being law for over fifty years, no reported case law on published informational content uses the Article 2 "basis of the bargain" standard. Joel R. Wolfson, *Express Warranties and Published Informational Content under Article 2B: Does the Shoe Fit?,* 16 John Marshal Journal of Computer & Info. Law 384 (1997). Published informational content entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability pertaining to published informational content must balance contract themes with these policies.

The cases treat obligations for published informational content as questions of express contractual obligation, rather than warranty. A promise to provide an electronic encyclopedia obligates the party to deliver that type of work, but that is simply a matter of defining the basic contractual promise. When focusing on the quality of informational content, most courts conclude that the level of risk vis a vis published informational content and the potentially stifling effect that contract liability might have on the dissemination of speech encourage limiting

or excluding liability. See *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987). This section rejects the seemingly simple, but ultimately inappropriate step of merely adopting the basis of the bargain concept from sales of goods to this much different context. However, if a contract obligation is breached with respect to published informational content in a transaction covered under this Act, remedies of this Act apply and replace remedies under the common law. This includes all provisions of Part 8 of this Act.

9. Third Parties. This section does not deal with the enforceability under tort law of representations made by remote parties and relied on by an ultimate user of information. Cases in tort pertaining to information do not parallel cases dealing with the manufacture and sale of goods. See, e.g., *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991). Information providers are liable to third parties in tort in only a few, atypical cases. This Act does not affect such third party liability.

10. Electronic Agents. This section does not deal with "representations" by electronic agents in an automated negotiation. It deals with representations by a licensor. Human beings, with rich contextual understandings, can often distinguish between "falsity" and "white lies" or "puffing". Electronic agents are rarely capable of recognizing the difference. *See* Stuart Russell & Peter Norvig, Artificial Intelligence: A Modern Approach (1995).

SECTION 403. IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM.

(a) [**Terms of implied warranty.**] Unless the warranty is disclaimed or modified, a licensor that is a merchant with respect to computer programs of the kind warrants:

(1) to its end user licensee that the computer program is fit for the ordinary purposes for which such computer programs are used;

(2) to its distributor that:

(A) the program is adequately packaged and labeled as the agreement requires; and

(B) in the case of multiple copies, the copies are within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and

(3) to the parties described in paragraphs (1) and (2), that the program conforms to any promises or affirmations of fact made on the container or label.

(b) [**Implied warranties arising from course of dealing or usage of trade.**] Unless

disclaimed or modified, other implied warranties with respect to computer programs may arise from course of dealing or usage of trade.

(c) [**Rule for informational content.**] No warranty is created under this section with respect to informational content, but an implied warranty may arise under Section 404.

Uniform Law Source: Uniform Commercial Code: Sections 2-314; 2A-212 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Computer program"; "Contract"; "Copies," "Delivery"; "Informational content"; "Licensor"; "Merchant".

Comment

1. Scope of the Section. This section adapts the implied warranty of merchantability from Article 2 of the Uniform Commercial Code (1998 Official Text) to computer programs. This expands the scope of that warranty since, under prior law, in many transactions Article 2 does not apply and there are no other implied warranties. The warranties in subsection (a) arise only if the licensor is in a contractual relationship with the indicated party or if Section 409 so provides. See Section 613, Comment 3(b). Disclaimer or modification of the implied warranty is dealt with in Section 406. Obligations regarding informational content are in Section 404.

2. Background and Policy. The implied warranty of merchantability comes from one of three different legal traditions associated with computer information transactions. The **first**, the source of this warranty, is the Article 2 world of the sale of goods and focuses on the quality of the result (product) delivered, establishing an implied assurance that this product will conform to ordinary standards for products of that type. The **second**, from common law dealing with licenses, services and information contracts, focuses on the process or performance effort, rather than the result, establishing standards such as that the work will be performed in a workmanlike manner. The **third**, from common law, pertains to services and information contracts in some States, rejecting any implied obligation in a contract other than one involving a special relationship of reliance.

This and the following two sections reflect the combined influence of these traditions, making distinctions between computer programs, on the one hand, and information, informational content or services, on the other. The implied merchantability warranty and the warranty in Section 404 pertaining to the accuracy of data may both apply to the same transaction. The one (merchantability) applies to the computer program, while the other (accuracy) applies to the informational content and data.

3. Merchantability. Merchantability sets out an implied obligation based on expectations about ordinary meanings and ordinary transactions in commerce. The warranty runs between the immediate parties in contractual privity. Under this Act, and particularly Section 613, a contract may exist between the end user and the dealer, or as well as separately between the end user and the publisher. The extent to which persons other than ones in a direct contract relationship with each other receive the benefit of the implied warranty under contract law is discussed in Section 409.

The substantive meaning of the implied warranty turns on the ordinary meaning for the kind of computer program as recognized in the applicable business, trade or industry. As in the Uniform Commercial Code, the implied warranty is made only by all merchant-licensors.

a. Fit for Ordinary Purposes. In transactions with end users, under subsection (a)(1), the program must be fit for the ordinary purpose for which programs of that description are used.

To be fit for ordinary purposes does not require that the program be the best or most fit for that use or that it be fit for all possible uses. To an extent greater than for goods, computer programs are often adapted and employed in unlimited or inventive ways or ways that go well beyond the uses for which they were distributed. The focus of the implied warranty is on the ordinary purposes for which programs are used. Use of ordinary, mass-market programs in highly sensitive or commercial applications does not change the warranty into one of fitness for purposes of that use.

Merchantability does not require a perfect program, but only that the subject matter be generally within the average standards applicable in commerce for programs having the particular type of use. The presence of some defects may be consistent with merchantability standards. Uniform Commercial Code § 2-314 (1998 Official Text) explains the concept in terms of "fair average," i.e., goods that center around the middle of a belt of quality B some may be better and some may be worse, but they cannot all be better and need not all be worse. That approach applies here. While perfection is an aspiration, it is not a requirement of an implied warranty for goods, computer programs or any other property. Indeed, a perfect program may not be possible at all.

In the late 1990's, a popular operating system program for small computers used by both consumers and commercial licensees contained over ten million lines of code or instructions. In a computer, these instructions interact with each other and with code and operations of other programs. This contrasted with a commercial jet airliner that contained approximately six million parts, many of which involved no interactive function. Of course, the market price of the airliner and the program are materially different. Typical consumer goods contain fewer than one hundred parts and a typical book has fewer than one hundred fifty thousand words. Most computer programs not only have many lines of code, but must utilize and interact with code in third-party programs, further multiplying the possible interactions. It is often literally impossible or commercially unreasonable to guarantee that software of any complexity contains no errors that might cause unexpected behavior or intermittent malfunctions, so-called "bugs." The presence of minor errors is fully within common expectations. The question for merchantability is not whether errors exist but whether, the program still comes within the middle belt of quality in the applicable trade or industry, i.e., whether it is reasonably fit for the ordinary purposes for which such programs are used in accordance with average levels of quality and reasonable standards of program capability. A great deal of theoretical and practical work is currently focused on techniques to reduce the time and cost needed to determine program "correctness." Professional standards also exist for software quality evaluation. Commercially reasonable use of existing testing techniques can be one benchmark of whether a computer program is merchantable in law. As industry standards evolve, what constitutes a merchantable program will evolve along with those standards.

b. Distribution. If the transfer is to a person acquiring the program for re-distribution, the program must be honestly capable of re-distribution. Subsection (a)(2) sets out two criteria under which this can be gauged B adequate packaging and even quality among multiple units. Consistent with the general concept these standards are judged in light of ordinary commercial expectations.

c. Labels. Under subsection (a)(3), merchantability includes conformance to descriptions of fact contained on labels or containers, if any. As under U.C.C. Article 2, this follows from the general obligation of good faith which requires that a licensee should not be placed in the position of using, or sublicensing when allowed, information that is mislabeled. With respect to descriptions, the statements must be statement so of fact, not mere puffing. The implied warranty arises from facts that often also constitute an express warranty, in which case the rules for express warranties also apply. The meaning of any descriptive statement must be interpreted in light of the commercial context.

4. Disclaimer. In Article 2 of the Uniform Commercial Code (1998 Official Text), the implied warranty of merchantability may be disclaimed pursuant to the fundamental policy that

the agreement of the parties controls. That principle is implemented in Section 406. The right to disclaim is central to the right of a party to determine what it agrees to sell or license and how the parties allocated commercial risks. The law in some States prohibits disclaimer of implied warranties in consumer cases. This Act does not alter that law. Similarly, although one can disclaim all implied warranties under this Act and under Article 2, disclaimers are ordinarily not effective with respect to express warranties of description or otherwise.

5. Informational Content, Aesthetics. Merchantability does not apply to information intended to be communicated to a human being ("informational content"), including the aesthetics of a product. This follows case law under the Uniform Commercial Code. Aesthetics refers to questions of the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste. On the other hand, merchantability can be relevant to whether the computer program is what it purports it to be. For example if a claim about images created by a computer program is that they are not attractive or well-executed, merchantability does not apply. If the complaint is that the program does not function properly and that thus the images are distorted, an issue of merchantability exists. A statement that a clip art program contains images of "horses" gives assurance that the subject matter of the program is horses, but does not purport to state that the images are tasteful or artistically pleasing or whether they are brown, white or green.

6. Cause of Action for Breach. As in other law, in a cause of action for breach of warranty it is necessary to show not only the existence of the warranty, but that the warranty was breached and that the breach was the proximate cause of the loss sustained. In such an action, e.g., in complex computer systems involving different hardware and software, that loss must be caused by defects in the computer program for which breach is claimed. Proof that losses were not so caused or were caused by events after the program was installed and unconnected to it, operate as a defense here as in other law.

SECTION 404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) [**Terms of implied warranty.**] Unless the warranty is disclaimed or modified, a merchant that, in a special relationship of reliance with a licensee, collects, compiles, processes, provides, or transmits informational content warrants to that licensee that there is no inaccuracy in the informational content caused by the merchant's failure to perform with reasonable care.

(b) [**When no warranty exists.**] There is no warranty under subsection (a) with respect to:

(1) subjective characteristics of the informational content, such as the aesthetics, appeal, and suitability to taste;

(2) published informational content; or

(3) a person that acts as a conduit or provides no more than editorial services in

collecting, compiling, distributing, processing, providing, or transmitting informational content that under the circumstances can be identified as that of a third person.

(c) [**Disclaimer permitted.**] The warranty under this section is not subject to the preclusion in Section 115(b)(1) on disclaiming obligations of diligence, reasonableness, or care.

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References: Section 102: "Informational content"; "Licensee"; "Merchant"; "Party"; "Published informational content".

Comment

1. Scope and Effect. This section creates a new implied warranty. The warranty focuses on data conveyed in a relationship of reliance. It recognizes an implied assurance in such contracts that no data inaccuracies are caused by a failure of reasonable care.

2. Accuracy. This warranty is based on the expectation of a person receiving data in a special relationship of reliance that the data are not made inaccurate because of the provider's lack of reasonable care in performing the contract. The warranty is limited to inaccuracies caused by a failure to use reasonable care. One who hires an expert cannot expect infallibility unless the express terms clearly so require. Reasonable efforts, not perfect results, provide the appropriate standard in the absence of express terms to the contrary. The discussion by a New York court in an analogous setting reflects the policy adopted here. *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).

What constitutes reasonable care depends on the commercial circumstances and the contracted for duties. For example, in a contract to transmit computer information, there is no duty to screen or vouch for accuracy, but merely to avoid a lack of reasonable care in the transmission that causes inaccuracies. A data provider in a context where major loss of human life is possible has a higher degree of care than a provider in other settings.

a. Ordinary Standards as Described. Informational content is accurate if, within applicable understandings of permitted errors, it correctly portrays the objective facts to which it relates. Whether or not data are inaccurate is based on expectations gauged by ordinary standards of the relevant trade under the circumstances. In most large commercial databases, ordinary expectations are that some data will be incorrect. Variations or error rates within the range of commercial expectations of the business, trade or industry do not breach the warranty. If greater accuracy is expected, that must be made express in the agreement. For example, if the normal expected error rate is then percent for a particular type of database, an error rate of five percent is not an inaccuracy within this section and does not breach the implied warranty.

The presence of an inaccuracy is also affected by what the data purport to be under the agreement. This section follows cases such as *Lockwood v. Standard & Poor's Corp.*, 175 Ill.2d 529, 689 N.E.2d 1140, 228 Ill. Dec. 719 (Ill. App. 1997). A contract to estimate the number of users of a product in Houston does not imply an obligation to provide an accurate count, but merely requires an estimate. That estimate, if honestly made, does not breach this warranty.

b. Accuracy and Aesthetics. This warranty is not a warranty about aesthetics, subjective quality, or marketability. These are subjective issues. Assurances on these issues require express agreement.

3. Reliance Relationship. The computer information must be provided by a merchant in a "special relationship of reliance" between the licensor and the licensee. In the absence of such relationship, the mere fact that one person contracts to provides information to another creates no

implied obligation beyond good faith.

a. Reliance Relationships in General. The requirement of a special relationship of reliance is fundamental to balancing protecting client expectations while not imposing excessive liability risk on informational content providers in a way that might chill information-providing activities. This stems in part from cases applying *Restatement (Second) of Torts* § 552. The special element of reliance comes from the relationship itself, a relationship characterized by the provider's knowledge that the particular licensee plans to rely on the data in its own business and expects that the provider will tailor the information to its needs. The obligation arises only with respect to persons who possess unique or specialized expertise and who are in a special position of confidence and trust with the licensee such that reliance on the inaccurate information is justified and the party has a duty to act with care. See *Murphy v. Kuhn*, 90 N.Y.2d 266, 682 N.E.2d 972 (N.Y. 1997).

The relationship also requires that the provider make the information available as part of its own business of providing such information. The licensor must be in the business of providing that type of information. This adopts the rationale of cases holding that information provided as part of a differently focused commercial relationship, such as the sale or lease of goods, does not create protected expectations about accuracy except as might be created under express warranty law. *A.T. Kearney v. IBM*, 73 F.3d 238 (9th Cir. 1997) describes many of the relevant issues. See also *Picker International, Inc. v. Mayo Foundation*, 6 F. Supp.2d 685 (N.D. Ohio 1998).

A fundamental aspect of a special reliance relationship is that the information provider is specifically aware of, and personally tailors information to the needs of the licensee. A special relationship does not arise for information made generally available to a group in standardized form even if those who subscribe to the information service believe it is relevant to their commercial needs. The information must be personally tailored for the recipient. A special reliance relationship does not require a fiduciary relationship, but does require indicia of special reliance.

b. Published Informational Content. Published informational content is the subject matter of general commerce in ideas, political, economic, entertainment or the like, whose distribution engages fundamental public policy interests in supporting and not chilling this distribution by creating liability risks. This Act treats published informational content that is computer information analogously to print newspapers or books which are not exposed to contractual liability risks based on mere inaccuracy; treating the computer informational content differently would reject the wisdom of prior law. Creating greater liability risk in contract would place an undue burden on the free flow of information. This policy underlies the result in *Cubby, Inc. v. CompuServe, Inc.*, 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991) and *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987). See also *Great Central Insurance Co. v. Insurance Services Office, Inc.*, 74 F.3d 778 (7th Cir. 1997) (no implied warranty).

The implied warranty in this section thus does not apply to published informational content. By definition, such content is information transferred other than in a reliance relationship. Published informational content is informational content made available to the public as a whole or to a range of subscribers on a standardized, not a personally tailored, basis. This includes a variety of commercially important general distribution or subscription services providing informational content such as an Internet web site that lists information about local restaurants, their prices and their quality, as well as services that provide data about current stock or monetary exchange prices to subscribers.

4. Conduits and Editing. The implied warranty relates only to information provided by the licensor. Subsection (b) clarifies that there is no warranty with respect to third party content where the provider identifies the information as coming from a third party. The implied warranty also does not apply to parties engaged in editing informational content of another person. See *Doubleday & Co. v. Curtis*, 763 F.2d 495 (2d Cir.), cert. dismissed, 474 U.S. 912 (1985).

A person collecting, summarizing or transmitting third party data as a conduit does not create

the same expectations about performance as does a direct information provider. Whatever expectations arise focus on the third party. The third party may not be contractually obligated to the licensee. The conduit's obligation and the licensee's reasonable expectations with respect to it do not entail an obligation regarding the accuracy of the third party data. Concerning the policy issues in dealing with conduits, see *Zeran v. America On-Line, Inc.,* 129 F.3d 327 (4th Cir. 1997). On the related issue of tort liability for publishers who are not authors, see *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991) (describes policy interests that also support subsection (b)).

5. Disclaimer. This section creates a new warranty. The obligation may be disclaimed. Section 406. See *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 665 (Ill. App. 1993). Subsection (c) makes clear that disclaimer of the warranty is not subject to the general rule that duties of reasonable care cannot be disclaimed. See Section 115(b)(1). That general rule is inapplicable here: what is disclaimed is a warranty related to the accuracy of the content, not the exercise of reasonable care. No duty of reasonable care is created under this section.

SECTION 405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) [**When implied warranty as to licensee's purpose arises.**] Unless the warranty is disclaimed or modified, if a licensor at the time of contracting has reason to know any particular purpose for which the computer information is required and that the licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, the following rules apply:

(1) [**Fitness.**] Except as otherwise provided in paragraph (2), there is an implied warranty that the information is fit for that purpose.

(2) [**Effort.**] 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 fitness of the resulting information, the warranty under paragraph (1) is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable effort.

(b) [**When no warranty exists.**] There is no warranty under subsection (a) with regard to:

(1) the aesthetics, appeal, suitability to taste, or subjective quality of informational content; or

(2) published informational content, but there may be a warranty with regard to the licensor's selection among published informational content from different providers if the selection is made by an individual acting as or on behalf of the licensor.

(c) [**Implied warranty of system integration.**] If an agreement requires a licensor to provide or select a system consisting of computer programs and goods, and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components provided or selected will function together as a system.

(d) [**Disclaimer permitted.**] The warranty under this section is not subject to the preclusion in Section 115(b)(1) on disclaiming diligence, reasonableness, or care.

Uniform Law Source: Uniform Commercial Code: Sections 2-315; 2A-213 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Computer program"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Published informational content". Section 117: "Reason to know".

Comment

1. Scope of the Section. Subsections (a) and (b) deal with cases where the expertise of the licensor is relied on by the licensee to achieve its purposes. Subsection (c) imposes a new implied warranty.

2. General Approach. Subsection (a) applies when a licensor has reason to know of the licensee's particular purpose in the transaction and that the licensee is relying on the licensor's expertise in selecting or developing information suitable for that purpose. The subsection resolves a conflict in case law. Some cases, relying on Article 2, apply a standard which creates an implied warranty that the product will be suitable to the purpose. Others, treating a contract as one for services, hold that no enhanced obligation exists unless there are express terms creating it. This section uses the first standard in some cases but subsection (a)(2) applies a reasonable effort standard for cases where the relationship appears to concern services-like obligations. Under prior law, the decision was based on whether a court viewed the transaction as a sale (result) or services (effort) contract.

3. Warranty of Fitness. Subsection (a)(1) applies to cases analogous to transfers involving products and adopts Uniform Commercial Code § 2-315 (1998 Official Text). Whether or not this warranty arises is a question of fact determined by the circumstances at the time of contracting. A "particular purpose" differs from the ordinary purpose for which the information is used in that it envisages a specific use by the licensee peculiar to the nature of its business, while the ordinary purposes for which the computer information is used are contemplated under the concept of merchantability. Normally, this fitness warranty arises only if the licensor is a merchant with appropriate skill or judgment.

The warranty does not exist if there is no reliance in fact or if the particular purposes are not

made known to the licensor. For this warranty to arise, the needs of the licensee must have been particularized and the licensor made aware of them, and the licensor must implicitly undertake to fulfill them.

No exclusion is made for cases where the information product is identified by a trade name. The designation of an item by a trade name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the licensee actually relied on the licensor, but it is not of itself decisive of the issue. If the licensee insists on a particular brand, it is not relying on the licensor's skill or judgment – and no warranty arises. But the mere fact that the information has a trade name is not sufficient to indicate nonreliance.

The warranty obligates the licensor to meet known licensee needs if the circumstances indicate that the licensee is relying on the provider's expertise. There are many development contract and other settings where no reliance exists, including where the licensee provides contract performance standards, rather than relying on the licensor or where both are knowledgeable. The express terms of the agreement may then require that the product meet the specifications, but no reliance exists on whether meeting the specifications meets the licensee's purposes.

4. Services Warranty. Subsection (a)(2) applies if the transaction more closely resembles services contracts; it applies the type of obligation most appropriate to such cases. A skilled service provider does not guaranty a result suitable to the other party unless it expressly agrees to do so. *Milau Associates v. North Avenue Development Corp.,* 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977). Subsection (a)(2) provides a standard to determine when a contract calls for services and effort, rather than result. The test centers on whether the circumstances indicate that the service provider would be paid for time or effort, regardless of the fitness of the result. Such payment terms typify a services contract. Other factors may also indicate that the parties intended a services obligation as delineated in subsection (a)(2). What constitutes reasonable effort depends on the project and other circumstances of the relationship. *Micro Manager, Inc. v. Gregory*, 147 Wisc.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Subsection (d) makes it clear that this warranty may be disclaimed. See Comments to Section 404.

5. Aesthetics and Published Information. The warranty does not apply to aesthetics and the like. Subsection (b) repeats a theme of the Act, which is that implied warranties do not apply to the aesthetics of informational content. Aesthetics refers to the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste, rather than elements susceptible to implied warranty.

6. System Integration. Subsection (c) creates a new implied warranty regarding system performance in cases of systems integration contracts. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a), will meet the licensee's purposes, that it is an optimal system, or that it will not infringe third party rights. The warranty is merely that the system will functionally operate as a system. Thus, if the agreement requires the licensor to select a computer, printer and five software applications, the warranty is that the five applications will run on the computer selected and that the printer will work with the computer and the software. Whether these components were the best choice or will meet the actual needs of the licensee is not within these subsection (c) warranty.

7. Disclaimer. This section creates a new warranty. The obligation may be disclaimed. Subsection (d) makes clear that disclaimer of the warranty is not subject to the general rule that duties of reasonable care cannot be disclaimed. See Section 115(b)(1). That general rule is inapplicable here: what is disclaimed is a warranty related to the accuracy of the content, not the exercise of reasonable care. No duty of reasonable care is created under this section.

SECTION 406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) [**Express warranties and disclaimers.**] Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 301 with regard to parol or extrinsic evidence, the disclaimer or modification is inoperative to the extent that such construction is unreasonable.

(b) [**Implied warranties: disclaimer or modification.**] Except as otherwise provided in subsections (c), (d), and (e), to disclaim or modify an implied warranty or any part of it, but not the warranty in Section 401, the following rules apply:

(1) [**Disclaimer of Section 403 and 404 warranties.**] Except as otherwise provided in this subsection:

(A) To disclaim or modify the implied warranty arising under Section 403, language must mention "merchantability" or "quality" or use words of similar import and, if in a record, must be conspicuous.

(B) To disclaim or modify the implied warranty arising under Section 404, language in a record must mention "accuracy" or use words of similar import.

(2) [**Disclaimer of Section 405 warranty.**] Language to disclaim or modify the implied warranty arising under Section 405 must be in a record and be conspicuous. It is sufficient to state "There is no warranty that this information, our efforts, or the system will fulfill any of your particular purposes or needs", or words of similar import.

(3) [**Disclaimer of all implied warranties.**] Language in a record is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or, except for the warranty in Section 401, if it is conspicuous and states "Except for express warranties stated in this contract, if any, this 'information' 'computer program' is 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.

(4) [**Disclaimer or modification pursuant to other law.**] A disclaimer or modification sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of merchantability is sufficient to disclaim or modify the warranties under Sections 403 and 404. A disclaimer or modification sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of fitness for a particular purpose is sufficient to disclaim or modify the warranties under Section 405.

(c) [**Effect of "as is" or "with all faults".**] Unless the circumstances indicate otherwise, all implied warranties, but not the warranty under Section 401, are disclaimed by expressions like "as is" or "with all faults" or other language that in common understanding calls the licensee's attention to the disclaimer of warranties and makes plain that there are no implied warranties.

(d) [**Effect of precontract examination.**] If a licensee before entering into a contract has examined the information or the sample or model as fully as it desired or has refused to examine the information, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed to the licensee.

(e) [**Effect of commercial context.**] An implied warranty may also be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(f) [**Terms apply to all performances.**] If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer or modification which complies with this section is effective with respect to all performances under the contract.

(g) [**Limitation of remedies.**] Remedies for breach of warranty may be limited in accordance with this [Act] with respect to liquidation or limitation of damages and contractual modification of remedy.

Uniform Law Source: Uniform Commercial Code: Section 2A-214 (1998 Official Text).

Definitional Cross References: Section 102: "Computer program"; "Conspicuous"; "Contract"; "Course of Dealing"; "Course of Performance;" "Information"; "Licensee"; "Licensor"; "Mass-market license"; "Record"; "Usage of Trade."

Comment

1. General Structure and Policy. This section deals with disclaimer or limitation of warranties, except Section 401 statutory warranties that may only be disclaimed under Section 401. This section generally corresponds to Article 2 and Article 2A of the Uniform Commercial Code (1998 Official Text). Those statutes refer to "negating" or "limiting" warranties. This Act reflects modern terminology, referring to "disclaiming" or "modifying" warranties. No substantive change is intended. This Act does not alter consumer protection statutes that may preclude disclaimer of implied warranties in consumer cases, or federal law that may in some cases prevent disclaimer of implied warranties for consumer products. The section follows the Uniform Commercial Code and common law holding that implied warranties are default rules that parties may disclaim or limit by agreement.

2. Express Warranties. General language of disclaimer cannot exclude express warranties. While courts should construe contract terms of disclaimer and language of express warranty as consistent whenever reasonable, in cases of inconsistency, express warranty language controls. An express warranty cannot be disclaimed, but a representation that might otherwise be an express warranty can be excluded from the bargain by the agreement. Language of the agreement, including a disclaimer, may indicate that a purported warranty did not in fact become part of the bargain and is not, therefore, an express warranty. This may occur when the language of the agreement contradicts the alleged express warranty or where the agreement expressly precludes reliance on representations outside the authenticated record.

While express warranties may survive general disclaimers, as in Article 2, the licensor is protected against unfounded claims of oral express warranties by the provisions of this Act on parol or extrinsic evidence and by the other terms of its contract. It is protected against unauthorized representations by agency law. Remedies for breach of warranty are dealt with in other sections of this Act and may be modified in accordance with this Act.

3. Disclaimers and Fraud. This Act does not alter the law of fraud. If the licensor makes an intentional misrepresentation of an existing material fact on which the licensee reasonably relied, it may be liable for fraud even if a disclaimer eliminates contractual liability. A failure to disclose known material problems in a product may constitute fraud if the elements of fraud are met and an obligation to disclose exists under law. *See e.g., Strand v. Librascope, Inc.,* 197 F. Supp. 743 (E.D. Mich. 1961). While general language of disclaimer does not generally foreclose liability for intentional fraud in most states, disclaimers specific to particular facts or categories of risk or other risk-shifting language may foreclose a fraud claim by eliminating reasonable reliance on a misrepresentation.

4. Disclaimer of Implied Warranties. Subsection (b) states rules for disclaimer of implied warranties. These are subject to subsections (c), (d) and (e). The purpose of disclaimer rules is to provide a means by which the parties can clearly achieve their intended result in either disclaiming or retaining a warranty, and yet a procedure to assure that the party against which the disclaimer operates has fair notice of its terms.

a. When a Record is Required. This Act follows Uniform Commercial Code § 2-316 (1998 Official Text). Disclaimer of implied warranties of merchantability (Section 403) or by analogy accuracy (Section 404) need not be in a record. Disclaimer of the "fitness" warranty must be in a record.

b. Merchantability and Accuracy. Except as indicated in paragraphs (b)(3) and (b)(4), under subsection (b)(1), to disclaim the warranty of merchantability or accuracy, a disclaimer is sufficient if it mentions "merchantability", "accuracy", or uses words of similar import and, if a record is used for disclaimer, the language is conspicuous. These rules follow Uniform Commercial Code § 2-316 (1998 Official Text). Alternative words must reasonably achieve the purpose of clearly indicating that the warranty is not given. The rules here are subject to the general disclaimer language in subsection (b)(3) and to the other rules of subsection (c), (d) and

(e).

c. Fitness Warranty; Systems Integration Warranty. Except as indicated in paragraphs (b)(3) and (b)(4), subsection (b)(2) provides language adequate to disclaim the warranties under Section 405. The specific language is not mandatory but must be in a record and conspicuous. This applies the rule in Article 2 for the "fitness" warranty to both this Act's "fitness" warranty and the new systems integration warranty.

d. Disclaimer of All Warranties. In some cases all implied warranties are disclaimed. Subsection (b)(3) sets out language that is sufficient for this purpose. This general disclaimer language must be in a record and be conspicuous so as to assure fair notice of its terms.

e. Article 2 and 2A Disclaimers. Subsection (b)(4) provides for cross-statute validity of disclaimer language. Language adequate to disclaim a warranty under one statute is adequate to disclaim the equivalent warranty under this Act, including new warranties created under this Act. The purpose is to avoid a trap for the unwary when, in common understanding, the parties have reason to know that all implied warranties were disclaimed.

5. Disclaimers of Implied Warranties By Circumstances. Subsections (c), (d) and (e) deal with situations in which the circumstances are sufficient to call the licensee's attention to the fact that an implied warranty is not made or is excluded. These rules apply to implied warranties and do not exclude express warranties.

a. "As is" Disclaimers. Terms such as "as is" and "with all faults" in ordinary commercial usage are understood to mean that the transferee takes the entire risk as to the quality of the information involved. Typically, such expressions are not accompanied by extensive express warranties. As in Uniform Commercial Code Article 2, recognition of the effectiveness of these terms here is a specific application of rule in subsection (e) which provides for exclusion or modification of implied warranties by usage of trade. The terms also accommodate electronic commerce that may require summary terms because of limited space in records or displays. The language need not be in a record.

b. Inspection. Subsection (d) follows Uniform Commercial Code Article 2 (1998 Official Text). Implied warranties may be excluded or modified where the licensee examines the information or a sample or model of it before entering into the contract. The examination or opportunity to do so must occur before the contract is made. "Examination" is not synonymous with inspection before acceptance of information tendered pursuant to a contract. It goes to the nature of the responsibility assumed by the licensor in the contract. If the buyer discovers a defect and goes ahead to make the contract, or if it unreasonably fails to examine the information before making the contract, there is no basis to imply a warranty on a subject which examination did reveal or should have revealed.

For a transaction to be within subsection (d), it is not sufficient that the information merely be available for inspection. There must be a demand or offer by the licensor that the licensee examine it. This puts the licensee on notice that it is assuming the risk of defects examination ought to reveal. On the other hand, if the offer of examination is accompanied by words giving assurance about their merchantability or about specific attributes and the licensee indicates clearly that it is relying on those words rather than on an examination, the words may create an express warranty.

