NOTICE

Under Conference procedures, the responsibility for Official Comments rests with the Reporter and Chair of the Drafting Committee. However, suggestions to the Chair and the Reporter are welcome. The initial draft of Official Comments is posted below. Any suggestions should be received on or before November 1 to be assured of consideration by the Chair and Reporter. Also posted is the final styled Uniform Computer Information Transactions Act (UCITA). Please e-mail any suggestions to:

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DRAFT

FOR DISCUSSION ONLY

COMMENTS

TO

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

OCTOBER 15, 1999

SECTION 101. SHORT TITLE.
SECTION 102. DEFINITIONS.
Official Comments:

1. "Access contract." An access contract is an agreement that authorizes access to an electronic facility, including a computer or Internet site, authorizes obtaining information from that type of facility, or allows an equivalent form of access. The term does not include contracts granting a right to enter a building or other physical location, or the purchase of a television, radio, or similar goods merely to 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 allowing 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. Thus, when a licensee of a spreadsheet uses it to interact with and obtain information from computers on the licensee's network, that is not an access contract because the licensee is supplying all programs and systems. However, another person can provide the equivalent of access, and thereby create an access contract, even though the information is only used in the licensee's system. For example, an on-line data provider may elect 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 the contract allows a copy of the database to be loaded into the user's system, but the data are intermittently updated with data from remote systems. On the other hand, if a software publisher simply allows downloading of 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, be able to give 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.

2. "Agreement". This term is from Uniform Commercial Code § 1-201 (1998 Official Text). As in Article 1, whether an agreement has legal consequences is determined by this Act or other applicable law. 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 of the parties is determined by the language they 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 effect5 is determined by this Act. Section 114(d).

3. "Attribution procedure." An "attribution procedure" is a procedure to identify the person who sent an electronic message, or to verify the absence of changes in its content, agreed to or adopted by the parties or otherwise established by applicable law. The agreement may occur between the two parties or through a third party. For example, the operator of a multi-database system which includes information provided by third parties, may arrange with database providers and customers for use of a particular attribution procedure. Those arrangements, although made with the third party, establish an attribution procedure for purposes of this Act between the customers and the individual database providers. The substantive provisions related to attribution are set out in Sections 108 and 213.

4. "Authenticate." This term replaces "signature" and "signed." A similar change is in Uniform Commercial Code Article 9 (1998 Official Text). The definition makes clear that qualifying electronic systems are adequate for what once were paper-based requirements. The definition is technologically neutral.

Any signature under prior law is an authentication under this Act. Like a signature, an "authentication" may express various effects. The ordinary effects are (i) accepting an agreement, and (ii) adopting of a record or specific term(s). Authentication may serve other functions such as confirming the content of the record or identifying the person. What effects are intended are determined by the context and objective indicia associated with that context. There is no requirement that the authentication be in a record retained by a party.

Authentication may be on, logically associated with, or linked to the record. In 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. It can be electronic. However, there must be an association supporting the inference that the authenticating party intends to adopt or accept the associated or referenced record. "Referring to" or "linked to" captures a similar concept applicable to the Internet and similar systems, indicating that it is adequate to have an electronic connection, such as an Internet hyperlink.

Authentication includes qualifying use of any identifier such as a personal identification number (PIN) or a typed or otherwise signed name. It includes qualifying actions and sounds such as encryption, voice and biological identification, and other technologically enabled acts. A voice print, voice recognition, or similar technology is adequate if, as with the other options, done with the proper intent In all cases, of course, establishing the efficacy and the commercial reasonableness of attribution is covered by Sections 108 and 213.

5. "Automated transaction." This term refers to contracts formed automatically and which are effective even though one or both parties is represented by an electronic agent instead of a human being (an individual). Operations of automated systems can create binding legal obligations for those who use them for that purpose. It may be that in some systems a human might actually review a particular transaction or aspect of it before the transaction is completed, such as when there is a problem with the system. If such review is made other than in the ordinary course, the transaction still can qualify as an automated transaction.

8. "Cancellation." This definition follows the 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.

9. "Computer". The definition of "computer" draws on definitions in federal and state criminal, tax and other statutes regarding computers. The definition should be applied by the courts with common sense. The term does not include a traditional television set, radio or toaster even though it includes a computer chip. It might include new generations of machines that combine computation, word processing, Internet access, and traditional broadcast reception. Under various state statutes, unauthorized access to a computer is a crime, but while the definition of computer in those statutes is typically broad, courts exercise discretion and common sense in applying the definition which should also apply here. Thus, while an automobile might contain a computer or several computers, the automobile is not itself a computer.

