The following Official Comments are in final form. However if one has concerns and they are communicated promptly to Ray Nimmer (rnimmer@uh.edu) and Carlyle Ring (ccring@ober.com), they will be considered if received by April 1,2000.

Sections 103, 201, and [216] contain language relating to amendments to the official text that have been approved by the NCCUSL Executive Committee, but have not yet been considered by the NCCUSL membership. The commentary language is in brackets. If a state adopts the amendments approved by the NCCUSL Executive Committee, the bracketed language in the comments should be inserted in the official comment text.

SECTION 101. SHORT TITLE.

SECTION 102. DEFINITIONS.

Official Comments:

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, but also includes contracts for remote data processing, 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 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 be "access contracts" were they not excluded by section 103(d)(1) as a "financial services transaction", which excludes "related identifying, verifying, access-enabling, authorizing or monitoring information." Under section 104, the parties may 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 the provisions of 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 113(b); Section 301 (parol evidence rule). Whether an agreement has legal effect is determined by this Act or other applicable law. Section 114(d).

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, under this Act, 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 multi-database 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 a procedure established by two parties in the expectation that a third party may rely on it when the third party in fact relies on or adopts 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 subsequent transaction. Similarly, a group consisting of member companies may establish attribution procedures that are intended to bind members in dealing with one another. All such arrangements are attribution procedures under this Act. The substantive provisions on attribution are set out 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 definition, the term "sign" should be interpreted consistent with the use of that term in Uniform Commercial Code § 1-201 (1998 Official Text), except that there is no limitation that signing be limited to authenticating a *writing*.

The definition is technologically neutral, but makes clear that qualifying electronic systems fulfill what once were paper-based requirements. 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. There is no requirement that the authenticated record be retained by a party unless that requirement is established 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. See *Parma Tile Mosaic & Marble Co. v. Short*, 663 N.E.2d 633 (N.Y. 1996) (intent requirement not met). "Referring to" or "linked to" captures the traditional concept of incorporating a record or terms by reference, as well as use of an electronic connection, such as an Internet hyperlink.

An "authentication" may express various intended effects. The ordinary effects are (i) accepting an agreement, or (ii) adopting a record or specific term(s). Authentication may also confirm the content of the record or identify a person. 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). In some systems a human being might review a particular transaction or aspect of it before the transaction is completed, such as when there is a problem with the system or when some aspect of the transaction appears to be irregular. If such review does not occur in the ordinary course (e.g., when no system problems exist), the transaction qualifies as an automated transaction. The term automated transaction is not inconsistent with a system in which, when some aspect of the transaction appears to be irregular, or when a message or transaction being processed by an automated system fails system edits and is repaired by a data entry clerk or other employee with no authorization to bind a party.

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, tax and other sources. The term does not include a traditional television set, radio or toaster even though such goods may include a microprocessor chip. 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. Under various state statutes, 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 and heat operations controlled by software is not a

computer, but merely ordinary goods enhanced by software. On the other hand, a desktop computer that receives telephone calls 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 other non-electronic formats of information.

9. "Computer information transaction." This term establishes the scope of this Act. Section 103. It requires an agreement involving computer information. The term includes transfers 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. 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 may be represented in digital form. The subject matter of that agreement is not the computer information, but the service – air transportation. See comments to Section 103.

A transaction is not for the "creation" of computer information in the sense intended here where 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 it was put into that form.

10. "Computer program." The first sentence parallels 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. The distinction here 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 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 substantive 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 measured. For example, if recovery is based on lost volume, the damages measure assumes that another transaction is not a substitute for the lost transaction and, thus, the idea of mitigation through a replacement transaction is not germane. 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 case law under Uniform Commercial Code Article 2. For an injured party to recover for economic losses resulting from the party's 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. In addition, 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 considering 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 a use that violates clear warnings against the particular type of use.

12. "Conspicuous." This definition is from Uniform Commercial Code § 1-201(10) (1998 Official Text), but updated for electronic commerce. Whether a term is conspicuous is determined by the court. Section 114. The definition of "conspicuous" does not change requirements of other law that specifies the content, timing or location of disclosures or warnings. If other law requires specific content, location, or timing of disclosure, those requirements apply under Section 105 and Section 114.

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 is not so limited; it can include an oral or automated voice presentation that meets the basic 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 sets out several methods of making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). The statutory illustrations reduce uncertainty and litigation. The illustrations are not exclusive. For cases outside their terms, the general standard governs.

The definition adapts the U.C.C. standard to cover methods relevant in 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). It includes a term or reference that provides: *** Disclaimer *** or <<< Disclaimer >>>. 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 <u>from</u> the display and not by 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 <u>term</u> in it is conspicuous.

Paragraph (B) operates independently of paragraph (A) and 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 might not meet paragraph (A), but in a way that precludes the user from proceeding without assenting to or rejecting this condition, suffices.

13. "Consumer" and "consumer contract." A "consumer" is a human being (individual) 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 the then-intended use of the information. For computer information, however, 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 if the software is acquired for use in an investment management business, the transaction is not a consumer transaction. The profit-making standard for determining whether a transaction is a consumer contract is followed in other areas of law. See, e.g., *Thomas 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.

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 copies and information provided under the contract. Unless otherwise expressly indicated, a contractual use term does not govern the same information lawfully obtained from other sources. For this definition, the use term must come from a contract and not simply from regulatory or property rights law. The contractual term must be enforceable to be within the definition. Thus, if trade secret or competition law precludes enforcement of a particular term dealing with non-competition, that term is not a contractual use term under this Act to the extent it is unenforceable.

In this Act, terms establishing the scope of a license are contractual use terms. They delimit the licensee's contractual rights. Under intellectual property law, however, with respect to determining whether an infringement occurs, not all contract terms are coequal. See *Sun Microsystems v. Microsoft Corp.*, 188 F.3d 1115 (9th Cir. 1999); *Schoenberg v. Shappolsky Publishers, Inc.* 971 F.2d 926 (2d Cir. 1992). The definition in this Act does not alter that 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 intellectual property law.

17. "Copy." This term refers to the medium containing the information. For purposes of this Act, 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 moving software within computer memory or making a transient copy is an infringement does not relate to contract law issues and is not dealt with in this Act. *Stenograph v. Bossard*, 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 is restricted 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 as compared to conduct prior to the agreement which is under the term "course of dealing." Both terms are part of the commercial approach under this Act to interpreting contracts in a practical manner. The parties know best what they meant by their agreement; their conduct is often the best indication of what that meaning was. A course of performance is always 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 transfers, information may not *move* from one location to another, but a copying of the information into another location or making it available in a system shared or accessible by the recipient and the party making delivery. There are many ways that transfer of possession or control might occur. For example, in an electronic delivery, a transfer of possession or control would occur when the information comes 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 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 of information such as *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 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 creation or performance of 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 automated agent is not equivalent to common law agency, but takes into account that 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 it is intended for communication to another person or an electronic agent; it does not merely record information. Communication of a message may entail 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, however, the 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 security interest is governed by Uniform Commercial Code Article 9. An agreement in which royalties for use accrue over time and are paid periodically is not a financial accommodation contract, but simply a royalty-bearing license (or assignment) of the information.

26. "Financial services transaction." This term includes a variety of financial system activities and transactions governed under federal and other state law which are excluded from this Act under section 103(d). Many of these 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 product of transactions that the software is used to process is excluded.

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 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, 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 & Nates 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.

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.

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 other law, such as the consumer protection law of this state. Some but not all of the items or transactions treated as financial services transactions in this Act are also excluded from the definition of goods. No inference is intended that those not so excluded, such as payment orders or loans, are thereby to be treated as goods.

30. "Incidental damages." This term corresponds to the same term in 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 that are the subject of a contractual

relationship. As used here, "data" refers to facts whether or not organized or interpreted. A "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. In this Act, 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 the 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 inevitably involves an intent that the information be perceivable by its creator. Informational content need not actually be communicated to an individual; it merely must be information that in ordinary use is communicated to individuals. For example, stock quotes remain informational content even if an investor uses an electronic agent to make orders and never looks at the actual quotes themselves. However, the term does not include computer program instructions that merely control interaction of a computer program with other programs or with a machine or device.

34. "Informational rights." This term includes but is not limited to "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 with reference to privacy law. Other laws determine when such rights exist. As with traditional intellectual property law, the rights need not be exclusive as to all other persons and all uses. This Act does not modify those laws under which such rights are created and exist. The term does not include mere tort claims such as the right to sue for defamation.

35. "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.

36. "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 form 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 nature of a consignment. This 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 of a copy 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. To be a license, the contract, whatever its form, must control the rights. 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 whether the contract transfers title to a copy. Title to a copy is distinct from questions about the extent to which use of the computer information is controlled by the contract. *DSC v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 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.

37. "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.

38. "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. One purpose of the definition is to avoid artificial distinctions among business and consumer transferees in an ordinary retail market. The term includes all consumer contracts and also includes some transactions between businesses if they are in a retail market. "Retail market" has its standard dictionary meaning. Mass-market transactions do not include commercial transactions between businesses using ordinary commercial methods, such as purchase orders or 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. The prototypical retail context is a department store, grocery store, gas station, shopping center, or the like. It does not include transactional contexts, whether online or otherwise, that center on the 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 relatively small quantities, non-negotiated terms, and transfers to an end user rather than one who plans to resell or re-license the product.

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, a subgroup of the general public, 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 types of 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. By excluding online transactions that do not involve a consumer, the definition gives commerce room to develop without regulation while preserving consumer interests.

39. "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 involved. The term "merchant" has roots in the "law merchant" concept of an expert or professional in business. This status may be based upon 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 is applied. In this Act, as relevant to business practices, "merchant" refers primarily to businesses with 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.

The reference to attributing knowledge by the employment of an agent confirms that 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.

40. "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.

41. "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 covered by this Act, but is governed by other law.

42. "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 the notice, not its receipt. If receipt is the relevant standard, that is stated in the statute.

43. "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.

44. "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 as used in this Act, refers only to a natural human being, whether acting in a representative capacity or solely on the individual's own behalf.

45. "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). For purposes of this definition, the information must be informational content, that is, intended to communicate to a human being, rather than simply to operate a machine. 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 are used by individual recipients who, for example, may search the database using a computer program. The information is generally available and the end user selects from the 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.

46. "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 constitutes receipt by the addressee, if that electronic mail address was held out as a place for receipt of such messages.

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. Outside electronic commerce, parties often require that notice be to a particular address or person. The same is true in electronic commerce. 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.

47. "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.

48. "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 implement 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 "quasi-contracts," enforceable on that basis. This Act does not change that law.

49. "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 112, 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 terms. When the 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 re-delivered 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 proffered contract terms and previously committed to pay or paid the contract fee. Making a return available then 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 114.

A right to a return may arise in reference to "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 merely summing up the fees that would be required for each product if transferred in an unbundled setting; often, bundled products include information products that are 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 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 particular 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 distribution arrangement premised on the economics of bundling multiple products. If no price is attributed in the agreement to the information products, a return does not require reimbursement of a fee since none has been charged.

50. "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. For example, 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. Further, 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 software and the copy of the information may be exactly the same and the differences can only be determined by reading the license.

51. "Send." This definition adapts Uniform Commercial Code § 1-201(38)(1998 Official Text) to cover electronic notices. In modern electronic technology sending a message does not require that the information move from one location to another. Electronic transfers often involve initiating processes that copy the information into another location or that make it available in a system shared with or accessible by the recipient. The message must be capable of being processed by the type of system involved. This refers to the type of system in its general, reasonably expected configuration and not to atypical system configurations. Of course, if the sender has knowledge of the details of the actual system to which it is sending the message, its actions may need to take that knowledge into account. The phrase "in addition" makes it clear that the electronic sending must also comply with

relevant criteria for other media, such as use of a commercially reasonable carrier. The message or item sent must be directed to a location or system that is held out as a place for receiving communications of that kind.

52. "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 ordinarily tailored 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.

53. "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.

54. "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.

55. "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.

56. "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 used in 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 of trade be "ancient or immemorial," "universal" or the like. Under this definition, full recognition is thus 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.

57. *Subsection b* refers to a variety of provisions of the Uniform Commercial Code which contain additional definitions of terms used in this Act. Unless otherwise expressly indicated, the reference is to the Official Text as of the end of 1998.