The licensee's skill and the normal method of examining information in the circumstances determine what defects are excluded. A failure to notice obvious defects cannot excuse the licensee. However, an examination made in circumstances which do not permit extensive testing would not exclude defects that could be ascertained only by extensive testing. Nor are latent defects excluded by a simple examination. A merchant licensee examining a product in its own field assumes the risk for all defects which a merchant in that field ought to observe, while a non-merchant licensee assumes the risk only for such defects as an ordinary person might be expected to observe.

c. Course of Dealing, etc. Subsection (e) follows Uniform Commercial Code § 2-316(3)(c) (1998 Official Text). It permits disclaimer of implied warranties by course of

performance, course of dealing or usage of trade independent of any language of disclaimer. It is consistent with the concept of practical construction of contracts established under Article 2 and followed in this Act.

d. Detailed Specifications. As in Article 2, if a licensee gives detailed specifications for computer information, implied warranties may be excluded. The warranty of fitness will not normally apply because there is no reliance on the licensor. The warranty of merchantability must be considered in connection with Section 408 which, as in Article 2, provides that express warranties displace inconsistent implied warranties. If the licensee gives detailed specification, neither the implied warranty of fitness nor the implied warranty of merchantability normally will apply.

SECTION 407. MODIFICATION OF COMPUTER PROGRAM. A licensee that modifies a computer program, other than by using a capability of the program intended for that purpose in the ordinary course, does not invalidate any warranty regarding performance of an unmodified copy but does invalidate any warranties, express or implied, regarding performance of the modified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to the computer program.

Definitional Cross References: Section 102: "Computer program"; "Copy"; "Licensee".

Comment

1. Scope and policy of Section. This section deals with the effect of modifications by the licensee to computer programs if the modifications are not made using an aspect of the program intended for that purpose. The section provides that such modifications eliminate performance warranties with respect to the modified copy. This rule applies only to a modified copy. Responsibility for defects in an unmodified copy is not altered. The warranties affected by a modification do not include title and non-infringement warranties. The policy flows from the complexity of computer programs; even small changes may cause unanticipated and uncertain results. It often is not possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

2. Application. The section covers cases where the licensee makes changes that are not in the program options. If a user employs a menu of options to tailor a computer program, this section does not apply. However, if the user modifies code in a way not intended by program options, modification eliminates performance warranties as to the altered copy. This section does not apply to modifications that occur where the parties jointly develop a program, with each authorized to change code created by the other.

SECTION 408. CUMULATION AND CONFLICT OF WARRANTIES. Warranties, whether express or implied, must be construed as consistent with each other and as cumulative,

but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) [**Effect of specifications.**] Exact or technical specifications displace an inconsistent sample or model or general language of description.

(2) [**Effect of a sample.**] A sample displaces inconsistent general language of description.

(3) [**Relation of express and implied warranties.**] Express warranties displace inconsistent implied warranties other than an implied warranty under Section 405(a).

Uniform Law Source: Uniform Commercial Code § 2-317 (1998 Official Text).

Definitional Cross References: Section 102: "Party".

Comment

1. Scope of Section. This section deals with the relationship among various warranties. It follows Article 2 of the Uniform Commercial Code (1998 Official Text).

2. Cumulative Warranties. No warranty is created except by some conduct by the licensor. Therefore, the presumption is that all warranties are cumulative unless this construction is impossible or unreasonable, or the terms of the agreement otherwise indicate.

3. Inconsistent Warranties. Paragraphs (1), (2) and (3) give interpretive rules for determining the intent of the parties as to which of several inconsistent potential warranties prevail. These rules do not displace concepts of estoppel, but apply where the licensor in good faith engaged in conduct or made representations that might establish warranties which are inconsistent. If the licensor led the licensee to believe that all the inconsistent warranties can be performed, the licensor may be estopped from setting up any inconsistency as a defense.

The rules in paragraphs (1), (2) and (3) ascertain the intent of the parties by reference to what probably claimed their attention in the first instance. Thus, express warranties displace inconsistent implied warranties and exact or technical specifications displace any inconsistent sample. In both cases, the more specific or explicit terms define the agreement. This rule may be changed by evidence showing that conditions at the time of contracting make that construction inconsistent with the agreement or unreasonable in light of it.

SECTION 409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) [**Third-party beneficiaries.**] Except for published informational content, a warranty to a licensee extends to persons for whose benefit the licensor intends to supply the information or informational rights and which rightfully use the information in a transaction or application of

a kind in which the licensor intends the information to be used.

(b) [**Consumer's family or household.**] A warranty to a consumer extends to each individual consumer in the licensee's immediate family or household if the individual's use would have been reasonably expected by the licensor.

(c) [**Contractual term limiting beneficiaries.**] A contractual term that excludes or limits the persons to which a warranty extends is effective except as to individuals described in subsection (b).

(d) [**Effect of warranty or remedy disclaimer or modification.**] A disclaimer or modification of a warranty or remedy which is effective against the licensee is also effective against third persons to which a warranty extends under this section.

Uniform Law Source: Restatement (Second) of Torts § 552.

Definitional Cross References: Section 102: "Consumer"; "Consumer contract"; "Contract"; "Information"; "Licensee"; "Licensor"; "Party"; "Person"; "Published informational content"; "Term".

Comment

1. Scope of the Section. This section adopts third-party beneficiary concepts based on the contract law theory of "intended beneficiary" and the theory of *Restatement (Second) of Torts* § 552 as interpreted in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) and *A.T. Kearney v. IBM*, 73 F.3d 238 (9th Cir. 1997). It expands both as to the licensee's household. The section does not create a warranty, but deals with the question of, given a contractual obligation to one party, when does that obligation extend to others.

2. Liability to Third Parties. Liability is restricted to intended third parties and those in a special relationship with the information provider. Intent requires more than that the person be within a general category of those who may use the information (e.g., all readers). There must be a closer and more clearly known connection to a particular party. The liability covers use in transactions that the licensor intended to influence. It does not include liability for published informational content.

> **Illustration:** Licensor (author) contracts with Publisher for publication of an electronic text on chemical interactions. Publisher obtains an express warranty that Licensor exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published informational content), nor Licensor makes a warranty to a general buyer of the book.

To impose liability under contract law, the information provider must have known of and clearly intended to have an effect on the third party. This requires a conscious assumption of risk or responsibility for particular third parties. Even then, courts should not aggressively find the requisite intent. Information has a unique role in our culture. It is also uniquely difficult to show or disprove a causal connection between a release of informational content and harmful effects to third parties. This section reflects that placing excessive liability exposure on information

providers without their express undertaking may chill the dissemination of information.

3. Product Liability Law. This section does not deal with product liability or other tort issues. It neither expands nor restricts tort concepts, leaving that issue to other law. Few courts impose third party tort liability in transactions involving information. The *Restatement (Third) on Products Liability* notes that informational content is not a product for that law. The only reported cases that impose product liability on information involve air flight charts. Most courts specifically decline to treat informational content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to remote parties who obtain it. *Winter v. G. P. Putnam's Sons,* 938 F.2d 1033 (9th Cir. 1991); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990).

As in transactions in goods, there may be a tension between the idea of merchantability in this Act and its role in product liability law. The primary source of tension arises from disagreement about whether the concept of defect in tort and the concept of merchantability in contract are coextensive where personal injuries are involved (i.e. if a product is merchantable under warranty law can it still be defective under tort law, and if a product is not defective under tort law can it be unmerchantable under warranty law?). The answer to both questions should be no. Any tension between merchantability in warranty and defect in tort when personal injuries are involved should be resolved as follows: (1) when recovery is sought for injury to person or property, whether goods are merchantable is determined by applicable state products liability law; and (2) when a claim for injury to person or property is based on an implied warranty of fitness or an express warranty, this Act determines whether an implied warranty of fitness or an express warranty was made and breached, as well as what damages are recoverable.

4. Household and Family Use. Subsection (b) expands the intended beneficiary concept to include individuals in the family of a consumer licensee. This covers both personal injury and economic losses and applies to consumer use by the indicated persons. The use by the family member must be authorized under the license and the licensee must be an individual (a human being), not a corporation. The section assumes that the licensor had some reason to anticipate that the information would be used in the licensee's household. If a household member uses a commercial system licensed to a professional, this section does not extend warranties to that household member because the predicate transaction was not a warranty to a consumer. On the other hand, a licensor of mass-market word processing software might reasonably expect acquisition of it by a consumer for use at home.

5. Limitation by Contract. The rules in this section establish beneficiary status, not product liability. Under subsections (c) and (d), a disclaimer or a statement excluding intent to affect third parties excludes liability under this section. This follows current law. See *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 665 (Ill. App. 1993). Restrictions on the ability to limit damages for personal injury is treated in Section 803.

SECTION 410. NO IMPLIED WARRANTIES FOR FREE SOFTWARE.

(a) **[Free software defined.]** In this section, "free software" means a computer program with respect to which the licensor does not intend to make a profit from the distribution of the copy of the program and does not act generally for commercial gain derived from controlling use

of the program or making, modifying, or redistributing copies of the program.

(b) **[Implied warranties inapplicable.]** The warranties under Sections 401 and 403 do not apply to free software.

Uniform Law Source: None.

Definitional Cross References: Section 102: "Computer program"; "Copy"; "Licensor".

Comment

1. Scope and Effect of Section. This section provides that there are no implied warranties of non-infringement or of merchantability in transactions where a licensor does not intend to profit from the distribution of the copy or engage generally in seeking commercial gain by controlling the reproduction, use, modification or redistribution of copies. The effect of coming within this section is that no disclaimer or limitation is needed for those warranties because they will not be implied by this Act in such transactions.

2. Non-commercial Transactions. Under this section, transactions in computer programs do not give rise to implied warranties if they are non-commercial in nature. Thus, transactions among "shareware" providers and users, or among contributors to the development of so-called "open source" software do not involve the implied warranties when the transactions are not for commercial gain. Many such transactions may not involve a contractual relationship and would, on that basis, fall outside of the scope of this Act. See Section 105(d). Some involve licensors who do not meet the requirements necessary for certain of the implied warranties, such as warranties only provided by licensors who merchants or merchants who deal in information.

This section excludes implied warranties in cases where they would not otherwise be excluded on the foregoing bases. The exclusion depends upon the absence of intent for commercial gain from transfer or the copy or from controlling its use. In such transactions, the expectations of the parties do not parallel that of commercial transactions. The imposition of an implied warranty would put an undue burden on such transactions and the methods of software development and distribution they involve.

The exclusion covers a wide range of transactions as long as they occur without commercial profit objectives associated with distribution of the copy or controlling its use. Truly free software distribution involves no implied warranty, whether or not source code is made available. For example, the section excludes implied warranties for a computer program posted on the Internet to be freely downloaded with no restrictions on use, reproduction, or distribution of additional copies. On the other hand, a program provided free for a limited period of time with no right to make or distribute copies is not within the exclusion of this section if, after the limited period, the licensor expects to obtain a paid license from the licensee to enable its further use of the program.

3. Commercial Context as Disclaimer. Even if a transaction does not come within this section, implied warranties may be excluded by course of dealing, trade use, or the like. Section 406(e). For example, a conveyance of program code between academic entities as a voluntary part of the development of free software may occur in a setting where none of the parties anticipate implied warranties and, as a result of a trade use to that effect, may have no such warranties regardless of whether this section applied or whether an effective disclaimer was made.

4. Mixed Objectives. The touchstone lies in whether the transferor intends to profit from distribution of the copy (e.g., obtain a price for the transfer that exceeds the cost of the copy), or

to obtain commercial advantages from controlling use, reproduction, modification or redistribution. In many cases, the circumstances are clear; a pure, voluntary, noncommercial transfer entails no implied warranties under this section. Other cases may be less clear. The issue does not depend on labels used in the transaction. Thus, a transfer of a copy of a program as part of a computer system is not within this section simply because the price paid by the end user does not include a fee designated for the copy. The restrictions on use of the copy and the general commercial nature of the transaction in such case means that this section does not apply. Similarly, a charge of $200 for a transaction involving a copy of a program does not come within this section simply because the licensor designated the charge as being for support, rather than for delivery of the copy. On the other hand, if a provider of software makes the program freely available with no restrictions or cost from a website, but also offers support and other services that the licensee may obtain or refuse, and the licensee obtains the software from that website without being required to purchase a tangible copy or a computer into which the online version can be loaded, this section would exclude implied warranties for the program. However, if the economic reality of the transaction is that the program is distributed for commercial gain because it has no real viability absent procurement of the service contract, then this section would not apply.

PART 5

TRANSFER OF INTERESTS AND RIGHTS

[SUBPART A. OWNERSHIP AND TRANSFERS]

SECTION 501. OWNERSHIP OF INFORMATIONAL RIGHTS.

(a) [**Transfer of ownership rights.**] If an agreement provides for conveyance of ownership of informational rights in a computer program, ownership passes at the time and place specified by the agreement but does not pass until the program is in existence and identified to the contract. If the agreement does not specify a different time, ownership passes when the program and the informational rights are in existence and identified to the contract.

(b) **[Effect of Transfer of copy.**] Transfer of a copy does not transfer ownership of informational rights.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Information"; "Informational rights"; "Transfer."

Comment

1. Scope of the Section. This section deals with contractual transfers of ownership of intellectual property rights. It is subject to federal law, such as the requirement of a written conveyance under copyright law. Section 105. If copyright law on work for hire applies, it controls to the extent of any inconsistency.

2. Copy vs. Rights Ownership. Ownership (title) to a copy is distinguished from ownership of intellectual property rights. This distinction is fundamental in intellectual property law and made explicit in the Copyright Act and other law. It is acknowledged in subsection (b). While obtaining ownership of a copy may give the copy owner some rights with respect to that copy, it does not convey ownership of the underlying intellectual property rights in a work of authorship, a patented invention or other intellectual property. The copy is merely a conduit for use, but not ownership, of rights.

3. Rights Ownership. Subsection (a) deals with when ownership of informational rights transfers as a matter of state law. The section is confined to cases where there is an intent to transfer ownership of informational rights as compared to a license to use such rights or an intent to merely transfer title to a copy.

The agreement controls. The terms of agreement may be found in express terms or usage of trade, course of dealing, or the circumstances of the particular transaction. In the absence of agreed terms, transfer of ownership of informational rights does not hinge on delivery of a copy. It occurs when the information and the rights come into existence and are identified to the contract. The subsection thus reverses *In re Amica,* 135 Bankr. 534 (Bankr. N.D. Ill. 1992) to the extent that case suggests that ownership cannot pass until delivery of the completed work.

Identification to the contract requires both completion to a sufficient level to separate the

information from other information of the transferor and an indication by the transferor that the particular information is that which will be transferred under the contract. *In re Bedford Computer,* 62 Bankr. 555 (D.N.H. 1986) provides guidance on the relevant issues. The term "identification to the contract" is used in Article 2 of the Uniform Commercial Code (1998 Official Text) and should be interpreted in light of that use. Early drafts or working copies are ordinarily not "identified" to a contract that provides only for a transfer of ownership of rights in a completed program because the interim drafts and working copies are not intended for the licensee in fulfillment of the contract. However, if the agreement is that the licensee will own all work in progress and working drafts, then those are the contractual subject matter. They are identified to the contract when created if creating the work in progress is connected to the contract.

In many cases, an agreement provides that ownership does not vest in the transferee until it performs all of its obligations. In such cases, a material failure to perform an obligation such as to pay or provide other consideration due, precludes transfer of ownership until the obligations are met. If payment or other consideration is deferred under the agreement until after ownership clearly vests, a court may reasonably conclude that receipt of that consideration was not a condition precedent to the transfer of title.

SECTION 502. TITLE TO COPY.

(a) [**Rules regarding title to copy.**] In a license:

(1) title to a copy is determined by the license;

(2) a licensee's right under the license to possession or control of a copy is governed by the license and does not depend solely on title to the copy; and

(3) if a licensor reserves title to a copy, the licensor retains title to that copy and any copies made of it, unless the license grants the licensee a right to make and sell copies to others, in which case the reservation of title applies only to copies delivered to the licensee by the licensor.

(b) [**When title to copy passes.**] If an agreement provides for transfer of title to a copy, title passes:

(1) at the time and place specified in the agreement; or

(2) if the agreement does not specify a time and place:

(A) with respect to delivery of a copy on a tangible medium, at the time and place the licensor completed its obligations with respect to tender of the copy; or

(B) with respect to electronic delivery of a copy, if a first sale occurs under federal

copyright law, at the time and place at which the licensor completed its obligations with respect to tender of the copy.

(c) [**When title to copy revests.**] If the party to which title passes under the contract refuses delivery of the copy or rejects the terms of the agreement, title revests in the licensor.

Uniform Law Source: Section 2-401; Section 2A-302 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Sale"; "Transfer".

Comment

1. Scope of the Section. This section deals with transfers of title to or ownership of a copy.

2. Ownership of a Copy. Subsection (a) applies only to licenses. The basic rule is that the agreement controls. If the agreement does not provide for a transfer title to a copy, title to the copy remains in the transferor. In this Act, however, title to the copy has only limited significance. Thus, subsection (a)(2) notes that the ability of a licensee to possess or control a copy does not depend "solely" on title to it – obviously, the agreement of the parties is the most relevant source.

a. Copy Ownership. In a license, title to the copy depends on the terms of the license. As in Uniform Commercial Code Article 2A (1998 Official Text), this Act does not presume a transfer of title occurs on delivery. If the license is silent, determination of whether there was an intent to transfer title to the copy to the licensee may require consideration of the context of the transaction. In general, title does not vest in the licensee if the license imposes restrictions on use of the information on that copy that are inconsistent with ownership of the copy. *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999) , cert. den. 528 U.S. 923 (1999).

b. Right to Possession. Paragraph (a)(2) clarifies that the license governs rights to possession or control of a copy and that those rights do not depend solely on who has title to the copy. This corresponds to ordinary commercial expectations.

c. Effect of Reservation of Title. Under paragraph (a)(3), reservation of title to a copy implies a reservation of title in all copies of it made by the licensee. That rule is altered if the transaction contemplates that the licensee will make copies for sale. Thus, a license of a manuscript to a publisher contemplating production of the manuscript for sale to others, reserves title only to the delivered copy and not the digital copies produced by the publisher. This rule does not apply where the licensee will transfer copies to others subject to a license mandated by the licensor. In that case, the distribution contemplated is in the form of a license and not a sale. In any case, of course, the agreement controls; express terms displace the rule in paragraph (a)(3).

3. When Title to a Copy Passes. Subsection (b) deals only with contracts where the parties agree to transfer title to a copy. The subsection states presumptions relating to when title passes, but the general rule is that the terms of the contract control. In the absence of agreed terms, this section distinguishes between physical and electronic transfers. The rule for physical transfers of a tangible copy parallels Uniform Commercial Code Article 2 (1998 Official Text). Title transfers when the licensor completes its obligations regarding tender of delivery, which obligations are spelled out in Section 606. The rule for electronic transfers is the same, but explicitly defers to federal copyright law. Some argue that even if there is an intent to transfer title to a copy, an electronic transfer of a copy of a copyrighted work is not a first sale because it

does not involve transfer of a copy from the licensor to the licensee. Under subsection (b), state law expressly coordinates with resolution of that issue in federal law.

SECTION 503. TRANSFER OF CONTRACTUAL INTEREST. The following rules apply to a transfer of a contractual interest:

(1) [**When transfer of contract permitted.**] A party's contractual interest may be transferred unless the transfer:

(A) is prohibited by other law; or

(B) except as otherwise provided in paragraph (3), would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.

(2) [**Enforceability of term prohibiting transfer.**] Except as otherwise provided in paragraph (3) and Section 508(a)(1)(B) , a term prohibiting transfer of a party's contractual interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ineffective to create contractual rights in the transferee against the nontransferring party, except to the extent that:

(A) the contract is a license for incorporation or use of the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance and the transfer is of the completed, combined work;

(B) the transfer is of a right to payment arising out of the transferor's due performance of less than its entire obligation and the transfer would be enforceable under paragraph (1) in the absence of the term prohibiting transfer; or

(C) the term is in a mass-market license and the transfer complies with 17 U.S.C. Section 117, is made with the computer containing the authorized copy, and is a gift or donation:

(i) to a public elementary or secondary school;

(ii) to a public library; or

(iii) from a consumer to another consumer.

(3) [**Transfer of monetary rights permitted.**] A right to damages for breach of the whole contract or a right to payment arising out of the transferor's due performance of its entire obligation may be transferred notwithstanding an agreement otherwise.

(4) [**Transfer of mass-market license.**] A term that prohibits transfer of a contractual interest under a mass-market license by the licensee must be conspicuous.

Uniform Law Source: Uniform Commercial Code: Section 2-210; Section 2A-303 (1998 Official Text). Restatement (Second) of Contracts § 317.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Term"; "Transfer".

Comment

1. Scope of the Section. This section deals with transfers of contractual interests. It concerns transferability when the agreement is silent and the effect of a term prohibiting or limiting transfer. With respect to some transfers, Article 9 of the Uniform Commercial Code applies and, to the extent it contains provisions that conflict with this section, Article 9 governs. See Section 103(c).

2. Transfer of Contract. The term "transfer" when used with respect to a contractual interest refers to what in many contexts is described as an "assignment of a contract." Section 102. The term as used in this Act does not refer to a "transfer of a copyright" or similar intellectual property interest. A transfer of the contract differs from performing the contract through a delegate in that, when a delegate is used, there is no change to or addition of parties to the contract.

3. Transferability in the Absence of Contract Restrictions. Subsection (a) adopts the principle that, in the absence of contrary contract terms, contractual interests are presumed transferable unless the transfer adversely affects the interests of the other party. This parallels common law and Article 2 of the Uniform Commercial Code (1998 Official Text). This promotes an optimal open market in contractual rights, enhancing their value to the contracting parties.

a. Federal Policy and Other Law. Paragraph (1) recognizes two limitations on the rule that, when an agreement does not otherwise indicate, transfer of contractual interests may be made without consent of the other party. The first is when other law prevents transfer. In licensing, the other source of law may very well come from a federal intellectual property policy that precludes transfer of a non-exclusive copyright or patent license without the consent of the licensor. *In re Catapult Entertainment, Inc.*, 165 F.3d 747 (9th Cir. 1999); *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984); *Unarco Indus., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303 (7th Cir. 1972); *In re Patient Education Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997); *In re Alltech Plastics, Inc.*, 71 Bankr. 686 (Bankr. W. D. Tenn. 1987). The Copyright Act also precludes the rental of a copy of a computer program by the owner of a copy without the permission of the licensor. 17 U.S.C. § 107. See *Central Point Software v. Global Software & Access*, 880 F. Supp. 957, 965 (E.D.N.Y. 1995)

When applicable, these federal rules preempt contrary state law, including paragraph (1).

The federal policy on transfers flows in part from the fact that a nonexclusive license is a personal contractual privilege that does not create a property interest. It is also embedded in policies of encouraging innovation and reserving to the rights owner control over to whom and when a license is granted. See, e.g., *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996). This Act does not change that policy.

b. Material Harm to Other Party. The second limit when the contract is silent is that the contract cannot be transferred without consent, if transfer would impair the other party's position or its expectation of performance. In addition, in some cases, a transfer may be cause for insecurity and a demand for assurance of future performance. Section 504.

These rules correspond to Article 2 of the Uniform Commercial Code (1998 Official Text) and to the *Restatement (Second) of Contracts* § 317. Impairment may occur if the transfer is made by a party owing executory or ongoing performance and the transfer shifts that performance to a third party or otherwise undermines its occurrence. Material harm should be interpreted in light of the commercial context and the original expectations of the contracting parties. The issue is not only whether there will be actual harm, but whether there is a material impairment of an expectation of return performance. A continuing sense of security that the promised performance will be forthcoming when due is an important feature of a bargain B parties do not bargain merely for a promise or for the right to win a lawsuit. The federal policies noted above are relevant. Also, as noted in Article 2A, "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Section 2A-303, Comment 3. Licensors similarly have residual interests in licensed computer information.

Computer information transactions involve different background policy and underlying property considerations than Article 2 contracts for sales of goods and this may lead to different decisions about whether a transfer has a material adverse effect. Many non-exclusive licenses may be non-transferable without the licensor's consent. In some commercial licenses, the subject matter includes confidential information that is protected by enforceable contractual use restrictions. In such cases, the party disclosing the confidential information contracts in large part on the basis of the reliability of the particular other party. The presence of confidential information may foreclose non-consensual transfers because the transfer jeopardizes the other party's enforceable interests in confidentiality and would place the confidential material in the hands of a person to which the licensor never agreed. The fact that the interest can be protected by a lawsuit for damages due to wrongful disclosure does not alter the reality that the transfer itself adversely affects the contractual interest. In some cases, a similar conclusion might be reached in the absence of confidential information. For example, a licensor might agree to license one company, but refuse to license a competitor that otherwise may not have access to the information. In such cases, allowing the licensee to transfer the license without consent adversely affects the licensor's interests as expressed and protected in the original license and given the intangible nature of the property and the ease of its reproduction, in effect places a licensee in direct competition with the licensor as a source of the information. Of course, in some cases, refusals to license may violate other law, but that possibility is outside the scope of this Act. Similarly, a transfer that places information in the hands of a competitor or a person who will engage in greater commercial or other use may be precluded if a license for such greater use would ordinarily have required additional terms or consideration.

Mass market licenses may present a different context. Transfer of the license will frequently not materially increase the burden or risk imposed on the other party. Even though a mass-market licensee may or may not be an owner of a copy, a transfer complying with Section 117 of the Copyright Act, which allows an owner of a copy to transfer that copy so long as it transfers or destroys all copies in its possession, will often be permissible in the absence of contractual restrictions. Thus, if a consumer licensee transfers his license for word processing software to another consumer and keeps no copy, there may be no impairment under this section. In other cases, however, a transfer may impair the licensor's interests. For example, if a mass market license for income tax reporting software includes a promise by the licensor to indemnify

the licensee against IRS penalties incurred because of any defects in the software calculations, repeated transfers of the license multiple times during a tax preparation season may increase the licensor's burden or risk. A transfer of a license along with a single copy by a licensee that retains other copies subject to the same license may also have an adverse impact (in addition to being a copyright infringement).

4. Contractual Restrictions. Under paragraph (2) terms prohibiting transfer of a contractual interest are enforceable. This rule follows general common law and the approach of the *Restatement*. As the *Restatement (Second) of Contracts* § 322 notes, policies that disfavor restraints on the alienation of property have little significance with respect to contractual interests. For contractual interests, the dominant policy recognized in the *Restatement* is the ability of the parties to determine the nature and scope of their contract. When they do so expressly, that choice will be recognized. In reference to licenses, this rule also reflects the importance of the retained interest of the licensor. The rule in paragraph (2) parallels the rule for transfers made without licensor consent in copyright and patent law. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995).

5. Transfer Ineffective. A prohibited transfer is ineffective, rather than merely a breach. "Ineffective" means that the transfer creates no contractual rights or privileges in respect to the relationship of the transferee and the party to the original license who did not participate in the transfer. Between the transferor and its transferee, the transfer does create contractual rights and obligations. While an ineffective transfer creates no rights against the licensor, that does not mean that the transfer automatically creates a cause of action for infringement by the licensor against the transferee. Whether an infringement action exists is determined by other law. Copyright law might permit a claim of infringement against the transferor and against the transferee if their conduct infringes exclusive rights under copyright. If information is not protected under copyright, trademark, patent or other informational rights law, the fact that the transfer is ineffective does not necessarily expose the transferee to liability under this section or otherwise. Thus, in trade secret law, a good faith transferee without notice may have a right to use information it receives with respect to claims under this body of law. That rule is not changed by the contract rule stated here. The rule making a prohibited transfer ineffective merely indicates that the transferee does not receive contractual rights against or from the party who did not participate in the transfer.

As between the transferee and the party that did not participate in the transfer, if the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), there would be a potentially significant period of time in which the transferee might be protected by the license before the license could be canceled in litigation. During that time, there could be serious adverse impact on the non-transferring party, despite its contractual effort to limit transferability of the license.

> **Illustration.** Assume a license for $5,000 that allows Small Licensee (SL) (a five employee company) to make "as many copies as needed for use in licensee's business"; the license is expressly not transferable. SL transfers the license to AT&T, a company with 300,000 employees. If the transfer is merely a breach, AT&T may be permitted to make as many copies as it needs for 300,000 employees until licensor learns of the breach and cancels the license against SL. The rule making the transfer ineffective preserves the original bargain. As between SL and AT&T, AT&T would be entitled to refund of the consideration paid for the transfer.

6. Payment Streams. Paragraph (2)(B) allows transfer of payment streams despite a contrary contractual provision unless the transfer of the payment stream would make a material change of the other party's position and therefore be precluded under subsection (1). In cases

where Article 9 of the Uniform Commercial Code applies, this Act does not affect the Article 9 rule that, in itself, a contract term or statutory rule cannot preclude such transfer of a payment stream. Uniform Commercial Code § 9-406(d)(c) (1999 Official Text). Article 9 governs in the case of conflict with this Act. Section 103(c).

7. Donations and the Like. Paragraph (2)(C) creates an exception to enforceability of no-transfer clauses that does not exist in any other law. The exception enables gifts to certain non-profit entities and non-commercial transfers between consumers. Federal policy precludes non-consensual transfers in many situations. The exception here pushes against that policy, but restricts the invalidation of the no transfer clause to cases that are within Section 117 of the Copyright Act, a section that allows transfers of a copy by its owner under certain restrictions stated in that section.

8. Mass Market Licenses. Subsection (c) provides that a term prohibiting transfer of a mass-market license must be conspicuous. This refers to terms that prohibit transfer. It does not refer to terms that control the scope of use under the license or to whom warranties or other obligations extend.

SECTION 504. EFFECT OF TRANSFER OF CONTRACTUAL INTEREST.

(a) [**Effect of particular language.**] A transfer of "the contract" or of "all my rights under the contract", or a transfer in similar general terms, is a transfer of all contractual interests under the contract. Whether the transfer is effective is determined by Sections 503 and 508(a)(1)(B).

(b) [**Effect of transfer generally.**] The following rules apply to a transfer of a party's contractual interests:

(1) [**Contractual use terms apply.**] The transferee is subject to all contractual use terms.

(2) [**Delegation of duties.**] Unless the language or circumstances otherwise indicate, as in a transfer as security under [Article 9 of the Uniform Commercial Code], the transfer delegates the duties of the transferor and transfers its rights.

(3) [**Enforceable promise to perform.**] Acceptance of the transfer is a promise by the transferee to perform the delegated duties. The promise is enforceable by the transferor and any other party to the original contract.

(4) [**No novation.**] The transfer does not relieve the transferor of any duty to perform, or of liability for breach of contract, unless the other party to the original contract agrees

that the transfer has that effect.

(c) [**Reasonable grounds for insecurity.**] A party to the original contract, other than the transferor, may treat a transfer that conveys a right or duty of performance without its consent as creating reasonable grounds for insecurity and, without prejudice to the party's rights against the transferor, may demand assurances from the transferee under Section 708.

Uniform Law Source: Uniform Commercial Code: Sections 2-210; 2A-303 (1998 Official Text).

Definitional Cross References: Section 102: "Contract"; "Contractual use term": "Party"; "Rights"; "Term"; "Transfer".

Comment

1. Scope of Section. This section follows Articles 2 and 2A of the Uniform Commercial Code (1998 Official Text). It describes the effect of a transfer of contract rights. It is not a comprehensive statement of the law on assignment and delegation. Issues not addressed here are left to other law.