10. "Computer information." This term focuses on information that is in an electronic form that is obtained from, accessible with, or useable by, a computer; it includes the information as well as a copy of it (e.g., diskette containing the information) and its documentation (including non-electronic documentation). The reference to "electronic" by that definition includes digital or information in a form having similar capabilities covering analog and future computational technologies, eliminating the possibility that a limit to "digital" technology would limit the Act 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. The term does not generally include printed information or other non-digital formats in which information is encompassed, but which are not directly useable in computers.

11. "Computer information transaction." This term establishes the scope of this Act. (Section 103) It requires an agreement involving computer information. 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 it to do so. An agreement to use e-mail to communicate about a contract for shipment of petroleum does not bring that transaction within this definition. A contract for an airline ticket is not a computer information transaction simply because the ticket may be in digital form. The subject matter is not the computer information, but the service – air transportation from one location to another. The term does not cover the many cases in which a person provides computer information to another for purposes of another transaction, such as making an employment or loan application.

The term includes transfers of computer programs and software development contracts. A transaction is not for the "creation" of computer information in the sense intended here where the contracted-for activities are merely secretarial or clerical in nature. The computer information must be created, i.e, produced through some business, professional, artistic, or imaginative effort.

11. "Computer program." The first sentence parallels copyright law. 17 U.S.C. § 101 (1998). The second sentence distinguishes between computer programs as operating instructions and

“informational content” communicated to human beings. As used in this Act, “computer program” refers to functional and operating aspects of a digital or similar system, while “informational content” refers to output that communicates to a human. For any issue requiring this distinction, the answer lies in whether the issue concerns operations (program) or communicated content (informational content). This 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 obligation.

13. “Consequential damages.” This is from Uniform Commercial Code § 2-715(2)(1998 Official Text). The definition does not specifically exclude losses that could be avoided by mitigation through cover or otherwise, but a duty to mitigate is an express limit on all damage claims under Section 807; no change in law is intended. 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, where recovery is based on the idea of lost volume, the damages measure itself assumes that another transaction is not a substitute for the first (lost) transaction and 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 contracted performance, such as lost profits, damage to reputation, lost royalties that would have been accrued from a licensee’s proper performance, lost value of a trade secret from wrongful disclosure or use, lost income from wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss 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. They must have been foreseeable. For the injured party to recover for economic losses resulting from its special circumstances, the party in breach must have had notice of those circumstances at the time of contracting. In contrast, losses from ordinary general requirements can often be presumed to have been within the contemplation of the other party. 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 (e.g., property not within the contract itself) may be consequential damage. The definition follows Article 2 of the Uniform Commercial Code regarding personal injury or property damage by requiring proof that the damage “proximately” resulted from the breach. 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. Also, proximate causation may not exist where damages result from misuse or a use that violates clear warnings against the particular type of use.

The term does not include direct damages.

14. "Conspicuous." This definition is from Uniform Commercial Code § 1-201(10) (1998 Official Text), but adjusts the standard to reflect modern practice, including electronic commerce. Whether a term is conspicuous is determined by the court. Section 114. This Act also uses the concept of manifesting assent to a contract term in some cases as a means of ensuring that a term is called to the attention of a reasonable person. “Conspicuous” does not relate to or change any requirement of any other law that specifies the content, timing or manner of disclosure of information or warnings.

A term is conspicuous if it is so positioned or presented that the attention of an ordinary individual reasonably ought to have been called to it. Often, conspicuous terms are presented in a record, but the concept is not so limited; it includes verbal or automated voice presentation that meets the basic standard. 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 an ordinary system or method of receiving or reviewing such messages unless, of course, the provider of the term knows that the recipient is using a different system. If a transaction involves use of 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 delineates some methods of making a term conspicuous. The policy behind requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term on how that result can be achieved). The illustrations establish safe harbors intended to reduce uncertainty and litigation. The illustrations are not exclusive. Outside the illustrative safe harbors, the general standard governs.

The definition updates prior law under the Uniform Commercial Code and recognizes methodologies relevant in electronic commerce. Paragraph (A)(ii) contemplates setting off the term or a label by symbols so that conspicuous formatting can be reliably transferred in electronic commerce (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 a 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 term. The access must be from 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 record is prominently referenced does not automatically mean that a particular term in that record is conspicuous. Good faith in the performance of these provisions is required. Section 114. If other law requires specific content, location, or timing of disclosure, those requirements apply under Section 105 and Section 114.