[SUBPART B. GENERAL SCOPE AND TERMS]

SECTION 103. SCOPE; EXCLUSIONS; AGREEMENT THAT ACT GOVERNS.

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

Official Comments: [If a state adopts the amendment approved by the NCCUSL Executive Committee, the bracketed language in the comments should be inserted in the official comment text.]

1. *General Structure.* This section states the scope of this Act. Subsection (a) outlines the affirmative scope. Subsections (b) and (c) establish rules for transactions where more than one subject matter is involved. Subsection (d) sets out exclusions from the Act.

2. *Transactions in Computer Information.* This Act deals with contracts and not property law. It governs agreements pertaining to computer information on matters addressed by contract law. 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."

In computer information transactions, the transferee seeks the information and contractual rights to use it. Unlike a buyer of goods, the purchaser (e.g., buyer, lessee, or licensee) of computer information has little interest in the diskette or tape originally containing the information after the information is loaded into a computer, unless the information remains on that media and nowhere else. In online use and distribution of computer information, there is often no tangible medium at all.

This Act deals with a variety of transactions central to the information economy where the

contractual subject matter is computer information, whether that information entails text, images, data, programs, or other 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 the computer information, but the service – air transportation. A contract to create and publish a print book is not a computer information transaction even though the author chooses or is required to deliver the work product 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 law.

b. *Computer Programs.* This Act applies to transactions involving distribution of, or grant of a right to use, a computer program. Section 102(a)(11). These transactions are within the Act whether they involve a license or an unrestricted sale of a copy of a program. The difference between a license and an unrestricted sale of a copy, however, is relevant. As reflected in this Act, a license may involve either a more substantial retention of rights or a greater transfer of rights than an unrestricted sale. Most provisions of this Act apply to all transactions within this Act, but 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 which, 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)(40).

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, as well as by exclusions stated in subsection (d). As a result, the Act leaves unaffected all transactions in the traditional core businesses of non-digital information industries (e.g., print). Whether a magazine, book or newspaper publisher can contractually limit use of the information by purchasers of copies and what contract liability applies to print works is outside this Act, as are the following:

- Sales or leases of goods
- Personal services contracts (except computer information development and support agreements)
- Casual exchanges of information
- Contracts where computer information is not required
- Employment contracts
- Contracts where computer information is insignificant (de minimus)
- Computers, televisions, VCR's, DVD players, or similar goods
- Financial services transactions
- Contracts for print books, magazines, or newspapers
- Contracts for sound recordings and musical works
- Contracts for motion pictures, broadcast or cable programming [outside the mass market].

This Act does not apply to "information," but to contracts and agreements regarding computer information.

4. *Mixed Transactions.* A computer information transaction may involve computer information and other subject matter and thus present 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 such as Article 2 or Article 2A. 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 may at least be governed by the common law of services, common law relating to information, federal and labor law, copyright law, and state regulatory law.
- A contract to buy a toaster may be governed by Article 2, common law of contract, consumer law, and various federal or state regulations.
- A contract to develop a multimedia product may be governed by common law of services, common law relating to information contracts, common law on licensing, copyright law, and other intellectual property law.

Since virtually all contracts of all types involve "mixed" law, the issue is not whether multiple sources of contract law apply, but to what extent this Act applies in lieu of another law. Subsections (b) and (c) decide the 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, the general rule is that, in the absence of contrary agreement under Section 104, the rules of the Uniform Commercial Code apply to its subject matter and the provisions of this Act apply to its subject matter. That principle is stated in subsection (b)(1), subsection (c), and subsection (d)(6). For example, under subsection (d)(6), 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. Subsection (c) provides that, if there is a conflict between a provision of this Act and Article 9 of the Uniform Commercial Code, Article 9 prevails. This resolution in favor of Article 9 is consistent with that in other Articles of the Uniform Commercial Code and other state law statutes. It preserves uniformity in Article 9's application across a wide variety of personal property financing transactions.

b. *Computer Information and Goods Generally.* One context in which the relation between this Act and an article of the Uniform Commercial Code arises involves transactions that include goods and computer information. "Goods" is defined for purposes of this Act in Section 102. Generally the terms do not overlap since computer information and informational rights are not goods. See, e.g., *United States v. Stafford*, 136 F.3d 1109 (7th Cir. 1998); *Fink v. DeClassis* 745 F.Supp. 509, 515 (N.D. Ill. 1990) (trademarks, tradenames, advertising, artwork, customer lists, sales records, unfulfilled sales orders, goodwill and licenses are not "goods"). If there is a diskette, the diskette is a tangible object but the information on the diskette does not become goods simply because it is contained on a 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).

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). Some courts 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. Each body of law governs as to its own subject matter. A similar distinction has long existed 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).

c. *Computer Information and Goods: Exceptions to General Rule.* There are exceptions to the gravamen test. 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.

In contrast, in some cases, this Act excludes coverage of a copy of a computer program if the copy is embedded in and sold or leased as part of goods, such as a copy of a computer program that controls engine timing in a car. Subsection (b)(1) outlines how courts should approach cases where a computer program is embedded in and inseparable from goods that are sold or leased as goods. A similar issue is addressed in Uniform Commercial Code Article 9 (1999 Official Text), but the resolution there deals with issues about creating and perfecting security interests under that statute and is not pertinent to general contract law; it is not adopted here.

For contract law, the appropriate rules center 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.

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. A commercial choice to distribute a program in embedded form, rather than in a form requiring loading the program into a computer or peripheral does not change the applicability of this Act. For example, the software for a medical imaging device that relies on software capabilities would be within this Act, whether the software is embedded in the imaging device or loaded into it after purchase. Of course, this Act does not apply to the computer; it only applies 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 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. This standard looks at materiality in an objective sense, centered on transactions of the type, rather than on the subjective goals or intent of the particular parties. Furthermore, materiality focuses on the particular goods in which the program is embedded, rather than the overall transaction as a whole. The test deals with 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.

In determining whether use of the program is a material purpose in obtaining the goods, courts should examine the commercial context. One relevant issue involves between whom the pertinent part of a transaction occurs. Some transactions entail three parties and two agreements. If goods are sold by a vendor but the buyer must obtain a license from a publisher, as to the license between the publisher and licensee, 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 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, and the extent to which the program is or could commercially be made available separate and apart from the goods. 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, obtaining the automobile's functionality rather than the program is the purpose of the transaction; 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 are within this Act. A sale of an ordinary television set that uses a computer program to preset choices of channels is not within this Act.

d. *Computer Information and Subject Matter not within the U.C.C.* If a computer information transaction involves subject matter that is not governed by the U.C.C. or by this Act, subsection[s] (b)(2) [and(3)] states [state] how to determine the extent of applicability of this Act. The general rule adopts the gravamen of the action standard in which this Act ordinarily applies only to its own subject matter, but not to aspects involving the other subject matter unless the computer information is the primary purpose of the agreement. This Act never applies to subject matter excluded under subsection (d) unless, pursuant to Section 104 or otherwise, the parties agree to coverage by this Act for such subject matter.

[(1). *Motion Picture Rights Contracts.* Subsection (b)(2) provides a different rule applicable to some agreements to create or obtain rights to create a motion picture. Subsection (f) defines "motion picture" for purposes of this Act. Contracting practices in this part of that industry follow established, unique patterns. 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. Thus, 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. The rule here applies only to the extent that the motion picture aspect of the transaction is excluded under subsection (d)(2)(A).

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 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 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 the motion picture rights comprise the dominant character of the agreement, this Act does not apply. If motion picture rights are not the dominant character of the agreement, 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)(2)(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 Section 104, of course, the parties can in all cases agree about whether the transaction is or is not governed entirely by this Act.

(2) *Other Subject Matter.* The gravamen test generally applies for all other subject matter. That basic rule is restated in subsection (b)(3), which also provides for an exception to that rule.]

If obtaining the computer information or informational rights is the primary purpose of the transaction, this Act applies to the entire transaction, except for subject matter excluded by subsection (d). Variations of this test have been used for years in cases involving goods and services. The test asks a court to consider whether the computer information or other subject matter (e.g., services) is the main focus. This language adopts, for mixed information and services, 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. [Also, it requires less than the test in subsection (b)(2).] In considering whether, under this 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 when this Act is contrasted to common law. 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 at various levels of use or distribution, but the results may differ at each level. For example, a courier company that licenses communications software from a software publisher is engaged in an transaction entirely within this Act. The subject matter is a license of software. 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, if the software publisher enters into a license with the end user, as between the publisher and the end user, that license is 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 law governs. See Section 104. 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. Ordinarily, a court should not apply this Act by analogy to excluded subject matter, but should refer to other law.

a. *Core Financial Functions.* Subsection (d)(1) excludes core banking, payment and financial services activities. Many of these transactions are regulated by federal or state law and are largely within the scope of the U.C.C. "Financial services transaction", is defined in Section 102. Financial services transactions are similar in many ways to computer information transactions. See Section 102, *comment* 26. Both types of transactions include trades in symbols, albeit symbols of very different use and effect. They share some common legal issues: *e.g.*, authenticity, data integrity, and authority. 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) is not an entity exclusion. Regulations such as Regulation E of the Board of Governors of the Federal Reserve System on funds transfer do not apply solely to banks but to any holder of a qualifying account. To the extent that non-banks engage in the activities indicated in the exclusion, those activities are also excluded from this Act. On the other hand, banks engage as licensors and as licensees in many computer information transactions; such 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. *Core Entertainment, Cable and Broadcast.* Subsection (d)(2) 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.

[Business practices in the 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)(2) 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 within the exclusion in subsection (d)(2) 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 for "motion picture," also the meaning set out in subsection (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].

[The term "enhanced sound recording" encompasses products such as enhanced music CD's, audio DVD's and the products commonly known as music videos. A music video qualifies as an enhanced sound recording because its dominant character consists if recorded sounds, even though it also includes visual depiction's 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)(2)(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)(2) 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. The term "programming", obviously, does not refer to computer software or computer programs as they may be programmed by a licensor. 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. Supp2d 851 (ED 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.

c. *Compulsory Licenses.* Subsection (d)(3) excludes compulsory licenses provided pursuant to the Copyright Act and similar statutes. These transactions are not voluntary contractual relationships and the contract choice principles which underlie this Act are not appropriate.

d. *Employment Contracts.* This Act does not deal with employee contracts; they are excluded under subsection (d)(4). A vast network of labor law and other regulatory rules apply to the relationship between an employee and employer and the intent in this Act is to leave that law unchanged. The Act does apply to contracts involving independent contractors other than freelancers in the news reporting industry.

e. *Voluntary Use of Computer Information.* Under Subsection (d)(5) 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. For example, 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 in print, does not come within this Act merely because it elects to develop the product using digital systems,

f. *Form is Insignificant.* This Act generally applies to its subject matter and other law governs other subject matter. However, 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)(5) 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 a trivial part of the relationship. 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.

For the exception to apply, 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. AGREEMENT THAT ACT GOVERNS

Definitional cross-references: Section 102: "Agreement"; "Computer"; "Computer Information"; "Computer program"; "Conspicuous"; "Copy"; "Good faith"; "Goods"; "Information"; "Informational rights"; "Mass-market transaction"; "Party".

1. *Scope of Section.* This section adopts the basic rule that, generally, parties can agree to have this Act apply to an entire transaction, part of a transaction, or none of a transaction. This rule deals with applicability of this Act and not other law, including law that supplements this Act.

2. *General Rule.* This section acknowledges a contractual capability that is presumed to exist under general law. Express recognition of this concept here is important because the narrow subject matter scope of the Act may create uncertainty or differences in coverage that the parties should be able to avoid by agreement. The ability to contractually choose what substantive rules govern in this context allows parties to avoid large costs associated with legal uncertainty.

Subject to the stated limitations, parties can agree to apply or to preclude application of this Act to a transaction if a material part of the transaction involves either computer information or subject matter excluded under Section 103 (d)(1) or (d)(2). This section does not foreclose agreements enforceable under other law, but any agreement to opt-in or opt-out is subject to the limitations in subsections (1) - (5).