2. Subject to Contract Terms. An effective transfer of a contract constitutes a transfer of contract rights and, unless the agreement or the circumstances otherwise indicate, a delegation of contractual duties. The transferee, by accepting the transfer, promises to perform the contract. It is bound by the terms of the original contract, including contractual use terms. The transferee's obligation can be enforced by the other party to the original contract. In effect, as between the transferee and the other party to the original contract, the transfer places the transferee into the position held by its transferor.

However, as between the transferor and the other party to the original contract, paragraph (b)(4) follows current law, providing that the transfer does not alter the transferor's obligations to the original contracting party in the absence of an express consent by that party to a novation. Mere transfer does not create a novation or eliminate the otherwise enforceable contractual rights created between the original parties.

3. Transfers in General and for Security. Subsection (b)(2) recognizes a general rule of construction distinguishing between a commercial assignment of a contract, which puts the transferee into the position of the transferor as to rights and duties, and other transfers that might be for a different purpose such as a transfer to create a security interest under Article 9 of the Uniform Commercial Code. When the latter occurs, the transfer constitutes neither an outright transfer of rights of the transferor nor a delegation of the transferor's duties to the secured party.

4. Assurances. Subsection (c) recognizes that the non-transferring party has a stake in the reliability, identity or other aspects of the person to whom the contract is transferred. In part, that stake is protected under Section 503. Subsection (c) also gives the non-transferring party a right to demand adequate assurances of future performance and to proceed under Section 708 to protect its interest in performance of the contract. See Comments to Section 503.

SECTION 505. PERFORMANCE BY DELEGATE; SUBCONTRACT.

(a) [**General rule.**] A party may perform its contractual duties or exercise its contractual rights through a delegate or a subcontract unless:

(1) the contract prohibits delegation or subcontracting; or

(2) the other party has a substantial interest in having the original promisor perform or control the performance.

(b) [**Obligation of delegating party.**] Delegating or subcontracting performance does not relieve the delegating party of a duty to perform or of liability for breach.

(c) [**Effect of violation.**] An attempted delegation that violates a term prohibiting delegation is not effective.

Uniform Law Source: Section 2-210; Section 2A-303 (1998 Official Text).

Definitional Cross References: Section 102: "Contract"; "Party"; "Term."

Comment

1. Performance Through a Delegate. Performance through a delegate or subcontracting of performance occurs when a party to the original contract uses a third party to make an affirmative performance under a contract. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. Effect of Contract. The ability to delegate is subject to terms of the agreement to the contrary. Those terms may be direct or indirect. For example, a contract might expressly preclude delegation or it might restrict use of licensed information to a named person or entity and thus indirectly preclude delegation of the rights or duties to any other person. A contract whose terms are confidential might have the same effect because to disclose contract terms to the delegate (in order to ensure appropriate performance of the contract) might breach the duty of confidentiality.

3. Delegation in the Absence of a Contract Restriction. In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original party perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions in 503, but it may also have such an interest in other cases. Thus, for example, a contract for software to be developed by an internationally known individual software developer might ordinarily not permit that individual to delegate the development entirely to a third party of lesser stature.

SECTION 506. TRANSFER BY LICENSEE.

(a) [**Effect of transfer by licensee.**] If all or any part of a licensee's interest in a license

is transferred, voluntarily or involuntarily, the transferee does not acquire an interest in information, copies, or the contractual or informational rights of the licensee unless the transfer is effective under Section 503 or 508(a)(1)(B). If the transfer is effective, the transferee takes subject to the terms of the license.

(b) [**No greater rights received.**] Except as otherwise provided under trade secret law, a transferee acquires no more than the contractual interest or other rights that the transferor was authorized to transfer.

Uniform Law Source: Uniform Commercial Code Section 2A-305 (1998 Official Text).

Definitional Cross References: Section 102: "Copy"; "Information"; "Informational rights"; "License"; "Licensee"; "Party"; "Term"; "Transfer".

Comment

1. Scope of the Section. This section deals with the effect of a transfer of a licensee's contractual interest. If there is a conflict between this section and Article 9 of the Uniform Commercial Code, Article 9 governs. See Section 103(c).

2. Transferee Interests. Subsection (a) provides that a transferee of the licensee acquires only the rights that the license and this Act allow. This rule applies to purchasers of contractual interests, including persons who acquire an interest for the purposes of financing, and to transferees that acquire the transfer by involuntary means, such as enforcement of a judgment. This rule reflects the simple fact that what is transferred is the contract and that the transfer cannot change that contract. This principle holds true even if the transfer includes physical manifestations of the computer information that is subject to the license. The recipient of an effective transfer takes subject to the terms of the license.

3. Transfers and Underlying Property Rights. Subsection (b) provides that as a general rule, a licensee's transferee acquires only those contractual or other rights that the licensee was authorized to transfer. There is no principle of bona fide purchaser of a mere contract right.

Similarly, neither copyright nor patent recognize concepts of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred even if the transfer includes delivery of a copy associated with the contract. Transfers that exceed or are otherwise unlicensed by a patent or copyright owner create no rights of use in the transferee. Indeed, such transfers may in themselves be an infringing act. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase and its use is likely to constitute infringement. See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.,* 846 F. Supp. 208 (ED NY 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995); *Marshall v. New Kids on the Block*, 780 F. Supp. 1005 (S.D.N.Y. 1991).

Subsection (b) recognizes the major exception to this principle, which allows a bona fide purchaser in reference to trade secret claims to the extent that body of law confers such rights. Trade secret law enforces confidentiality. If a party takes without notice of such confidentiality restrictions, it may not be bound by them; it is in effect a good faith purchaser, free of any obligations under that law. This section does not define when or to what extent this is true, but

defers to applicable rules under that body of law.

[SUBPART B. FINANCING ARRANGEMENTS]

SECTION 507. FINANCING IF FINANCIER DOES NOT BECOME LICENSEE. If a financier does not become a licensee in connection with its financial accommodation contract, the following rules apply:

(1) [**Independence of financier.**] The financier does not receive the benefits or burdens of the license.

(2) [**Governance of licensee's rights and obligations.**] The licensee's rights and obligations with respect to the information and informational rights are governed by:

(A) the license;

(B) any rights of the licensor under other law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B), any financial accommodation contract between the financier and the licensee, which may add additional conditions to the licensee's right to use the licensed information or informational rights.

Definitional Cross References: Section 102: "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor".

Comment

1. Scope of the Section. This Act recognizes two different positions in which a financier may become involved in financing related to a license. The first involves a financing relationship where the financier does not become party to the license. The second is where the financier does become a party to the license and transfers the contractual rights to the party ultimately intended to use the computer information. This latter arrangement resembles a "finance lease" as dealt with in Article 2A of the Uniform Commercial Code, but concerns licensed computer information, rather than leased goods. This section deals with circumstances in which a financier in a transaction with a licensee does not become a licensee of the license as part of the transaction.

2. Financier. A "financier" is a person who makes a financial accommodation to a licensee under a financial accommodation contract. Because a contract that creates or provides for a security interest governed by Article 9 of the Uniform Commercial Code cannot be a financial accommodation contract under the definition of that term, a financier does not include a secured party under Article 9. Nor does the term include a licensor. A secured party's position is governed by Article 9 of the Uniform Commercial Code.

3. Rights of Financier. If the financier does not become a party to the license, it obtains neither the benefits nor the burdens of the license. Under paragraph (2)(c), the financial accommodation contract between the financier and the licensee may add additional conditions to the licensee's right to use the licensed information or rights, but these terms are solely between the licensee and the financier. This enables this form of financing by enforcing conditions to support it. In effect, to the extent conditions are established in the financial accommodation contract, the licensee contracts away its own contractual right to act under the license, but does not alter or convey any part of, or interest in, the license itself.

4. Relationship to Licensor. Paragraph (2) makes clear that, notwithstanding any private arrangement between the licensee and a financier, the contractual and other rights of the licensor are dominant with respect to the licensed information. Thus, the financier's contract cannot expand any of the licensee's rights under the license. The financier's contract cannot alter any of the rights of the licensor.

SECTION 508. FINANCE LICENSES.

(a) [**General rules if financier is sublicensor.**] If a financier becomes a licensee in connection with its financial accommodation contract and then transfers its contractual interest under the license, or sublicenses the licensed computer information or informational rights, to a licensee receiving the financial accommodation, the following rules apply:

(1) **[When transfer or sublicense effective.]** The transfer or sublicense to the accommodated licensee is not effective unless:

(A) the transfer or sublicense is effective under Section 503; or

(B) the following conditions are fulfilled:

(i) before the licensor delivered the information or granted the license to the financier, the licensor received notice in a record from the financier giving the name and location of the accommodated licensee and clearly indicating that the license was being obtained in order to transfer the contractual interest or sublicense the licensed information or informational rights to the accommodated licensee;

(ii) the financier became a licensee solely to make the financial accommodation; and

(iii) the accommodated licensee adopts the terms of the license, which terms may be supplemented by the financial accommodation contract, to the extent the terms of the

financial accommodation contract are not inconsistent with the license and any rights of the licensor under other law.

(2) **[Only single transfer permitted without further consent.]** A financier that makes a transfer that is effective under paragraph (1)(B) may make only the single transfer or sublicense contemplated by the notice unless the licensor consents to a later transfer.

(b) [**Transfer by financier.**] If a financier makes an effective transfer of its contractual interest in a license, or an effective sublicense of the licensed information or informational rights, to an accommodated licensee, the following rules apply:

(1) **[Determination of rights and obligations of accommodated licensee.]** The accommodated licensee's rights and obligations are governed by:

(A) the license;

(B) any rights of the licensor under other law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B), the financial accommodation contract, which may impose additional conditions to the licensee's right to use the licensed information or informational rights.

(2) **[Financier's warranties limited.]** The financier does not make warranties to the accommodated licensee other than the warranty under Section 401(b)(1) and any express warranties in the financial accommodation contract.

Definitional Cross References: Section 102: "Financier"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Record."

Comment

1. Scope of the Section. This section deals with "finance licenses." A "finance license" is analogous to the finance lease in Article 2A of the Uniform Commercial Code, but involves different subject matter and different practical expectations. The transaction involves a license to the financier and an immediate transfer to the financially accommodated licensee. Subsection (a) describes when the retransfer of the license is effective. Subsection (b) deals with some of the resulting substantive conditions among the parties.

2. Transfer for Financial Purposes. The basic transaction occurs when a license is made to a financier who then transfers the license to the accommodated licensee. Paragraph (a)(1) sets out two sets of conditions for when this transfer is effective. The first is when a transfer of contractual interests is allowed by Section 503. This occurs when there is no impairment of the licensor's interests and the license does not preclude transfer. The second, provided for in

paragraph (a)(1)(B) creates a new method of transfer limited to this context and providing for enhanced opportunities to engage in license-based financing. This paragraph establishes a notification procedure requiring clear notice to the licensor, but otherwise enabling an efficient system of allowing the financier's transfer to its client. The notice must be in a record and received by the licensor before the information is delivered or the license granted. It must clearly indicate the intended purpose and name the eventual licensee. Under these conditions, if the accommodated licensee adopts the terms of the license, the transfer or sublicense to it is effective even if there is no formal consent by the licensor.

Under paragraph (a)(2), the de facto consent created through this notification procedure covers only the single, designated transfer of contractual rights in the license. Of course, if the contract between the financier and its licensee creates a right to payment to the financier under the license, the financial accommodation contract, or otherwise, a transfer of that payment right is not affected by this rule. In many cases, the transfer of the payment right will be governed by Article 9 of the Uniform Commercial Code. The focus is on transfers by the financier of other rights under the license, such as the right to use or disclose the licensed information.

3. Licensee's Rights. Given an effective transfer, paragraph (b)(1) makes clear that the licensee's position with respect to the licensed information is governed primarily by the terms of the license and is subject to the licensor's informational rights. The license is the dominant contractual relationship. The financier and the licensee, however, may agree on additional conditions between themselves. These are enforceable against the licensee even though the primary rights and limitations regarding the information will come from the license and will be the licensor's rights.

4. Warranties. Under paragraph (b)(2), as in Article 2A of the Uniform Commercial Code, a financier does not make implied warranties to the accommodated licensee, except for the warranty of non-interference. As to substantive performance issues pertaining to the licensed information, the financier is outside the structure pertinent to the polices that support merchantability and other warranties.

SECTION 509. FINANCING ARRANGEMENTS: OBLIGATIONS IRREVOCABLE.

Unless the accommodated licensee is a consumer, a term in a financial accommodation contract providing that the accommodated licensee's obligations to the financier are irrevocable and independent is enforceable. The obligations become irrevocable and independent upon the licensee's acceptance of the license or the financier's giving of value, whichever occurs first.

Definitional Cross References: Section 102: "Consumer"; "Financier"; "Financial accommodation contract"; "License"; "Licensee"; "Term."

Comment

1. Scope of the Section. This section applies irrespective of whether the financier becomes a licensee. It adopts a principle recognized in common law and in Article 2A of the Uniform Commercial Code that allows the creation by contract of irrevocable rights that are independent of otherwise available defenses. As in Article 2A, this principle does not extend to consumer contracts, leaving the issue in such cases to other law.

2. Hell or High Water. This section extends the benefits of the classic "hell or high water" clause to a finance license that is not a consumer license. However, the "hell or high water right" must be a term of the contract. This section makes promises in a financial accommodation contract irrevocable and independent due to the function of the financier in a three party relationship: the licensee is looking to the licensor to perform essential covenants and warranties. On the licensee's acceptance of the license, the licensee's promises to the financier under the financial accommodation contract become irrevocable and independent. While the accommodated licensee must perform with respect to the financier even if the licensor's performance is not in accordance with the license. The licensee may have and pursue a cause of action against the licensor.

SECTION 510. FINANCING ARRANGEMENTS: REMEDIES OR ENFORCEMENT.

(a) [**Material breach of financial accommodation contract.**] Except as otherwise provided in subsection (b), on material breach of a financial accommodation contract by the accommodated licensee, the following rules apply:

(1) [**Financier may cancel.**] The financier may cancel the financial accommodation contract.

(2) [**Financier may pursue contractual remedies.**] Subject to paragraphs (3) and (4), the financier may pursue its remedies against the accommodated licensee under the financial accommodation contract.

(3) [**Financier may exercise remedies of licensor.**] If the financier became a licensee and made a transfer or sublicense that was effective under Section 508, it may exercise the remedies of a licensor for breach, including the rights of an aggrieved party under Section 815, subject to the limitations of Section 816.

(4) [**Financier may preclude further use of information.**] If the financier did not become a licensee or did not make a transfer that was effective under Section 508, it may enforce a contractual right contained in the financial accommodation contract to preclude the licensee's further use of the information. However, the following rules apply:

(A) The financier has no right to take possession of copies, use the information or informational rights, or transfer any contractual interest in the license.

(B) If the accommodated licensee agreed to transfer possession of copies to the financier in the event of material breach of the financial accommodation contract, the financier may enforce that contractual right only if permitted to do so under subsection (b)(1) and Section 503.

(b) [**Limitations on financier's remedies.**] The following additional limitations apply to a financier's remedies under subsection (a):

(1) [**Limits on financier's taking possession or limiting use of information.**] A financier described in subsection (a)(3) which is entitled under the financial accommodation contract to take possession or prevent use of information, copies, or related materials may do so only if the licensor consents or if doing so would not result in a material adverse change of the duty of the licensor, materially increase the burden or risk imposed on the licensor, disclose or threaten to disclose trade secrets or confidential material of the licensor, or materially impair the licensor's likelihood or expectation of obtaining return performance.

(2) [**Limits on financier's control over information.**] The financier may not otherwise exercise control over, have access to, or sell, transfer, or otherwise use the information or copies without the consent of the licensor unless the financier or transferee is subject to the terms of the license and:

(A) the licensee owns the licensed copy, the license does not preclude transfer of the licensee's contractual rights, and the transfer complies with federal copyright law for the owner of a copy to make the transfer; or

(B) the license is transferable by its express terms and the financier fulfills any conditions to, or complies with any restrictions on, transfer.

(3) [**Financier's remedies subject to licensor's rights.**] The financier's remedies under the financial accommodation contract are subject to the licensor's rights and the terms of the license.

Definitional Cross References: Section 102: "Aggrieved party"; "Cancel"; "Copy"; "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Term; "Transfer". Section 701: "Material Breach."

Comment

1. **Scope of the Section.** The primary relationship between the financier and the licensee is based on their financial accommodation contract. This contact may grant enforcement rights to the financier on breach of that contract. Subsection (a) sets out aspects of the financier's rights on breach. A premise of this section is that, notwithstanding the rights created under the financial accommodation contract, exercise of those rights is subject to the predominant rights of the licensor under the license.

2. Rights in the Event of Breach. Subsection (a)(1) and (a)(2) recognize the enforceability of the financial accommodation contract. Those rights may be subject to the overriding rights of the original licensor, however, as indicated in paragraphs (a)(3) and (a)(4). Under subsection (a)(4), the remedies in the financial accommodation contract are the only remedies that a financier may exercise if the financier did not become a licensee. This includes the right to enforce contractual rights preventing further use of the information. However, such a right does not give this type of financier a right to possession, control or use of the information itself. That right remains controlled by the license and the licensor.

3. Finance Licenses (subsection (a)(3)). Where the transaction involves a finance license in which the financier acquires a license for purposes of transferring it to the licensee, on breach of the financial accommodation contract the financier has the remedies under this Act, subject to restrictions of this Act. These remedies are the remedies provided by this Act for breach, not remedies that may be in the license. The financier may also exercise remedies in the financial accommodation contract or allowed by other law as applicable.

4. Other Financiers (subsection (a)(4)). Subsection (a)(4) deals with cases where the financier did not become a licensee. It recognizes that, as between the financier and licensee, on breach of the financial accommodation contract the financier has a right to enforce a term in that contract preventing further use of the information. However, that does not give this type of financier a right to possess, control, or use the information, or to transfer the license. Transfer is not appropriate because the financier did not become a licensee and thus has nothing to transfer. However, a provision of the financial accommodation contract allowing the financier to take possession of or to use information may or may not be a transfer of a contractual right that would invoke Section 503. Subsection (a)(4) requires compliance with both Section 503 and subsection (b).

5. Relationship of License and Accommodation Contract. Subsection (b) sets out additional restrictions on the subsection (a) remedies. The protections are like those in Section 503 but do not necessarily involve, as does Section 503, a transfer of contractual rights. The basic premise is that actions of the financier and the licensee should not impair the rights of the licensor without appropriate consent. Thus, notwithstanding any contrary rights under the financial accommodation contract, the financier cannot take possession of or use the information if doing so would adversely affect the licensor. Similarly, except as expressed in paragraph (b)(2), the financier cannot transfer the license or the information. In cases where the license is royalty-bearing, the principle that the licensor's expectation and return performance cannot be seriously impaired by exercise of remedies under the financial contract may preclude any remedy by the financier preventing use by the licensee without the licensor's consent to that step.

SECTION 511. FINANCING ARRANGEMENTS: EFFECT ON LICENSOR'S RIGHTS.

(a) [**No obligations on licensor.**] The creation of a financier's interest does not place any obligations on or alter the rights of a licensor.

(b) [**Licensor's intellectual property rights not affected.**] A financier's interest does not attach to any intellectual property rights of the licensor unless the licensor expressly consents to such attachment in a license or another record.

Definitional Cross References: Section 102: "Financier"; "License"; "Licensor"; "Record".

Comment

1. Effect on Licensor. While this Act expands the ability of parties to establish financier interests related to a license, subsection (a) makes clear that creating a financier's interest places no obligations on the licensor, nor does it alter the licensor's rights. For example, the licensor can, despite the existence of the financier's relationship with the licensee, exercise rights to cancel or otherwise enforce the license. The licensor's position is not affected by the financier's involvement unless the licensor has otherwise expressly agreed to alter it. A financier's relationship to a licensee, as is true with a secured creditor's relationship, is dependent and conditional on the terms of the license. A decision by a licensor to cancel the license can be exercised entirely with reference to the financier's contractual position. Once the license is canceled, of course, it no longer provides a basis for the financier's recovery of its loans, but that is inherent in the nature of the relationship itself.

2. Intellectual Property Rights. Subsection (b) makes clear that any relationship established between the licensee and a financier does not affect the intellectual property rights of the licensor unless there is an express consent by the licensor to that effect in a record. Such consent may be in a license or in another record.

PART 6

PERFORMANCE

[SUBPART A. GENERAL]

SECTION 601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) [**Performance must conform to contract.**] A party shall perform in a manner that conforms to the contract.

(b) [**Effect of uncured material breach.**] If an uncured material breach of contract by one party precedes the aggrieved party's performance, the aggrieved party need not perform except with respect to restrictions in contractual use terms. In addition, the following rules apply:

(1) [**Right to refuse.**] The aggrieved party may refuse a performance that is a material breach as to that performance or a performance that may be refused under Section 704(b).

(2) [**Right to cancel.**] The aggrieved party may cancel the contract only if the requirements of Section 802 are satisfied.

(3) [**Information from other sources.**] The contractual use terms do not apply to information or copies properly received or obtained from another source not covered by the agreement.

(c) [**Effect of tender of performance.**] Except as otherwise provided in subsection (b), tender of performance by a party entitles the party to acceptance of that performance. In addition, the following rules apply:

(1) [**When tender occurs.**] A tender of performance occurs when the party, with manifest present ability and willingness to perform, offers to complete the performance.

(2) [**Simultaneous performances.**] If a performance by the other party is due at the time of the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete the tendered performance.

(3) [**Effect of acceptance.**] A party shall pay or render the consideration required by the agreement for a performance it accepts. A party that accepts a performance has the burden of establishing a breach of contract with respect to the accepted performance.

(d) [**Performance relating to copies.**] Except as otherwise provided in Sections 603 and 604, in the case of a performance with respect to a copy, this section is subject to Sections 606 through 610 and Sections 704 through 707.

Uniform Law Source: Restatement (Second) of Contracts § 237. Revised. Uniform Commercial Code: Section 2-507 (1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use term"; "Copy"; "Party".

Comment

1. Scope of the Section. This section brings together general principles of contract performance. Where performance involves a tender of a copy, under subsection (d), this section is supplanted by specific sections on tender, acceptance, and refusal of copies. This section and Parts 6 and 7 generally, use the term "refusal" in circumstances where Article 2 of the Uniform Commercial Code would use the term "rejection." The concepts are similar, although the differences between information and goods precludes rote application of Article 2 rules.

2. Duty to Conform. A party must conform to its contract. A failure to conform gives the aggrieved party a right to a remedy, subject to concepts of waiver. Under this Act, what remedies are available depends on the agreement and, in absence of agreement, on whether the breach was material. Under the *Restatement* view, and as adopted here, a party's duty to perform is contingent on the absence of an uncured prior material breach by the other party. *Restatement (Second) of Contracts* § 237. This contingent relationship described in subsection (b) does not refer to restrictions in contractual use terms. A breach by one party does not allow the other to ignore those restrictions even if the aggrieved party has a duty to mitigate loss. A breach by the licensor, for example, does not give the licensee rights to act in derogation of use restrictions or to ignore the intellectual property rights that may buttress them.

3. Material Breach. Subsection (b) follows the *Restatement (Second) of Contracts* and common law. It adopts the standard of material breach for determining the nature of the remedies available for breach by the other party. The concept of material breach is applied throughout contract law and has been relied on by courts for generations. It holds that a minor defect in performance does not warrant rejection or cancellation of a contract: the remedy lies in recovery of damages. The policy is to avoid forfeiture for small errors. Often, truly perfect performance cannot even be expected. If the parties desire to create a more stringent standard, they must do so in their agreement. The material breach standard applies to performances of both the licensor and licensee. A licensor that receives imperfect performance cannot cancel the contract for a minor problem, nor can the licensee.

The reference to contractual use terms is a reference to the restrictions in such terms. If a licensor breaches, the licensee is the aggrieved party and need not perform, e.g., the licensee need not make a payment. However, if the contractual use terms include a restrictions such as "business use only," that restriction continues to apply because breach does not change the nature of the contract. If a licensee breaches, the licensor is the aggrieved party and need not

perform, e.g., the licensor need not provide access to a licensee under an access contract. However, if the access was to data of the licensee that the licensor agreed to hold in confidence, the licensor remains bound by that contractual use term restriction. Again, breach does not change the nature of the contract.

4. Conforming Tender: Mass Market. Under subsection (b)(1), the material breach standard does not apply to delivery of a copy in a mass-market transaction. See Section 704(b). Instead, this Act adopts the rule in Article 2 and Article 2A of the Uniform Commercial Code, which allow rejection of a copy that does not conform to the contract in one situation: a delivery not part of an installment contract. This "conforming tender" rule (sometimes described as the "perfect tender" rule) for cases involving delivery of a copy in mass-market transactions As in Article 2, what is a conforming tender is restricted by considerations regarding merchantability, a right to cure, and usage of trade and course of dealing. It is further limited by principles of waiver. As one leading treatise comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ." *White, James and Summers, Robert, Uniform Commercial Code* (Fourth Edition) at 440-441 (West Publishing Co., 1995).

5. Duty to Accept and Tender. Subsection (c) brings together general rules from the Restatement and Uniform Commercial Code Article 2 (1998 Official Text) regarding the sequence of performance where mutual performances are to be exchanged. The primary principle is that tender of performance entitles the tendering party to acceptance of that performance. If the tendered performance is a material breach, the party receiving it is not required to perform. As subsection (d) indicates, where the performance is delivery of a copy, these general rules are subject to the more specific rules on tender and acceptance of copies in sections 606 through 610, and 704 through 707.

6. Refusing a Performance and Cancellation. An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. A party may refuse a performance if it is a material breach as to that performance. Whether that breach also allows the party to cancel the entire contract depends on whether the breach is material to the entire contractual relationship. In contracts where the entire performance is delivery of a single copy, a right to refuse the copy corresponds to the right to cancel the contract. In more complex situations, a single breach may not be material to the whole agreement.

SECTION 602. LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) [**Enable use defined.**] In this section, "enable use" means to grant a contractual right or permission with respect to information or informational rights and to complete the acts, if any, required under the agreement to make the information available to the licensee.

(b) [**How use enabled.**] A licensor shall enable use by the licensee pursuant to the contract. The following rules apply to enabling use:

(1) [**On contract enforceability.**] If nothing other than the grant of a contractual right or permission is required to enable use, the licensor enables use when the contract becomes

enforceable.

(2) [**On tender of copy.**] If the agreement requires delivery of a copy, enabling use occurs when the copy is tendered to the licensee.

(3) [**On delivery of copy.**] If the agreement requires delivery of a copy and steps authorizing the licensee's use, enabling use occurs when the last of those acts occurs.

(4) [**Tender of access material.**] In an access contract, enabling use requires tendering all access material necessary to enable the agreed access.

(5) [**Tender of record for filing.**] If the agreement requires a transfer of ownership of informational rights and a filing or recording is allowed by law to establish priority of the transferred ownership, on request by the licensee, the licensor shall execute and tender a record appropriate for that purpose.

Definitional Cross References: Section 102: "Access contract"; "Access material"; "Agreement"; "Contract"; "Deliver"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Record"; "Transfer."

Comment

1. Scope of the Section. This section states and defines the licensor's general obligation to enable use of the information or access that it provides to the licensee. The licensor's obligation in most cases consists of two elements: making the information available (if necessary) and giving authority or permission to use the information. Of course, this is subject to contrary agreement.

2. No Acts Required. A licensor may or may not be required to deliver anything. In many cases, it suffices to authorize use of information that the licensee obtained from other sources or to authorize access to information. Paragraph (b)(1) recognizes that fact and the role of mere authorization of use or access in such cases (e.g., when a party is already in possession of a photograph that it desires to use in a digital multi-media work, but must obtain permission to do so from the photographer holding the copyright).

3. Tender of Copy. Paragraph (b)(2) deals with cases where enabling use requires providing a copy of the information. The rule it states parallels existing law concerning goods. The obligation is to tender delivery of the copy to the licensee.

4. Access Material. Subsection (b)(3) requires the licensor to supply necessary authorization codes or other access materials to obtain the agreed access. It is limited to items unique to that access such as a password; the fact that access may assume use of generic items such as a computer or a particular kind or version of software browser does not make those items "access materials" or require the licensor to supply them in order to enable use.

5. Recording Information. If the agreement involves a transfer of ownership of informational rights and a filing or other recording is needed to complete that transfer so as to

have priority over other transfers, subsection (b)(4) indicates that the licensor must cooperate in completing that recording.

SECTION 603. SUBMISSIONS OF INFORMATION TO SATISFACTION OF PARTY. If an agreement requires that submitted information be to the satisfaction of the recipient, the following rules apply:

(1) [**Rules about copies do not govern.**] Sections 606 through 610 and Sections 704 through 707 do not apply to the submission.

(2) [**Permitted efforts to correct.**] If the information is not satisfactory to the recipient and the parties engage in efforts to correct the deficiencies in a manner and over a time consistent with the ordinary standards of the business, trade, or industry, neither the efforts nor the passage of time required for the efforts is an acceptance or a refusal of the submission.

(3) [**Express refusal or acceptance required.**] Except as otherwise provided in paragraph (4), neither refusal nor acceptance occurs unless the recipient expressly refuses or accepts the submitted information, but the recipient may not use the submitted information before acceptance.

(4) [**Effect of silence and failure to act.**] Silence and a failure to act in reference to a submission beyond a commercially reasonable time to respond entitle the submitting party to demand, in a record delivered to the recipient, a decision on the submission. If the recipient fails to respond within a reasonable time after receipt of the demand, the submission is deemed to have been refused.

Definitional Cross References: Section 102: "Agreement"; "Information"; "Party"; "Record". Section 117: "Reasonable time."

Comment

1. Scope of the Section. This section deals with situations where rules on the sale of goods, involving tender, acceptance and rejection of the goods, are not appropriate because the agreement calls for submissions of informational content to the satisfaction of the receiving party. The section deals only with contract law and does not address rights under other law or equity principles.

2. Tender-acceptance Rules Not Applicable. Under paragraph (1), rules regarding tender,

acceptance and rejection of copies do not apply if the transaction involves information submitted under terms providing for approval to the satisfaction of the licensee. These rules are modeled on rules for the sale of goods. There, the focus is on making immediate decisions about the particular item. In computer information transactions of the type described here, a submission triggers a process that centers around the commercial expectation that the recipient has the right to reject if the submission does not satisfy its expectations, but that immediate acceptance or rejection will often not occur. A process of revision and tailoring more commonly occurs. The rule here corresponds the law to ordinary commercial expectations.

3. Express Choices. Acceptance or refusal of the submission is not to be implied from delay and silence alone. Consistent with ordinary practices, paragraph (3) makes clear that only explicit refusal or acceptance suffices since the agreement is conditioned on the satisfaction of the receiving party. However, until acceptance, the recipient cannot "use" the submitted information. This refers to commercial exploitation and does not prevent use for the purpose of reviewing, correcting, or otherwise adjusting the information to meet the recipient's satisfaction if permitted by the agreement.

4. Demand for Decision. Paragraph (4) recognizes that in some cases an extraordinary delay in responding creates rights in the submitting party to obtain a firm answer. What constitutes sufficient delay for this purpose must be judged in reference to ordinary commercial standards associated with the applicable context.