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 is displayed in a way that precludes the user from proceeding without assenting to or rejecting this condition, suffices.

15. “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 particular transaction is determined at the time of contracting. It depends on the then intended use of the information. Many “personal” contracts are not consumer contracts (e.g., stock broker employee of a brokerage house personally acquiring software to monitor client investments). The definition distinguishes profit making, professional or business use, from non-business, personal or family use. Only when the contract is primarily for the latter is there a consumer contract. The profit-making standard for determining whether a transaction is a consumer contract is followed in many 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 (excluding from the act’s protection of consumer credit, extensions of credit “primarily for business, commercial, or agricultural purposes”). A purpose stated in the agreement would ordinarily determine the purpose of the transaction for this definition.

16. “Contract.” This is from Uniform Commercial Code § 1-201(11) (1998 Official Text).

17. “Contract fee.” This term includes any monetary payment required under a contract.

18. “Contractual use term.” This term includes any enforceable restriction that defines or limits access to, use or disclosure of information or informational rights created by a contract under this Act. Use terms relate only to the copies and information provided under the contract. Unless otherwise expressly indicated, a contractual use term does not govern use of the same information lawfully obtained from other sources. The be within this definition the use restriction or permission must come from a contract. The term does not include limitations imposed by property or regulatory law. The term must be enforceable under this Act and other law to be within the definition. Thus, if trade secret law precludes enforcement of a particular non-competition term, that term is not a contractual use term to the extent of its unenforceability.

19. “Copy.” This term refers to the media containing information. In this Act, the term is used with reference to questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, in appropriate cases, the time during which the information is fixed on a media can be temporary if this fulfills the purpose of the performance. This Act does not deal with the copyright law question of whether a brief reproduction in computer memory is an infringement. *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).

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

21. "Course of performance." This is from Uniform Commercial Code § 2-208 (1998 Official Text). Conduct prior to the agreement is covered under the related term "course of dealing." Both are part of the commercial approach to understanding contracts based on practical interpretation adopted in this Act. The parties themselves know best what they meant by their agreement and 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. See Uniform Commercial Code § 1-205, *comment* 2 (1998 Official Text).

22. "Delivery." Delivery can occur either through transfer of possession of a tangible copy or by electronic transfer. In electronic transfers, a copy may not *move* from one location to another. Transfers often entail copying the information into another location or making it available for use in a common system shared or accessible by the recipient and the person making the delivery.

23. "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 intended use of the performance or its results. Direct damages are measured by formulae in Sections 808(b) and 809(a). They are capped by the contracted-for price and 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. .

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

25. "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 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 fully equivalent to common law agency, but takes into account that the "agent" is not a human. Parties who adopt use of electronic agents are ordinarily bound by the results of their operations.

26. "Electronic Message." A message is distinguished from a "record" by the fact that it is intended to be communicated 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 for use in a common system shared by or accessible to the recipient. In effect, it is stored or generated for purposes of communicating to another.

27. "Financial accommodation contract." A financial accommodation occurs in a loan in whole or in part for information or in a lease of a copy of computer information. The recipient of the accommodation is the licensee. A security interest is not within this definition; security interests are governed by Uniform Commercial Code Article 9. An agreement under which royalties for use of information accrue over time and are paid periodically is not a financial accommodation, but simply a royalty-bearing license (or assignment) of rights in the information. The financial accommodation contract can be in any form, including in a lease of goods or a lease of software.

28. "Financial services transaction." This term includes a variety of financial system activities and transactions governed under federal and other state law and are not covered in this Act. Section 103(d).

29. "Financier." A financier is a lender or a lessor dealing with the licensee under a financial accommodation contract. The financier may have any of several relationships to licensed computer information. One relationship is that the financier obtains rights as a licensee for purposes of transfer to the eventual licensee who is also the accommodated party. This is like a finance lease under Uniform Commercial Code Article 2A, but deals with licensed computer information, rather than leased goods. A second relationship is 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 of the underlying license is not a financier for purposes of this Act. The 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.

30. "Good Faith." This definition adopts an expanded version of Uniform Commercial Code § 1-201 (1998 Official Text), conforming more to Uniform Commercial Code § 2-103(b) (1998 Official Text). It rejects the pure "honesty in fact" as the sole standard. While good faith in performance of contractual obligations or rights is an element of all contracts covered by this Act, the obligation of good faith does not over-ride 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 a party act to benefit or avoid harm to the other at the cost of advantages that it fairly has obtained for itself 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 the standards in each case are directed to different aspects of commercial conduct.