The materiality requirement should be liberally construed to enable agreements. It does *not* ask a court to determine what is the most significant or primary part of a transaction, but merely whether the computer information or otherwise excluded information has some significance *to the part* of the transaction to which the agreement applies. Materiality is not present if the computer information is a trivial or otherwise insignificant aspect of that part of an overall transaction. The materiality rule in this section applies only to choices to opt in or opt out of coverage by this Act. It does not apply to or alter the ability of parties to change the effect of any rule in this Act or other law that is variable by agreement. Similarly, it does not affect contract choice of what state's law governs under Section 109, even if that choice results in application of this Act to the transaction.

An agreement under this section may include opting into, or out of, the contract formation rules of this Act. "Contract formation" rules are those rules of this Act necessary to determine whether an enforceable agreement to opt-in or opt-out has been formed, whether an enforceable contract concerning computer information has been formed, whether actions are attributed to a person, and how terms of the agreement are adopted. The parties may choose to apply the rules of this Act to part but not all of their transaction. For example, a company providing financial services excluded from this Act may enter into an electronic agreement that enables a customer to access the company's database for the purpose of an otherwise excluded transaction (e.g., deposit or withdrawal of funds) and that opts into this Act with respect to contract formation rules. The enforceability of that agreement is determined by this Act. The same agreement may also, under this Act, indicate terms and conditions regarding computer information that is not excluded from the Act. The financial transactions themselves are excluded.

In determining whether an enforceable agreement to opt-in or opt-out was formed, a court should apply the contract formation rules of this Act. Either a material part of the agreement involves computer information within the Act or the transaction includes computer information about which the parties may be uncertain regarding the application of the Act. Thus, this Act determines whether an electronic message indicating agreement with an opt-in term is attributable to the person to whom it is sought to be attributed, and whether the other requirements for contract formation have been met.

In a mass-market transaction, a contract term to opt-in or to opt-out of the Act under subsection (3) must be conspicuous.

3. *Limitations on Right.* Subsections (1) through (5) place limitations on agreements to opt into or out of this Act.

a. Opt-In Agreements: General. Subsection (1) deals with agreements providing that this Act governs aspects of a transaction to which it would not otherwise apply ("opt-in agreements"). Under subsection (1), the agreement does not supplant any rule that would otherwise apply and cannot be varied by agreement or that can be varied only in a prescribed manner. The agreement thus cannot alter rights of third parties not party to the agreement. For the limitation to apply, the non-variable rule must be applicable to the transaction in the absence of the opt-in agreement. Also, the rule is subject to the provisions of Section 105(d)(1-4).

In addition, an opt-in agreement cannot alter the effect of otherwise applicable consumer protection statutes or state law dealing with rights in a copy of printed information (e.g., a book on paper) distributed in the mass market. This section does not address what state laws apply to contracts for print information; it simply leaves existing law unchanged. A consumer protection statute is a provision of a statute that applies specifically to consumers and creates a more protective rule for a consumer than exists for all other parties in similar transactions.

b. Opt-In Agreements: Embedded Programs. Subsection (4) follows the exclusion in Section 103 for some computer programs embedded in goods. If a copy of a computer program is excluded from coverage of this Act, the parties cannot use that copy to bring the goods in which the program is embedded into the Act. Thus, under Section 103(b), this Act does not apply to a car or to a copy of a computer program regulating the brakes of the car and sold or leased as part of the car. With respect to the car and program, the parties could not opt into this Act. The result would be different if an embedded program is within this Act under Section 103.

c. Opt-out Agreements. Subsection (2) concerns agreements to opt-out of coverage by this Act. An agreement to opt-out places the transaction within other contract law as to the portion of the transaction to which this Act would otherwise apply. Because of this, subsection (2) places only limited restrictions on what aspects of this Act can be altered by virtue of that type of agreement.

4. *Other Limitations.* In addition to the limitations stated in this section, any agreement under this Act, including an agreement to opt-in or opt-out of this Act, is subject to standards of unconscionability and fundamental public policy. It also must be performed in good faith.

SECTION 105. RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

Uniform Law Source: Uniform Commercial Code §§ 9-104(1)(a); 2A-104(1) (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Authenticate"; "Conspicuous"; "Consumer"; "Contract"; "Electronic"; "Information"; "Informational Rights"; "Record"; "Term".

Official Comments:

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) states a similar principle for consumer protection statutes subject to the narrow electronic commerce rules in subsection (d).

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 self-help 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) restates a rule that would apply in any event under federal law. If federal law invalidates a state contract law 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). Subsection (a) refers to preemption, but doctrines grounded in copyright misuse and other 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 F2d 426 (8th Cir. 1993); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Case law will continue to develop in this area. As state law, this Act does not address that issue. No effort is or feasibly can be made in this Act to define whether or to what extent 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, in certain circumstances, terms may be unenforceable because 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 be applicable 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 are not invalid under fundamental public policy.

Even in mass-market transactions, however, limitations in a license for software or other information, 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 policy, but how they are resolved may be instructive to courts in applying this subsection. A recent 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 expressly addresses reverse engineering and security testing in connection with circumvention of technological measures that limit access to copyrighted works. It recognizes a policy to not 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."). It further recognizes a policy to not prohibit 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 outweigh a contract term to the contrary.

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. *State Law: Consumer Statutes.* This Act generally does not alter state consumer protection statutes or, if the state chooses to so state, administrative rules. The reference to regulations is bracketed because administrative regulations can fairly be seen as deriving from statutes.

This treatment of consumer statutes acknowledges the important and independent role of state consumer protection statutes and the diversity that exists nationally in those statutes. 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 consumers and that give consumers greater protection than other parties in similar transactions. Consumer protection statutory rules may be embodied in other statutes, such as the Uniform Commercial Code.

This Act deals with general contract and commercial law principles. It does not promulgate a consumer protection code, although the Act does contain numerous consumer protections. Historically, consumer protection statutes have been developed on a state-by-state basis. This Act, as a general commercial statute, does not override these judgments. With the exception of the limited procedural rules in subsection (d), a state's consumer protection statutes trump this Act. Thus, a consumer protection statute that regulates advertising, mandates disclosure of the licensor's main business office, requires disclosure of a term in specified content, manner, typeface or the like, provides for recovery of treble damages for particular types of breach, or limits disclaimers of warranty in a consumer contract, is not altered by this Act. Similarly, this Act does not alter the scope of coverage of any existing consumer statute since that scope is determined by the consumer statute itself. If the statute can reasonably be interpreted as applying to computer information transactions, it would be within this subsection (c).

5. *State Law: Electronic Commerce Issues.* Subsection (d) provides for limited displacement of other state law on several electronic commerce issues, shifting those requirements to standards consistent with the electronic commerce treatment in this Act. This approach parallels digital signature laws and electronic signature legislation, and it is appropriate and necessary to facilitate the cost savings and expanded access to information that electronic commerce offers. The rules apply to transactions within this Act, whether by agreement or otherwise, and to agreements under Section 104. For computer information transactions generally, this Act supplants other law as to contract issues. For consumer transactions, substantive statutes inconsistent with or in addition to those of this Act, such as statutes regulating the content, timing, and manner of a disclosure or warning, are preserved. As to four stated electronic commerce rules, this Act selectively replaces limited procedural rules but does not otherwise alter the substance of the consumer law. A state may, however, review its consumer laws and specifically preserve any limitations it desires from the operation of subsection (d).

Subsection (d)(1) allows an electronic record to suffice for a writing required in a transaction within this Act. This does not alter the form or content required under consumer law. It assumes that the form and presentation of material and disclosures in the record otherwise meets the substantive requirements of the relevant other statute. For example, a consumer protection statute may require that the consumer be able to retain the writing; this subsection does not alter that retainability requirement. Similarly, some consumer statutes require that the consumer initial particular terms of the record. Subsection (d) does not alter that rule although electronic "initials" can suffice for handwritten initials. The record that substitutes for a writing must meet all underlying requirements.

Similarly, subsection (d)(2) states that an authentication under this Act satisfies requirements of a signature if given for the purposes and in the context associated with the requirements of the other law.

Subsection (d)(3) updates the concept of conspicuousness when used, but not otherwise defined, in other law. The update reflects the electronic commerce themes adopted in this Act. This rule does not affect other disclosure rules. For example, a consumer rule which requires disclosure of particular information before a transaction occurs is not affected. Similarly unaffected is any rule that regulates the content of a required disclosure or the specific timing, form, location, language, or manner in which it must be made. This subsection does not alter statutes that relate to advertising or the like. Such statutes are not within the scope of this Act and are preserved.

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, it is likely that such statutes do not provide a consumer defense to electronic errors of the type provided in Section 214 of this Act but instead simply attribute a contract made in compliance with such statutes to the consumer regardless of error. If a State wishes to afford consumers the protections of Section 214, 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.

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".

Official Comments:

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

2. *Purpose of the Act.* This Act must be construed in light of its purposes, as stated in paragraph (1). They 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 the general purposes supplant its 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." Neither drafting style alters the basic rule that the agreement controls in all cases, except as indicated in Section 113(a). 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 statute provision is mandatory). The agreement, including trade usage and the like, also controls on the meaning of the language parties use in their contract. For example, a contract may provide that a party may "terminate" for breach. The Uniform Commercial Code and this Act define "termination" to mean ending a contract without breach. The proper interpretation of the contract, however, is based on its context and whether 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.

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

Definitional Cross References: Section 102: "Agreement"; **"**Authentication"; "Electronic"; "Electronic agent"; "Person"; "Record"; "Receive"; "Sent". Section 112: "Manifestation of assent".

Official Comments:

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, and to agreements under Section 104. These rules do not amend the other statutes.

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 equivalency between electronic and other records. The rule refers to the form of the authentication or record, not to its content. See Section 105(d). Subsection (a) does not address questions of proving attribution of a record or authentication or 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.* Subsection (b) clarifies that nothing in this Act requires parties to use electronic processes. In some cases, parties may wish to require use of traditional paper documents; this Act does not disturb 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. They are not required to deal electronically or to accept an electronic record or authentication unless they desire to do so. This principle does not authorize one party unilaterally to change requirements previously established by agreement. Subsection (c) does not require parties to establish requirements regarding electronics – the section 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 suffice as 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.* Generally, operations of an electronic agent bind the party that used the electronic agent for that purpose. Subsection (d). This is limited to situations where the party selects the agent, a concept which covers the case 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 imply a choice from among several electronic agents, but rather a conscious decision to use a particular agent.

The concept stated 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 in terms of 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). Cases of fraud, manipulation and the like are discussed in Section 206.

SECTION 108. PROOF AND EFFECT OF AUTHENTICATION.

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

Official Comments:

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. To satisfy the idea of authentication, however, the act that was required to proceed must constitute an authentication.

3. *Authentication Procedure.* Under Subsection (b), compliance with an effective or commercially reasonable attribution procedure for authentication removes questions about whether an authentication was intended or occurred. The attribution procedure must be one for authenticating a record and must be complied with. Compliance with such a procedure does not necessarily resolve the issue of to whom the authentication is attributed, but obviously may have weight on that question. See Section 213.

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 the use of an authentication procedure. It includes instances in which one of the contracting parties has 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.

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".

Official Comments:

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 such terms. Subsection (a) enforces the agreement of the parties except with respect to mandatory consumer protection rules. Subsections (b) and (c) provide clarity on what law applies in the absence of an enforceable contract term.

2. *Contractual Choice of Law.* Contract terms that choose 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 operating 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 could be subject to the law of all fifty states and of all countries in the world. That would impose large costs and uncertainty on an otherwise efficient system of commerce; it would raise 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 enforces contract choices only if the selected state's law has a "reasonable relationship" to the transaction. In a

global information economy, limitations of that type are inappropriate, especially in cyberspace transactions where physical locations are often irrelevant or not knowable. Also, in global commerce, 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, e.g.,* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997.

b. Limitations. Agreed choice of law terms are subject to this Act's general limitations such as the doctrine of unconscionability. Also, some terms may be unenforceable under the 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) 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 fundamental policy of freedom of contract should not permit overriding the consumer rule if a state, having addressed the cost and benefits to all parties, determines that the consumer rule is not waivable by contract.

3. *Choice of Law: No Contract term.* Subsection (b) states choice-of-law rules that govern in the absence of a contract term. These rules apply to all contract-related issues and they replace common law. Contracts in computer information can be created and performed remotely, a factor encouraging the need for tailored and understandable rules that enhance certainty and thus facilitate global commerce. As to general 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 clear or even 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). The licensor's location does not depend on the location of the computer that contains the information.