SECTION 604. IMMEDIATELY COMPLETED PERFORMANCE. If a performance involves delivery of information or services which, because of their nature, may provide a licensee, immediately on performance or delivery, with substantially all the benefit of the performance or with other significant benefit that cannot be returned, the following rules apply:

(1) [**Rules about copies do not apply.**] Sections 607 through 610 and Sections 704 through 707 do not apply.

(2) [**Section 601 and usage of trade.**] The rights of the parties are determined under the other provisions of this [Act], including Section 601 and the ordinary standards of the business, trade, or industry.

(3) [**Inspection permitted.**] Before tender of the performance, a party entitled to receive the tender may inspect the media, labels, or packaging but may not view the information or otherwise receive the performance before completing any performance of its own that is then due.

Definitional Cross References: Section 102; "Agreement"; "Delivery"; "Information"; "Licensee"; "Party".

Comment

1. Scope of the Section. This section deals with subject matter that is, in effect, fully received when made available to, or viewed or read by the transferee. For this subject matter, concepts of inspection, rejection and return from the sales of goods law cannot apply.

2. General Rules Govern. For transactions involving informational content that, once seen or experienced, have communicated a significant value of the agreed performance, this section leaves the parties to the general rules of Section 601 which incorporate common law, along with ordinary standards of the relevant business, trade or industry. Sections of this Act dealing with tender and handling of copies is excluded because those rules are modeled after rules relating to transfer of goods and do not accommodate the commercial expectations found in these transactions.

3. Inspection. In transactions governed by this section, merely viewing or receiving the information transfers significant value to the licensee which cannot be returned. Given that fact, subsection (3) clarifies that inspection rights are limited to media and packaging. A person that joins a fee-based celebrity chat room cannot participate (e.g., receive the performance) before deciding whether to accept or not accept it. The participation itself transfers the value and that value cannot be returned. A person licensing the formula for Coca Cola cannot view the information and potentially memorize the formula before being bound to the contract and its performance under the contract. Of course, in these and all other cases, if the performance when received does not conform to the contract, the aggrieved party is entitled to remedies for breach.

SECTION 605. ELECTRONIC REGULATION OF PERFORMANCE.

(a) [**Automatic restraint defined.**] In this section, "automatic restraint" means a program, code, device, or similar electronic or physical limitation the intended purpose of which is to prevent use of information contrary to the contract or applicable law.

(b) [**Inclusion of automatic restraints.**] A party entitled to enforce a limitation on use of information may include an automatic restraint in the information or a copy of it and use that restraint if:

(1) a term of the agreement authorizes use of the restraint;

(2) the restraint prevents a use that is inconsistent with the agreement;

(3) the restraint prevents use after expiration of the stated duration of the contract or a stated number of uses; or

(4) the restraint prevents use after the contract terminates, other than on expiration of a stated duration or number of uses, and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) [**Access to licensee's information.**] This section does not authorize an automatic restraint that affirmatively prevents or makes impracticable a licensee's access to its own information or information of a third party, other than the licensor, if that information is in the possession of the licensee or a third party and accessed without use of the licensor's information or informational rights.

(d) [**Effect of use of authorized restraint.**] A party that includes or uses an automatic restraint in accordance with subsection (b) or (c) is not liable for any loss caused by the use of the restraint to prevent use of information contrary to the contract or applicable law. This subsection does not alter the effect or enforceability of contractual terms such as warranties or of other laws.

(e) [**Replacement of earlier copy.**] This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy or version under an agreement to replace or disable the earlier copy by electronic means with an upgrade or other new information.

(f) [**No use as remedy for breach.**] This section does not authorize use of an automatic restraint to enforce remedies because of breach of contract or for cancellation for breach. If a right to cancel for breach of contract and a right to exercise a restraint under subsection (b)(4) exist simultaneously, any affirmative acts constituting self-help may only be taken subject to the limitations in Sections 815(b) and 816 instead of this section. Affirmative acts under this subsection do not include:

(1) use of a program, code, device or similar electronic or physical limitation that operates automatically without regard to breach; or

(2) a refusal to prevent the operation of a restraint authorized by this section or to reverse its effect.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Notice"; "Party"; "Term"; "Termination."

Comment

1. **Scope of the Section.** This section deals with electronic or physical limitations on use of

information that enforce contract terms by preventing breach, by preventing uses that are inconsistent with the contract, or by implementing a contracted-for termination of rights to use the information. The section does not deal with devices used to enforce rights in the event of cancellation for breach or with enforcement concerning information outside the subject matter of this Act. The restraints here derive from contract terms and limit use consistent with the contract.

2. Nature of a Restraint. The idea of a "restraint" is analogous to the concept in the Copyright Act of a technological measure restricting access to a copyrighted work, but is related to contract terms, rather than copyright protection. 17 U.S.C. § 1201 (1999). It does not refer to situations in which the formatting, language or other characteristics of the computer information itself by their nature limit how access to or use of information can occur, nor does it create an affirmative obligation to prepare or transform information in a manner so that it will be accessible by other systems – incompatibilities are not a restraint as used in this section. Rather, "restraint" refers to a technological or physical measure whose intended purpose is to create a limitation to conform use of the information to the contract, such as a device that restricts access at the end of the duration of a license. An analog in a physical world would be the timing device that limits a laundromat dryer to 30 minutes use if only a 30 minute duration was purchased.

3. Bases for Use. The basic principle is that a contract can be enforced and that it may be appropriate to do so through automated means. Subsection (b) states alternative bases that permit use of automated restraints. The alternatives are coequal; satisfying any one supports use of the restraint under this section. The list is not exclusive and does not limit federal or other law (including other contract law) allowing use of limiting devices (restraints). The enforceable terms of the agreement must support the restraint. A restraint inconsistent with the contract is a breach of contract.

a. Contract Authorization. Subsection (b)(1) applies if the agreement authorizes the party to use the restraint. The authorization must be in addition to the contract term that the restraint enforces. Thus to be within subsection (b)(1) in a contract for 30 minutes of use, an agreement must also contain a term authorizing use of a restraint to enforce that limitation of duration of use.

b. Passive Restraints That Prevent Breach. Subsection (b)(2) provides that a restraint can be used without notice or specific contract authorization if it merely prevents use inconsistent with contract terms or the intellectual property rights of the party using the restraint. All the restraint may do is prevent use; if it does more than that, it is not authorized by this subsection, but must find support in other law. For example, if a license restricts the licensee to only one back-up copy, this subsection authorizes a restraint to enforce that limitation so long as the restraint does not destroy the licensed information. However, an agreement that limits use to a particular location may allow destruction of the copy set up at an unauthorized location if the licensee still retains the copy at the appropriate location. Of course, this presumes that the agreement limits the location at which the information could be used. Determining what is the agreement depends on the relevant considerations applicable under this Act. Restraints enforce contracts, but do not impose a penalty for attempted breach. Thus, if an enforceable contract term limits use of a copy of digital information to a single concurrent user, a restraint precluding multiple concurrent users is authorized. A restraint that deletes the authorized digital copy if the licensee attempts to allow multiple concurrent users is not authorized by this subsection.

c. Enforcing Informational Rights. Subsection (b)(2) also allows use of passive devices that preclude infringing informational rights. Merely preventing the infringing act does not require a contract term or notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, is silent on the right of the licensee to transmit additional copies electronically, although such may be precluded by intellectual property law absent fair use. A device that precludes communication of the file electronically, but does not alter or erase the

image in the event of an attempt to do so, is authorized under (b)(2).

d. Enforcing Termination. The restraints authorized in subsections (b)(3) and (b)(4) enforce termination, which ends the contract for reasons other than breach. Subsection (b)(3) allows restraints that end use upon expiration of a stated term or number of uses. At termination, the restraint may do more than merely prevent use because, at the end of the contract period, the party no longer has any rights in the information under the license. Thus, a machine allowing a single video game play can automatically discontinue use or delete the game when that game is completed. A license for a time-limited use of downloaded software fragments allows erasure of those elements when the limited time for use expires. Consistent with general contract law rules on termination, no prior notice is required for such termination. In contrast, subsection (b)(4) requires prior notice if the restraint implements termination other than on the happening of an agreed event.

4. Licensee's Information. Under subsection (c), nothing in this section authorizes active devices that affirmatively limit the licensee's ability to access or use its own information through its own means (means other than by continued use of the licensed subject matter itself). Thus if a licensee storing data on its own Internet server contracted to use spreadsheet application X for 30 minutes with that data, a restraint in the spreadsheet may terminate its use after 30 minutes but may not block access to the data. If the licensee obtains a license to use spreadsheet application Y, it may access its data with the new spreadsheet but may not continue to use spreadsheet X to do so (absent a license for additional use). Use of a restraint that prevents the licensee from accessing its information through means other than the licensed subject matter is a breach of contract and may be a basis for liability under other law if applicable.

5. Proper Use. Subsection (d) confirms that if use of a restraint is consistent with enforceable terms of the license and permitted under this section, there is no liability in contract from its use. If the restraint misfunctions and causes damage to, or deletion of, property of the licensee that is outside this section, there may be liability for such loss in contract or under other law. This section does not alter law in such cases. Similarly, if use of the restraint violates another promise, such as a warranty that no restraints were in the software, that breach of contract and any resulting damages are not affected by this subsection.

6. Cancellation. Subsection (f) makes it clear that nothing in this section authorizes or otherwise deals with devices used to enforce rights or remedies in the event of any breach or in the event of cancellation. Cancellation means ending a contract because of breach. Section 102(a). Electronic remedies for breach are prohibited under this Act by Section 816.

Illustration. A one-year license requires payments on the first of each month. Licensee makes one payment five days late. Licensor electronically turns off the software since late payment was a breach. That act is not authorized under this section since it depends on breach of contract. If, however, after the license reaches the end of the contracted year a restraint turns off and deletes the software, such does not depend upon breach and is valid under this section.

[SUBPART B. PERFORMANCE IN DELIVERY OF COPIES]

SECTION 606. COPY: DELIVERY; TENDER OF DELIVERY.

(a) [**Location for delivery.**] Delivery of a copy must be at the location designated by agreement. In the absence of a designation, the following rules apply:

(1) [**Copy on tangible medium.**] The place for delivery of a copy on a tangible medium is the tendering party's place of business or, if it has none, its residence. However, if the parties know at the time of contracting that the copy is located in some other place, that place is the place for delivery.

(2) [**Electronic copy.**] The place for electronic delivery of a copy is an information processing system designated or used by the licensor.

(3) [**Documents of title.**] Documents of title may be delivered through customary banking channels.

(b) [**Requirements for tender of delivery of copy.**] Tender of delivery of a copy requires the tendering party to put and hold a conforming copy at the other party's disposition and give the other party any notice reasonably necessary to enable it to obtain access to, control, or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires tender of access material and other documents required by the agreement. The party receiving tender shall furnish facilities reasonably suited to receive tender. In addition, the following rules apply:

(1) [**Copy not to be moved.**] If the contract requires delivery of a copy held by a third person without being moved, the tendering party shall tender access material or documents required by the agreement.

(2) [**Shipment contract is norm.**] If the tendering party is required or authorized to send a copy to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, the following rules apply:

(A) In tendering delivery of a copy on a tangible medium, the tendering party shall put the copy in the possession of a carrier and make a contract for its transportation that is reasonable in light of the nature of the information and other circumstances, with expenses of transportation to be borne by the receiving party.

(B) In tendering electronic delivery of a copy, the tendering party shall initiate or cause to have initiated a transmission that is reasonable in light of the nature of the information and other circumstances, with expenses of transmission to be borne by the receiving party.

(3) [**When delivery to a destination is required.**] If the tendering party is required to deliver a copy at a particular destination, the tendering party shall make a copy available at that destination and bear the expenses of transportation or transmission.

Uniform Law Source: Uniform Commercial Code: Sections 2-503; 504 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Access Materials"' "Copy"; "Delivery"; "Document of title"; "Electronic;" "Information"; "Licensor"; "Notice"; "Party"; "Person"; "Receive"; "Send".

Comment

1. Scope of the Section. This section deals with how tender of delivery of a copy is made. It corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) with changes that reflect information as the subject matter. As with the other section in Part 6, Subpart B of this Act, this section deals only with delivery of a copy, not with the license to use the information. The effect of a defective tender is discussed in Part 7, Subpart B of this Act.

2. Shipment vs. Destination Contracts. Subsection (a) maintains the distinction between shipment and destination contracts as that rule exists under Article 2 of the Uniform Commercial Code (1998 Official Text) and also the underlying doctrine about when a contract is a shipment or a destination contract. The norm is a shipment contract; destination contracts are the exception which require an explicit agreement, such as by use of destination contract terms. For illustrative cases, see *California State Electronics Assoc. v. Zeos International Ltd.,* 49 Cal. Rptr. 2d 127 (Cal. App. 2 Dist. 1996) and *Windows, Inc. v. Jordan Panel Systems Corp.*, 38 UCC Rep. Serv. 2d 267 (2d Cir. 1999).

The strong presumption is that the licensor is not required to deliver to a particular destination unless the agreement explicitly so provides. Thus, the obligation in the absence of a contrary agreement, is to make the copies available at the licensor's site (in Incoterms 2000, the Group "E" terms (EXW-Ex Works)) or, if shipment is agreed, to tender them per the licensee's instructions for carriage or to a transmission facility making appropriate arrangements for their transport or transmission, with fees payable by the licensee.

Merely designating a place to which shipment will be made does not create a "destination" contract or alter the presumption that a "shipment contract" is intended. U.C.C. examples of shipment contract terms include "F.O.B. point of shipment" (U.C.C. § 2-504), "C.I.F.", "C.I.F. destination" and "C.&F." (U.C.C. § 2-320). Under the international Incoterms 2000, shipment (departure) contracts include the Group "F" terms and the Group "C" terms such as "FCA" (Free Carrier), CIF (Cost, Insurance and Freight), but not the Group "D" terms such as "DAF" (Delivered At Frontier). The Group "D" terms are destination contracts, also known as "arrival" contracts. Customs of ports and regions, as well as trade usage, can also influence the meaning of trade terms.

3. Tender of a Copy. Subsection (b) provides default rules regarding what constitutes tender of delivery of a copy. These rules generally correspond to Uniform Commercial Code Article 2 (1998 Official Text) and to the *Restatement (Second) of Contracts.* A tender requires that the copy be put and held available at the appropriate place and that the other party be notified of the tender. A physical or electronic tender not made through a carrier must be at a place to which the party receiving tender has access for purposes of obtaining the copy.

4. Electronic Tender. Subsection (b)(2)(B) recognizes that electronic tenders of a copy may or may not involve transmission by the tendering party itself. That party may instead

contract with the equivalent of an electronic carrier who is better suited to make transmissions, such as secure transmissions. In that event, putting the copy into the hands of, or otherwise making it available to, the electronic transmitter has the same effect as putting a physical copy into the hands of a traditional carrier or the like.

SECTION 607. COPY: PERFORMANCE RELATED TO DELIVERY; PAYMENT.

(a) [**Performances as to delivery.**] If performance requires delivery of a copy, the following rules apply:

(1) [**Tender by other party required.**] The party required to deliver need not complete a tendered delivery until the receiving party tenders any performance then due.

(2) [**Tender entitles acceptance.**] Tender of delivery is a condition of the other party's duty to accept the copy and entitles the tendering party to acceptance of the copy.

(b) [**Rules if payment due on delivery.**] If payment is due on delivery of a copy, the following rules apply:

(1) [**Tender as condition to payment.**] Tender of delivery is a condition of the receiving party's duty to pay and entitles the tendering party to payment according to the contract.

(2) [**Single delivery required.**] All copies required by the contract must be tendered in a single delivery, and payment is due only on tender.

(c) [**Apportioning payment for delivery in lots.**] If the circumstances give either party the right to make or demand delivery in lots, the contract fee, if it can be apportioned, may be demanded for each lot.

(d) [**Right to retain or dispose of copy or document.**] If payment is due and demanded on delivery of a copy or on delivery of a document of title, the right of the party receiving tender to retain or dispose of the copy or document, as against the tendering party, is conditioned on making the payment due.

Uniform Law Source: Uniform Commercial Code: Sections 2-307; 2-511 (1998 Official Text).

Definitional Cross References: Section 102: "Contract fee"; "Copy"; "Delivery"; "Document

of title;" "Party."

Comment

1. Scope of the Section. This section brings together a variety of rules from Article 2 of the Uniform Commercial Code (1998 Official Text) and from the Restatement (Second) of Contracts as applicable. It deals only with transfers involving delivery of a copy.

2. Basic Rule. The basic approach follows Article 2. A tender of delivery of a copy is a condition to the duty to accept the copy and to the obligation to pay for that copy. This is subject to contrary agreement, including the effect of applicable usage of trade. In many transactions, the commercial context and the agreement alters this expectation. For example, an agreement that involves payment of royalties alters the rule - royalties cannot accrue until use of the licensed information. In such contracts, payment is due as agreed.

SECTION 608. COPY: RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) [**General rule.**] Except as otherwise provided in Sections 603 and 604, if performance requires delivery of a copy, the following rules apply:

(1) [**Right of inspection.**] Except as otherwise provided in this section, the party receiving the copy has a right before payment or acceptance to inspect the copy at a reasonable place and time and in a reasonable manner to determine conformance to the contract.

(2) [**Expenses of inspection.**] The party making the inspection shall bear the expenses of inspection.

(3) [**Place or method of inspection.**] A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method, or standard does not postpone identification to the contract or shift the place for delivery, passage of title, or risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was an indispensable condition the failure of which avoids the contract.

(4) [**Inspection right subject to confidentiality obligations.**] A party's right to inspect is subject to existing obligations of confidentiality.

(b) [**Effect of inconsistent agreement.**] If a right to inspect exists under subsection (a) but the agreement is inconsistent with an opportunity to inspect before payment, the party does

not have a right to inspect before payment.

(c) [**When payment not excused.**] If a contract requires payment before inspection of a copy, nonconformity in the tender does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 704; or

(2) despite tender of the required documents, the circumstances would justify an injunction against honor of a letter of credit under [Article 5 of the Uniform Commercial Code].

(d) [**When payment not acceptance.**] Payment made under circumstances described in subsection (b) or (c) is not an acceptance of the copy and does not impair a party's right to inspect or preclude any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Uniform Commercial Code: Sections 2-512; 513 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Letter of credit"; "Party".

Comment

1. Scope of the Section. This section deals with the right to inspect a copy and its relationship to acceptance of the copy and the duty to pay. It follows Article 2 of the Uniform Commercial Code (1998 Official Text) with changes that reflect computer information as the subject matter.

2. Relationship to Acceptance. An opportunity to inspect a copy is ordinarily a condition to acceptance of it. Acceptance in this sense refers to acceptance of the copy and not to accepting the terms of an agreement or adopting contract terms. Where payment occurs before an opportunity to inspect the copy, subsection (d) makes clear that payment is not acceptance of the copy. Thus, for example, the licensee may nevertheless refuse the copy because of a defect once an opportunity to inspect is had. This is the same rule as in Article 2.

3. Type of Inspection. The type of inspection permitted depends on the commercial context, including the agreement of the parties. This follows Article 2 and cases decided under Article 2 are applicable in interpreting this section. If the parties agree to an extended or extensive procedure of pre-acceptance testing, that agreement supplants the general standard of this section. In the absence of agreement, the standard is that inspection must be in a reasonable time and manner.

4. Confidentiality Obligations. Under subsection (a)(4), if a party is under an obligation of confidentiality, its inspection of a copy is subject to that obligation. The requirement that the obligation be existing requires that it be in the contract giving rise to the inspection or another agreement, including agreements formed by course of dealing, usage of trade and the like.

However, the inspecting party is not required to infer or presume an obligation of confidentiality.

5. Defects Not Discovered. As in Article 2, a failure to inspect or a failure to discover all defects during an inspection does not necessarily alter the party's remedies for the undiscovered defect. If a latent defect exists which was not known to the accepting party, acceptance of the copy does not alter that party's right to a remedy for the defect when eventually discovered. Section 610. The right to inspect should be contrasted to the rule stated in Section 402 which deals with the effect of an examination of the copy on the existence of an express warranty. Both rules conform to Article 2 (1998 Official Text). "Examination" as a means of establishing or precluding contract terms or warranties infers a more extended opportunity to analyze the copy than does the right to inspect before acceptance of a copy under this section.

SECTION 609. COPY: WHEN ACCEPTANCE OCCURS.

(a) [**When acceptance occurs.**] Acceptance of a copy occurs when the party to which the copy is tendered:

(1) signifies, or acts with respect to the copy in a manner that signifies, that the tender was conforming or that the party will take or retain the copy despite the nonconformity;

(2) does not make an effective refusal;

(3) commingles the copy or the information in a manner that makes compliance with the party's duties after refusal impossible;

(4) obtains a substantial benefit from the copy and cannot return that benefit; or

(5) acts in a manner inconsistent with the licensor's ownership, but the act is an acceptance only if the licensor elects to treat it as an acceptance and ratifies the act to the extent it was within contractual use terms.

(b) [**Opportunity to inspect.**] Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect under Section 608 or the agreement, acceptance of a copy occurs only after the party has had a reasonable opportunity to inspect the copy.

(c) [**Acceptance of delivery in stages.**] If an agreement requires delivery in stages involving separate portions that taken together comprise the whole of the information, acceptance of any stage is conditional until acceptance of the whole.

Uniform Law Source: Uniform Commercial Code Sections 2-606; 2A-515 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Contractual use term"; "Copy"; "Delivery;" "Information"; "Licensor"; "Party".

Comment

1. Scope of the Section. This section deals with what constitutes acceptance of a copy. The effect of acceptance of a copy is stated in Section 610. This section derives from Uniform Commercial Code Article 2 and Article 2A (1998 Official Text). It does not deal with "offer" and "acceptance" as they pertain to formation of a contract or adoption of terms.

2. Nature of Acceptance. Acceptance of a copy is the opposite of refusal of a copy. Under Section 610(a), acceptance precludes refusal and, if made with knowledge of any nonconformity, may not be revoked because of it unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance puts the burden on the party accepting the copy to prove any breach with respect to that copy. See Section 601. However, while acceptance of a copy precludes refusal of it, acceptance does not in itself impair any other remedy for nonconformity, including revocation of acceptance.

3. What Constitutes Acceptance. Subsection (a) provides guidance on what constitutes acceptance of a copy. Paragraphs (a)(1) and (a)(2) conform to Uniform Commercial Code Article 2-606 and to Article 2A (1998 Official Text). Acts as well as communications may signify acceptance. Similarly, a failure to reject constitutes acceptance, even if there has been no communication to that effect to the other party. These rules must be read in connection with subsection (b) which indicates that the referenced acts or communications are not acceptance unless they occur after a reasonable opportunity to inspect, if it had a right to inspect the information or copy under the agreement or this Act.

a. Commingling. Paragraphs (a)(3) and (a)(4) focus on two circumstances significant in computer information that differ from cases involving goods. Paragraph (a)(3), reflects that it is inequitable or impossible to reject data or information after having commingled it. The commingling party retains its remedies for breach, but commingling renders inappropriate the remedy of refusing the copy. To refuse a copy or revoke an acceptance of it, the refusing party must return or keep it available for return to the other party: commingling precludes this. Commingling includes blending the information into a common mass in which it is indistinguishable. It also refers to software integrated into a complex system in a way that renders removal and return impossible and to information integrated into a database from which it cannot be separated.

b. Non-returnable Benefits. Subsection (a)(4) treats as acceptance the receipt, use or exploitation of a value of the information provided by the licensor. In many instances merely being exposed to data or other material transfers significant value. See Comments to Section 604. Often, use of the information does the same. Refusal is not a useful paradigm as a remedy. The recipient can sue for damages for breach and, depending on the nature and extent of breach, either obtain reimbursement of the price or avoid paying a price that would otherwise be due.

c. Ownership. Paragraph (a)(5) follows the rule in Uniform Commercial Code Article 2 (1998 Official Text). In Article 2, the rule is that, even if the buyer did not explicitly accept the goods, acts inconsistent with the seller's ownership constitute acceptance if ratified by the seller. This gives the seller an option to either treat the acts as acceptance, or as a rejection followed by acts of conversion or the like.

In information transactions, the options are less clear, since a licensee can avoid express acceptance of the information, but act in a manner that would be outside the contract terms, even had it accepted the tender. Paragraph (a)(5) gives the licensor a right to elect where the inconsistent acts are within contractual use terms. It recognizes that, if the licensor decides to treat the acts as acceptance, it need not also ratify acts of a licensee that would, in any event, be outside the contract terms and constitute infringement. For example, if a licensor provides a

conforming copy of educational software for use in a single school district and the district, while not signifying acceptance of the copy, distributes the software throughout the country, the licensor can either: 1) treat the silence as refusal of the tender and sue for breach of contract and infringement, or 2) treat the actions as acceptance and sue for the price, ratifying uses within the contractual authority, but also sue for infringement as to uses or distribution outside the contract terms.

4. Delivery in Stages. Subsection (c) deals with an agreement in which the intended final product is delivered and accepted in segments or modules. This is not an installment contract where the modules are and will remain separate, but a delivery in stages of a single information product. In such cases, acceptance of each module is a separate event, but this subsection provides that each acceptance is implicitly conditional on eventual acceptance of the whole. While this rule can be varied by agreement, it represents the most likely expectation of the parties in such ongoing development contexts.

SECTION 610. COPY: EFFECT OF ACCEPTANCE; BURDEN OF ESTABLISHING; NOTICE OF CLAIMS.

(a) [**Effect of acceptance.**] A party accepting a copy shall pay or render the consideration required by the agreement for the copy it accepts. Acceptance of a copy precludes refusal and, if made with knowledge of a nonconformity in a tender, may not be revoked because of the nonconformity unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance by itself does not impair any other remedy for nonconformity.

(b) [**Burden of establishing breach.**] A party accepting a copy has the burden of establishing a breach of contract with respect to the copy.

(c) [**Post-acceptance notification of disputes.**] If a copy has been accepted and a breach of contract or a breach of warranty is claimed, the following rules apply:

(1) **[Duty to notify of breach.]** If the claim is of a type other than a claim alleging a breach of a warranty of noninfringement or breach of an express warranty about misappropriation or for libel, slander, or the like, the accepting party shall notify the other party of the breach within a reasonable time after it discovers or should have discovered a breach of contract or be precluded from any remedy for the breach.

(2) **[Duty to notify other party of litigation.]** If the claim is for breach of warranty

of noninfringement or breach of an express warranty about misappropriation or for libel, slander, or the like and the accepting party is sued by a third party for such claim, the accepting party shall notify the other party within a reasonable time after receiving notice of the litigation or be precluded from any remedy over for the liability established by the litigation.

Uniform Law Source: Uniform Commercial Code: Sections 2-606; 2-607(2); 2A-515 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Deliver"; "Knowledge"; "Notice"; "Notify"; "Party"; "Seasonably"; "Receive". Section 117: "Reasonable time." Section 701: "Breach".

Comment

1. Scope of the Section. This section deals only with treatment of copies and focuses on the effect of acceptance of a copy. It derives from Article 2 and Article 2A of the Uniform Commercial Code (1998 Official Text) with changes reflecting the nature of computer information.

2. General Effect of Acceptance. Acceptance of a copy is the reverse of refusing the copy. Acceptance obligates the accepting party to pay and render any other agreed performance with respect to that copy. Generally, however, as indicated in subsection (a), unless acceptance occurs with knowledge of a defect under circumstances causing a waiver, acceptance of a copy does not waive the accepting party's remedies. If there is a material, undiscovered defect in the copy or the information, the licensee may have a right to revoke acceptance. Whether or not that is true, the licensee retains the right to sue for damages. The rule conforms to Article 2.

3. Burden of establishing. A party that has accepted a copy has the burden of establishing the breach. "Burden of establishing" has the meaning set forth in Uniform Commercial Code Article 1 (1998 Official Text), which is that the party must persuade the trier of fact that the existence of the fact (e.g., breach) is more probable than its non-existence.

4. Notice of Breach. Subsection (c)(1) follows U.C.C. Article 2 (1998 Official Text) and provides that the party accepting the copy must notify the other party of the defect within a reasonable time or be barred from any remedy. This is a rule of fairness, reflecting that the accepting party is in control of the copy and controls any issues with respect to it. It is also a rule of closure. At some point, the other party is entitled to conclude that the transaction has reached a successful end. In the case of latent defects, the notice must be given within a reasonable time after the defect was or should have been discovered. What is a reasonable time is discussed in Section 117.

[SUBPART C. SPECIAL TYPES OF CONTRACTS]

SECTION 611. ACCESS CONTRACTS.

(a) [**Access over time.**] If an access contract provides for access over a period of time, the following rules apply:

(1) [**Modification of information.**] The licensee's rights of access are to the information as modified and made commercially available by the licensor from time to time during that period.

(2) [**When a modification is breach.**] A change in the content of the information is a breach of contract only if the change conflicts with an express term of the agreement.

(3) [**Restrictions on information obtained.**] Unless it is subject to a contractual use term, information obtained by the licensee is free of any use restriction other than a restriction resulting from the informational rights of another person or other law.

(4) [**Availability of access.**] Access must be available:

(A) at times and in a manner conforming to the express terms of the agreement; and

(B) to the extent not expressly stated in the agreement, at times and in a manner reasonable for the particular type of contract in light of the ordinary standards of the business, trade, or industry.

(b) [**Effect of unavailability of access.**] In an access contract that gives the licensee a right of access at times substantially of its own choosing during agreed periods, an occasional failure to have access available during those times is not a breach of contract if it is:

(1) consistent with ordinary standards of the business, trade, or industry for the particular type of contract; or

(2) caused by:

(A) scheduled downtime;

(B) reasonable needs for maintenance;

(C) reasonable periods of failure of equipment, computer programs, or communications; or

(D) events reasonably beyond the licensor's control, and the licensor exercises such commercially reasonable efforts as the circumstances require.

Definitional Cross References: Section 102: "Access contract"; "Agreement"; "Contract";

"Contractual use term"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Person"; "Software"; "Term".

Comment

1. Scope of the Section. This section establishes default rules for access contracts.

2. Nature of an Access Contract. There are many types of access contracts. In one there is no on-going relationship. This kind of access contract is like visiting a store: the customer is bound by the contractual rules in effect on the date of the visit. There is no continuing relationship – if the customer visits the store again or obtains access again, the new visit is not part of the prior contract.

In a second, a continuous access contract, the licensee has a contractual right to access at times of its own choosing within periods of agreed availability or at times established in the contract. This relationship occurs in on-line services that operate on a subscription or membership basis. The typical agreement is not only that the transferee receives the access or information, but that the resource be accessible on a continuing basis. A continuous access contract is unlike installment contracts under Article 2 of the Uniform Commercial Code, which are segmented into multiple tender-acceptance sequences. In continuing access contracts, a licensor merely keeps the system available for the licensee to access when it chooses within the agreed times for access. This is a modern application of licensed use of resources.