31. "Goods." This definition corresponds to proposed revisions of Uniform Commercial Code, 1999 proposed draft. It clarifies that computer information, including computer programs, are not goods for purposes of this Act. The definition does not alter definitions of goods or tangible products under any other law.

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

33. "Information." This term embraces a wide range of subject matter, but its use in this Act is limited to transactions within the Act's scope. As used here, "data" refers to facts whether or not organized or interpreted. Data is not limited to subject matter to which informational property rights attach. It includes factual data if the data are the subject of a contractual relationship. A "mask work" is defined in federal law; the term refers to a representational technology used in creation of semiconductor products.

34. "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. In that context, whether the system is a computer is not pertinent.

35. "Informational content." This is information whose ordinary use involves communication of the information to a human being (individual). This is the information humans read, see, hear and otherwise experience. For example, if an electronic database of images includes the images and a program enabling display or access to the images, the images are informational content while the search program is not. The Westlaw search program is not informational content, but the text of cases and statutes is. The term applies based on the nature of the information 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.

36. "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 and, 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.

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

38. "License." A license is an agreement entailing a limited or conditional contractual transfer of information or a grant of limited or restricted contractual rights or permissions to use information. A contract right entails an affirmative commitment that a party can engage in a specific use, while a contract "permission" means simply that the licensor will not object to the use. Either can be the basis of a license. No specific formality of language is required. For purposes of this Act, the term includes

consignments of copies of information, but does not otherwise alter the 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 a unrestricted sale of a copy; such a sale lacks express contractual restrictions on use. Similarly, a "copyright notice" which merely states the rights or restrictions in a first sale under copyright law does not change an unrestricted sale of a copy into a license. To be a license, the contract must control the rights. A license exists if a *contract* grants greater privileges than a first sale, restricts privileges that might otherwise exist, or deals with other issues of scope of use. Whether such terms are enforceable is determined under this Act and applicable federal law. However, this Act does not affect the enforceability of copyright notices that are not part of a contractual relationship.

The existence of a license does not depend on whether the contract transfers title of a copy. Title to a copy (a material object) is distinct from questions about the extent to which use of the information is controlled by contract. The analysis in *DSC v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999) indicates how the issues may be separable. Restrictions in a license that are materially inconsistent with ownership of a delivered copy may result in the holder of the copy not being treated as the owner of the copy.

A license is a contract. To create contractual terms of license, the requirements for an agreement must be met. The term does not include the myriad of 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. These casual exchanges do not involve a contractual relationship. Thus, when a friend approaches another and offers to describe the marital problems of a third party if the other does not "tell anyone else," that exchange is not a license under this Act because it is not a contract and because it is not a computer information transaction.

39. "Licensor" and "Licensee." These definitions refer to the transferee and transferor in any contract covered by this Act, whether or not the contract is a license. In the frequent situation 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.

40. "Mass-market license" and "mass-market transaction." The term "mass market license" is a new term and the definition must be applied in light of its intended and limited function. That function is to describe small dollar value, routine and anonymous transactions involving information that is directed to the general public and the transaction occurs in a retail market available to and used by the general public. A 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 some transactions between businesses in a retail market. It does not include ordinary commercial transactions between businesses using ordinary commercial methods of acquiring or transferring commercial information such as with purchase orders or on terms offered to businesses but not to consumers.

A "mass-market" transaction is characterized by 1) the *market* in which the transaction occurs, 2) the *terms* of the transaction, and 3) the *nature* of the 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 market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract, the general public as a whole. They are characterized by the fact that, while retail merchants make transactions with other businesses, a predominant type of transaction involves consumers. In a retail market, most transactions involve relatively small quantities, non-negotiated terms, and transactions to an end user rather than a purchaser who plans to resell the acquired product. The products are available to anyone who enters the retail location and pays the stated price.

The computer information must be of a type aimed at the general public as a whole, including consumers. This does not include information products 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. In determining when the definition applies, courts should reflect the purpose of the definition which is to avoid artificial distinctions among business and consumer purchasers in an ordinary retail market. The transactions covered do not include specialty computer 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 intends 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 information, and therefore the transaction, outside the concept of a mass-market transaction.

The transaction must be with an end user. An end user licensee is one that generally intends to use the information or the informational rights in its own internal business or personal affairs. An end user is not engaged in the business of reselling, distributing, or sub-licensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information commercially available to third parties.