Subsection (b)(2) is a consumer protection rule that applies to transactions involving delivery of tangible (physical) copies. In the absence of agreed terms, the law of the place where the copy is or was to be delivered governs. Thus, if a consumer is to receive physical delivery of a tangible copy of software 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, by definition, to be delivered into that 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 (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. The "most significant relationship" standard requires consideration of various 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. Subsection (c) provides a rule for cases where the default rules in subsection (b) result in selecting the law of a foreign country and the law of that country 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. The general principle in (c) allows a court to use a different choice of law principle 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.

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

Official Comments:

1. *Scope of the Section.* This section deals with agreements choosing an exclusive judicial forum. Agreements choosing arbitration and other non-judicial forum choices are governed by other law.

2. *General Rule.* Choice of forum agreements are generally enforceable. This rule adopts the approach of *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972), and cases following that decision, which treat choice of forum terms as presumptively valid. The *Restatement (Second) of Conflicts of Law* adopts a similar rule.

3. *Limitations.* Contract terms that select an exclusive forum are subject to the doctrine of unconscionability and to the fundamental public policy rule in Section 105 which may limit the enforceability in some cases. In addition, under this section, a choice of an exclusive judicial forum is not enforceable if it is unreasonable and unjust. This follows *Breman* and its progeny. The agreed term is unenforceable if it has no valid commercial purpose and has severe and unfair impact on the other party. 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 and their impact may be unjust if the term unfairly harms the other party. 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.).

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 greater impact on small enterprises. Choice of forum agreements thus serve a significant commercial purpose by allowing parties to control the uncertainty and the risk or cost that it creates. See, e.g., *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998); *Caspi v. The Microsoft Network, L.L.C. et. al*., 732 A.2d 528 (N.J. A.D. 1999). The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991) in a different, but similarly 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 in the absence of such language. 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.

SECTION 111. UNCONSCIONABLE CONTRACT OR TERM.

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

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

Official Comments:

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 114 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*, -- F3d --, 1999 WL 1000717 (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 remains a useful tool that enables courts to police explicitly against the contracts or clauses which they find to be unconscionable. *See, e.g., Brower v. Gateway 2000, Inc.,* 676 NYS.2d 569 (N.Y.A.D. 1998).

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 214. 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 that are contrary to the essential purpose of the agreement, 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 to be submitted to the general triers of fact for resolution of a matter in dispute.

SECTION 112. MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

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 114: "Reason to know".

Official Comments:

1. *Scope of Section.* This section provides standards for "manifestation of assent" and "opportunity to review".

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 in this Act establishes uniformity that is lacking in common law.

"Manifesting assent" has several roles, being 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 both the first and the second result. In this Act, having an opportunity to review a record is a precondition to manifesting assent.

The *Restatement* states: "The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act." *Restatement (Second) of Contracts* § 19(1). Subsection (a) adopts this view. Words are not the only way to indicate assent to a contract or its terms. Conduct can convey assent as clearly as words. This is important in electronic commerce, since most interactions there involve conduct rather than words. Subsection (b) adapts that principle to use of electronic agents in contracting.

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 made available in a manner that ought to call it to the attention of a reasonable person and in a form that readily permits review. Subsection (e) may also require a right of return if the opportunity to review does not occur before initial 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 inaction if the circumstances so indicate.

- Third, the conduct, statement, or authentication must be attributable in law to the person. General agency law and Section 213 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 under the 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 the inference of assent would be drawn. Actions objectively indicating assent are assent. This follows the modern contract law doctrine of objective assent. It is especially important in electronic commerce. 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). That is the same rule that 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. Common law courts have used common sense in applying this same standard and they 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" that 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 that is 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 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 acts, not knowledge, of the electronic agent. 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. Subsection (e)(2) provides that, for an electronic agent, that opportunity occurs only if the record or term was presented in such a way that a reasonably configured electronic agent could react to it. 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.

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 a manifestation of 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. The described product defines the bargain. 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 made obvious and there is no assent or agreement to terms defining it, the 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 terms. 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 contains language to encourage use of double assent procedures. 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. The Microsoft Network, L.L.C. et. al.*, 732 A.2d 528 (N.J.A.D. 1999).

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 214.

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 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 contractual 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 213 or rules in this Act on attribution. Other law governs questions of ordinary agency law, estoppel and the like.

7. *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.

This Act is 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.

8. *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 adapts concepts that curtail procedural unconscionability. 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. 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 manipulates the circumstances to induce the other party not to review the record.

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 effectively preclude 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 a commitment to the transaction, subsection (e) indicates that ordinarily there is no opportunity to review unless the party can return the product (or in the case of a vendor that refuses the other party's terms, recover the product) and receive reimbursement of any payments if it rejects the contract terms. The required return 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 operation of law, the right must be communicated in terms available to the other person so that the person can become aware of it.

Frequently, computer information is distributed without charge for the purpose of enabling the recipient to enter into transactions with the licensor. The "beginning of performance" under subsection (e)(3) with respect to such information is not payment, but is typically the selection of a password or other security or attribution procedure for the purpose of engaging in a transaction or the initiation of a transaction. In such situations, a right of return need be offered only if the license or term is not available prior to such time. The licensor's obligation is satisfied if it provides instructions upon request for the destruction of such information and, if applicable under Section 209, reimburses the party for the costs, if any, incurred in restoring the licensee's information processing system. 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 competitive market price.

This provides incentive for a licensor to make the terms of the license available up-front if commercially practicable. Doing so avoids the right of return stated in this section and in Sections 209 and 613. In addition, under Sections 208 and 209, when presentation of terms is deferred, the terms cannot become part of the original 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 records are presented after the initial commitment to the transaction does not invalidate the agreement, but creates the 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 must be determined by consideration of 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 regarding the conditions or terms of the agreement. An agreement with payment and other agreed terms reflecting a right to use for consumer purposes only cannot be transformed into an unlimited right of commercial use by a failure of assent.

9. *Modifications and Layered Contracting.* The return provisions do not apply to proposals to modify an agreement or cases where there is an agreed right of a party to specify particulars of performance. 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 (e)(3). This is common in software development and other complex contracts; this Act does not disturb commercial practice.

10. *Modification of Rules.* Subsection (f) allows parties, by prior agreement, to define what constitutes assent with respect to future conduct. Compare Section 113(a)(3). The parties may call for more or less 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 113. VARIATION BY AGREEMENT; COMMERCIAL PRACTICE.

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"; "Opportunity to Review."

Official Comments:

1. *Scope of Section.* This section sets out basic principles on the effect and meaning of an agreement. It generally follows Uniform Commercial Code (1998 Official Text).

2. *Contract Choice.* The fundamental principle of this Act is that freedom of contract controls. Subsection (a). See also Uniform Commercial Code § 1-102(3), *Official Comment* 2 (1998 Official Text). With narrow exceptions, the agreement of the parties controls; the effect of provisions of this Act may be varied by agreement unless the provision is expressly non-variable. This rule reflects fundamental contract law theory in a free market economy and is essential to allow parties to tailor transactions to their circumstances. 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. The agreement to vary the effect of a provision of this Act must be between the parties to which the provision applies. Several provisions of this Act allow a financier to establish financing with 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 (a) 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 (a)(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 (a)(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 (c)(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(f).

3. *Usage of Trade, etc.* There are two ideas in subsection (b).

First, terms of an *agreement* must be found 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 provide the background and give meaning to language used. They establish a framework of common commercial understanding. The meaning of the terms of any agreement must be interpreted in light of practical considerations. Abstract concepts about what an agreement should mean are not as important as are grounded interpretations of what an agreement does mean in context. See Section 302.

4. *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 if created in consumer protection statutes. Section 105.

SECTION 114. SUPPLEMENTAL PRINCIPLES; GOOD FAITH; DECISION FOR COURT; REASONABLE TIME; REASON TO KNOW.

U**niform Law Source**: Uniform Commercial Code §§ 1-102(3); 1-104; 1-203; 1-205(3); 2-303.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Conspicuous"; "Consumer"; "Court"; "Financier"; "Good faith"; "Knowledge".

Official Comments:

1. *Scope of Section.* This section sets out principles that generally follow Uniform Commercial Code (1998 Official Text).

2. *Supplemental Rules.* Under subsection (a), common law rules continue to apply to transactions under this Act unless displaced by a provision or policy of this 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 adopted 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 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.

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.

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 triggered by an agreement. Absent agreement, no basis for allocating risk under contract principles exists and this Act leaves the issue to other law.

2. *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). This subsection makes it clear that good faith is relevant to the performance of all contract relationships within the scope of this Act, thus expanding the rule of good faith in states that have not adopted this view. 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 & Nates 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. The fair dealing concept does not alter 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 merely directs a court towards interpreting 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.

3. *Issues as a Matter for the Court.* As to unconscionability and conspicuousness, subsection (c) 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, federal preemption and fundamental public policy are questions for the court. Other issues are also made questions for the court. These are indicated in the relevant section or in applicable case law or procedural rules.

4. *Legal Effect.* Subsection (d) 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.

5. *Reasonable Time.* Subsection (e) 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, the subsection provides for disregarding 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.

6. *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.

PART 2
FORMATION AND TERMS
[SUBPART A. GENERAL]

SECTION 201. FORMAL REQUIREMENTS.

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 114: "Reason to know".

Official Comments: [If a state adopts the amendment approved by the NCCUSL Executive Committee, the

bracketed language in the comments should be inserted in the official comment text.]

1. *Scope of the Section.* This section requires an authenticated record for enforceability of certain agreements. The requirement is especially important in transactions in information because of the intangible nature of the subject matter and the split of interests in licenses, with ownership of rights in one party and contractual rights or privileges in the other. 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 the requirements of this section. The rules in this section also apply to agreements brought within this Act by an agreement in accordance with Section 104.

2. *Relationship to Federal Law.* Federal intellectual property law may in some cases 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., *Grappo v. Alitalia Linee Aeree Itaniane, S.p.A.* 56 F.3d 427 (2nd Cir. 1995); *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). 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, the existence of 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 approach to a 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. On the other hand, 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 writing afford a basis for reasonably believing that the offered oral evidence rests on a real agreement. A memorandum that fulfills the conditions suffices. The record must indicate that a contract was formed, and not merely that a contract was being negotiated.

Merely because a record satisfies this section does not establish that a contract exists. Not does it establish the terms of the contract, which must be determined under other section of this Act, such as Section 301. 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 exist, contract formation concepts must be met. For example, while a record need not describe all of the scope of a license, even if it meets the standards here 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 computer 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 contract for use of a digital photograph, a reference to a "photograph of Greenacre" satisfies the section even if the record does not describe the rights granted in the photograph. 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 designation of copy or subject matter, if met, cannot be defeated for purposes of the statute of frauds by showing that the designation was incorrect. However, the contract is not enforceable beyond either 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 Whistdata" 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, creates no enforceable right. 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. These are 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, acts by both parties adequately establish that a contract may exist; the authenticated record required under 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 tender and acceptance or access. A party relying on the exception must show both. 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 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. See Section 112.

Performance under this subsection allows the party only to attempt to prove the existence of a contract. It does not prove that a contract exists or, if it does exist, what terms govern. These must be established under other provisions of this Act. For example, in the case of 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 it.

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 Uniform Commercial Code 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 set out 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 formal 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 statute and the policies of requiring minimal indication that a contract was formed. The purpose of a statute of frauds is to prevent fraud, not to inhibit the 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 relating to transactions within this Act. This rule is applicable only with respect to state law. In many licenses, federal law requires 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.

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".

Official Comments:

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). It confirms that, 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 adopts the rule that dominates both the U.C.C. and common law. It focuses on the commercial context and on deciding 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.* Subsection (c) recognizes that if the parties intend to make a binding agreement, that agreement is binding despite there being 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. *See, e.g., Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2d Cir. 1998) ("Under New York contract law, parties may enter into a contract orally even though they contemplate later memorializing their agreement in writing. If, however, the parties do not intend to be bound absent a writing, they will not be bound until a written agreement is executed."); *Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543 (2d Cir. 1998).