3. Basic Obligations. The basic obligation in a continuous access contract is to keep the system available in a manner consistent with contract terms and industry practices.

a. Content Changes. Absent agreement to the contrary, an access contract does not bind the licensor to holding available particular computer information. Access is granted to the information or other resources provided as they exist at the time of the particular access. Databases may be added, modified or deleted consistent with this core obligation. Paragraph (a)(1) recognizes that. However, if the agreement was to make available specific information as indicated in an express term of the agreement, removing that information may breach the contract under paragraph (a)(2). A change that so totally alters the content of the access information that the licensee receives something entirely different from what the parties bargained for may be a breach if is not done in good faith. On the other hand, subsection (a)(2) confirms that good faith changes of content are a breach only if they conflict with an express term of the agreement giving assurance that no such changes would occur.

b. General Standards of Availability. As indicated in subsection (a)(4), availability is subject to contract terms, but in the absence of such, the appropriate reference is to general standards of the industry involving the particular type of transaction. A contract involving access to an 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).

c. Use of Received Information. The access contract may or may not restrict use of the information obtained. If there are no restrictions in the agreement, subsection (a)(3) indicates that the information is received on an unrestricted basis, subject to intellectual property rights and any separate agreement concerning that information. For example, if an access contract enables access to news articles, but does not limit their use by the licensee, no limit exists other than under copyright or other applicable law (e.g., publicity rights).

If the access contract or a separate agreement place limitations on use of information obtained, those license terms would be governed under this Act. They are interpreted and enforced pursuant to other provisions of this Act and the terms of the agreement. Once information is received by the licensee, the relationship is simply a license, if any, at that point. For example, if licensee uses the access provided by its access contract with ABC to acquire a

copy of a spreadsheet program, when the program is received by the licensee, the rights and remedies of the parties with respect to use of the program are governed by the agreement with respect to that program and, in the absence of agreed terms, by the rules of this Act. As to the software, the relationship ceased to be an access contract when the software was received by the licensee. The terms of the license may be found in the agreement establishing the access contract or in a separate agreement concerning the licensed information.

Restrictions are not necessarily based on a license. In some cases, a copyright notice restricts use of the information obtained through on-line access. *Storm Impact, Inc. v. Software of the Month Club*, 13 F.Supp.2d 782 (N.D. Ill. 1998).

4. Downtime. Subsection (b) indicates that, unless the agreement provides otherwise, occasional unavailability is expected as part of contracts of this type. Of course, this can be altered by agreement. Subsection (b) provides several common situations in which unavailability can be expected; subsection (b)(2)(A) focuses on scheduled unavailability such as a period during which online activity may be suspended during a scheduled reconciliation of online account activity

SECTION 612. CORRECTION AND SUPPORT CONTRACTS.

(a) [**Effect of agreement to correct problems.**] If a person agrees to provide services regarding the correction of performance problems in computer information, other than an agreement to cure its own existing breach of contract, the following rules apply:

(1) [**Services as part of limited remedy.**] If the services are provided by a licensor of the information as part of a limited remedy, the licensor undertakes that its performance will provide the licensee with information that conforms to the agreement to which the limited remedy applies.

(2) [**All other cases.**] In all other cases, the person:

(A) shall perform at a time and place and in a manner consistent with the express terms of the agreement and, to the extent not stated in the express terms, at a time and place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry; and

(B) does not undertake that its services will correct performance problems unless the agreement expressly so provides.

(b) [**Obligation to provide support.**] Unless required to do so by an express or implied warranty, a licensor is not required to provide instruction or other support for the licensee's use

of information or access. A person that agrees to provide support shall make the support available in a manner and with a quality consistent with express terms of the support agreement and, to the extent not stated in the express terms, at a time and place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry.

Uniform Law Source: Restatement (Second) of Torts § 299A. Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Information"; "Licensee"; "Licensor"; "Person"; "Term".

Comment

1. Scope of the Section. This section concerns agreements to correct performance problems (subsection (a)) or to provide support for the use of computer information (subsection (b)).

2. Nature of Obligation to Correct Problems. There are three types of agreements that involve correction of performance problems. One arises where, as part of an effort to cure an existing breach, the vendor agrees to make specific corrections. That agreement and the general concept of cure are not covered in this section. The second is where, as part of the original agreement, the licensor provides a limited remedy of replacement or repair of defects. That agreement is covered under subsection (a)(1), which provides that the contractual obligation is to conform the product to the original contract. The third setting is where, as a separate undertaking, the licensor agrees to provide ongoing maintenance services correcting problems which may or may not have been a breach of the original contract. This type of services agreement is covered in subsection (a)(2). These are contracts where a vendor agrees to be available to attempt to correct problems in software for a fee. The contract is analogous to a maintenance or repair contract for goods. An agreement to provide updates or new versions, on the other hand, is like an installment contract to deliver new versions as developed and made available. New versions may cure problems in earlier versions, but an update agreement deals with new products, while a maintenance contract entails correcting problems in an older product. The standards by which the distinction is made focus on the factual context, the terms of the agreement, and general industry standards.

3. Services Obligation. Subsection (a)(2) deals with agreements for repair and maintenance of computer information. Most such agreements are services contracts. In the absence of contrary agreement, the rule on the contract obligation is stated in subsection (a)(2). It parallels the obligation that any services provider undertakes: a duty to act consistently with the standards of the business to complete the task. A services provider does not guaranty that its services will yield a perfect result, but rather that its performance will be characterized by a particular quality and effort to correct the problems. This section measures that by reference to standards of the relevant trade or industry. Of course, if a particular problem covered by such an agreement is a breach of the original license agreement, this standard does not change that result.

4. Services in Lieu of Warranty. In some cases, an agreement to correct performance problems is part of a limited remedy or warranty and the promissor agrees to a particular outcome, such as a limited express warranty that includes a duty to repair the defective product. The agreements are under subsection (a)(1). In these cases, the obligation is to repair the product such that it conforms to the contract. What performance conforms to the general contract to which the remedy relates, of course, hinges on the terms of that agreement as interpreted in light of usage of trade, course of performance and the like. If the performance fails

to yield a conforming product, the remedy for that failure depends on other terms of the agreement, such as any right to provide a refund as an alternative to repair or replacement options and the rules in this Act.

5. Support Agreements. A support agreement is an agreement to provides advice or consulting services relating to the information. Subsection (b) provides a default rule regarding support agreements. The first sentence of subsection (b) is subject to the existence of any warranty that might, in a particular transaction, establish an obligation to provide instruction materials or other support as part of the basic agreement. As a services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

SECTION 613. CONTRACTS INVOLVING PUBLISHERS, DEALERS, AND END USERS.

(a) [**Definitions.**] In this section:

(1) "Dealer" means a merchant licensee that receives information directly or indirectly from a licensor for sale or license to end users.

(2) "End user" means a licensee that acquires a copy of the information from a dealer by delivery on a tangible medium for the licensee's own use and not for sale, license, transmission to third persons, or public display or performance for a fee.

(3) "Publisher" means a licensor, other than a dealer, that offers a license to an end user with respect to information distributed by a dealer to the end user.

(b) [**Contract between dealer and end user.**] In a contract between a dealer and an end user, if the end user's right to use the information or informational rights is subject to a license by the publisher and there was no opportunity to review the license before the end user became obligated to pay the dealer, the following rules apply:

(1) [**Conditioned on agreement to license.**] The contract between the end user and the dealer is conditioned on the end user's agreement to the publisher's license.

(2) [**Right of return to dealer.**] Unless the end user agrees, such as by manifesting assent, to the terms of the publisher's license, the end user has a right to a return from the dealer. A right under this paragraph is a return for purposes of Sections 112, 208, and 209.

(3) [**Independence of dealer obligations.**] The dealer is not bound by the terms, and

does not receive the benefits, of an agreement between the publisher and the end user unless the dealer and end user adopt those terms as part of the agreement.

(c) [**Distribution by dealer.**] If an agreement provides for distribution of copies on a tangible medium or in packaging provided by the publisher or an authorized third party, a dealer may distribute those copies and documentation only:

(1) in the form as received; and

(2) subject to the terms of any license that the publisher provides to the dealer to be furnished to end users.

(d) [**Dealer as licensor.**] A dealer that enters into an agreement with an end user is a licensor with respect to the end user under this [Act].

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Merchant"; "Party"; "Person"; "Receive"; "Return"; "Term".

Comment

1. Scope of the Section. This section deals with three-party retail relationships involving a publisher, dealer, and end user. It only applies to retail distribution of tangible copies.

2. Parties. Subsection (a) contains three definitions that apply solely within this section. A "dealer" is a retailer or other distributor that receives information for redistribution, e.g., a retail store that stocks its shelves with copies of computer information products. The term does not include a mere intermediary, such as a service provider, that creates an environment (electronic or otherwise) in which publisher and the end user deal directly to establish a license or other transaction directly. The "end user" is the consumer or other person who acquires for use as opposed to re-distribution. A "publisher' is a licensor other than the dealer, e.g., the copyright owner who licensed the dealer to distribute the information. For example, if a licensor of a word processing program distributes physical copies to Store for license to consumers, the licensor would be the "publisher," the Store would be the "dealer," and the consumer would be the "end user."

3. Dealer and End User. Subsection (b) addresses the dealer's relationship with the end user. While the end user acquires the copy from the dealer, whether the dealer has authority to grant a right to use the work under copyright or other law is determined by its contract with the publisher. In many retail distribution systems, that contract allows distribution only under specified conditions, which may include a requirement that the end user's rights are subject to a publisher's license with the end user. Unlike in sales of goods law, under copyright law, the end user's rights do not flow simply from delivery of the copy to it, but depend on the dealer's compliance with the distribution license and on the end user's license from the publisher. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994). The rights to make and distribute copies are exclusive rights of the copyright owner (the publisher), they do not pass to the transferee simply by delivery of a copy. Subsection (b) does not concern a case where the publisher sold or authorized sale of copies not subject to a license.

a. Contracts Separable. Paragraph (b)(3) makes clear that the dealer is not bound by, nor does it benefit from, a contract between the publisher and end user unless the dealer and end user adopt those terms as part of *their* agreement. This follows case law on manufacturer warranties in other contexts, although that rule is overridden in some states and this Act does not alter those rules. See Cal. Civ. Code § 1791 ("as is" disclaimer). Warranties or other obligations of a dealer to the end user are not affected if the publisher's license is accepted by the end user.

b. Dealer as Licensor. The dealer is a "licensor" with respect to the end user. It has contractual obligations under this Act from its agreement with the end user; this does not mean that the dealer has the rights of the publisher that it can pass on to the end user. That the dealer has the obligations of a licensor as to the end user corresponds to ordinary retail expectations. As a result, the end user licensee may have recourse against two different parties, the dealer and, if the end user agrees to the license, the publisher.

c. Conditional Rights. Under subsection (b)(1) and (b)(2), the dealer's agreement with the end user hinges on the end user's ultimate rights to use the information supplied. This depends on the license between the publisher and the end user. If the end user declines the publisher's license, can obtain a refund from the dealer. This is a *right*, rather than merely an option.

The agreement may create different relationships. One might treat the publisher's license as part of the dealer's contract which the end user and dealer understood from the outset would be provided to complete the terms of the relationship. This is an application of the right, recognized in commercial law, of parties to make a contract leaving it to one party to supply particulars of performance after the initial agreement, with the specifications in this case coming in the publisher's license. Where the arrangement is that assent to these later particulars is required and the end user rejects the terms, it in effect is also rejecting the contract with the dealer and is entitled to return the copy and receive a refund. Agreement here, as in other respects, does not depend solely on express terms, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trade, in course of dealing and the like.

4. Dealer and Publisher. Often the publisher's agreement with the dealer is a license that retains ownership of copies in the publisher and permits distribution only subject to an end user license. The legislative history of the Copyright Act indicates that, whether or not there was a sale of the copy, 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). See *DSC Communications v. Pulse Communications*, 170 F.3d 1354 (Fed. Cir. 1999) , cert. den. 528 U.S. 923 (1999).

[SUBPART D. LOSS AND IMPOSSIBILITY]

SECTION 614. RISK OF LOSS OF COPY.

(a) [**General rule.**] Except as otherwise provided in this section, the risk of loss as to a copy that is to be delivered to a licensee, including a copy delivered by electronic means, passes to the licensee upon its receipt of the copy.

(b) [**Rules for copy on tangible medium.**] If an agreement requires or authorizes a licensor to send a copy on a tangible medium by carrier, the following rules apply:

(1) [**Shipment contract rule.**] If the agreement does not require the licensor to deliver the copy at a particular destination, the risk of loss passes to the licensee when the copy is duly delivered to the carrier, even if the shipment is under reservation.

(2) [**Destination contract rule.**] If the agreement requires the licensor to deliver the copy at a particular destination and the copy is duly tendered there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered at that destination.

(3) [**Risk of loss if nonconformity.**] If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains with the licensor until cure or acceptance.

(c) [**Rules if copy held by third party.**] If a copy is held by a third party to be delivered or reproduced without being moved or a copy is to be delivered by making access available to a third party resource containing a copy, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title or other access materials covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing the third party, pursuant to an agreement between the licensor and the third party, to make delivery or authorizing the third party to allow access.

Uniform Law Source: Uniform Commercial Code: Section 2-509 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Contract"; "Copy"; "Delivery"; "Licensee"; "Licensor"; "Party"; "Record"; "Receive"; "Send". Uniform Commercial Code: "Document of title": Section 1-201.

Comment

1. Scope of the Section. This section applies to risk of loss of copies; it does not apply to access contracts and does not deal with other risks of loss, such as loss of the information itself

or of informational rights. The section does not alter rules of this Act about passage of title or tender of delivery.

2. Basic Approach. Which party bears the risk of loss is determined by the agreement and, in the absence of agreement, by standards that focus on the transaction rather than on title to copies or tender of delivery. This rule is subject to variation by agreement. Agreement may be found in express terms, course of dealing, usage of trade or inferred from the circumstances of the contracting. Absent contrary agreement, risk of loss generally lies with the person in possession or control of the copy. It passes from one party to the other on receipt of the copy or control of it, unless another rule governs under this section or the agreement.

3. Electronic Transfer. If a copy is transferred electronically, risk of loss passes to the recipient when the copy is received. The recipient should have no risk regarding the loss of a copy that has not yet been received where electronic transmissions are, in effect, virtually instantaneous. The risk of loss during transmission is on the sender. The transferor who sends the copy electronically also retains a copy that could be used for retransmission. This rule does not concern when tender of delivery occurs.

4. Delivery of Physical Copies. Subsection (b) deals with transactions involving transfer of a tangible copy to be shipped. The rules are from U.C.C. Article 2 (1998 Official Text). They distinguish between a shipment contract (Section 606(b)(2)) and a destination contract (Section 606(b)(3)). Most shipments of tangible copies are shipment contracts. "Duly delivered" in a shipment contract requires that the sender tender the copy to the carrier pursuant to an appropriate contract with the carrier.

5. Delivery without Moving the Copy. Subsection (c) deals with transfers accomplished without moving a copy. Risk of loss transfers when the transferee receives the ability to control the copy or when it receives access materials to access the copy. These rules correspond to U.C.C. Article 2 (1998 Official Text) but are updated for where the transaction entails electronic access from which a copy can be obtained.

SECTION 615. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) [**Effect of delay or nonperformance.**] Unless a party has assumed a different obligation, delay in performance by a party, or nonperformance in whole or part by a party, other than of an obligation to make payments or to conform to contractual use terms, is not a breach of contract if the delay or nonperformance is of a performance that has been made impracticable by:

(1) the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made; or

(2) compliance in good faith with any foreign or domestic statute, governmental rule, regulation, or order, whether or not it later proves to be invalid.

(b) [**Notice required.**] A party claiming excuse under subsection (a) shall seasonably

notify the other party that there will be delay or nonperformance.

(c) [**Allocation of performance.**] If an excuse affects only a part of a party's capacity to perform an obligation for delivery of copies, the party claiming excuse shall allocate performance among its customers in any manner that is fair and reasonable and notify the other party of the estimated quota to be made available. In making the allocation, the party claiming excuse may include the requirements of regular customers not then under contract and its own requirements.

(d) [**Options upon receipt of notice.**] A party that receives notice pursuant to subsection (b) of a material or indefinite delay in delivery of copies or of an allocation under subsection (c), by notice in a record, may:

(1) terminate and thereby discharge any executory portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(e) [**When contract lapses.**] If, after receipt of notice under subsection (b), a party does not modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

Uniform Law Source: Uniform Commercial Code: Sections 2A-405, 2A-406; 2-615, 2-616 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Copy"; "Contract"; "Contractual use terms"; "Delivery"; "Good faith"; "Notice"; "Notify"; "Party"; "Receive"; "Record"; "Seasonable;" "Terminate." Section 117: "Reasonable time."

Comment

1. Scope of the Section. This section adopts the impossibility doctrine in Uniform Commercial Code Article 2 (1998 Official Text). However, the doctrine is made applicable to both parties.

2. Nature of Excuse. Subsection (a) conforms to Uniform Commercial Code § 2-615 (1998 Official Text) and adopts the policies reflected in that section, but applied to both parties. A party is excused from timely performance of a contractual obligation if that performance becomes commercially impracticable due to unforeseen events not within the contemplation of the parties at the time of contracting. The standard of excuse does not apply to an obligation to pay or to follow restrictions in contractual use terms. See Section 601, *Comment* 2 and 3. The requirement to perform payment obligations does not displace general law on the effect of governmental regulations as an excuse for a payment obligation. The section does not address that issue, leaving its resolution to common law.

Increased cost does not excuse performance unless the increase is due to an unforeseen contingency that alters the essential nature of the performance obligation and that cannot reasonably be viewed as within the contingencies that were foreseeable in the original agreement.

A rise or a fall in the market or market prices is not in itself a justification. Market and cost fluctuations are the type of business risk which commercial contracts cover. Similarly, if the agreement calls for development of new technology, no excuse arises if the agreed development itself proves to be technologically impossible or excessively costly. That risk is inherent in a development agreement and is assumed to be allocated in the basic contract. However, if both parties proceeded on the assumption that a third-party technology would be completed, but this does not occur and renders the project impossible, the agreement may have been based on an assumed fact or occurrence that did not ensue and an excuse may be appropriate.

Excuse doctrine does not apply if, under the agreement, the party seeking to claim an excuse agreed to assume the risk. Such agreement can be found not only in express terms of the contract, but in the circumstances of the contracting, trade usage, course of dealing and the like. The exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the contract terms, either consciously or as a matter of reasonable commercial interpretation from the circumstances.

3. Notice. Subsection (b) requires seasonable notice to the other party who will be affected by the performance deficiency caused by the excuse.

4. Allocation Rules. Subsections (c) and (d) are based on Article 2 and limited to contractual obligations to deliver copies. Under subsection (c), the licensor is required to make an allocation of the copies available for delivery among its customers and its own requirements. A licensor that has a partial excuse under this section must fulfill its contract to the extent that the overriding contingency permits. If the events affect its ability to supply its customers generally, this section allows the licensor to take into account the needs of all customers and of itself when fulfilling its obligation to one customer as far as possible. This may include customers not then under contract. However, good faith requires that, in cases of doubt, current contract customers should generally be favored. Except for such considerations, the standard here is intended to leave open reasonable business leeway to the licensor.

5. Rights of Other Party. The interests of a party faced with a material or indefinite delay are protected in subsection (d). The party may either accept the proposed allocation or treat the contract as terminated as to executory obligations. The latter option does not allow treating the case as involving a breach, but merely permits termination. If the party fails timely to accept the proposed modification, under subsection (e), the contract lapses as to the relevant performance.

[SUBPART E. TERMINATION]

SECTION 616. TERMINATION: SURVIVAL OF OBLIGATIONS.

(a) [**Effect of termination.**] Except as otherwise provided in subsection (b), on termination all obligations that are still executory on both sides are discharged.

(b) [**Obligations surviving termination.**] The following survive termination:

(1) a right based on previous breach or performance of the contract;

(2) an obligation of confidentiality, nondisclosure, or noncompetition to the extent enforceable under other law;

(3) a contractual use term applicable to any licensed copy or information received from the other party, or copies made of it, which are not returned or returnable to the other party;

(4) an obligation to deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party, an obligation to destroy copies, or a right to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve disputes by alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for giving notice;

(8) an indemnity term or a right related to a claim of a type described in Section 805(d)(1);

(9) a limitation of remedy or modification or disclaimer of warranty;

(10) an obligation to provide an accounting and make any payment due under the accounting; and

(11) any term that the agreement provides will survive.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505(2); 2-106(3) (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Contractual use term"; "Copy"; "Information"; "License"; "Party"; "Receive"; "Record"; "Remedy"; "Term"; "Termination".

Comment

1. Scope of the Section. Termination means ending a contract other than for breach. This section describes the effect of termination and lists some obligations that survive termination unless otherwise agreed. The list is not exclusive.

2. Effect of Termination. Termination discharges *executory* obligations. It does not terminate vested rights or remedies that have not previously been waived.

3. Executory Obligations. An executory obligation is one that is not fully performed on both sides. If the prior performance of one party earned a reciprocal performance (e.g., payment or delivery), termination does not affect that earned reciprocal performance. If the obligations of one or both parties are partly, but not fully completed, the obligation is executory for purposes of this section if the unperformed part is such that a failure to perform it would be a material breach excusing the other party's obligation to perform. Minor remaining acts typically would not leave an obligation executory, but material remaining performance does.

4. Survival Rules. Subsection (b) lists terms and rights that survive termination. The list presumes that the surviving obligation was created in the agreement and identifies terms that parties ordinarily would designate as surviving. The intent of this list is to provide background rules, reducing the need for specification in the contract. Of course, the parties may delete or add terms by agreement, which agreement can be found in express terms or in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like. Upon termination, various other rights may be vested and not executory: these also survive by application of the standard in subsection (a).

SECTION 617. NOTICE OF TERMINATION.

(a) [**When notice required.**] Except as otherwise provided in subsection (b), a party may not terminate a contract except on the happening of an agreed event, such as the expiration of the stated duration, unless the party gives reasonable notice of termination to the other party.

(b) [**Termination of access contract.**] An access contract may be terminated without giving notice. However, except on the happening of an agreed event, termination requires giving reasonable notice to the licensee if the access contract pertains to information owned and provided by the licensee to the licensor.

(c) [**Terms dispensing with notice.**] A term dispensing with a notice required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for giving notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Uniform Commercial Code Section 2-309(c) (1998 Official Text).

Definitional Cross References: Section 102: "Access contract"; "Contract"; "Information"; "Licensee"; "Licensor"; "Give notice"; "Party"; "Term"; "Termination".

Comment

1. Scope of the Section. This section deals with when notice of termination is required; it does not deal with when a contract may be terminated. The rules do not apply to cancellation for breach.

2. Termination on the Happening of an Event. No notice is required for termination based on an agreed event (e.g., the end of the stated license term). This follows Article 2 of the Uniform Commercial Code (1998 Official Text) and common law. The parties are charged with awareness of agreed terms; in cases covered by this rule, they agreed that the contract would expire on the happening of an objectively ascertainable event. No notice is needed when this event occurs.

3. Notice in Other Cases. Except as stated in subsection (b), termination based on discretion of one party, such as an "at will termination", requires that reasonable notice be given.

What notice is reasonable varies with the circumstances. For example, where the reason for termination involves suspected unlawful conduct or a desire to prevent harmful acts, notice at or promptly after termination will ordinarily suffice; in such cases, notification may consist of the inability to further access the computer information. In less exigent or harmful circumstances, giving prior notice ordinarily may be required. The notice requirement when there are no exigent circumstances and there is no material breach gives the other party an opportunity to make other arrangements and to avoid use of the information after termination that may result in breach of contract or infringement of intellectual property rights.

The party terminating the contract must give notice, but a requirement that notice be received would create uncertainty that is undesirable where the terminating party is merely exercising a contractual right.

4. Access Contracts. Under subsection (c), termination of an access contract does not require notice even if based on exercise of discretion by the terminating party. Of course, the termination must be allowed by the contract. An access contract gives contractual rights to access a resource owned or controlled by the licensor. When the contract terminates, the access privilege terminates. This rule is consistent with common law for a license of this type. This section provides a limited exception to the common law rule, when the access contract involves information that is provided to the licensor and owned by the licensee, such as when a licensee has provided its employee list for storage on a computer of the licensor that is accessed under license to the licensee. In that case, notice is required. What is meant here is ownership of the information. Thus if a customer provides information to effect a transaction, or if the customer has previously provided information to the licensor for other transactions, the customer transactional information is not owned by the customer to whom it refers and the exception does not apply.

5. Contract Modification. Subsection (c) corresponds to U.C.C. Article 2 (1998 Official Text). Under subsection (c), a notice requirement may be waived or the terms, timing and other aspects of notice may be specified by agreement. The subsection places two restrictions on this principle.

First, an agreed waiver of notice is enforceable only if enforcement of the term is not unconscionable. This rule permits contractual waivers of notice, but allows a court to police exercise of the right thus created if that exercise is unconscionable. The focus is not on the term in this context, but on its operation. This rule does not apply where the agreement sets standards for notice of termination. For an application of this concept, see Intergraph Corp. v. Intel Corp., 195 F.3d 1346 (Fed. Cir. 1999); Zapatha v. Dairy Mart, Inc., 381 Mass. 284, 408 N.E.2d 1370, 1375 (Mass. 1980).

Second, standards set by agreement for notice of termination are enforceable unless they are manifestly unreasonable. This rule permits flexibility in an agreement, but allows a court to reject clearly abusive terms. It does not allow invalidation simply because application of the standard causes an undesirable result when viewed in retrospect.

SECTION 618. TERMINATION: ENFORCEMENT.

(a) [**Return of materials.**] On termination of a license, a party in possession or control of information, copies, or other materials that are the property of the other party, or are subject to a contractual obligation to be delivered to that party on termination, shall use commercially reasonable efforts to deliver or hold them for disposal on instructions of that party. If any

materials are jointly owned, the party in possession or control shall make them available to the joint owners.

(b) [**Cessation of license rights.**] Termination of a license ends all right under the license for the licensee to use or access the licensed information, informational rights, or copies. Continued use of the licensed copies or exercise of terminated rights is a breach of contract unless authorized by a term that survives termination.

(c) [**Enforcement.**] Each party may enforce its rights under subsections (a) and (b) by acting pursuant to Section 605 or by judicial process, including obtaining an order that the party or an officer of the court take the following actions with respect to any licensed information, documentation, copies, or other materials to be delivered:

(1) deliver or take possession of them;

(2) without removal, render unusable or eliminate the capability to exercise contractual rights in or use of them;

(3) destroy or prevent access to them; and

(4) require that the party or any other person in possession or control of them make them available to the other party at a place designated by that party which is reasonably convenient to both parties.

(d) [**Injunctive relief.**] In an appropriate case, a court of competent jurisdiction may grant injunctive relief to enforce the parties' rights under this section.

Definitional Cross References: Section 102: "Copy"; "Contract"; "Court"; "Electronic"; "Information"; "Informational Rights"; "License"; "Licensee"; "Party"; "Person"; "Term"; "Termination".

Comment

1. Scope of the Section. This section deals with obligations arising on termination of a license. The section does not deal with cancellation for breach or with transactions other than a license. For cancellation, see sections 802, 815 and 816.

2. Obligation to Return. Subsection (a) states the unexceptional principle that, on termination of a license, a party (licensor or licensee) is entitled to return of any materials that it owns or that the contract requires to be delivered at the end of the relationship. This is a contract right. The obligation is to use commercially reasonable effort. In some cases, circumstances may delay return. A reasonable effort, however, does not encompass intentional or knowing

retention of copies. Similarly, subsection (b) makes clear that use of the information after the contract terminates is a breach of contract, the remedy for which survives the termination.

3. Terminating Rights of Use. Termination of the license ends all rights of use pursuant to the license except those rights that by agreement survive or are irrevocable. This rule corresponds to prior law and reflects the conditional nature of the rights established under a license. Continued use not authorized by the license breaches the contract. If intellectual property rights are involved, such use may also be an infringement. Since termination does not entail actions in response to a breach of contract, no provision is made for limited use to mitigate damages. Compare Section 802.

Uses referred to here relate to use of the licensed copy or information. If a licensee obtains a new license, or obtains the same information from other persons, the right to use that information does not depend on the original license and is not covered by this section.

4. Enforcement. Subsection (c) provides for judicial enforcement of termination rights if the parties do not timely comply with their obligations when the contract.

PART 7

BREACH OF CONTRACT

[SUBPART A. GENERAL]

SECTION 701. BREACH OF CONTRACT; MATERIAL BREACH.

(a) [**When breach occurs.**] Whether a party is in breach of contract is determined by the agreement and this [Act]. A breach occurs if a party without legal excuse fails to perform an obligation in a timely manner, repudiates a contract, or exceeds a contractual use term, or otherwise is not in compliance with an obligation placed on it by this [Act] or the agreement.

(b) [**Effect of breach.**] A breach of contract, whether or not material, entitles the aggrieved party to its remedies. Whether a breach of a contractual use term is an infringement or a misappropriation is determined by applicable informational property rights law.

(c) [**Material breach.**] A breach of contract is material if:

(1) the contract so provides;

(2) the breach is a substantial failure to perform a term that is an essential element of the agreement; or

(3) the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the business, trade, or industry, and the character of the breach, indicate that:

(A) the breach caused or is likely to cause substantial harm to the aggrieved party; or

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

(d) [**Effect of cumulative breaches.**] The cumulative effect of nonmaterial breaches may be material.

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

Definitional Cross References: Section 102: “Aggrieved party”; “Agreement”; “Contract”; “Contractual use term”; “Party”; “Term”.

Comment

1. Scope of Section. This section defines what is a breach of contract and standards to distinguish between material and non-material breach.

2. Material Breach and non-material Breach. This Act follows common law: a party's contractual remedies are determined by whether a breach is material or immaterial. Both types of breach entitle the aggrieved party to remedies, but a material breach gives a right to cancel the contract.

3. What is a Breach? What is a breach of contract is determined by the agreement or, in the absence of agreement, this Act. A party must conform to the contract. A breach occurs if a party acts in a manner that violates the agreement or fails to act in a manner required by the contract. This includes but is not limited to a failure timely to perform, a breach of warranty, a repudiation, non-delivery, wrongful disclosure, uses in violation of the contract, exceeding restrictions in contractual use terms, and other breaches.

4. What is a material breach? Parties are entitled to the performance for which they bargain. Any breach of contractual obligations entitles the other party to damages as appropriate. Beyond that, this Act adopts the rule in common law and international law distinguishing between material and immaterial breaches. Some breaches are so immaterial that they do not justify cancellation of the contract. In such cases, it is better to preserve a contract despite minor problems than to allow one party to cancel and thereby risk an unwarranted forfeiture or unfair opportunism. Materiality depends on the agreement; the agreement can either define a type of breach as material or it can simply state that the remedy of cancellation exists. Failing contract delineation, what is a material breach depends on the circumstances. A failure fully to conform to promises about the capability of software to handle 10,000 files may not be material if the licensee's use will not exceed 4,000 files and the software is able to handle 9,000 files. Materiality is judged from the aggrieved party's perspective in light of the nature of the bargain and the benefits expected from performance of the contract.

A statute cannot define materiality with precision, but can give appropriate reference points. Subsection (b) provides three: contract terms defining materiality, a substantial failure to perform an essential term, and a breach causing substantial harm to the aggrieved party or a denial of a reasonably expected significant benefit. This last consideration, of course, refers to substantiality in context of the agreement itself. Thus, in a contract for a ten dollar software license, a breach causing ten dollars of harm would be material even though, in a thirty million dollar license, a ten dollar loss should be immaterial.