The parties must intend to be bound. 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. In law a decision about 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. There is a difference between preliminary negotiations and actions or statements made with intent to be bound, even though terms are left open. If there is no intent to contract, no contract exists under this section and neither the negotiations nor this Act create one. If the parties did not intend

to be bound unless terms were later agreed to, subsection (e) gives guidance for unwinding the relationship if there is a failure to agree.

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 and 305. Any concept that a contract must arise at a single point in time and that this single event also defines all the terms of the contract is inconsistent with commercial practice. Contracts are often formed over a period of time, and terms are often developed during performance, rather than before any performance occurs. Often the 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 a proposed modification is appropriate only if the deal has, in commercial understanding of both parties, been 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.

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. 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. As indicated in this subsection, there is an obligation to return copies or information received during the preliminary period. Any rights in the contractual use terms do not apply because no contract was formed. If, however, the parties agreed to restrictions on the information or copies, the restrictions in those contractual use terms continue as to that information or those copies. The restrictions must be agreed to, independent of agreement or lack of agreement on the entire contract. This often occurs with preagreement terms on nondisclosure of confidential material. The continued effect of restrictive terms assumes agreement in fact. Thus, a negotiation involving four mutually conditional points does not create a contractual use term if that is the only term on which consensus emerges and no agreement occurs on the other terms which were conditions to an actual agreement even on the use term. In any event, the terms do not extend to authorized copies obtained from *other* sources. For example, a preliminary agreement containing contractual use restrictions regarding data compression software remains 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 any contract terms, intellectual property law may limit a party's use of information.

SECTION 203. OFFER AND ACCEPTANCE IN GENERAL.

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".

Official Comments:

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 through insistence on agreement to all terms or on following a stated method required for expressing 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). It accommodates new methods of communication as they develop.

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 the copy, unless the offer otherwise states. The second sentence accommodates the fact 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 not an acceptance of the offer if the shipping party notifies the licensee that the shipment is offered only as an accommodation to the licensee. Paragraph (2) has a 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 contract for 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 effective acceptance if it unambiguously indicates an intent to be bound. Paragraph (3) follows Uniform Commercial Code § 2-206 (1998 Official Text) to limit that effect so as to prevent abuse. Under this section, beginning performance, even if a reasonable means of acceptance, requires notice to the offeror that there has been acceptance. If this 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.

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 114: "Reasonable time."

Official Comments:

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

2. *Basic Rule.* 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 U.C.C. Article 2 and is not now followed even as common law in most states. Subsection (a) follows Uniform Commercial Code § 2-207(1) (1998 Official Text).

If a purported acceptance varies from the offer, it forms a contract only if the accepting party had an intent to form the contract and enough similarity exists between the acceptance and the offer to conclude that the offer was accepted. For this to occur, an acceptance with varying terms must be a *definite* expression of *acceptance.* Anything less is a counter-offer or, perhaps, no more than negotiation. 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. Also, under subsection (a), a response is not an acceptance if it materially alters the offer. One does not accept by proposing materially different terms.

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. Section 210 does not apply, because the contract is formed by offer and acceptance, not conduct. Under subsection (d), the terms of the contract are based on the terms

of the offer and other terms as indicated. Conflicting terms contained 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 terms of the offer.

SECTION 205. CONDITIONAL OFFER OR ACCEPTANCE.

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

Official Comments:

1. *Scope of Section.* This section deals with conditional offers or acceptances. It supersedes the prior sections on these issues.

2. *Basic Rule.* Subsection (a) states the basic contract law principle that a person can insist on preconditions for acceptance of its offer without being forced into a different contractual 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 conditioning language need not be in a record or stated in any specific form of language.

3. *Standard Forms.* The basic rule does not change merely because the conditions are in a standard form. Conditional standard 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 limited 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 on terms, there is no contract based on the standard forms. However, in practice, the parties often act as if a contract exists.

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 by its conduct ignores that condition, the condition itself 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 a party accepts the terms, under paragraph (b)(2) the contract is formed based on those terms, except to the extent they 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 enforceable. 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. The same result occurs if Licensor ships, but includes in the information a code that prevents use of the information 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.

SECTION 206. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Electronic agent"; "Information"; "Party"; "Person"; "Term". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section deals with contracts formed by an 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.* An interaction of electronic agents creates a contract if the parties use the agents to achieve that type of result and the operations of the electronic agents indicate that a contract exists. Conduct, even if automated, can create a contract. However, a contract is formed only by conduct 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.

The test for whether a contract is formed focuses on the operations of the agents. The basic 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.

3. *Electronic Mistake and Fraud.* Subsection (a) makes clear that restrictions analogous to common law concepts of fraud and mistake are appropriate in this automated context to prevent abuse or clearly unexpected results. Of course, parties may agree to allocate the risk of mistake or fraud in an agreement. In cases involving a consumer, Section 214 provides a special application of mistake theory in some automated contracts.

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 inference of assent that would occur through the 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 the existence of a contract occur in circumstances that are not within the reasonable contemplation of the person who selected either electronic agent for use. In such cases, the circumstances are analogous to mutual mistake. Courts applying these concepts may refer to cases involving 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 an interaction of an individual (human being) and an electronic agent. Subsection (b) does not try to 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 merely describes one setting that entails 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.

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

Official Comments:

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. While a release is a license, it does not contain any significant, affirmative obligation by the releasing party to enable the other party's use of the information.

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, Section 308 may apply. 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, the release is effective only with respect to its own terms; a release that allows use of an image in an Internet site does not release rights to other uses of that image.

SECTION 208. ADOPTING TERMS OF RECORDS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Party"; "Record"; "Standard form"; "Term". Section 112: "Manifest assent"; "Opportunity to review." Section 114: "Reason to know".

Official Comments:

1. *Scope of Section.* This Act deals separately with forming a contract and establishing its terms, although most often the same conduct establishes both. This is the primary section stating when a party adopts terms of a record as terms of a contract. Section 209 limits terms in mass-market licenses. Section 210 deals with cases when records do not create terms, but a contract exists because of conduct. In interpreting the meaning of terms, 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 113(b), 302.

2. *Adopting Terms.* If a party assents to a record, that party adopts the terms of the record as the terms of the contract, whether or not the record is a standard form. There is no difference on this issue between adopting terms of a customized record or a standard form. Standard forms are common in commercial practice and provide efficiencies for both parties. Treating them in law as generally less than other records documenting terms of a contract would place commercial contract law in conflict with commercial contract practice. Because of modern digital technology, standard forms will increasingly be used by both parties, even in consumer transactions on the Internet.

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 112. A party seeking assent must ensure that this opportunity is created.

3. *Later Terms: Layered Contracting.* Subsection (2) follows the concept of layered contracting. While some contracts are formed and their terms fully defined at a single point in time, many transactions involve a rolling or layered process. An initial agreement exists, but terms are clarified or defined over time. Often, the commercial expectation is that terms will follow or be developed after performance begins. This Act rejects cases that treat contracting as a single event notwithstanding ordinary practice and expectations that terms will follow after initial agreement or initial performance. It adopts a rule widely followed in cases that recognize the commercial reality that contracts are often formed over time. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Brower v. Gateway 2000, Inc.*, 676 NYS.2d 569 (N.Y.A.D. 1998); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. App. 1999).

Subsection (b) qualifies that rule by requiring as a precondition for later terms to be binding, that the parties have reason to know that terms will follow. Reason to know does not require specific notice or specific language in an original agreement, although such factors may establish reason to know since actual notice that terms will follow suffices. Reason to know can also be inferred from the entire 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. In Section 208, the time over which the record can be proposed is shaped by the expectations of the parties. At some point, the deal has been closed, but specifying when this occurs in terms of a fixed time is impossible in general commerce. It requires an analysis focused on the context and circumstances.

Under subsection (2) contract terms can be proposed and later agreed as part of completing the initial contract, even though they are provided after the beginning of performance by one or both parties. Such terms are treated as part of the initial contracting process if, at the time of initial agreement, the parties had reason to know and, thus, expected that this would occur and that terms of a record to be later agreed upon would provide elaboration of their contract. If, instead, the parties did not have reason to know, but instead considered the terms of the deal to be closed at the outset, subsequently proposed terms from either party are a proposed modification of the agreement, effective only under concepts applicable to such modifications.

Subsection (2) deals with cases that differ from Section 305, which refers to agreements that give one party or its designate a contract right to specify terms of future performance. In cases governed by Section 305, the party receiving the terms is not presented with proposed terms for agreement, since under the original agreement the one party has the right to specify terms. Since no further assent is required under Section 305, the terms to be effective must be proposed in good faith and in accordance with reasonable commercial standards.

4. *Mass-Market Cases.* The standard set out in subsection (2) also applies in the mass market under Section 209. Section 209 places a time limit on when proposal of the terms must occur and precludes the terms from altering terms that are expressly agreed by the parties.

5. *Right to a Return.* In some cases governed by subsection (2) and in mass-market licenses, if assent is sought after the person paid or delivered or became 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 subsequently proposed terms. Section 112. If a right to return is not given, there can be no effective assent to the terms. Section 112 (a). This rule also applies in mass market transactions where the licensor's performance is delivery of a copy with a standard form included. The rule does not necessarily apply in other commercial contexts, where there is merely an expectation that terms will be agreed to (or rejected) at some point during performance. See Section 112. In these contexts, general principles of equity apply to deal with the circumstances where there is a failure to agree; Section 202(e) provides guidance where the parties did not intend to have a contract in the absence of their agreeing to the later terms.

6**.** *Adoption of Terms.* Subsection (3) states a principle from the *Restatement* and general common law. Assent to a record adopts all of the terms of the record; there is no requirement that the party read, understand or separately assent to each term. Of course, the enforceability of terms is subject to the various doctrines set out in this Act regarding unconscionability, public policy, good faith, and the like.

This Act rejects the rule of *Restatement (Second) of Contracts* § 211(3), which suggests that a term of a standard form which is not unconscionable or induced by fraud may nevertheless be invalidated because a court later holds that a party could not have expected it to be in the standard form. Absent unconscionability, fraud or similar conduct, parties are bound by the terms of the records to which they assent, subject to Section 209 and Section 105. Concerns about unfair surprise and the like are addressed in Section 209, the doctrine of unconscionability, and in other specific provisions of this Act.

SECTION 209. MASS-MARKET LICENSE.

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

Official Comments:

1. *Scope of Section.* This section limits the enforceability of contract terms in mass-market licenses. The section must be read in connection with Sections 208 and 112. In addition, of course, in interpreting the meaning of the terms, 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 sources of practical construction. Sections 113(b), 302.

Many mass-market licenses are available for review and agreed to at the outset of a transaction; some are presented afterwards. This section deals with both settings. Many mass-market transactions involve three parties. This circumstance is addressed here and in Section 613. The limitations stated in subsection (b) impose costs that create incentives for licensors to present terms at the outset when practicable.

2. *General Rules.* There are various ways in which the terms of consumer contracts or other contracts can be established. An oral agreement suffices, as does an agreement to terms presented in a record. In other cases, the parties may agree that the terms or particulars of performance may be specified later by one party, its designate or a third party. Section 305 governs those cases.

This section deals with where assent to a standard form record containing terms for a mass market license is sought, either at the outset or after the transaction begins. Three limiting concepts govern:

a. Assent and Agreement. A party adopts the terms of a record that is 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. This means that 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. See Section 112.

Adopting terms of a record under this section is pursuant to Section 208, with the limitations stated in that section. If the terms of the record are proposed after a party commences performance, the terms are effective under these sections only if the party had reason to know that terms would be proposed and

assents to the terms when proposed. Even if reason to know exists, however, for mass-market licenses, the terms must be made available no later than the initial use of the information and, if the mass-market license was not available before initial agreement, the person has a right to a return if it refuses the license.

b. Unconscionability and Fundamental Public Policy. Even if a party adopts terms of a mass market license, a court may invalidate unconscionable terms or terms against fundamental public policy. These rules 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 trademarks or trade secrets of the licensee without any discussion of the issue would ordinarily be unconscionable. A court may also refuse to enforce a term that violates a fundamental public policy under Section 105(b).

c. Conflict with Expressly Agreed Terms. Paragraph (a)(2) provides that standard terms in a mass-market license cannot alter the terms expressly agreed 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 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 consumer requests a "90 day right to a refund at its discretion" and the vendor agrees to provide such a refund, the standard terms cannot alter that agreement. This section rejects the additional test in *Restatement (Second) of Contracts* § 211(3).

Of course, there must be an agreement, and it is subject to traditional parol evidence concepts. Additionally, under Section 613 the terms of any publisher's license does not alter the agreement between the end user and the retailer unless expressly adopted by them as their own agreement.

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 the computer information with a single user or with multiple users on a network, or between a right to consumer use or a right to commercial use, or between a right to private use or a right of public performance. 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.

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 or that the contract may constitute a "contract of adhesion" does not invalidate it under general contract law or this Act. A conclusion that a contract is a contract of adhesion may, however, require that courts take a closer look at contract *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 address concerns often relevant to such a review or a review for procedural unconscionability.

5. *Terms after Initial Agreement.* Mass market licenses are sometimes presented after initial general agreement between the ultimate licensee and either the retailer or the licensor-publisher. The contracting format allows contracts between end users and remote parties that control copyright or other interests in the information. Enforceability of the license is important to both parties. Under federal law, a sale of a copy of a copyrighted work does not give the copy owner a number of rights that it may desire.

a. Timing of Assent. Under this Act, 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 the software and other industries in that market. Of course, any applicable federal law that establishes a right to rescind a contract and return a product remains effective and is not altered by this Act. Section 105. Also, assent to the record does not alter the licensee's right to refuse a product that is defective and constitutes a breach of contract. Assent to terms of a contract is different from acceptance of the copy to which the contract pertains. Acceptance of the copy generally requires a prior right to inspect it. See Section 608.

b. Cost Free Return. Under subsection (b), if terms are not available until after initial agreement, the party being asked to assent must have a right to reject terms with a commensurate right to a return of the information product acquired. 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.

Most decisions under current law enforce contract terms 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.*, 970 P.2d 803 (Wash. App. 1999). This subsection enforces terms only if there is 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 the information or that it can return damaged, copied or altered information. The right to a return creates a situation equivalent to that which would have existed if the licensee had a chance to review and rejected the license at the preliminary agreement. It does not apply if the licensee agrees to the license. This return right also does not arise if there was an opportunity to review the license before making the preliminary agreement.

Exposure to 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. The return right under this section includes, but differs from the return right described in Section 112(e). 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 any 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 was required to be installed to review the license, expenses 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 to cover actual reasonable expenses that are foreseeable from the method used to obtain assent.

SECTION 210. TERMS OF CONTRACT FORMED BY CONDUCT.

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."

Official Comments:

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 of the agreement are determined under the general rules of this Act, including appropriate weight being given to usage of trade, course of performance, and course of dealing. See, e.g., Sections 113(b); 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 arising 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, including default 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 the scope of the grant.

3. *Battle of Forms and Conduct.* Some information transactions involve exchanges of inconsistent standard forms coupled with conduct of both parties indicating the existence of a contract. In these cases, 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 terms of the contract are not determined within this section. The second possibility is that the records and conduct related to them do not establish a contract because, for example, they materially disagree or the conditions of either or both forms are not met. See Sections 204 and 205. Such cases fall 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)(57). 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 when the contract was created by conduct, 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 by the licensee can be protected in appropriate cases by applying equitable principles without creating a grant that may not have been intended by the licensor.

SECTION 211. PRETRANSACTION DISCLOSURES IN INTERNET.

Uniform Law Source: none.

Definitional Cross References. Section 102: "Computer information"; "Copy"; "Electronic"; "Information"; "License"; "Licensee"; "Licensor"; "Standard form". Section 112(e): "Opportunity to review".

Official Comments:

1. *Scope of Section.* This section deals with pre-transaction disclosures of contract terms in transactions on the Internet 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 use 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 should be viewed under the general standards in Section 112.

3. *Disclosure and Downloading.* The disclosure rules in this section are modeled after provisions of the federal Magnuson-Moss Warranty Act. They combine actual disclosure with availability of terms. It is sufficient that standard terms be available on request. Thus, 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 those 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 information or instructions for obtaining it. The intended purpose of the close proximity standard is that the terms or the reference to them must assure that the term or reference will 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 such. It does require that there be nothing affirmatively done to preclude the possibility 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.

[SUBPART B. ELECTRONIC CONTRACTS: GENERALLY]

SECTION 212. EFFICACY AND COMMERCIAL REASONABLENESS.

Uniform Law Source: Uniform Commercial Code: Sections 4A-201; 202 (1998 Official Text).

Definitional Cross References: Section 102: "Attribution procedure."

Official Comments:

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 Commercially 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 that the procedure was 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 213. DETERMINING ATTRIBUTION.

Uniform Law Source: None.

Definitional Cross References.

Official Comments:

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 which 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 Section 105.

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 214. ELECTRONIC ERROR: CONSUMER DEFENSES.

Prior Uniform Law: None.

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”.

Official Comments:

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 reasonably 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 and 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. As elsewhere, the idea of a reasonable procedure here does not require use of the most effective procedure, 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 215. ELECTRONIC MESSAGE

Definitional Cross References. Section 102: "Electronic"; "Electronic message"; "Information"; "Receive".

Official Comments:

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 mail box 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.

[If a state adopts the amendment approved by the NCCUSL Executive Committee, the bracketed language in the comments should be inserted in the official comment text.]

[SECTION 216: INFORMATION SUBMISSION

Official Comment

Definitional References. Section 102: "Agreement"; "Information"; "Informational rights"; "License"; "Party"; "Record"; "Release".

Reporter's Note:

1. *Idea Submissions: General Premise.* Section 216 deals in a limited way with an important issue in information industries: submissions of ideas for the creation, development or enhancement of computer information. The section leaves undisturbed the array of doctrines dealing with equitable remedies, but clarifies the effect of a submission in contract law. A distinction is stated between submissions pursuant to an agreement and unsolicited submissions.

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 contractual relationship. The receiving party may have an obligation to return copies in some cases, but unilateral action of the other 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 especially clear in cases where, for example, a party maintains a website inviting clients and licensees generally to contact it with any complaints or ideas about how it might improve the site or its services. An idea or information about computer information is not solicited for purposes of this section simply by maintaining a general interactive customer contact and information site.

This is true, as indicated in subsection (a)(2), even if the industry 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 an Internet site at which it invites clients and licensees to contact it generally for information about products complaints and suggestions about its products generally. An idea of information is solicited if the recipient has specifically required information on a particular topic with some obligation to be a 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.* 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)**.** The licensee 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. But the information must not be something that is generally and widely known. 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 an agreement that does not hinge on the uniqueness of the proposed submission. Whether such agreement exists must be judged based on the fundamental notion that a party does not implicitly contract away its rights, without a fee, to use publicly known information merely because it contracted for "disclosure" of such material.]

SECTION 301. PAROL OR EXTRINSIC EVIDENCE.

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."

Official Comments:

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 which arises out of the commercial context in which it was used. See Section 302.

SECTION 302. PRACTICAL CONSTRUCTION.

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"; "Usage of trade". Uniform Commercial Code: "Party": Section 1-201; "Term": Section 1-201.

Official Comments:

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.

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".

Official Comments:

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.

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 authenticated by the party receiving the license. *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*, 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997). Such terms permit parties to make their own statute of frauds and to control their risk. The language of the 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 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(g) 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(g). 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 Section 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 conform to 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.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Good faith"; "Mass-market transaction"; "Notice"; "Notify"; "Party"; "Term"; "Termination".

Official Comments:

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 multi-year 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 mass-market 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.

Uniform Law Source: Uniform Commercial Code Section 2-311 (1998 Official Text).

Definitional Cross References. Section 102: “Agreement”; “Contract”; “Good faith”; "Seasonable"; “Party”.

Official Comments:

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.

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 which 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.

2. *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.

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

Official Comments:

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.

SECTION 307. INTERPRETATION AND REQUIREMENTS FOR GRANT.

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Person"; "Receive"; "Record"; "Scope"; "Term".

Official Comments:

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.* ,192 F.3d 356 (2d Cir. 1999). 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. *Number of Users.* A license can specify the number of permitted users or uses by stating a specific number or by referring to all users or uses at a particular location or site. Those express terms control. In the absence of such agreed terms, under subsection (c), the contract authorizes a number that is reasonable in light of the informational rights and commercial circumstances involved. In some cases, especially a mass market license, a single user limit would be assumed. In other contexts, site license concepts are more appropriate. Given the diversity of the marketplace, no single presumed number of users or uses could fairly meet all circumstances.

Of course, this provision is subject to contrary agreement, which agreement may be found as well in express terms as in course of dealing, usage of trade and course of performance. Thus, if the parties agree that all persons at a designated site may be users, that agreement controls and the default rule is not applicable.

5. *Improvements and Design Material.* Under subsection (d) and (e), 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).

6. *Grant Clauses.* Subsection (f) 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 (f)(1) and (f)(2) provide guidance on important license terms. Subsection (f)(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 (f)(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. DURATION OF CONTRACT.

Uniform Law Source: Uniform Commercial Code Section 2-309(2) (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Cancellation"; "Computer program"; Contract"; "Contract Fee"; "Contractual use term"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Notice"; "Party"; "Seasonable"; "Termination".

Official Comments:

1. *Scope of Section.* This section deals with contracts in which the agreement does not indicate its duration. The section follows common law and Uniform Commercial Code Article 2 (1998 Official Text) but sets out two new rules that expand licensee rights. This section does not deal with contracts that specify their duration, such as a license for a stated perpetual term or number of years. Also, the section applies only if there is a contract. In some cases, failure to agree on duration indicates that no contract exists.

2. *Basic Rule.* The duration of a contract is the duration stated in the agreement including consideration of applicable trade usage and course of dealing. If no term specifies duration, subsection (1) applies the rule in common law and U.C.C. Article 2 (1998 Official Text). The duration in such cases is for a commercially reasonable period. What time is reasonable for any given arrangement is determined by the commercial circumstances. Section 114. A contract that runs for a commercially reasonable time may continue indefinitely; if the parties continue to perform, the contract will not terminate until notice is given. The basic policy is that a party making an indefinite commitment cannot be placed in a position of perpetual servitude, but is required to perform over a time that is reasonable.

The commercial circumstances determining what is a reasonable time include third-party rights that limit the licensor. A licensor should not be presumed to have given a license that exceeds the duration of its own rights (such as in licenses it has from third parties). More generally, the reasonable duration should reflect the rights involved. A patent license that does not state its term can reasonably be presumed to extend for no longer than the life of the patent. A similar rule may exist for an indefinite copyright license, although this may be subject to preemptive copyright law rules. See Official Comment 3.

3. *Termination at Will.* A contract of indefinite duration can be terminated at will by either party, except as provided in subsection (2). This is the rule in common law. Under this rule, for example, a contract that grants a license and promises support services for an indefinite period can be terminated at will as to the support services. However, in contrast to common law, under this Act, treatment of the licensed rights is handled differently to protect licensees under subsection (2).

The "at will" termination rule is well-established under common law and Article 2 of the Uniform Commercial Code. One reported opinion holds that, for copyright licenses, federal law precludes application of the "at will" because all copyright licenses are terminable by the licensor during a period into the relationship. *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993). Two other federal courts hold that the state law "at will" termination rule is not preempted by this federal law. See *Korman v. HBC Florida, Inc.*, 182 F.3d 1291 (11th Cir. 1999); *Walthal v. Rusk*, 172 F.3d 481 (7th Cir. 1999).

"At will" termination enables non-judicial ending of the contract. Parties to a contract are not required, in giving notice of termination, to fix, at peril of breach, a time which is reasonable in the unforeseeable future judgment of a trier of fact. The right to terminate at will enables closure of the relationship on appropriate notice; whether or not this occurs after a reasonable time has passed for the entire contract is not relevant. If a party's communication sets a proposed time limit for termination of the contract, that proposal calls for a response; failure to reply will infer acquiescence. If objection is made on grounds that the proposed time for termination is unreasonable or if the demand is merely for information, demand for assurance on the ground of insecurity may be made under this Act pending further negotiation.

4. *Termination.* Termination discharges obligations that are executory on both sides, except as indicated in Section 616 or the agreement. It does not affect rights vested based on prior performance. Thus, if a contract grants a permanent right to use software, but the agreement also creates an indefinite duration obligation to support the software, termination does not affect the licensed rights (vested because of prior performance), but ends the obligation to provide support in the future.