The list in subsection (b) is not exclusive. When the contract is silent this section should be interpreted in light of common law and the *Restatement*. 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). Common law concepts preclude forfeiture for minor breaches; thus in the absence of agreement about a term, materiality hinges on substantial denial to the aggrieved party of the advantages (consideration) it sought from the transaction. The *Restatement (Second) of Contracts* § 241 (1981) lists five factors: 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 the party 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.

5. Contract Terms. An agreement may determine what is a material breach by express

terms that either give a right to cancel for a particular breach or provide that a particular type of breach is material. Of course, a court must interpret that agreement in light of general principles. Thus, a term providing that *any* failure to conform to *any* contract term permits cancellation should be interpreted in light of commercial context that includes usage of trade, course of performance, or course of dealing, unless clearly refuted by the circumstances. Section 116(c). That context may indicate that minor breach of some terms are nonetheless not adequate for cancellation.

The agreement might indicate that conforming to a specific requirement is a precondition to the performance of the other party. That condition should be enforced. The express condition defines part of the remedy: breach allows the aggrieved party not to perform simply because the express condition for its performance is not met.

Illustration: In a software development contract, the contract expressly conditions acceptance of the product on its meeting ten conditions. One condition is that it must operate at "no less than 150,000 rev. per second." The software does not meet that condition. Failure to meet the condition justifies refusal of the product.

6. What Remedies Apply? If a party's performance breaches the contract, the aggrieved party is entitled to its remedies. The remedies depend on the nature of the breach and any remedy limitations. All remedies are generally available for material or non-material breach, except the remedy of cancellation. The aggrieved party can cancel the contract only if the breach was material as to the entire contract. For either type of breach, there is an intermediate remedy in that a party whose expectations of future performance are impaired may suspend performance and demand adequate assurance of future performance from the other. Section 708.

7. Relation to Intellectual Property Rights. Subsection (a) makes it clear that this Act does not alter intellectual property rules about whether a breach also constitutes an infringement or misappropriation. *Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F3d 1115 (9th Cir., 1999) (distinguishing scope and breach of a covenant). In an appropriate case, where there is no double recovery, a party may have remedies under both contract and intellectual property laws. *Kepner-Tregoe Inc. v. Vroom*, 186 F.3d 283 (2nd Cir., 1999).

SECTION 702. WAIVER OF REMEDY FOR BREACH OF CONTRACT.

(a) [**Waiver as to executory performance.**] Except for a waiver in accordance with subsection (b) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance will be required in the future, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by that party.

(b) [**Waiver in a record.**] A claim or right arising out of a breach of contract may be discharged in whole or part without consideration by a waiver in a record to which the party making the waiver agrees after breach, such as by manifesting assent, or which the party making the waiver authenticates and delivers to the other party after breach.

(c) [**Waiver by acceptance of performance.**] A party that accepts a performance with knowledge that the performance constitutes a breach of contract and, within a reasonable time after acceptance, does not notify the other party of the breach waives all remedies for the breach, unless acceptance was made on the reasonable assumption that the breach would be cured and it has not been seasonably cured. However, a party that seasonably notifies the other party of a reservation of rights does not waive the rights reserved.

(d) [**Waiver by failure to inform.**] A party that refuses a performance and fails to identify a particular defect that is ascertainable by reasonable inspection waives the right to rely on that defect to justify refusal only if:

(1) the other party could have cured the defect if it were stated seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final statement of all defects on which the refusing party relied.

(e) [**Effect of waiver on similar future performance.**] Waiver of a remedy for breach of contract in one performance does not waive any remedy for the same or a similar breach in future performances unless the party making the waiver expressly so states.

(f) [**No retraction of waived breach.**] A waiver may not be retracted as to the performance to which the waiver applies.

Uniform Law Sources: Uniform Commercial Code: Sections 2-209; 2-607 (1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved Party"; "Authenticate"; "Contract"; "Knowledge"; "Merchant"; "Notice"; "Notify" ("give notice"); "Party"; "Receive"; "Record"; "Term"; "Seasonable". Section 112: "Manifest assent". Section 117: "Reasonable time."

Comment

1. Scope of the Section. This section deals with waivers. A "waiver" is a voluntary relinquishment of a known right. The section brings together rules from common law and from Article 2 of the Uniform Commercial Code (1998 Official Text).

2. Waivers in a Record. Waivers made in a record to which a party agrees, including by a manifestation of assent, are enforceable without consideration. This follows modern law. See Uniform Commercial Code § 2A-207; *Restatement (Second) of Contracts* § 277. The rule in subsection (a) does not preclude other forms of waiver, but merely confirms that waivers within it are effective.

3. Waiver by Accepting a Performance. Subsection (c) deals with waivers resulting from accepting a performance without objecting to known deficiencies in it. Waiver stems from conduct and knowledge of the defect coupled with silence beyond a reasonable time. This type of waiver does not apply if the party merely knows a performance is not consistent with the contract. The defective performance must have been tendered to and accepted by that party. Failure to object to uses that violate a license but pertain to performance not delivered to the other party is not a waiver. In some cases, of course, it may result in an estoppel.

A party presented with deficient performance is not required to elect between accepting or entirely refusing it. Subsection (c) permits the party to preserve its rights by (1) giving notice of objection to the deficiency within a reasonable time, or accepting the performance and giving prior notice that it does so while reserving its rights. The first option comes from Article 2 of the Uniform Commercial Code (1998 Official Text). The second is from Article 1 of the Uniform Commercial Code (1998 Official Text). Of course, the party in appropriate cases may simply refuse the performance.

4. Failure to Particularize. Refusal of a performance does not place the refusing party at risk if it does not state reasons for its refusal. There is no requirement that the party particularize the reasons for the refusal. Under subsection (d), however, a waiver results from a failure to particularize if the other party could have cured the problem had it been seasonably given the basis for refusal, or, between merchants, if the breaching party asks for a specification in a record of the reasons for refusal and a basis for refusal is not listed among the reasons. This adopts Uniform Commercial Code § 2-605 (1998 Official Text) and should be interpreted to correspond to that section. The rule is grounded in fairness: the aggrieved party is obligated to provide notice to the other party of defects reasonably known to the aggrieved party, but the aggrieved party does not waive defects that were later-discovered.

5. Scope of Waiver. Under subsection (e), absent express agreement or circumstances clearly indicating to the contrary, a waiver applies only to the specific breach waived and does not alter remedies for future breaches. This principle does not alter estoppel concepts; a waiver may create justifiable reliance as to future conduct in an appropriate case.

6. Retracting a Waiver. A waiver cannot be retracted with respect to past events whose consequences were waived. This principle is important in continuing relationships. It allows aggrieved parties to waive particular defects in performance without forfeiting rights as to future performances.

A waiver as to future events supported by consideration cannot be unilaterally retracted. Such waivers constitute a bilateral agreement. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* § 84, comment f. All other waivers as to executory portions of a contract may be retracted as to future events unless retraction would be unjust in view of a material change in position in reliance on the waiver. See Section 303, Comment 5.

SECTION 703. CURE OF BREACH OF CONTRACT.

(a) [**When cure permitted.**] A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not expired and the party in breach seasonably notifies the aggrieved party of its intent to cure and, within the time for performance, makes a

conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without monetary allowance, seasonably notifies the aggrieved party of its intent to cure, and provides a conforming performance within a further reasonable time after performance was due; or

(3) in a case not governed by paragraph (1) or (2), the party in breach seasonably notifies the aggrieved party of its intent to cure and promptly provides a conforming performance before cancellation by the aggrieved party.

(b) [**Cure of nonmaterial breach.**] In a license other than in a mass-market transaction, if the agreement required a single delivery of a copy and the party receiving tender of delivery was required to accept a nonconforming copy because the nonconformity was not a material breach of contract, the party in breach shall promptly and in good faith make an effort to cure if:

(1) the party in breach receives seasonable notice of the specific nonconformity and a demand for cure of it; and

(2) the cost of the effort to cure does not disproportionately exceed the direct damages caused by the nonconformity to the aggrieved party.

(c) [**Effect of cure.**] A party may not cancel a contract or refuse a performance because of a breach of contract that has been seasonably cured under subsection (a). However, notice of intent to cure does not preclude refusal or cancellation for the uncured breach.

Uniform Law Source: Uniform Commercial Code: Sections 2-508; 2A-513 (1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Cancellation"; "Contract"; "Copy"; "Direct damages"; "Good faith"; "License"; "Mass-market license"; "Notifies"; "Party"; "Receive"; "Seasonable". Section 117: "Reasonable time." Section 602: "Enable use". Section 701: "Material breach".

Comment

1. Scope of the Section. This section establishes an opportunity to cure a breach and retain a contractual relationship. For licensees, cure often involves acts to correct missing or delayed payments or failure to timely give required accounting or other reports. For licensors, cure often focuses on timeliness of performance and adequacy of a delivered product. This section sets limits on the opportunity to cure that balance the goal of preserving contract relationships and the

goal of giving the injured party the full benefit of its bargain. Subsection (b) creates a new, limited duty to cure in cases where the injured party was required to accept a copy because the breach was not material as to that copy.

2. General Idea of Cure. The idea that a breaching party may preserve the contract if it acts promptly to eliminate the effect of breach is embedded in modern law. See *Restatement (Second) of Contracts* § 237. However, there is significant disagreement about the scope of allowed cure, reflecting different balances drawn between the policy of allowing a party to preserve a contractual relationship and policies that protect the valid expectations of the aggrieved party. Compare UNIDROIT *International Principles of Commercial Contract Law* art. 7.1.4; *Convention on the International Sale of Goods* art. 48.

3. Right to Cure. This section generally allows cure if it is prompt and avoids harm to the aggrieved party. Cure is not an excuse for faulty performance, but rather an opportunity to avoid loss and retain the benefits of the contract for both parties. Cure does not eliminate a right to damages, but prevents cancellation based on the cured breach.

There is a *right* to cure before the time for performance expires. Paragraph (a)(1). A party whose early performance was a breach can make a good tender within the contract time. What is the time for performance is determined by the agreement at the time of performance, including any enforceable modifications.

Cure requires seasonable notice of an intent to cure. The closer that the time of the breach is to the contractual time for performance, the greater is the necessity for promptness in notice and completing the cure. What is seasonable notice depends on the context, including the importance of the expected performance and the timing and difficulty of obtaining substitutes. The notice is not the cure. Cure occurs when conforming performance is tendered.

4. Permissive Cure. If the time for performance expired before cure, cure is permissive only. There are two circumstances in which cure is permitted.

a. Expectation that performance would be acceptable. A party in breach has an opportunity to cure if it had "reasonable grounds to believe" that the original tender would be acceptable. Thus, payment of eighty percent of the amount due would create an opportunity to cure only if, from prior performance, the tendering party had reason to believe that tender would be acceptable. That reason can arise from prior course of dealing, course of performance or usage of trade, as well as the particular circumstances surrounding the contract. The party is charged with knowledge of factors in a particular transaction which in common commercial understanding require strict compliance with contractual obligations, but can also rely on course of dealing and usage of trade regarding variation of performance unless these have been clearly refuted by the circumstances, including the terms of the agreement. If the other party gives notice either implicitly through a clear course of dealing, or through terms requiring strict performance, those indications control this section. Requirements in a standard form that are not consistent with trade usage or the prior course of dealing and are not called to the other party's attention may be inadequate to make unreasonable any expectations consistent with trade usage or course of dealing.

b. Cure subject to other person's actions. Outside of the settings described in paragraphs (a)(1) and (a)(2), the opportunity to cure is limited by the aggrieved party's right to insist on performance and, under paragraph (a)(3), cure must occur before the aggrieved party cancels the contract. This puts control in the aggrieved party. As indicated in subsection (c), the aggrieved party is not required to withhold cancellation simply because of a notice of intent to cure from the other party.

In mass market cases governed by Section 704(b), refusal of the single copy that forms the basis of the transaction may be cancellation because the entire transaction focused on rights in that copy. No special notice or words of cancellation are required. Even if refusal is not, in the circumstances, equivalent to cancellation, a defect in a copy provided under Section 704(b)

gives a right to cancel. If the provider, when notified of refusal, gives notice that it intends to cure, under subsection (a)(3) the licensee can either agree to allow that or can refuse to do so and at that point cancel by refusing any offered cure.

5. What is a Cure. Cure requires the completion of acts that put the aggrieved party in essentially the position that would have ensued on conforming performance. Cure requires a party to perform the contract obligation and to compensate fully for loss. Monetary compensation may be required, but money is a cure only if provided in addition to full performance, such as tender of a conforming copy or tender of a late payment with any required late payment charges. Cure does not occur merely because one party announces its intention to cure, even if that intention is held in good faith. Cure only occurs when or if the proposed compensatory and conforming actions are completed.

Some contract breaches cannot be cured. This is true, for example, if a party breaches a contract by publicly disclosing licensed trade secret information. In such cases, the damage done cannot be reversed and cure is inapplicable. A similar condition may arise where the agreement demands performance on a specific date or hour, but the party materially fails to meet the deadline. Cure is an opportunity to avoid ending a contract relationship by bringing the performance into line with the other party's rightful expectations. It does not allow a breaching party to avoid the consequence of breaches that have significant irreversible effects.

6. Effect of Cure. Cure of a breach does not mean that the aggrieved party must accept without remedy less than conforming conduct. The effect of cure is that a contract cannot be canceled based on the cured breach. The aggrieved party retains its remedies under the agreement or this Act.

7. Duty to Cure. Subsection (b) applies to cases outside the mass market where a licensee must accept a copy because there is no material breach even though breach occurred. It creates an obligation to attempt to cure. The defect must, of course, constitute a breach of contract. Failure to undertake a required effort to cure is a breach of contract, but failure to correct the problem having attempted to do so is not a breach. The obligation to attempt a cure is limited by proportionality. No obligation exists if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, if a party delivers a one thousand name list for $500 that omits five non-material names in a context where that omission is a breach and where the omission reduces the value of the list by a small amount, the party has no obligation to cure if obtaining those additional names would be disproportionate to the direct damages. In such case, the proper remedy is the difference in value (if any) of the copy rendered and the performance promised.

[SUBPART B. DEFECTIVE COPIES]

SECTION 704. COPY: REFUSAL OF DEFECTIVE TENDER.

(a) [**Effect of defective tender.**] Subject to subsection (b) and Section 705, tender of a copy that is a material breach of contract permits the party to which tender is made to:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) [**Conforming tender in mass-market transaction.**] In a mass-market transaction that calls for only a single tender of a copy, a licensee may refuse the tender if the tender does not conform to the contract.

(c) [**Ineffective refusal.**] Refusal of a tender is ineffective unless:

(1) it is made before acceptance;

(2) it is made within a reasonable time after tender or completion of any permitted effort to cure; and

(3) the refusing party seasonably notifies the tendering party of the refusal.

(d) [**When cancellation permitted.**] Except in a case governed by subsection (b), a party that rightfully refuses tender of a copy may cancel the contract only if the tender was a material breach of the whole contract or the agreement so provides.

Uniform Law Source: Uniform Commercial Code Sections 2-601, 2-602, 2A-509 (1998 Official Text).

Definitional Cross References: Section 102: Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Licensee"; "Mass-market transaction"; "Notifies"; "Party". Section 117: "Reasonable time."

Comment

1. Scope of Section. This section deals with refusal of copies. It does not refer to other types of performance. The right to refuse is subject to Sections 705, 706, and 610.

2. Refusal of the Tender. A party may accept or refuse a tender of a copy. Except as stated in subsection (b), this section adopts common law that refusing a performance is appropriate only if the performance entails a material breach as to that performance (the copy). Acceptance of a copy does not generally waive the party's rights to a remedy for breach. What is acceptance of a copy is dealt with in Section 609.

Refusal is the reverse of "acceptance" of a copy. A decision to refuse a tender of a copy ordinarily requires refusal of all of the tendered copies. However, a licensee may accept some tendered commercial units (copies) and reject the rest, if the commercial units are separable in light of the contracted performance. For example, if the licensor tenders thirty copies and ten are defective, the commercial unit is the copy and the licensee can accept the thirty and refuse the remainder. On the other hand, tender of a copy of a single program with ten modules that are defective and thirty not, does not involve multiple commercial units; the tender must be refused in whole or not at all. This section does not permit a party to disassemble an integrated or composite product. The part accepted (or refused) must be a commercial unit as intended by the party tendering it; the issue is not whether some of the product could have been provided separately, but whether, as provided pursuant to the agreement, it was a separable commercial unit. As with all performance, partial acceptance must be in good faith and conform to standards

of commercial fair dealing.

3. Conforming Tender Rule. Subsection (b) adopts the "conforming tender" rule for mass-market transactions where the only performance is tender of a single delivery. In more complex transactions, in this Act as in Article 2, conforming tender is not the appropriate standard for cancellation; the rules of subsection (a) and Section 601 apply.

While sometimes described as a "perfect tender" rule, the "conforming tender" rule does not require tender of a "perfect" product, but merely one that conforms to the contract. What conforms to the contract depends on the agreement, including express terms as interpreted in light of usage of trade, course of dealing and concepts of merchantability. The relationship between refusal under subsection (b) and the ability to cure a defect is discussed in Section 703, *Comment* 4(b).

4. Effective Refusal. Under subsection (c), refusal of a tender is ineffective if the refusing party does not timely notify the other party of its refusal. This precludes arguments that silent refusal can be effective or coupled with use of the information. The rule corresponds to waiver rules in common law and this Act. The refusal is effective if it occurs within a reasonable time after any permitted, but ineffective effort to cure. Refusal is not permitted after breach has in fact been cured.

5. Refusal and Cancellation. Many transactions involve commitments that go beyond delivery of a particular copy. Subsection (d) confirms that an aggrieved party that refuses tender of a copy may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides. Cancellation of the entire contract requires breach that is material as to the entire agreement, or a contract term that allows cancellation.

SECTION 705. COPY: CONTRACT WITH PREVIOUS VESTED GRANT OF RIGHTS. If an agreement grants a right in or permission to use informational rights which precedes or is otherwise independent of the delivery of a copy, the following rules apply:

(1) [**Effect of refusal of copy.**] A party may refuse a tender of a copy which is a material breach as to that copy, but refusal of that tender does not cancel the contract.

(2) [**Cure permitted.**] In a case governed by paragraph (1), the tendering party may cure the breach by seasonably providing a conforming copy before the breach becomes material as to the whole contract.

(3) [**When cancellation permitted.**] A breach that is material with respect to a copy allows cancellation of the contract only if the breach cannot be seasonably cured and is a material breach of the whole contract.

Definitional Cross References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Informational Rights"; "Party"; "Seasonably".

Comment

1. Scope of the Section. The section distinguishes (1) agreements where a grant to use informational rights vests independently of any copy, and (2) agreements where the purpose is to obtain informational or other rights associated with a copy. It applies to the first context.

2. Effect of Breach. In transactions of this type, refusal of a defective copy does not necessarily permit cancellation of the contract. The contractual grant of rights (already vested) is an independent, performed part of the agreement; any particular copy used to implement that grant is a mere conduit. If the defective tender of a copy does not materially breach the entire contract, the tendering party has a right to cure. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement. Similarly, the aggrieved party has a right to retain its rights but refuse the copy: refusal of a copy does not alter the vested rights.

3. Nature of the Transaction. The section applies only if the contract vests the right to use informational rights without the transferee's receipt of a copy. Whether this is the nature of a particular contract depends on the agreement. If there is a vested rights transaction, the parties view a copy as a mere conduit to complete an already vested grant. In such cases, a defect in one copy is not necessarily material to the entire contract; a licensee can refuse the copy and retain the contractual rights. In contrast, if the contract is only for rights associated with a copy, a licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract.

Illustration 1. IBM grants licensee (LE) the right to distribute twenty thousand copies of its software in the United States during one year. Several weeks later, IBM delivers a master disk of the software to LE. The master disk contains a manufacturing flaw. The contract is within this section. LE can refuse the copy if the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. IBM can cure by timely tendering a conforming copy. LE can recover damages, if any.

Illustration 2. LE orders a 100 person site license from Red Hat for its operating system software. Red Hat ships a copy of the software, but the copy is warped and defective and arrives several weeks late. This contract is not within this section since there was no vested right to use informational rights independent of the copy to be delivered.

Illustration 3. Prince D's estate grants LE an exclusive license to show still photographs of Prince D on an Internet website for one week during the first anniversary of Prince D's death, also giving LE the right to advertise the exhibit. A copy of the photographs is to be delivered one week before the first showing. The copy is delivered several days late and is technically defective. It cannot be used. LE refuses the copy. The contract is within this section because the grant of rights is independent of the copy.

SECTION 706. COPY: DUTIES UPON RIGHTFUL REFUSAL.

(a) [**Refusal or revocation of acceptance of copy.**] Except as otherwise provided in this section, after rightful refusal or revocation of acceptance of a copy, the following rules apply:

(1) [**If contract canceled.**] If the refusing party rightfully cancels the contract, Section 802 applies and all restrictions in contractual use terms continue.

(2) [**If contract not canceled.**] If the contract is not canceled, the parties remain bound by all contractual obligations.

(b) [**Supplemental rules.**] On rightful refusal or revocation of acceptance of a copy, the following rules apply to the extent consistent with Section 802:

(1) [**When use is breach.**] Any use, sale, display, performance, or transfer of the copy or information it contains, or any failure to comply with a contractual use term, is a breach of contract. The licensee shall pay the licensor the reasonable value of any use. However, use for a limited time within contractual use terms is not a breach, and is not an acceptance under Section 609(a)(5), if it:

(A) occurs after the tendering party is seasonably notified of refusal;

(B) is not for distribution and is solely part of measures reasonable under the circumstances to avoid or reduce loss; and

(C) is not contrary to instructions concerning disposition of the copy received from the party in breach.

(2) [**Obligations of refusing party.**] A party that refuses a copy shall:

(A) deliver the copy and all copies made of it, all access materials, and documentation pertaining to the refused information to the tendering party or hold them with reasonable care for a reasonable time for disposal at that party's instructions; and

(B) follow reasonable instructions of the tendering party for returning or delivering copies, access material, and documentation, but instructions are not reasonable if the tendering party does not arrange for payment of or reimbursement for reasonable expenses of complying with the instructions.

(3) [**Effect of failure to provide instructions.**] If the tendering party does not give instructions within a reasonable time after being notified of refusal, the refusing party, in a reasonable manner to reduce or avoid loss, may store the copies, access material, and documentation for the tendering party's account or ship them to the tendering party and is entitled to reimbursement for reasonable costs of storage and shipment.

(4) [**Contractual use terms.**] Both parties remain bound by all contractual use terms that would have been enforceable had the performance not been refused.

(5) [**Good faith.**] In complying with this section, the refusing party shall act in good faith. Conduct in good faith under this section is not acceptance or conversion and may not be a ground for an action for damages under the contract.

Uniform Law Source: Uniform Commercial Code Sections 2-602(2), 2-603, 2-604.

Definitional Cross References: Section 102: "Access material"; "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use term"; "Copy"; "Delivery"; "Good faith"; "Information"; "License"; "Notify"; "Party"; "Seasonably". Section 117: "Reasonable time."

Comment

1. Scope of the Section. This section deals with the rights and obligations of a party that rightfully refuses tender of a copy and is in possession or control of it or copies made from it. The section coordinates with Section 802 on cancellation of the contract.

2. Cancellation and Refusal. Refusal of a copy may or may not result in canceling the contract. Upon cancellation, Section 802 controls to the extent of any inconsistency with this section. If the contract is not canceled, this section applies and the parties remain bound by all contractual obligations, except as altered by the breach and the remedies for breach.

Cancellation requires that both parties promptly disengage from the contract, returning any material previously received and refraining from any use that would have been allowed under the license. Cancellation ends the license. On the other hand, refusal without cancellation presumes that the contract continues, although the refused copy and related material will be returned to the tendering party, or any defect cured. Of course, the continued effectiveness of the contract is subject to the aggrieved party's remedies for breach under this Act and the agreement.

3. No Right to Use. In general, a refusing party has no right to use the refused copies or any copies made from them. Uses inconsistent with this section or the contract are a breach and may, in appropriate cases, be treated as acceptance of the tendered copies. Despite this, limited use for mitigating loss due to the other party's breach may be permitted. The use must be solely to mitigate and does not extend to uses more appropriately viewed as acceptance of the copy; use also cannot entail disclosure of confidential information, violation of a restriction in a contractual use term, or sale, licensing, or other transfer of the copies. This section asks courts to reach the balance reached regarding goods 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), but with an understanding of the nature of any intellectual property rights that may be involved.

The limited ability to use for purposes of mitigation is also subject to the requirement that the use not be contrary to instructions received from the other party regarding disposition of the information. Instructions that have the effect of preventing use for purposes of mitigation are, in effect, a waiver of the right to insist that mitigation in this form occur. The instructions must, of course, be given in good faith and generally are subject to a standard of commercial reasonableness.

4. Handling Copies. The refusing party has no right to sell or otherwise dispose of information, documentation or copies under any circumstance. The information may be confidential or subject to overriding proprietary rights held by the other party. There is no

commercial necessity to sell that copy to a third party to avoid commercial loss because the copy is not the relevant value in the transaction; the transaction focuses on the information.

5. Restrictions in Contractual Use Terms. Both parties remain bound by restrictions in contractual use terms, including confidentiality obligations. See Section 812, *Comment* 4. It is not uncommon that each party have some such information of the other; a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The restrictions relate only to the information acquired under and subject to the license. This does not restrict the party's ability to obtain the same information from alternative lawful sources independent of the contract restrictions.

6. Relationship to Section 802. On rightful refusal or revocation of acceptance of a copy, the Section 706 rules apply unless the contract has been rightfully canceled. In that event, the Section 706 rules apply to the extent not inconsistent with Section 802.

SECTION 707. COPY: REVOCATION OF ACCEPTANCE.

(a) [**When revocation permitted.**] A party that accepts a nonconforming tender of a copy may revoke acceptance only if the nonconformity is a material breach of contract and the party accepted it:

(1) on the reasonable assumption that the nonconformity would be cured, and the nonconformity was not seasonably cured;

(2) during a continuing effort by the party in breach at adjustment and cure, and the breach was not seasonably cured; or

(3) without discovery of the nonconformity, if acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) [**Notice of revocation required.**] Revocation of acceptance is not effective until the revoking party notifies the other party of the revocation.

(c) [**When revocation precluded.**] Revocation of acceptance of a copy is precluded if:

(1) it does not occur within a reasonable time after the party attempting to revoke discovers or should have discovered the ground for it;

(2) it occurs after a substantial change in condition not caused by defects in the information, such as after the party commingles the information in a manner that makes its return impossible; or

(3) the party attempting to revoke received a substantial benefit or value from the information, and the benefit or value cannot be returned.

(d) [**Duties after revocation.**] A party that rightfully revokes has the same duties and is under the same restrictions as if the party had refused tender of the copy.

Uniform Law Source: Uniform Commercial Code Sections 2A-516; 2-608.

Definitional Cross References: Section 102: "Contract"; "Copy"; "Information"; "Informational Rights"; "Licensee"; "Notifies"; "Party"; "Receive"; "Seasonable". Section 117: "Reasonable time."

Comment

1. Scope of Section. This section corresponds to Uniform Commercial Code §§ 2A-516; 2-608 (1998 Official Text). It deals only with revocation of acceptance of a copy. Revocation returns the parties to the same position as if the copy had been refused. It is equivalent to rescission. The revoking party is no longer liable for the price of the copy and, in appropriate circumstances, can obtain a refund. A "return" described in Section 102 is not relevant in this section because it refers to rights on rejecting a contract, not refusing a copy tendered pursuant to a contract.

2. Conditions for Revocation. Revocation is appropriate only for material defects that would have justified refusal had the defect then been known. This is true even in mass market licenses. Acceptance of a copy ordinarily establishes closure of the transaction with respect to the copy. That expectation cannot be altered based on minor defects. For this purpose, the general standards of material breach apply. This rule follows Article 2 and Article 2A (1998 Official Text). Under subsection (b), effective revocation requires notification of the other party.

Revocation is inappropriate if based on a defect in the copy or information of which the accepting party was aware when it accepted the copy. This follows Article 2. Acceptance with knowledge of a defect does not eliminate other remedies unless it creates a waiver, but does bar revocation based on the defect unless conditions mentioned in subsection (a) are present. These deal with two different circumstances:

a. Expectation of Cure. Revocation may be permitted if acceptance was on the assumption of cure. See paragraphs (a)(1) and (a)(2). Parties may engage in a mutual effort to resolve problems within the contract, rather than by ending it.

b. Adjustment and Effort to Cure. Paragraph (a)(2) deals with a common issue. In cases of joint continuing efforts to adjust the computer information to fit the contract or otherwise be acceptable to the licensee, both parties know that problems exist. This paragraph encourages and supports such joint efforts. The licensee willing to jointly participate in the effort may revoke acceptance if the effort fails within a reasonable time and if other conditions barring revocation do not arise.

c. Latent Defects. Paragraph (a)(3) follows Article 2 of the Uniform Commercial Code (1998 Official Text) and permits revocation if the defect was not discovered before acceptance because of the difficulty of discovery or inducement by the other party that had the effect of delaying discovery.

[SUBPART C. REPUDIATION AND ASSURANCES]

SECTION 708. ADEQUATE ASSURANCE OF PERFORMANCE.

(a) [**Options when reasonable grounds for insecurity.**] A contract imposes an obligation on each party not to impair the other's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the aggrieved party may:

(1) demand in a record adequate assurance of due performance; and

(2) until that assurance is received, if commercially reasonable, suspend any performance, other than with respect to restrictions in contractual use terms, for which the agreed return performance has not been received.

(b) [**Construction according to commercial standards.**] Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered is determined according to commercial standards.

(c) [**Effect of acceptance of improper delivery or payment.**] Acceptance of any improper delivery or payment does not impair an aggrieved party's right to demand adequate assurance of future performance.

(d) [**Effect of failure to provide assurance.**] After receipt of a justified demand under subsection (a), failure, within a reasonable time not exceeding 30 days, to provide assurance of due performance which is adequate under the circumstances of the particular case is a repudiation of the contract under Section 709.

Uniform Law Source: Uniform Commercial Code: Section 2-609 (1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Contract"; "Contractual use term"; "Delivery"; "Merchant"; "Party"; "Record"; "Received". Section 117: "Reasonable time."

Comment

This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) and should be interpreted in that light but with recognition of the different nature of computer information transactions. Subsection (2) refers to contractual use restrictions. If the licensee is the aggrieved party, it may seek adequate assurances of performance and suspend its own performance. However, any restrictions in contractual use terms continue to apply. Insecurity

does not change the contract.

SECTION 709. ANTICIPATORY REPUDIATION.

(a) [**Options upon anticipatory repudiation.**] If a party to a contract repudiates a performance not yet due and the loss of performance will substantially impair the value of the contract to the other party, the aggrieved party may:

(1) [**Await performance or resort to remedy.**] await performance by the repudiating party for a commercially reasonable time or 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 its performance; and

(2) [**Suspend performance.**] in either case, suspend its own performance or proceed in accordance with Section 812 or 813, as applicable.

(b) [**When repudiation occurs.**] Repudiation includes 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.

Uniform Law Source: Uniform Commercial Code: Section 2-610.