5. *Contracts for Definite Term.* This section does not apply if the agreement specifies its duration. Agreement to a definite duration may be found in express language, usage of trade or course of dealing. A distinction may be made between the duration of a license and the duration of obligations requiring affirmative performance. A license for "the life of the edition", "for so long as the work remains in print" or "perpetually," defines a duration just as does a contract that specifies a one year duration. On the other hand, an obligation to "lifetime" service or support is indefinite in duration. In the case of a license duration, what is being defined is the period over which use extends and there is no risk of servitude that justifies ignoring the literal terms of the grant. On the other hand, a commitment for support or new editions raises the servitude issue and the underlying problem to which the "reasonable term" rule applies

6. *Presumed Perpetual Licenses.* Subsection (2) rejects common law and Article 2 in two contexts. It provides that the duration of an indefinite license, other than for source code, is presumed to be perpetual as to the licensed rights and use restrictions in computer programs if:

(1) The license transfers ownership of a copy or delivers a copy of a computer program for a single fee, the total amount of which is determined at or before delivery. This does not contemplate royalty or other variable fees whose total dollar amount cannot be determined at the outset. The rule is overridden in cases where the circumstances suggest that, despite a single fee or similar terms, there is no agreement for perpetual rights.

(2) The licensed information is incorporated into a product for distribution to third parties, such as an image licensed for use in a digital multimedia encyclopedia. This recognizes the reliance interests that develop in such case and which would be disrupted by an at-will termination right.

The exception for source code acknowledges the common law rule and commercial practice that denies long term rights in confidential material in the absence of express agreement. This exception only applies to licensed use of confidential source code. If an agreement provides that, on the occurrence of a stated event, the licensee can obtain source code from an escrow or other relationship, that right does not affect the license for the object code which may be nevertheless perpetual if the requirements of the subsection (2) are met. Subsection 2 does not apply to the agreement for the source code, the duration of which is determined by the agreement or under subsection (1) or other applicable law. See Comment No. 2 above.

SECTION 309. AGREEMENT FOR PERFORMANCE TO PARTY'S SATISFACTION.

Uniform Law Source: Restatement 228. Revised.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Informational content"; "Party"; "Person"; "Term".

Official Comments:

1. *Scope of Section.* This section deals only with cases where the agreement provides that the acceptability of a required performance is to be based on the satisfaction of the party receiving the performance. This often occurs in licenses where a work needs to appeal to the aesthetic sensibilities or taste in a market to which the licensee will direct it. The section only applies where the parties have agreed to a "to the satisfaction" clause.

2. *Basic Rule.* Subsection (a) follows the *Restatement (Second) of Contracts* § 228. Contract terms that define acceptability in terms of "to the satisfaction" of another party are ordinarily interpreted as requiring a determination under an objective or ordinary reasonable person standard. The issue is whether the tender would be acceptable to a reasonable person. This rule is supplemented in this Act by the general obligation of good faith that applies to all contracts.

3. *Subjective Standard.* There are cases where a subjective standard of satisfaction is appropriate. Subsection (b) indicates when such a subjective standard applies. The most obvious is when the contract so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard.

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) (If a contract imposes as a condition precedent that a submission be to one party's subjective satisfaction, 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.

SECTION 401

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 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section deals with implied warranties on non-infringement, exclusivity, and non-interference. These warranties 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 which 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.

2. *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).

3. *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 coinventors 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.

4. *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.

5. *Disclaimer.* Subsection (d) derives from U.C.C. § 2-312 (1998 Official Text). The infringement and other warranties in this section can be disclaimed. 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.

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".

Official Comments:

1. *Scope and Basis of Section.* This section follows Article 2 of the Uniform Commercial Code (1998 Official Text) on express warranties, 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 used in 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 standard 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. This standard enables the creation of express obligations on the more general showing that statements about the information are part of and basic to the deal. The question is whether statements of the licensor made to the licensee have in the circumstances and in objective judgment become part of the basic deal. However, an express warranty concerns a bargain and this rule 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 any of 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 law in 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 actually occurs. 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 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 which 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. The court's discussion in *NMP Corp. v. Parametric Technology Corp.*, 958 F. Supp. 1536 (S.D. Okla. 1997) is illustrative for software demonstrations.

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 extensive and 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 <u>not</u> 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" made 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.

Uniform Law Source: Uniform Commercial Code: Section 2-314; 2A-212 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Computer program"; "Contract"; "Copies," "Delivery"; "Informational content"; "Licensor"; "Merchant".

Official Comments:

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. 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 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 type 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 such programs are used. Use of ordinary, mass-market programs in highly sensitive or commercial applications does not change the warranty into one that assures fitness for purposes of that use.

Merchantability does not require a perfect program, but 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 – 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, in many cases a perfect program is not reasonably possible at all. *See e.g.,* Raymond Greenlaw and H. James Hoover, *Fundamentals of the Theory of Computing* p. 10-13 (1998). This does not mean that one cannot find and cure all defects, but that the cost and time to do so, given an inherent and natural error rate, is prohibitive and clearly beyond the scope of capability of small providers that comprise most of the software industry.

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 such minor errors that is fully within common expectation. 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. Reasonable use of existing testing techniques that are commercially available 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 - 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.

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References. Section 102: "Informational content"; "Licensee"; "Merchant"; "Party"; "Published informational content".

Official Comments:

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 1242 (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. 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. CompuServ, 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 of accuracy).

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); *Windt v. Shepard's McGraw-Hill, Inc.*, 1997 WL 698182 (ED Pa. Nov. 5, 1997)

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 113(a)(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.

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 114: "Reason to know".

Official Comments:

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.

SECTION 406. DISCLAIMER OR MODIFICATION OF WARRANTY.

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."

Official Comments:

1. *General Structure and Policy.* This section deals with disclaimer or limitation of warranties, except Section 401 statutory warranties which 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 disclaimers do not foreclose liability for intentional fraud in most states, disclaimers specific to particular facts or categories of risk may foreclose a claim in fraud by eliminating reasonable reliance on a material 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. The intent is to avoid requiring parties to make a prior determination about which law governs. 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 of the subsection 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 of the transaction are sufficient to call the licensee's attention to the fact that an implied warranty is not made or is excluded. These rules of exclusion apply only to implied warranties. They 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 which 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 which 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 under circumstances which do not permit extensive testing would not exclude defects that could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A merchant licensee examining a product in its own field is held to have assumed the risk for all defects which a merchant in the field ought to observe, while a non-merchant licensee is held to have assumed 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. It is consistent with the general 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.

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

Official Comments:

1. *Scope and policy of Section.* This section deals with the effect of modifications by the licensee to computer programs other than changes made using an aspect of the program intended for that purpose. The changes eliminate any performance warranty with respect to the modified copy. This rule applies only to a modified copy. If the defects exist in the unmodified copy, modifications have no effect. The warranties affected by modification relate only to performance; the rule does not apply to title and non-infringement warranties. The complexity of computer programs means that 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 which 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.

Uniform Law Source: Uniform Commercial Code § 2-317 (1998 Official Text).

Definitional Cross References. Section 1-102: "Party".

Official Comments:

1. *Scope of Section.* This section deals with the relationship among various types of 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) derive from Article 2. They 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) are designed to 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

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".

Official Comments:

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 that 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 to be 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) departs from 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 basis of this section lies in beneficiary status, rather than 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 501. OWNERSHIP OF INFORMATIONAL RIGHTS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Information"; "Informational rights"' "Transfer."

Official Comments:

1. *Scope of the Section.* This section deals with contractual transfers of ownership of intellectual property rights This section is subject to federal law requirements, such as the requirement of a written conveyance under copyright law. Section 105. If copyright law doctrines on a work for hire apply, they control 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 stands for the proposition 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 for a transfer of ownership of rights in a completed product or program because in that case 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 work in progress and working drafts, then by agreement those are the contractual subject matter. They are identified to the contract when created, where 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.

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".

Comments:

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 that 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, who has 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 that 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 entire terms and context of the transaction. In general, title does not vest in the licensee if the license places 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).

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 in a license 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 or other distribution. Thus, a license of a manuscript to a publisher contemplating production of the manuscript as computer information for sales to others, reserves title only to the delivered copy and not to 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, distribution is

contemplated, but in the form of a license and not a sale of copies. In any case, of course, the agreement controls and express terms on this issue 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

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".

Official Comments:

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 – 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 therefor 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. *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 RIGHTS.

Uniform Law Source: Uniform Commercial Code: Section 2-210; 2A-303 (1998 Official Text) .

Definitional Cross References. Section 102: "Contract"; "Contractual use term": "Party"; "Rights"; "Term"; "Transfer".

Official Comments:

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 A DELEGATE; SUBCONTRACT

Uniform Law Source: Section 2-210; Section 2A-303 (1998 Official Text).

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

Official Comments:

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.

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".

Official Comments:

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.

SECTION 507. FINANCING WHERE FINANCIER DOES NOT BECOME LICENSEE.

Definitional Cross References: Section 102: "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor".

Official Comments:

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.

2. *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.

3. *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.

Definitional Cross References: Section 102: "Financier"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Record."

Official Comments:

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

Definitional Cross References: Section 102: "Consumer"; "Financier"; "Financial accommodation contract"; "License"; "Licensee"; "Term."

Official Comments:

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.

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."

Official Comments:

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: MISCELLANEOUS RULES.

Definitional Cross References: Section 102: "Financier"; "License"; "Licensor"; "Record".

Official Comments:

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.

SECTION 601. PERFORMANCE OF CONTRACT IN GENERAL.

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".

Official Comments:

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.

Definitional Cross References. Section 102: "Access contract"; "Access material"; "Agreement"; "Contract"; "Deliver"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Record"; "Transfer."

Official Comments:

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.

Definitional Cross References. Section 102: "Agreement"; "Information"; "Party"; "Record". Section 114: "Reasonable time."

Comments:

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

Definitional Cross References. Section 102; "Agreement"; "Delivery"; "Information"; "Licensee"; "Party".

Official Comments:

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.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Notice"; "Party"; "Term"; "Termination."

Official Comments:

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 dealt with in Section 816 which requires a right to cancel, notice and compliance with other substantive conditions.

> **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.

SECTION 606. COPY: DELIVERY; TENDER OF DELIVERY.

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"..

Official Comments:

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.

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."

Official Comments:

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 is consistent with Section 601 and 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 a default rule that is subject to contrary agreement, including the effect of applicable usage of trade. In many computer information transactions, the commercial context and the agreement of the parties alters this expectation. For example, an agreement that involves payment of royalties alters the rule in that royalties cannot accrue until use of the licensed information occurs. In such contracts, payment is due as agreed. Agreement for this purpose can be found in express terms as well as in the actions of the parties or the commercial circumstances.

SECTION 608. COPY: RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

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".

Official Comments:

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.

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".

Official Comments:

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.

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 114: "Reasonable time." Section 701: "Breach".

Official Comments:

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.

3. *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 constitutes a reasonable time is discussed in Section 114.

SECTION 611. ACCESS CONTRACTS.

Definitional Cross Reference: Section 102: "Access contract"; "Agreement"; "Contract"; "Contractual use term"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Person"; "Software"; "Term".

Official Comments:

1. *Scope of the Section.* This section establishes default rules for access contracts.

2. *Nature of an Access Contract.* There are several types of access contracts. In one, access and agreement occur at the same time; there is no on-going relationship. This kind of access contract is like visiting a store: assuming a contract is made, the customer is bound by the contractual rules in effect on the date of the visit. There is no continuing contract or 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 AGREEMENTS.

Uniform Law Source: Restatement (Second) of Torts § 299A. Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Information"; "Licensee"; "Licensor"; "Person"; "Term".

Official Comments:

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.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Merchant"; "Party"; "Person"; "Receive"; "Return"; "Term".

Official Comments:

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).

SECTION 614. RISK OF LOSS OF COPY.

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.

Official Comments:

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.

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 114: "Reasonable time."

Official Comments:

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.

4. *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.

SECTION 616. TERMINATION; SURVIVAL OF OBLIGATIONS.

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".
Official Comments:

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.
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".
Official Comments:

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.

a. 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.

b. 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.