Definitional Cross References: Section 102: "Aggrieved party"; "Contract"; "Notify"; "Party". Section 117: "Reasonable time."

Comment

1. Repudiation. Subsection (a) corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text).

2. Definition. Subsection (b) follows the definition in the *Restatement (Second) of Contracts.*

SECTION 710. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) [**When repudiation may be retracted.**] A repudiating party may retract its repudiation until its next performance is due unless the aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that it considers the

repudiation final.

(b) [**Manner of retraction.**] A retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 708.

(c) [**Effect of retraction.**] Retraction restores a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay caused by the repudiation.

Uniform Law Source: Uniform Commercial Code: Section 2-611.

Definitional Cross References: Section 102: "Aggrieved party"; "Cancel"; "Contract"; "Party".

Official Comment

This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text).

PART 8

REMEDIES

[SUBPART A. GENERAL]

SECTION 801. REMEDIES IN GENERAL.

(a) [**Remedies cumulative.**] The remedies provided in this [Act] are cumulative, but a party may not recover more than once for the same loss.

(b) [**Contractual use terms independent of remedies.**] Except as otherwise provided in Sections 803 and 804, if a party is in breach of contract, whether or not the breach is material, the aggrieved party has the remedies provided in the agreement or this [Act], but the aggrieved party shall continue to comply with any restrictions in contractual use terms with respect to information or copies received from the other party and the contractual use terms do not apply to information or copies properly received or obtained from another source.

(c) [**Damage claims not inconsistent with rescission.**] Rescission or a claim for rescission of the contract, or refusal of the information, does not preclude and is not inconsistent with a claim for damages or other remedy.

Uniform Law Source: Uniform Commercial Code Section 2A-523.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use term"; "Information"; "Party".

Comment

1. General Scope. This section states general rules on contract remedies. Unless otherwise expressly indicated, the effect of the rule can be varied by agreement.

2. Cumulative Remedies. Contract remedies seek to put an aggrieved party in the position that would have resulted if performance had occurred as agreed. The remedies in this Act are cumulative to the extent consistent with that general goal. This Act rejects any concept of election of remedies. However, the parties by agreement may alter a remedy or make it unavailable. The agreement governs unless expressly invalidated by this Act.

3. Aggrieved Party Choice. In litigation, an aggrieved party chooses the remedy, subject to substantive limitations under this Act or the agreement. The court does not control the choice.

4. Remedies Retained. This Act is supplemented by general law, including equitable remedies. Section 114. Similarly, a remedy for contract breach does not displace a right under

intellectual property law. Damage awards are limited by the principle that prohibits double recovery for the same wrong, but often the two forms of recovery refer to different damages and are not a double recovery.

5. Contractual Use Terms. Breach does not eliminate restrictions in contractual use terms - both parties remain bound by them - but breach may end rights under the use terms. For example, a licensee licensed to distribute computer information cannot continue to do so if the licensor cancels the license because of the licensee's breach, but restrictions, such as limitations on disclosure, continue to apply. Those restrictions relate to information acquired under and subject to the license and do not restrict the party's ability to obtain the same information from alternative lawful sources independent of the contract restrictions.

SECTION 802. CANCELLATION.

(a) [**When cancellation allowed.**] An aggrieved party may cancel a contract for breach if the breach is a material breach of the whole contract which has not been cured or waived or the agreement allows cancellation for the breach.

(b) [**Notice of cancellation.**] Cancellation is not effective until the canceling party gives notice of cancellation to the party in breach, unless a delay required to notify the party would cause or threaten material harm or loss to the aggrieved party. The notification may be in any form reasonable under the circumstances. However, in an access contract, a party may cancel rights of access without notice.

(c) [**Effect of cancellation.**] On cancellation, the following rules apply:

(1) [**Duties regarding licensed materials.**] If a party is in possession or control of licensed information, documentation, materials, or copies of licensed information, the following rules apply:

(A) A party that has rightfully refused a copy shall comply with Section 706(b) as to the refused copy.

(B) A party in breach of contract which would be subject to an obligation to deliver under Section 618, shall deliver all information, documentation, materials, and copies to the other party or hold them with reasonable care for a reasonable time for disposal at that party's instructions. The party in breach of contract shall follow any reasonable instructions received from the other party.

(C) Except as otherwise provided in subparagraphs (A) and (B), the party shall comply with Section 618.

(2) [**Executory obligations discharged.**] All obligations that are executory on both sides at the time of cancellation are discharged, but the following survive:

(A) any right based on previous breach or performance; and

(B) the rights, duties, and remedies described in Section 616(b).

(3) [**Cessation of contractual right to use.**] Cancellation of a license by the licensor ends any contractual right of the licensee to use the information, informational rights, copies, or other materials.

(4) [**Limited use permitted.**] Cancellation of a license by the licensee ends any contractual right to use the information, informational rights, copies, or other materials, but the licensee may use the information for a limited time after the license has been canceled if the use:

(A) is within contractual use terms;

(B) is not for distribution and is solely part of measures reasonable under the circumstances to avoid or reduce loss; and

(C) is not contrary to instructions received from the party in breach concerning disposition of them.

(5) [**Payment of reasonable value.**] The licensee shall pay the licensor the reasonable value of any use after cancellation permitted under paragraph (4).

(6) [**Obligations apply to all materials.**] The obligations under this subsection apply to all information, informational rights, documentation, materials, and copies received by the party and any copies made therefrom.

(d) [**No cancellation terms.**] A term providing that a contract may not be canceled precludes cancellation but does not limit other remedies.

(e) [**Renunciation not presumed.**] Unless a contrary intention clearly appears, an expression such as "cancellation," "rescission", or the like may not be construed as a renunciation or discharge of a claim in damages for an antecedent breach.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505; 2-106(3)(4), 2-720.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Cancellation"; "Copy"; "Contract"; "Information"; "Informational Rights"; "License"; "Notify"; "Party"; "Term". Section 117: "Reasonable time". Section 701: "Material breach".

Comment

1. Scope of the Section. This section describes when cancellation is permitted and its effect.

2. Cancellation. "Cancellation" is a remedy under which one party ends the contract for breach. Section 102. Cancellation discharges executory obligations, but does not alter rights earned by prior performance or established by breach.

3. When Permitted. Cancellation is permitted if the agreement so provides or if there is a material breach of contract. What is a material breach depends on the agreement or the nature or effect of the breach. Section 701. A material breach does not require that the aggrieved party cancel. That party may continue to perform, demand reciprocal performance, and collect damages. If it does not cancel and the breaching party cures the breach, cure precludes cancellation based on that breach.

4. Notification. Subsection (b) requires notification to make the cancellation effective. Section 102(a)(49). This contrasts to existing Article 2. Notification must be interpreted in light of the circumstances and does not require proof that the notice is received. Section 102. The party harmed by the breach is not required at its risk to choose a fail-safe notification procedure. Notification is not required to cancel an access contract.

If a party has a right to cancel, the equities favor the injured party, not the party in breach. Thus, no formalities of notice are required. It is sufficient that the aggrieved party by its actions or words communicate that the contract has ended. Thus, in a contract calling for a single delivery of a copy, the decision to refuse the copy, return it, and demand a refund is sufficient notification. Commencing a judicial proceeding gives notice. The aggrieved party is not required to use formal terminology or procedures or to give a notice prior to taking an act that itself gives notice.

5. Effect on Use Rights. Many licenses permit the licensee to use, access or take other designated actions without being sued for infringement by the licensor. When a license is canceled, that defense dissolves. A licensee who continues to act in a manner inconsistent with intellectual property rights of the licensor may face an infringement claim. Whether or when this occurs is determined by applicable information property and contract law. *Sun Microsystems v. Microsoft Corp*, 188 F.3d 1115 (9th Cir. 1999).

6. Obligations Regarding Copies. Cancellation ends the contractual permission to use information and, in a license, contractual permission to retain copies of licensed information. Subsection (c) sets out some of the consequences of that result. However, subsection (c)(4) allows limited use by the licensee in a case where the licensee cancels because of the licensor's breach. This right is solely for purposes of allowing mitigation. See comments to Section 706. It does not create an implied license, but merely a limited contractual remedy premised on the principle that there is a duty to act reasonably to avoid loss in the event of breach. Use outside of that principle is wrongful.

7. Effect on Obligations. All obligations executory on both sides at the time of cancellation are discharged, but any right based on previous breach or performance and the rights, duties, and

remedies described in Section 616(b) survive unless otherwise agreed. To survive, of course, the right itself must exist at the time of cancellation. Rights previously waived or excused because of breach do not survive. Section 601(b).

8. "No cancellation" clause. Especially where information is licensed for inclusion in a product and significant investments are needed to create or distribute the product, contractual terms often provide that the licensor cannot cancel for breach. The clause does not alter other remedies. Section 803, *comment* 4b. However, it ensures that if the licensee continues to distribute the product, it does not infringe. When parties agree to this type of remedy limitation, that term should be enforced. In a consumer or other contract where the performance is delivery of an acceptable copy, a contract term that prohibits cancellation does not alter the consumer's or other transferee's rights, since they still retain all rights to sue for damages and to refuse the tendered product.

SECTION 803. CONTRACTUAL MODIFICATION OF REMEDY.

(a) [**Effect of contractual modification of remedies.**] Except as otherwise provided in this section and in Section 804:

(1) an agreement may provide for remedies in addition to or in substitution for those provided in this [Act] and may limit or alter the measure of damages recoverable under this [Act] or a party's other remedies under this [Act], such as by precluding a party's right to cancel for breach of contract, limiting remedies to returning or delivering copies and repayment of the contract fee, or limiting remedies to repair or replacement of the nonconforming copies; and

(2) resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(b) [**Failure of essential purpose.**] Subject to subsection (c), if performance of an exclusive or limited remedy causes the remedy to fail of its essential purpose, the aggrieved party may pursue other remedies under this [Act].

(c) [**When damage limitation independent.**] Failure or unconscionability of an agreed exclusive or limited remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy.

(d) [**Restrictions on exclusion or limitation of consequential or incidental damages.**] Consequential damages and incidental damages may be excluded or limited by agreement unless

the exclusion or limitation is unconscionable. Exclusion or limitation of consequential damages for personal injury in a consumer contract for a computer program that is subject to this [Act] and is contained in consumer goods is prima facie unconscionable, but exclusion or limitation of damages for a commercial loss is not unconscionable.

Uniform Law Source: Uniform Commercial Code: Section 2-719.

Definitional Cross References: Section 102: "Aggrieved party": "Agreement"; "Cancel"; "Computer program"; "Consequential damages"; "Consumer"; "Consumer contract"; "Contract"; "Incidental damages"; "Party"; "Term".

Comment

1. Scope of the Section. This section deals with agreed limitations on remedies for breach. It does not deal with the right to a return defined in Section 102 and used in Sections 113, 209 and 613. That is not a remedy for breach, but a procedure on declining contract terms. "Return" as used in this section does not refer to that right, but to a remedy for breach and is not a "return" as in Section 102(a).

2. Agreement Controls. Parties may by agreement fit their remedies to their particular deal. This is fundamental to contract practice and defines the cost of a transaction. A party that agrees to accept all liability for breach will charge more than a party that contractually limits liability. Similarly, a party may not be willing to acquire a product unless it obtains particular remedies and recourse. How parties order these choices depends on the agreement, but no principle of commercial contract law suggests that parties' ability to control these issues should be precluded.

3. Exclusive Remedies. An agreed remedy may modify or replace otherwise available remedies, or it may give an additional right. To be an exclusive remedy that displaces other remedies, the agreement must expressly so provide. This follows Article 2 of the Uniform Commercial Code (1998 Official Text).

4. Listed Illustrations. Subsection (a) lists several remedies common in commercial practice. The illustrations are not an exclusive list. They include:

a. Replacement, Repair and Refund. Agreed limited remedies that refer to replacement, repair, or refund are common. The three different terms, however, indicate different remedies: *replacement* refers to supplying another copy of the same product, *repair* obligates the party to eliminate defects that cause nonconformance with the contract, and *refund* usually obligates it to return the price already paid for the defective performance. The purpose of a "replacement" or a "repair" obligation is to limit remedies, but also to provide the licensee with an information product that fulfills contract obligations. The purpose of a "refund" remedy is to reimburse the amount paid for the defective performance and to limit damages.

In many transactions, refund refers to the price paid for a single copy. Other transactions entail ongoing royalties or other fees, including fees for services additional to furnishing the product (such as support or maintenance). Nothing in this section restricts the ability of parties to agree to a refund of a fixed maximum amount or portion of the expected contract fee or to exclude or include moneys paid for other services. Refund usually contemplates the payments for the product, not payment to cover all value received.

b. No Cancellation. Subsection (a) refers to an agreed term that bars cancellation for breach, but allows exercise of other remedies. This is important for cases of a licensee that

commits resources to develop and distributes a product based in whole or part on information rights licensed to it, or in other cases where continued use of the computer information is critical to the licensee. The ability to bar cancellation by agreement is important in this commercial environment where the licensee may devote great resources to development of a further product based on the originally licensed information or may predicate a business model upon it. Section 802, *comment*. The remedy limitation does not affect consumers since other remedies remain in force (refusal, recoupment, damages) that fully protect the consumer. This is also true for commercial end users. Waiver of a right to cancel does not bar enforcement of the license or other rights under it (such as the right to damages for breach or for specific performance).

5. Failure of Exclusive Remedy. Subsections (b) and (c) follow Article 2 of the Uniform Commercial Code (1998 Official Text) but clarify an issue litigated under Article 2.

a. Failure of Remedy. Under subsection (b), if performance of an exclusive remedy causes it to fail of its intended purpose, it no longer limits the remedies of the aggrieved party. This is the rule in Article 2. Courts must ask what was the purpose of the agreed remedy. A different purpose exists for remedies limited to replacement or repair, and remedies that include a remedy consisting of a refund right. In the absence of a refund remedy, the purpose is to provide a functioning product. In cases where the remedy includes a right to a refund, the purpose is to return money that was paid for the defective performance. Performance by giving a refund fulfills the purpose of a refund remedy if a party that did not receive a conforming performance receives the agreed refund. This contrasts to an agreement in which the remedy requires replacement or repair, but not a refund. In that case, the agreed remedy contemplates a functioning product. Non-performance of the remedy leaves the licensee without what it bargained for under the contract, a functioning product.

b. Related to Consequential Damage Limits. Subsection (c) deals with the effect that failure of a limited remedy has on agreed limits on consequential damages. The issue is whether one agreed term (exclusion of consequential damages) depends on, or is independent of, another agreed term (limited remedy). This section provides that the two terms are dependent on each other unless the agreement expressly indicates otherwise. This rule rejects cases under Article 2 of the Uniform Commercial Code which hold that the two types of terms are presumed independent. A consequential damage limit fails if performance of the limited remedy fails unless the agreement makes the consequential damages limit expressly independent of the other limited remedy. If the agreement expressly states that the terms are independent, there is no reason in principle to preclude enforcement of that agreement.

Except as otherwise agreed, a consequential damage limitation covers all obligations and remedies under the contract. Remedy clauses are part of the overall transaction. A consequential damages limitation applies to all loss except as otherwise expressly stated in the contract.

6. Minimum Adequate Remedy. An agreed remedy provision does not fail because the court believes that the remedy does not afford a "minimum adequate remedy." Doctrines of unconscionability, fundamental public policy and for determining whether mutuality of obligation exists for a binding contract set a floor on what agreed terms are binding with respect to remedies.

However, the essence of any contract is that parties accept the legal consequences of their deal and that there be at least a fair quantum of remedy in the event of breach. Contracts that do not do so may fail for lack of consideration or mutuality. This does not mean that a court can rewrite the agreement or the agreed remedies. If a remedy is provided and is made exclusive, the fact that it does not fully compensate the aggrieved party is not a reason to allow that party to avoid the consequences of its agreement. Remedy terms are agreed allocations of risks. For example, a contract that limits recovery for software defects used in a satellite system to the price of the software (e.g., $100,000) is not unenforceable because the defect caused loss of a $1 million satellite. A decision to set a limit affects pricing and risk and cannot be set aside because the loss eventually fell on one party. On the other hand, a contract that states "licensee will have

no responsibility for any harm to licensor caused by licensee's intentional breach of any aspect of the agreement" may lack mutuality to establish a contract.

7. Consequential Damage Limits. Disclaimer or limitation of consequential damages is generally enforceable. See U.C.C. Article 2-715, *comment* 3 (1998 Official Text). In consumer transactions involving defective computer programs embedded in consumer goods that cause personal injury, however, this section follows Article 2 of the Uniform Commercial Code (1998, Approved Draft) and makes disclaimer of personal injury damages prima facie unconscionable. Under Section 103(b), some computer programs embedded in goods are not governed by this Act but by Article 2, which has the same rule. This section does not create liability that would not exist under other law. Most cases reject personal injury claims against information providers even under tort law. This reflects that, for information products, courts balance public interests in encouraging distribution of information against interests in creating new sources of recovery. This Act does not alter the analysis that courts using general theories of tort law should make under that body of law.

SECTION 804. LIQUIDATION OF DAMAGES.

(a) [**When damages may be liquidated by agreement.**] Damages for breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of:

(1) the loss anticipated at the time of contracting;

(2) the actual loss; or

(3) the actual or anticipated difficulties of proving loss in the event of breach.

(b) [**Effect of unenforceability of liquidation term.**] If a term liquidating damages is unenforceable under this subsection, the aggrieved party may pursue the remedies provided in this [Act], except as limited by other terms of the contract.

(c) [**Restitution of payments.**] If a party justifiably withholds delivery of copies because of the other party's breach of contract, the party in breach is entitled to restitution for any amount by which the sum of the payments it made for the copies exceeds the amount of the liquidated damages payable to the aggrieved party in accordance with subsection (a). The right to restitution is subject to offset to the extent that the aggrieved party establishes:

(1) a right to recover damages other than under subsection (a); and

(2) the amount or value of any benefits received by the party in breach, directly or

indirectly, by reason of the contract.

(d) [**Limitation of damage term distinguished.**] A term that does not liquidate damages, but that limits damages available to the aggrieved party, must be evaluated under Section 803.

Uniform Law Source: Uniform Commercial Code Section 2-718 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Copy"; ""Delivery"; "Party"; "Receive"; "Term".

Comment

1. Scope of the Section. This section deals with liquidated damages clauses. The basic rule is that agreed terms are enforceable unless unreasonable.

2. General Standard. A liquidated damages contract term sets both a minimum and maximum recovery. A liquidated damages term is, in concept, no different than any other contract term. The presumption is that courts enforce agreed terms. Subsection (a) provides that liquidated damages terms are enforceable if the amount is reasonable in light of 1) before-the–fact estimates of likely damages, or 2) after-the-fact actual damages, or 3) the difficulty of proof. Basically, the term is enforceable unless there is no reasonable basis on which to sustain it. A liquidated damage clause chosen based on the parties' assessment of risk and cost should be enforced. Courts should not revisit the deal after the fact and disallow it because the choice later appeared to disadvantage one party. If the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to enforceability.

3. Remedies On Unenforceability. If a liquidated damage term is not enforceable, the aggrieved party may pursue the remedies it has under this Act in the absence of the term. Those remedies may be limited by other agreed terms. For example, if the contract excludes consequential damages, the aggrieved party remains bound by that exclusion even if the liquidated damages term is unenforceable.

4. Other Terms. A term that is not a liquidated damage clause but a limitation on damages, is governed by Section 803, not this section. Thus, a term that provides: "In no event shall either party be liable for damages exceeding $1 million dollars," is a limitation on damages governed under Section 803 because it limits recovery but does not guaranty a recovery of any particular amount unless the facts support damages in that amount.

SECTION 805. LIMITATION OF ACTIONS.

(a) [**General rule.**] Except as otherwise provided in subsection (b), an action for breach of contract must be commenced within the later of four years after the right of action accrues or one year after the breach was or should have been discovered, but not later than five years after

the right of action accrues.

(b) [**Alteration by agreement.**] If the original agreement of the parties alters the period of limitations, the following rules apply:

(1) [**One year minimum.**] The parties may reduce the period of limitation to not less than one year after the right of action accrues but may not extend it.

(2) [**No reduction if consumer contract.**] In a consumer contract, the period of limitation may not be reduced.

(c) [**When right of action accrues: general rule.**] Except as otherwise provided in subsection (d), a right of action accrues when the act or omission constituting a breach of contract occurs, even if the aggrieved party did not know of the breach. A right of action for breach of warranty accrues when tender of delivery of a copy pursuant to Section 606, or access to the information, occurs. However, if the warranty expressly extends to future performance of the information or a copy, the right of action accrues when the performance fails to conform to the warranty, but not later than the date the warranty expires.

(d) [**When right of action accrues: special rules.**] In the following cases, a right of action accrues on the later of the date the act or omission constituting the breach of contract occurred or the date on which it was or should have been discovered by the aggrieved party, but not earlier than the date for delivery of a copy if the claim relates to information in the copy:

(1) a breach of warranty against third-party claims for:

(A) infringement or misappropriation; or

(B) libel, slander, or the like;

(2) a breach of contract involving a party's disclosure or misuse of confidential information; or

(3) a failure to provide an indemnity or to perform another obligation to protect or defend against a third-party claim.

(e) [**Conclusion of action: effect on other remedies.**] If an action commenced within the period of limitation is so concluded as to leave available a remedy by another action for the

same breach of contract, the other action may be commenced after expiration of the period of limitation if the action is commenced within six months after conclusion of the first action, unless the action was concluded as a result of voluntary discontinuance or dismissal for failure or neglect to prosecute.

(f) [**Law on tolling preserved.**] This section does not alter the law on tolling of the statute of limitations and does not apply to a right of action that accrued before the effective date of this [Act].

Uniform Law Source: Uniform Commercial Code: Sections 2A-506; 2-725 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Consumer"; "Contract"; "Copy"; "Deliver"; "Information"; "Party"; "Termination".

Comment

1. Scope and Purpose. This section reconciles conflicting statute of limitations for computer information transactions.

2. Limitations Period. Subsection (a) bars a cause of action brought more than four years after the breach occurs, but adopts a discovery rule that may extend the time for bringing a cause of action up to five years from the time of breach. The period to bring the lawsuit is between four and five years, depending upon when breach occurred or should have been discovered.

3. Effect of Agreement. Subsection (b) limits the enforceability of agreements that modify the limitations period. The statute of limitations reflects public policy about how long of a period may be permitted before law concludes that no action may be brought. Subsection (b) precludes agreements that permit a period of limitations longer than that stated in the Act. This does not prevent "tolling agreements" entered into during disputes. It only precludes extensions in the *original* agreement.

Subsection (b) also precludes reducing the limitations period to less that one year. This does not affect contracts that limit a warranty to a stated period of less than one year (e.g., ninety days). Such agreements define the warranty itself. They state the period during which discovery of a defect or the occurrence of its effect must occur (e.g., product has no defects manifested during the first ninety days). Unless the agreement so states, this does not limit the time in which a lawsuit may be brought. However, such agreed terms control when the cause of action accrues and whether there is a breach since they provide that a defect that is not manifest during this time is not a breach.

4. Accrual of Cause of Action: Time of Performance. The four year term refers to four years from when the right of action accrues. This section applies two rules for when the cause of action accrues. The primary rule is subsection (c). The cause of action accrues when the breach occurs or should have been discovered. For an alleged breach of warranty, this generally occurs on delivery of the information or service, even if the defect does not become apparent until much later. Warranties are breached or not on delivery of the warranted subject matter.

In some cases, however, a warranty expressly "extends to future conduct." For example, if a warranty is that there are no defects that affect performance during the first ninety days after

delivery, subsection (c) gives the terms of this language their effect. Breach of the warranty occurs if a defect appears within the stated warranty term. Subsection (c) rejects cases holding that such a warranty changes the limitations rule to a pure "discovery" rule, i.e., the cause of action does not accrue until the defect is or should have been discovered. If the warranty is for a limited time (e.g., one year), the breach cannot occur later than the expiration of that stated time.

5. Traditional Discovery Rule. Subsection (d) describes cases in which the time of occurrence rule is replaced entirely by a traditional time of discovery rule. Each concerns circumstances in which it would be inappropriate to define breach as occurring when performance is delivered because the breach is never manifested until later and because the assurances involved in the contract obligation go to events beyond the time of delivery.

SECTION 806. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this [Act] for nonfraudulent breach of contract.

Uniform Law Source: Uniform Commercial Code: Section 2-721 (1998 Official Text).

Definitional Cross References: Section 102: "Contract"; "Information".

Comment

Follows Article 2 of the Uniform Commercial Code (1998 Official Text).

[SUBPART B. DAMAGES]

SECTION 807. MEASUREMENT OF DAMAGES IN GENERAL.

(a) [**Mitigation of loss.**] Except as otherwise provided in the contract, an aggrieved party may not recover compensation for that part of a loss which could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss. The burden of establishing a failure of the aggrieved party to take measures reasonable under the circumstances is on the party in breach of contract.

(b) [**Certain damages not recoverable.**] A party may not recover:

(1) consequential damages for losses resulting from the content of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative.

(c) [**Compensation for benefit obtained by disclosure or misuse.**] The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality includes as consequential damages compensation for the benefit obtained as a result of the breach.

(d) [**When market value determined.**] For purposes of this [Act], market value is determined as of the date of breach of contract and the place for performance.

(e) [**Damages computed at present value.**] Damages or expenses that relate to events after the date of entry of judgment must be reduced to their present value as of that date. In this subsection, "present value" means the amount, as of a date certain, of one or more sums payable in the future or the value of one or more performances due in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties in their agreement unless that rate was manifestly unreasonable when the agreement was entered into. Otherwise, the discount is determined by a commercially reasonable rate that takes into account the circumstances of each case when the agreement was entered into.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Consequential damages"; "Contract"; "Direct damages"; "Information"; "Informational content"; "Party"; "Present value"; "Published informational content".

Comment

1. Scope of the Section. This section brings together general rules on computation of damages. Specific rules for licensor damages (Section 808) and licensee damages (Section 809) are subject to the general principles stated here.

2. Mitigation. Subsection (a) requires mitigation of damages and places the burden of establishing a failure to mitigate on the party asserting the protection of the rule. "Burden of establishing" means that the party with the burden must persuade the trier of fact that the existence of the fact is more probable than its non-existence. Uniform Commercial Code § 1-201(8) (1998 Official Draft).

The idea that an injured party must mitigate its contract damages permeates contract law. Contract remedies are not punitive but compensatory. The injured party cannot act in a way that enhances loss and expect to have that loss compensated in damages recoverable from the other party. This does not create an obligation of an aggrieved party to cover. The damages formulae in Sections 808 and 809 contain various means of adjusting damages by statutory measures that in effect are a surrogate for mitigation (e.g., the statutory formulae based on market value of the performance). If the formula is used to compute damages, whether there was a actual mitigation is not relevant.

The reference in subsection (a) to otherwise provided in the agreement includes contractual liquidation of damages. An enforceable liquidated damages term creates an agreed measure of

damages. A court may not reduce or alter that contractual measure based on its determination about whether actual damages were adequately mitigated or not.

3. Published Informational Content. Subsection (b) excludes consequential damages for issues about the content of "published informational content." Whether characterized as a First Amendment analysis or treated as a question of social policy, our culture has a substantial interest in promoting the dissemination of information. This Act supports and encourages distribution of informational content to the public.

As indicated in the definition of published informational content, the context is one in which the content provider does not deal directly with the data recipient in a special reliance setting. Information of this type is typically low cost and high volume. Dissemination of such information would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the liability limitations even under tort law. The *Restatement of Torts*, for example, limits exposure for negligent error in data to intended recipients and to "pecuniary loss" which corresponds to direct damages.

The subsection does not exclude all consequential damage claims relating to published informational content. For example, if a party agrees to provide content for distribution over the Internet, but fails to deliver in a timely fashion, the resulting damages claim does not pertain to the content itself, but to the failed performance. Whether consequential loss is recoverable is determined under the general standards of this Act, the agreement of the parties, and common law.

Illustration 1: D distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. C reviews the online information and trades 1 million shares of Acme at a price that causes a $10 million loss because the data were incorrect. If C were in a relationship of reliance with D, consequential loss is recoverable. But this is published informational content, and C cannot recover alleged consequential loss.

Illustration 2: Internet-Games.com allows players to play a grisly 3-D game. One player who pays $5 is shocked by the violence and spends a sleepless week. That player should have no recovery at all, but if the player can show a breach, the player could not recover consequential loss since this is published informational content.

Each illustration assumes that the contract for the published informational content did not expressly provide for consequential damages.

4. Speculative Damages. This Act does not require proof with absolute certainty or mathematical precision. Consistent with the principle of Article 1 of the Uniform Commercial Code (1998 Official Text) that there be a liberal administration of the remedies of that Code, the remedies in this Act must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See *Restatement (Second) of Contracts* 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974).

5. Confidential Information. Subsection (c) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party to whom the confidentiality obligation is owed has an expectation of the information not being misused and that expectation is entitled to protection. Compensation for such loss is important. However, if the breach of confidence gives benefits to a third party that do not inure directly or indirectly to the party to the contract, recovery against the third party is under other law. The rule stated here, of course, is also subject to the prohibition on double recovery. Section 801.

6. Market Value. If market value is part of a damages computation, subsection (d) requires that market value be determined at the time and place for performance. Where performance is delivery of a copy, the place is as indicated in the agreement or this Act. In other cases, such as an Internet transaction that provides access to an information system, the nature of the subject matter makes geographic touchstones difficult to determine or inappropriate. In such cases, courts may refer to rules on choice of law in Section 109(b) this Act, which provide a stable reference point relevant to and protective of both parties.

In determining market value, due weight must be given to any substitute transaction actually entered into by a party, taking into account the extent to which the transaction involved terms, performance, information, and informational rights similar in terms, quality, and character to the agreed performance. See Comments to Section 808(a).

7. Present Value. Subsection (e) provides that damages as to future events are awarded based on present value as of the date of judgment. The definition of "present value" corresponds to Uniform Commercial Code §§ 2A-103; 1-201(37)(z) (1998 Official Text), but modifies the rules to cover present valuation of performances other than payments. This term provides for discounting the value of future payments or losses as measured at a particular point in time. This requires, as to damages awarded for eventualities that are in the future, that courts do so based on a present value standard. As to losses and expenses that have already occurred, the present value measurement does not apply. No change in law on pre-judgment interest is intended.

SECTION 808. LICENSOR'S DAMAGES.

(a) [**Definitions.**] In this section, "substitute transaction" means a transaction by the licensor which would not have been possible except for the licensee's breach and which transaction is for the same information or informational rights with the same contractual use terms as the transaction to which the licensee's breach applies.

(b) [**Computation of licensor's damages.**] Except as otherwise provided in Section 807, a breach of contract by a licensee entitles the licensor to recover the following compensation for losses resulting in the ordinary course from the breach, less expenses avoided as a result of the breach, to the extent not otherwise accounted for under this subsection:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and the market value of other consideration required under the contract for the performance that was the subject of the breach:

(A) the amount of accrued and unpaid contract fees and the market value of other consideration earned but not received for:

(i) any performance accepted by the licensee; and

(ii) any performance to which Section 604 applies;

(B) for performances not governed by subparagraph (A), if the licensee repudiated or wrongfully refused the performance or the licensor rightfully canceled and the breach makes possible a substitute transaction, the amount of loss as determined by contract fees and the market value of other consideration required under the contract for the performance less:

(i) the contract fees and market value of other consideration received from an actual and commercially reasonable substitute transaction entered into by the licensor in good faith and without unreasonable delay; or

(ii) the market value of a commercially reasonable hypothetical substitute transaction;

(C) for performances not governed by subparagraph (A), if the breach does not make possible a substitute transaction, lost profit, including reasonable overhead, that the licensor would have realized on acceptance and full payment for performance that was not delivered to the licensee because of the licensee's breach; or

(D) damages calculated in any reasonable manner; and

(2) consequential and incidental damages.

Uniform Law Source: Uniform Commercial Code: Sections 2A-528; 2-708 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Cancel"; "Consequential damages"; "Contract"; "Contract fee"; "Contractual use term"; "Direct damages"; "Good faith"; "Incidental damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value"; "Receive".

Comment

1. Scope of the Section. This section states how to measure damages for a licensor if the licensee breaches the contract. Under Section 807, damage awards related to events in the future are based on the present value at the time of the award.

2. General Approach. A licensor may choose any measure of damages described in subsection (b), subject to the limitation on double recovery. The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice creates double recovery. No order of preference is required. Subsection (b)(1) measures "direct damages" by the difference in value between performance promised and received. When appropriate, direct damages also include reimbursement for value already given and for which payment has not yet occurred. The damages are capped by the contract fee for the performance and the market value of other consideration to be received. This does not include the loss of

expected benefits from use of the expected performance in other contexts. If recoverable, those are consequential, not direct damages.

Damages under this section are subject to the general principles of this Act. Section 807 disallows recovery of consequential damages in some cases, including where claims are speculative or are for the content of published informational content. Under Section 807, also, recovery may be limited by the requirement that the aggrieved party act in a reasonable manner to mitigate loss.

3. Intangible Subject Matter: Substitute Transactions. Licensor remedies differ from remedies for sellers in Article 2 of the Uniform Commercial Code. Article 2 focuses on an assumption that the seller's loss lies in the sale of the particular item. For computer information transactions, the particular copy is not ordinarily relevant. The basic issue is whether breach enables a substitute transaction that could not have otherwise occurred and which is properly considered in determining direct damages.

The idea of a "substitute transaction" is a central concept. A transaction is not a substitute transaction simply because in it the transferor used a diskette that might have been used to deliver the same information to the original licensee. The focus is on the information, not the tangible media, and on contractual use terms. To be a substitute transaction, the transaction must involve the same information under the same use terms.

To be a "substitute transaction" the transaction must have been made possible by the breach. This rule requires that a substitute transaction must be possible. If there is no market and no alternative licensee for the same information product under the same terms, no substitute is possible. That will often occur when the contract is to develop software for a particular application of the licensee. Also, the rule requires that, if a transaction is possible, the licensor's ability to engage in it must be due to the breach and not simply because another transaction would have been possible in any event. For example, in the case of a breach of a non-exclusive access contract by the licensee, there would ordinarily not be a substitute transaction because the licensor has almost unlimited capability to make access available to others. While another access contract may subsequently occur, that contract was not made possible by breach – the new license would have occurred with or without the breach. More generally, in most non-exclusive licenses, breach does not enable a new transaction. On the other hand, cancellation for breach of an exclusive license to distribute a work in a geographic area may enable the licensor to make a substitute license in that area that could not otherwise have been made because of the exclusive nature of the breached license.

4. Computation Approaches. The damage formulae describe direct damages capped by the contract fee and the market value of consideration to be received by the licensor.

a. Accrued Fees and Consideration. Under paragraph (b)(1)(A) the aggrieved licensor is entitled to recover any accrued and unpaid fees and the value of other consideration owed for information or services actually delivered. These are direct damages. Recoveries beyond that, when appropriate, are consequential damages.

b. Measuring other Direct Damages. This section outlines several approaches to direct damages in addition to unpaid fees and consideration.

(i) Recovery Measured by Contract Fee: Substitute Transaction Enabled. Under paragraph (b)(1)(B), damages are measured by unaccrued contract fees and other consideration less the value of any actual or hypothetical "substitute transaction" made possible by the breach. Section 807 requires computation at present value for losses associated with events occurring after judgment. Speculative damages are not recoverable. *Restatement (Second) of Contracts* § 352. See Section 807.

Recovery for unaccrued (future) fees and consideration is reduced by due allowance for proceeds of a "substitute transaction." This is measured either by an *actual* substitute transaction or by the market value of a commercially reasonable *hypothetical* transaction. The substitute transaction must have been made possible by the breach. If breach makes possible a substitute

transaction, but no transaction actually occurs, recovery sought under this paragraph is reduced by the market value (if any) of the hypothetical substitute transaction made possible by the breach. As with actual substitute transactions, market value must assume a market for the same use restrictions for the same information over the same contract terms.

(ii) Recovery Measured by Lost Profits. Under paragraph (b)(1)(C), damage recovery is measured by lost profits caused by a failure to accept performance or by repudiation of the contract. Unlike in Article 2 of the Uniform Commercial Code (1998 Official Text), this Act does not require proof that alternative measures of damages are inadequate to compensate the licensor. The injured party chooses the method of computation. As with contract fees, lost profits must be proven with reasonable certainty and may not be speculative. *Restatement (Second) of Contracts* § 352. Similarly, recovery is subject to the general duty to mitigate. See Section 807 and *Krafsur v. UOP, (In re El Paso Refinery)*, 196 BR 58 (Bankr. WD Tex. 1996).

(iii) Measurement in any Reasonable Manner. Subsection (b)(1)(D) authorizes computation of direct damages in any manner that is reasonable, and thus recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases.

c. Consequential and Incidental Damages. The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. Section 102, *comment* 11. The damage recovery is also subject to the general provisions of Section 801 and 807.

5. Illustrative Situations.

Illustration 1: LR licenses a master disk of its software to LE allowing LE to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. LE wrongfully refuses the disk and repudiates the contract. Under (a)(1)(A), LR would recover $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach and (2) by any other failure to mitigate. However, (a)(1)(B) would ordinarily not apply since a second 10,000 copy license is not a substitute transaction if the license was not made possible by the breach. Recovery under subsection (a)(1)(C) is computed by assessing lost profit including reasonably attributable overhead.

Illustration 2: Same as Illustration 1, but the license was a worldwide exclusive license. On breach, LR makes an identical license with second LE for a fee of $900,000. This transaction was made possible because the first exclusive license was canceled. LR recovery under subsection (a)(1)(B) is $100,000 less any net cost savings not accounted for in the second transaction. If there was no actual second license, but the market value for such a license was $800,000, the recovery is $200,000 less any net cost savings not accounted for in the hypothetical market value.

Illustration 3: LR grants an exclusive U.S. license to LE to distribute copies of LR's copyrighted digital encyclopedia. This is a ten-year license at $50,000 per year. In Year 2, LE breaches and LR cancels. Recovery is the present value of the remaining contract fees with due allowance for any actual or hypothetical substitute transaction made possible by the breach.

6. Remedies under Other Law. The licensor may have remedies under other law, including intellectual property law. Breach introduces the possibility of an infringement claim if, for example, (a) the breach results in cancellation of the license and the licensee's continuing conduct is inconsistent with the licensor's informational rights, or (b) the breach consists of acting outside the scope of the license and in violation of the informational right. Remedies under informational rights laws do not displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general rule is that all remedies are cumulative, except that double recovery is not permitted.

SECTION 809. LICENSEE'S DAMAGES.

(a) [**Computation of licensee's damages.**] Subject to subsection (b) and except as otherwise provided in Section 807, a breach of contract by a licensor entitles the licensee to recover the following compensation for losses resulting in the ordinary course from the breach or, if appropriate, as to the whole contract, less expenses avoided as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways, but not to exceed the market value of the performance that was the subject of the breach plus restitution of any amounts paid for performance not received and not accounted for within the indicated recovery:

(A) with respect to performance that has been accepted and the acceptance not rightfully revoked, the value of the performance required less the value of the performance accepted as of the time and place of acceptance;

(B) with respect to performance that has not been rendered or that was rightfully refused or acceptance of which was rightfully revoked:

(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;

(ii) the market value of the performance less the contract fee for that performance; or

(iii) the cost of a commercially reasonable substitute transaction less the contract fee under the breached contract, if the substitute transaction was entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use terms; or

(C) damages calculated in any reasonable manner; and

(2) incidental and consequential damages.

(b) [**Adjustment for unpaid contract fees.**] The amount of damages must be reduced by any unpaid contract fees for performance by the licensor which has been accepted by the

licensee and as to which the acceptance has not been rightfully revoked.

Uniform Law Source: Uniform Commercial Code Sections 2A-518; 2A-519(1)(2). Revised.

Definitional Cross References: Section 102: "Consequential damages"; "Contract"; "Contract fee"; "Contractual use term"; "Direct damages"; "Good Faith"; "Incidental damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value"; "Receive"; "Term".

Comment

1. Scope and General Structure of the Section. This section states how to measure damages for a licensee if the licensor breaches the contract. The basic approach is that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice creates double recovery. Damages awarded for future events are based on present value at the time of the award. Section 807.

2. Direct and Consequential Damages. Subsection (a)(1) measures direct damages. Direct damages are capped by the market or contract value of the performance plus restitution of fees paid for which performance was not received. Market value refers to what would be the fee in a similar transaction for the performance. Section 807 provides when and where "market value" is determined.

"Direct damages" are the difference in market value between the performance promised and performance received, not counting lost expected benefits from anticipated use of the expected performance. This rejects cases such as *Chatlos Systems, Inc. v. National Cash Register Corp.,* 670 F.2d 1304 (3d Cir. 1982), cert. dism., *National Cash Register Corp. v. Chatlos Systems, Inc.*, 457 U.S. 1112 (1982), which, under a rule referring simply to "value", incorporate in direct damages an assessment of how valuable use of the performance would have been to the aggrieved party. If recoverable, those are consequential, not direct damages.

3. Computation. Subsection (a) provides for recovery under the formulae stated in that section less expenses saved as a result of the breach to the extent those are not otherwise reflected in the formula. All damages under this section are subject to general principles of this Act, including Section 807 and concepts of mitigation, and Section 116, including supplemental principles of equity such as concepts of mitigation and the prevention of economic waste.

a. Lost Value in Accepted Performance. Paragraph (a)(1)(A) provides for recovery for a performance accepted when the acceptance is not revoked even though the performance was defective; this covers any breach of contract, including a breach of warranty. Direct damages are measured by the difference in the contract price and the actual value received. If software with a value of $10,000 was to be delivered, but because of a defect, the value was $9,000, this yields a recovery of $1,000 if the licensee accepts and keeps the software. Value is generally measured by the contract fee. Recovery for any loss that exceeds that amount is consequential damages. This allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality, if those costs are commercially reasonable and incurred in good faith.

b. Performance not Received or Not Accepted. Paragraph (a)(1)(B) deals with damages for a performance that has not been accepted by the licensee or as to which the acceptance has been revoked.

(i) Recovery of Fees. The licensee is entitled to recover any fee paid for which performance was not received. Performance has not been received if the licensor fails to make a required delivery or repudiates, if the licensee rightfully refuses or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled. This paragraph allows restitution of amounts paid for such undelivered performance.

(ii) Market and Cover. Paragraphs (a)(1)(B)(ii) and (B)(iii) parallel Uniform

Commercial Code Article 2 (1998 Official Text) in computing direct damages by comparing contract price to either the market value of the performance not received or the cost of cover to replace that performance with a reasonable substitute, but also reflect the differences on this issue between sales of goods and transactions in computer information. Recovery is reduced by the amount of any expenses saved as a result of the breach. Section 807 requires that market value be determined as of the time and place for the performance.

Paragraph (B)(iii) allows cover as a way to fix damages and avoid further loss. In this Act, recovery can be computed based on a commercially reasonable cover with the same contractual use terms as the original contract. In administering damage claims based on cover, however, courts must recognize differences between this remedy in goods transactions and in information commerce. If the information not delivered can be obtained from numerous other sources, the similarity between goods and information is strong. On the other hand, in many contexts, the information may not be available from any other source. In such cases, obtaining a replacement involves obtaining different information. The different information is cover only if the similarities are so close and without differences in cost that their use as a measure of damages is clearly appropriate. This allows cover using commercially reasonable substitutes, but does not allow different information or information obtained under different contractual use terms. Use terms define the product and its price. They are sufficiently material that differences in such terms means that a different product is involved. If this occurs, recovery is under "market value" standards. For example, while a licensee can cover for a breach in delivery of a word processing program by obtaining a different program as a commercially reasonable substitute, that version cannot be obtained under a perpetual license if the original program was under a one year license.

c. Measured in any Reasonable Manner. Subsection (a)(1)(C) authorizes computation of direct damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance. The measurement, while open-ended in computation technique, is limited to the type of damages discussed here and by the cap on recovery of direct damages expressed in subsection (a)(1).

4. Consequential and Incidental Damages. The licensee may recover incidental and consequential damages except as limited by the agreement or this Act, including Section 807. If proven with reasonable certainty, consequential damages can include lost profits.

5. Illustrative Cases.

Illustration 1: LE contracts for a 1,000 person site license for database software from LR. The contract fee is a $500,000 initial payment and $10,000 for each month of use. The duration is two years. LE makes the first payment, but LR fails to deliver. LE cancels and obtains a substitute system under a three year contract for $500,000 and $11,000 per month. It is entitled to refund of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court must determine to what extent the second transaction defines market value given differences in terms of the license, the nature of the software, and other relevant variables. The replacement is not a cover because of the differences in contract terms.

Illustration 2: Same facts as in Illustration 1, but after breach LE obtains a license for LR software from another authorized distributor for a $600,000 initial fee under other terms identical to the LR contract. Since the new contract is for the same information under the same terms, LE has recovery of its initial payment, the $100,000 price difference, and any recoverable incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While LE could refuse the software, it elects to accept the license. It sues for damages. The issue is establishing the difference in value between the system as contracted and the one delivered, in light of the contract price. Assume the difference is $150,000. LE recovers that amount as direct damages, along

with any recoverable incidental or consequential damages.

SECTION 810. RECOUPMENT.

(a) [**Notice required.**] Except as otherwise provided in subsection (b), an aggrieved party, upon notifying the party in breach of contract of its intention to do so, may deduct all or any part of the damages resulting from the breach from any payments still due under the same contract.

(b) [**Limitation on recoupment.**] If a breach of contract is not material with reference to the particular performance, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Uniform Commercial Code Section 2-717 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Material breach"; "Notify"; "Party".

Comment

1. Scope of the Section. This section codifies the right of recoupment. Recoupment, as contrasted to set-off, allows self-help by recovering money owed through withholding payments due under the same contract. This section does not deal with set-off. The section derives from Section 2-717 of the Uniform Commercial Code (1998 Official Text), but expands it.

2. Basic Standard. Recoupment permits one party to deduct damages resulting from the other party's breach from payments owed to that party. The breach must be of the same contract under which the payment in question is being withheld. Exercise of the right requires notice to the other party. In the absence of notice, withholding payments is a breach. Withholding payments may provide cause for insecurity and a right to demand assurances under Section 708.

3. Non-material Breaches. Subsection (b) limits recoupment in cases of nonmaterial breach. This limit applies only if the breach was non-material as to both the particular performance and the entire contract. A failure to deliver a shipment is outside the limit since it is material as to that performance. On the other hand, if only a minor problem exists, the balance of interests shifts. In such contracts, allowing self-help reduction of payments creates a risk of overreaching by the party withholding payment without a clear justification for doing so.

[SUBPART C. REMEDIES RELATED TO PERFORMANCE]

SECTION 811. SPECIFIC PERFORMANCE.

(a) [**When permitted.**] Specific performance may be ordered:

(1) if the agreement provides for that remedy, other than an obligation for the payment of money;

(2) if the contract was not for personal services and the agreed performance is unique; or

(3) in other proper circumstances.

(b) [**Protections of rights and confidential information.**] An order for specific performance may contain any conditions considered just and must provide adequate safeguards consistent with the contract to protect the confidentiality of information, information, and informational rights of both parties.

Uniform Law Source: Uniform Commercial Code: Sections 2A-521; 2-716. Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Court"; "Information"; "Informational Rights"; "Party"; "Term".

Comment

1. Scope of this Section. This section adopts and clarifies the remedy of specific performance under the Uniform Commercial Code Article 2. It allows parties to contract for this remedy.

2. Contracted For Remedy. Subsection (a) allows parties to contract for a remedy of specific performance if a court can administer the remedy and the performance is not an obligation to pay. A court may refuse to enforce the contract if enforcing it would violate fundamental policy of the state.

3. Judicial Remedy. Subsection (a)(2) adopts Uniform Commercial Code Article 2 (1998 Official Text) and not *Restatement (Second) of Contracts* § 357, *Introductory note.*

a. Personal Services. Specific performance cannot be ordered for a "personal services contract." An individual cannot be forced to perform against the individual's will. Determining what is a personal services contract requires a court to look at the nature of the agreement and what was to be provided pursuant to it. A contract for a named individual of superior skill or artistry to perform a particular task is a personal services contract. Breach gives a right to damages, but not a right to specific performance enforceable by contempt powers against the individual. If a corporation agrees to provide services, on the other hand, the contractual obligation may not constitute personal services because any person in the corporation can perform. Of course, even if the contract does not involve personal services, this section does not require or necessarily permit an award of specific performance unless the other conditions are met.

b. Unique Subject Matter. Specific performance can only be ordered if the performance is "unique" or "in other proper circumstances." The test of uniqueness requires that

a court examine the commercial situation. The test requires a commercially realistic interpretation of the performance. Despite the often unique character of information, respect for a licensor's property rights and confidentiality interests will often preclude specific performance of an obligation to create or a right to use the informational property unless the need is compelling. See *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). Specific performance may be appropriate to prevent misuse or wrongful disclosure of confidential material because breach cannot be adequately responded to by an award of damages. Such cases are one illustration of the "other proper circumstances" referred to in this section.

4. Conditioning the Order. The terms of an order of specific performance are within the discretion of the court. While subsection (b) recognizes this, it provides an important protection for confidential information where performance might jeopardize interests in confidential information of a party. Confidentiality and informational rights must be adequately protected in any specific performance award.

SECTION 812. COMPLETING PERFORMANCE.

(a) [**Limited right to complete information after breach.**] On breach of contract by a licensee, the licensor may:

(1) identify to the contract any conforming copy not already identified if, at the time the licensor learned of the breach, the copy was in its possession;

(2) in the exercise of reasonable commercial judgment for purposes of avoiding loss and effective realization on effort or investment, complete the information and identify it to the contract, cease work on it, relicense or dispose of it, or proceed in any other commercially reasonable manner; and

(3) pursue any remedy for breach that has not been waived.

(b) [**Contractual use terms independent of remedies.**] On breach by a licensee, both parties remain bound by all restrictions in contractual use terms, but the contractual use terms do not apply to information or copies properly received or obtained from another source.

Uniform Law Source: Uniform Commercial Code: Sections 2A-524(2); 2-704(2) (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Contract"; "Contractual use term"; "Copy"; "Information"; "Licensee"; "Licensor"; "Party."

Comment

1. Scope of the Section. This section parallels Uniform Commercial Code Section 2-704 (1998 Official Text). It gives the licensor options for proceeding after breach by the licensee, which options are constrained by the general duty to mitigate damages.

2. Right to Identify Copies to the Contract. The right to identify conforming copies to the contract is applicable where the licensor intends to rely on the measure of damages involving comparison of the contract fee with the fee received in a substitute transaction for the same information. It will be less common in computer information transactions than in sales of goods because breaches regarding information licenses often do not result in this type of damages computation.

3. Right to Complete Unfinished Information. The licensor can complete the information or exercise its other options under subsection (a)(2) in the exercise of reasonable commercial judgment in light of the facts as they appear at the time. If commercially reasonableness is contested, the burden is on the licensee to show the commercially unreasonable nature of the licensor's action just as it would be under Section 807, if the licensor elected not to complete and the allegation was that the licensor failed to mitigate loss.

4. Contractual Use Terms. Breach does not invalidate restrictions in contractual use terms, but may void rights under those use terms. For example, a licensee's right to distribute copies is eliminated on breach if the licensor cancels the license, but restrictions on use, such as a limit on disclosure, continue to apply to both parties. Unless otherwise agreed, those restrictions, however, relate only to the information subject to the license. They do not restrict a party's ability to obtain the same information from alternative lawful sources.

SECTION 813. CONTINUING USE. On breach of contract by a licensor, the following rules apply:

(1) [**Right to continue use in absence of cancellation.**] A licensee that has not canceled the contract may continue to use the information and informational rights under the contract. If the licensee continues to use the information or informational rights, the licensee is bound by all terms of the contract, including contractual use terms, obligations not to compete, and obligations to pay contract fees.

(2) [**Remedy for breach not precluded.**] The licensee may pursue any remedy for breach which has not been waived.

(3) [**Rights remain.**] The licensor's rights remain in effect but are subject to the licensee's remedy for breach, including any right of recoupment or setoff.

Definitional Cross References: Section 102: "Cancel"; "Contract"; "Contract fee"; "Contractual use term"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Term".

Comment

This section allows the licensee to elect between canceling the license or retaining the contractual rights and obligations, while pursuing other remedies. The licensee can continue to use the information pursuant to license terms and sue for breach if it elects to accept the performance and not cancel the contract. If it does so, it remains bound by all contract terms, except of course for its remedy for breach. On the other hand, cancellation ends all rights under the license. Section 802.

SECTION 814. DISCONTINUING ACCESS. On material breach of an access contract or if the agreement so provides, a party may discontinue all contractual rights of access of the party in breach and direct any person that is assisting the performance of the contract to discontinue its performance.

Definitional Cross References: Section 102: "Access contract"; "Agreement"; "Party"; "Person". Section 701: "Material breach."

Comment

1. Scope of Section. This section deals with the right in an access contract to stop performance by denying further access to the other party. The section only applies to access contracts.

2. Right to Deny Access. An access provider may discontinue access without judicial authorization or prior notice in the event of material breach or if the contract so provides. The right to discontinue corresponds to common law which treats such contracts as subject to cancellation at will by the party who controls the facility even in absence of any breach, unless the contract otherwise provides. *Ticketron Ltd. Partnership v. Flip Side, Inc.,* No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993).

3. Not Retaking Transfers. This section does not give the licensor a right to retake transfers already made without judicial action, but merely to stop future performance. Rights with respect to information already in possession or control of the licensee at the time of discontinuance are dealt with elsewhere.

SECTION 815. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) [**Rights on cancellation.**] On cancellation of a license, the licensor has the right:

(1) to possession of all copies of the licensed information in the possession or control of the licensee and any other materials pertaining to that information which by contract are to be returned or delivered by the licensee to the licensor; and

(2) to prevent the continued exercise of contractual and informational rights in the licensed information under the license.

(b) [**Limitation on exercise without judicial process.**] Except as otherwise provided in Sections 814 and 816, a licensor may exercise its rights under subsection (a) without judicial process only if this can be done by taking possession of a tangible copy without a breach of the peace. In that event, the licensor may take further steps with respect to the copy, including erasing the copy by electronic means, subject to the same obligations that arise under Section 618(a) relating to return of the licensee's information and a licensor shall exercise reasonable care in the custody and preservation of the licensee's property in the licensor's possession.

(c) [**Judicial proceeding.**] In a judicial proceeding, the court may enjoin a licensee in breach of contract from continued use of the information and informational rights and may order the licensor or a judicial officer to take the steps described in Section 618.

(d) [**Expedited hearing.**] A party has a right to an expedited judicial hearing on a request for prejudgment relief to enforce or protect its rights under this section.

(e) [**Commingled information.**] The right to possession under this section is not available to the extent that the information, before breach of the license and in the ordinary course of performance under the license, was so altered or commingled that the information is no longer identifiable or separable.

(f) [**When licensee treated as licensor.**] A licensee that provides information to a licensor subject to contractual use terms has the rights and is subject to the limitations of a licensor under this section with respect to the information it provides.

Uniform Law Source: Uniform Commercial Code: Sections 2A-525, 2A-526; 9-503 (1998 Official Text).

Definitional Cross References: Section 102: "Cancellation"; "Contract"; "Contractual use term"; "Course of Performance"; "Court"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Party".

Comment

1. Scope of the Section. This section applies only to licenses canceled for breach. The aggrieved party has a right to recover licensed information and prevent further use by the

breaching party. The remedies are analogous to Article 2A of the Uniform Commercial Code (1998 Official Text). They are limited by the restrictions in Section 816.

2. Rights Recognized. In a license, the licensor retains overriding rights in the information. Cancellation of the license gives it an immediate right to prevent further use and retake the property conditionally made available to the licensee. The aggrieved party can obtain (1) possession of all copies of its information, and (2) when appropriate, an injunction against further use. On cancellation, the injured party has a right to preclude any further benefits to the breaching party. Merely returning copies may not achieve that result. The rights here, of course, apply only to information or copies provided under the license or made from licensed material. Information properly obtained from another source does not come within the provisions of this section.

3. Self-help. Subsection (b) allows a right of self-help to repossess the tangible copy without breach of peace and in that regard corresponds to Article 2A and Article 9 of the Uniform Commercial Code (1998 Official Text). In contrast, Section 816 prohibits electronic self-help under this Act. Repossession of a tangible copy is permitted unless there is a cancellation for breach so long as the repossession does not "breach the peace". Article 9 decisions are relevant on what is a breach of the peace. Subsection (b) makes clear that, having taken possession of the copy properly, the aggrieved licensor can erase it, but cannot destroy information that must be returned to the licensee.

4. Expedited Hearing. Subsection (d) gives each party a right to an expedited hearing to enforce or protect rights. This enables early judicial review, reducing the risks associated with non-judicial repossession and the risks associated with information misuse. The section does not specify the timing required. This is left to state procedural law.

5. Identifiability. Under subsection (e) there must be some identifiable thing with reference to which possessory rights can apply. A right to possession does not exist if the information has been so commingled as to be unidentifiable. This includes cases where data are thoroughly intermingled with data of the other party *and* that intermingling occurs in ordinary performance under the license. In such cases, repossession is impossible due to the expected performance under the contract.

This limit does not apply to the right to prevent use; it only means that a right to separable repossession of the information will not exist. For example, if trade secrets were provided to the licensee under contractual use terms, the ability to prevent further use hinges on whether a particular activity can be identified as use of the information. If an image, trademark, name or similar material is inseparable from property of the party in breach such as when it is incorporated into a product, that fact does not preclude the aggrieved party from preventing further use of the information. Thus, a license that allows use of an image in a video game does not prevent the licensor from barring use of the image in that game *after breach* even if the image is inseparable from the game. Of course, any prior authorized distribution of copies is not altered or impaired by subsequent cancellation.

SECTION 816. LIMITATIONS ON ELECTRONIC SELF-HELP.

(a) [**Electronic self-help defined.**] In this section, "electronic self-help" means the electronic exercise without court order of a licensor's rights in the event of

cancellation of a license because of a the licensee's breach of contract, but does not include actions expressly permitted under Sections 814 and 815 (b).

(b) [**Electronic Self-Help Prohibited.**] Electronic self-help is prohibited.

(c) [**Attorney's fees.**] In an application by a licensor in which the licensor seeks prejudgment relief pursuant to contractual rights to prevent continued use of the information by a licensee, a court may award the prevailing party in that proceeding reasonable attorneys fees with respect to the proceeding notwithstanding any term of a license.

(d) [**Limitations not waivable.**] The limitations under this section may not be waived or varied by an agreement before breach of contract.

(e) [**Other laws not affected.**] This section does not affect rights or obligations under laws other than this [Act], including Title 17 of the United States Code.

Comment

1. Scope of the Section. This section prohibits electronic self-help under this Act, denying a licensor a remedy to enforce its rights in the event of a breach by the licensee.

2. Self-Help for Breach. Electronic self-help deals with use of electronic means to prevent use of the computer program after the licensee commits a breach of sufficient seriousness that it allows the licensor to cancel the contract. The use of electronics to enforce a remedy for breach under this Act is precluded. The section does not deal with use of electronic restraints to prevent breach by limiting the licensee's performance to the terms of the contract or to the use of electronics when a license terminates by its own terms or otherwise without breach.

3. Non-waiver. The limitations under this section cannot be waived by agreement before breach.

4. Off-setting Rights. Electronic means of enforcing rights on breach are an efficient method of enforcing contract law rights that are important for small licensors that may be unable to litigate effectively against large licensees, such as a one-person developer who licenses software to a multi-national insurance company. Nevertheless, under this section, the developer is precluded from exercising electronic self-help under this Act. The section does not interfere with the licensor's right to cancel the license upon material breach (subject, of course, to the license terms) and the breaching licensee does not have any right to continue to use the program after cancellation. As part of the decision to ban electronic self-help under this Act, Section 816 provides for an award of attorneys fees for the prevailing party and an expedited hearing on the issuance of an injunction to effect, by court order, the actual cessation of use that would have been effected through electronic self-help but for the ban in this section.

The award of attorneys fees is independently authorized by this section with respect to a proceeding for a prejudgment relief brought because this section prohibits electronic self-help, and not subject to other rules regarding attorneys fees such as rules that may require a contract

term allowing such fees in order for a court to award them, or requiring qualification in equity in order to receive them. Here, the provision is intended to recognize that this Act's ban on electronic self-help is unique and disadvantageous to licensors in ways that are not reflected in other state laws. To the extent attorneys fees are available under other laws in other cases, this section does not disturb those laws.

5. Other Law. Nothing in this section alters the rights of a seller, lessor or a secured party to take possession or render goods unusable without removal and without judicial process if that can be done with no breach of the peace (see e.g., UCC §§ 2A-525; 9-609 (directly or via 2-401)) or rights under other law such as title 17 of the U.S. Code.

PART 9

MISCELLANEOUS PROVISIONS

SECTION 901. SEVERABILITY. If any provision of this [Act] or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 902. EFFECTIVE DATE. This [Act] takes effect [ ].

SECTION 903. REPEALS. The following acts and parts of acts are repealed:

SECTION 904. PREVIOUS RIGHTS AND TRANSACTIONS. Contracts that are enforceable and rights of action that accrue before the effective date of this [Act] are governed by the law then in effect unless the parties agree to be governed by this [Act].

SECTION 905. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et. seq., but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 7003(b)).

Comment

The federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et. seq., was enacted in summer of the year 2000. It precludes States from denying enforceability to an electronic record or an electronic signature solely because the record or signature is electronic, rather than in writing. The Electronic Signatures Act applies to cases where a state (or federal) law requires a writing or a written signature in order to have a particular effect. The Electronic Signatures Act allows state law to modify, limit or supersede its effect by laws consistent with it that are technologically neutral and that refer specifically to the Electronic

Signatures Act.

This Act does not distinguish between electronic and written records or signatures. It is thus consistent with the policy of the Electronic Signatures Act in avoiding discrimination against electronics. Furthermore, the provisions of this Act relating to the effect of a record or an authentication are technologically neutral. This Act does not modify the consumer protection provisions of 15 USC § 7001(c) and, like the federal act, is neutral on whether the notices referenced in 15 USC § 7003 (b) may be provided electronically.