Definitional Cross References. Section 102: "Copy"; "Contract"; "Court"; "Electronic"; "Information"; "Informational Rights"; "License"; "Licensee"; "Party"; "Person"; "Term"; "Termination".

Official Comments:

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) which 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 ends.

SECTION 701. BREACH OF CONTRACT; MATERIAL BREACH.

Uniform Law Source: Restatement (Second) Contracts § 241(1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use term"; "Party"; "Term".

Official Comments:

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 113(b). 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.

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 114: "Reasonable time."

Official Comments:

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 (b) 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 (b) 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 (c), 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 (d), 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.

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 114: "Reasonable time." Section 602: "Enable use". Section 701: "Material breach".

Official Comments:

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.

SECTION 704. COPY: REFUSAL OF DEFECTIVE TENDER.

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 114: "Reasonable time."

Official Comments:

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.

Definitional Cross References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Informational Rights"; "Party"; "Seasonably".

Official Comments:

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.

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 114: "Reasonable time."

Official Comments:

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 which 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.

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 114: "Reasonable time."

Official Comments:

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.

b. *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.

SECTION 708. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

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 114: "Reasonable time."

Official 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.

Uniform Law Source: Uniform Commercial Code: Section 2-610.

Definitional Cross References. Section 102: "Aggrieved party"; "Contract"; "Notify"; "Party". Section 114: "Reasonable time."

Official Comment: This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text).

SECTION 710. RETRACTION OF ANTICIPATORY REPUDIATION.

Uniform Law Source: Uniform Commercial Code: Section 2-611.

Definitional Cross References. Section 102: "Aggrieved party"; "Cancel"; "Contract"; "Party".

Official Comments:

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 801. REMEDIES IN GENERAL.

Uniform Law Source: Uniform Commercial Code Section 2A-523.

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use term"; "Information"; "Party".

Official Comments:

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.

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 114: "Reasonable time". Section 701: "Material breach".

Official Comments:

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)(48). 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. See *Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992). 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 engaged in an infringement. When parties agree to this type of remedy limitation, that term should be enforced. In a consumer contract, a contract term that

prohibits cancellation does not alter the consumer's rights, since it still retains any and all rights to sue for damages or to refuse the tendered product.

SECTION 803. CONTRACTUAL MODIFICATION OF REMEDY.

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".

Official Comments:

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 112, 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.

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".

Official Comments:

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, while a damage limitation caps recovery to a stated amount, but does not permit that recovery if facts do not support damages in the amount of the stated maximum. Damage limitations are governed under Section 803.

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 are limited by other agreed terms. For example, if a contract excludes consequential damages, the aggrieved party remains bound by that exclusion even if the liquidated damages term is unenforceable.

4. *Other Terms.* If a term is not a liquidated damage clause but is a limitation on damages, then Section 803 governs, not this section. 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. It limits recovery but does not permit recovery if facts do not support damages in the amount of the stated maximum.

SECTION 805. STATUTE OF LIMITATIONS.

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".

Official Comments:

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 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 that are 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 state 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. In reference to an alleged breach of warranty, generally this occurs on delivery of the information or service, even if the performance defect does not become apparent until much later. Warranties are breached or not on delivery of the warranted subject matter.

In some cases, 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) applies this language according to its terms. Breach of the warranty occurs if a defect appears within that 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.

Uniform Law Source: Uniform Commercial Code: Section 2-721 (1998 Official Text).**Definitional Cross References.** Section 102: "Contract"; "Information".

Official Comment: Follows Article 2 of the Uniform Commercial Code (1998 Official Text).

SECTION 807. MEASUREMENT OF DAMAGES IN GENERAL.

Definitional References. Section 102: "Aggrieved party"; "Agreement"; "Consequential damages"; "Contract"; "Direct damages"; "Information"; "Informational content"; "Party"; "Present value"; "Published informational content".

Official Comments:

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 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.

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".

Official Comments:

1. *Scope of the Section.* This section states how to measure damages for a licensee if the licensor breaches the contract. A licensee may choose among the alternatives, subject to the prohibition on double recovery. 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. 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.

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".

Official Comments:

1. *Scope and General Structure of the Section.* This section states how to measure damages for a licensee if the licensor breaches the contract. A licensee may choose among the stated alternatives, subject to the prohibition on double recovery. Under Section 807, damages awarded with reference to future events are based on present value at the time of the award.

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) 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 losses 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.

a. *Lost Value in Accepted Performance.* Paragraph (a)(1)(A) provides for recovery for a performance accepted when the acceptance is not revoked. 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 in an appropriate case and except as limited by the agreement or this Act, including Section 807. If proven with reasonable certainty, consequential damages can include lost profits. See Section 102, comment 11.

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 should consider to what extent this second transaction defines market value in light of differences in the terms of the license and the nature of the software and other relevant variables. The replacement is not a cover because of the differences in the contract terms on duration of the license.

Illustration 2: Same facts as in Illustration 1, but after breach LE obtains a license for LR software from an authorized distributor (Jones) 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 that the difference is $150,000. LE recovers that amount as direct damages, along with any recoverable incidental or consequential damages.

SECTION 810. RECOUPMENT.

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".

Official Comments:

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.

SECTION 811. SPECIFIC PERFORMANCE.

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".

Official Comments:

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. This provides an efficient means for parties to avoid loss if one party, by not performing, attempts to convert a contract obligation into an obligation to pay damages rather than perform. 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, however, 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. LICENSOR'S RIGHT TO COMPLETE.

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."

Official Comments:

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. 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. LICENSEE'S RIGHT TO CONTINUE USE.

Definitional Cross References. Section 102: "Cancel"; "Contract"; "Contract fee"; "Contractual use term"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Term".

Official 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. This section does not create or independently make the terms enforceable.

SECTION 814. RIGHT TO DISCONTINUE ACCESS.

Definitional Cross References. Section 102: "Access contract"; "Agreement"; "Party"; "Person". Section 701: "Material breach."

Official Comments:

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.

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".

Official Comments:

1. *Scope of the Section.* This section applies only to licenses that are canceled for breach. The aggrieved party has a right to recover the 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).

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. These correspond to Article 2A and Article 9 of the Uniform Commercial Code (1998 Official Text), but are limited by Section 816. Self-help cannot be used unless there is a cancellation for breach and the self-help does not "breach the peace" or create a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information. Article 9 decisions are relevant on what is a breach of the peace.

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 self-help 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 cannot exist if the information has been so commingled as to be unidentifiable. This includes, for example, 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. ELECTRONIC SELF-HELP.

Definitional Cross References. Section 102: "Cancellation"; "Consequential damages"; "Computer information"; "Copy"; "Court"; "Electronic"; "Incidental damages"; "Information"; "License"; "Licensee"; "Licensor"; "Notice"; "Party"; "Person"; "Record"; "Term". Section 112: "Manifesting assent". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section restricts the right of a licensor under this Act to use electronic means to prevent use of computer information after material breach and cancellation of a license. Prior law on use of electronic measures to enforce remedies on breach is unclear. See, e.g., *North Texas Preventive Imaging v. Eisenberg*, No. SA CV 96-71, 1996 U.S. Dist. LEXIS 19990 (Aug. 19, 1996); *American Computer Trust Leasing v. Jack Farell Implements Co.*, 763 F. Supp. 1473, aff'd, *American Computer Trust Leasing v. Boerboom*, 967 F.2d 1208 (8th Cir. 1992); *Franks & Sons, Inc. v. Information Solutions, Inc.*, No 88-C-1474-E, 1988 U.S. Dist. LEXIS 18646 (Dec. 8, 1988).

This Act does not alter rights arising under Uniform Commercial Code Articles 9, 2 or 2A. Also, the issue may be affected by federal law under the Communications Privacy Act and under the Copyright Act. See also 18 U.S.C. §1030

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.

2. *Nature of the Restrictions.* Electronic self-help is an efficient means of enforcing rights that may be vital to protect the many small licensors that participate in the modern economy, but the remedy creates risk of

abuse that require restrictions that ensure that there is an opportunity to resolve issues in court before electronic self-help occurs. The restrictions created by this section include:

- a requirement of assent in the original agreement to the *term* regarding availability of the right;
- a requirement of no less that 15 days notice before exercise of the right;
- a prohibition on any exercise of the right in certain cases, including any case where there is a threat of personal injury or severe harm to the public interest; and
- a non-waivable right to consequential damages for any wrongful use of electronic self-help.

a. *Term of Agreement.* Under this Act, electronic self-help is not permitted unless a term of the license expressly authorizes it and the licensee manifests assent to that term. Assent to the term requires that there be action with respect to the term itself, not merely general assent to the license. The requirement thus ensures that the term will be brought to the attention of the licensee. The licensee, of course, if free to refuse to consent to the term and this refusal, in itself, precludes electronic self-help.

In addition to providing notice that electronic self help is authorized by the contract, the term must specify the person designated by the licensee to whom notice of intended use of electronic self-help is to be sent. This includes designation of an office, such as the office of general counsel, as the designated recipient. The requirement that the licensee designate a person (as well as a method and place for) to whom notice of the intended use of self help is to be given helps to ensure that the licensee is aware of the electronic self help provision and that the self-help notification will be received by an agent who is capable of properly reacting to the notice.

b. *Notice of Exercise.* Under subsection (d), even if authorized by the license, electronic self-help cannot be used unless the licensor gives at least 15 days notice of its intent to exercise the right. The notice must state the claimed breach on which the right is based and the name and location of a person to which the licensee can communicate regarding the problem. The notice period serves several purposes. It ensures that the licensee will be aware of the risk of electronic self-help with sufficient time to react. The reaction may be to attempt to solve the problem. If the breach is cured, self-help can no longer be used. The reaction may be resort to the courts to forestall use of the remedy. Also, of course, if the licensee elects not to contest the issue, it will be able to make necessary, lawful adjustments to minimize the effects of its breach on its own operations.

c. *Exercise Prohibited.* Electronic self-help is exercised pursuant to Section 815(b) and, thus, cannot occur unless the conditions of that subsection are met. There can be no electronic self-help where a breach of the peace would result or where there is a threat of foreseeable damage of personal injury or significant physical damage to property other than the licensed information. In addition, under subsection (f), electronic self-help is barred if there is reason to know its use will result in substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third parties not involved in the dispute. For example, self-help cannot be used where the licensed software is integral to the funds transfer or payment systems of a banking institution, where the software involves air traffic control, life support systems, or where it pertains to national security systems. In such cases, the remedy of electronic self-help threatens disruption that far exceeds the benefits of allowing its use.

If electronic self-help is prohibited, the licensor's remedy is by judicial action. This section gives each party a right of prompt access to court. If a breach justifies cancellation, remedies under Section 815 are appropriate.

3. *Damages for Wrongful Use.* Under subsection (e), wrongful use of electronic self-help is a breach of contract entitling the aggrieved party to damages. It may also entitle the injured party to other remedies outside the scope of this Act.

Under this Act, in the event of wrongful use, the aggrieved party may recover direct, incidental and consequential damages as appropriate. In three cases, the right to consequential damages cannot be altered by agreement, whether by a term that excludes or limits consequential damages. One is when the licensor had reason to know that use of the electronic self-help remedy risked the type of general public or third party injuries referred to in subsection (f). The second is when the licensee gives a good faith notice of the general nature and magnitude of damages that might result from self-help. The notice must be in good faith, but the section does not bind the licensee only to those damages indicated in its notice. The third is when the licensor fails to give notice before exercising self-help.

Although Section 816 identifies certain conduct that constitutes wrongful use of electronic self-help, such as the exercise of electronic self-help in situations where there may be severe harm to the public interest,

other types of conduct may also be wrongful. If a licensor is not entitled to cancel the license, use of electronic self-help is wrongful. Whether the licensor is entitled to cancel is determined by Section 802.

4. *Expedited Hearing.* Ultimately in cases of doubt about the propriety of electronic self-help, the matter should be decided by the court before the fact. Subsection (g) gives each party a right to prompt consideration of the issue in court.

5. *Non-waiver.* The rights and obligations under this section cannot be waived by agreement before breach, except for additional provisions that are more favorable to the licensee. A contractual provision completely precluding use of electronic self-help is more favorable to the licensee and is expressly allowed under this section.