If the licensee is not a consumer, the terms and quantity in the transaction must be consistent with an ordinary transaction in the retail market. To provide further guidance, subsection (B)(iii) expressly excludes several types of transactions commonly not associated with routine retail transactions. The definition excludes a transaction for redistribution or for public display or performance of a copyrighted work. These are never a mass-market transaction because they involve no attributes of a retail market. In on-line contracting, consumer contracts are mass-market transactions, but business to business transactions are not. By excluding on-line transactions not involving a consumer, the definition follows an important principle. In the new on-line commerce, it is important not to regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer interests.

41. "Merchant." This 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 did not actually engage in prior transactions of the type involved. The term "merchant" has roots in the "law merchant" concept of a professional in business. This status may be based upon specialized knowledge as to the information, specialized knowledge about business practices, or specialized knowledge as to both. Which kind of specialized knowledge may be sufficient to establish merchant status is indicated by the nature of the provision in which the term is used. In this Act, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Section 401(a) and (e), and Section 403, however, require a more focused expertise in the particular type of information involved.

The reference to attributing knowledge by the employment of an agent confirms that merchant status does not always depend on the principal's knowledge. Similarly, an organization is charged with the expertise of its employees and even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel familiar with business practices.

42. "Non-exclusive license." In this type of license, the licensor does not foreclose itself from making additional licenses involving the same subject matter and scope. A non-exclusive license has been described as nothing more than a promise not to sue. While it often has more commercial aspects, a license does not convey property rights to the licensee.

43. "Notice." This 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 notice may cease to be effective is not covered by this Act, but is governed by other law.

44. "Notify", or "give notice". This 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. When receipt is the relevant standard, that is stated in the statute.

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

46. "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 to a natural human being, whether acting in a representative capacity or solely on it's the individual's own behalf.

47. "Published informational content." This type of information is the most closely associated with free expression. In previous technology, this would be newspapers, books, records and the like (which are outside the scope of this Act). For purposes of the scope of this Act, the term applies to computer information. 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 within this definition 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

programs, since 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 affirmatively supply selected portions of a larger database to individual licensees based on programmed parameters.

The term does not include informational content tailored by individuals (human beings) acting on behalf of the licensor to meet a specific recipient's needs or 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 that the licensor provides and that the licensee expects that the licensor will tailor the information to the client's business or personal needs. The 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 licensee such that reliance is justified and the party 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 of providing such content. 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 information service because they believe it relevant to their commercial or personal needs.

48. "Receive." This definition distinguishes between performances and notices. As to performances, it corresponds to Uniform Commercial Code § 2-103 (1998 Official Text). With respect to notices, "receive" includes circumstances in which a message is delivered to a place designated by the recipient even if that place is under the control of a third party. Arrival at a private post office box is receipt by the addressee even though the addressee may not remove or otherwise obtain the message until later. Similarly, receipt of a message at an electronic mail address, even though on a third party system, constitutes receipt as to the ultimate addressee, if that electronic mail address was held out as a place for receipt of such messages. The definition is met only if the person holds out a location or system as a place for receiving notices of a kind and the message is in fact of that kind. Outside of electronic commerce, parties frequently require that notice be delivered or sent to a particular address or person. The same is true in electronic commerce. If parties agree to send notice of default or of a change in terms to a particular e-mail address, receipt at that location suffices, but delivery to a general e-mail address does not.

In all cases, the message must be capable of being processed. This refers to processing in the type of system in its general, reasonably expected configuration and not to the details of an atypical configuration known or knowable only to the party operating the system. The message must be capable of interacting with an ordinary system of the particular type. Whether the message actually is processed is not relevant to receipt; similarly, if a letter is placed in a party's post office box it is received.

49. "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.

50. "Release." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information. A release is a form of a license. The term is used in this Act to identify a class of transactions in which the sole purpose of the agreement is to permit use and which agreements are often made on a less formal basis than a typical commercial license.

51. "Return." "Return" refers to acts restoring a party to its initial position if the party has rejected a contract contained in a record made available to it after the party committed to, or completed, an obligation to pay or deliver and, as a result of rejecting the contract, the transaction will not be carried forward. A return requires re-delivery to the licensor or its agent of information already delivered that would have been covered by the rejected record. When the licensee is the party who rejects the contract, "return" consists of a reimbursement of fees paid on re-delivery of all copies of the information and documentation. In both cases, the information and documentation must be re-delivered in their original condition. Of course, by consent or by agreement the copies can be destroyed in accordance with instructions.

Return is not a remedy for breach. It is a right that arises under this Act or by agreement if a party refuses a proffered contract and it has previously committed to, or paid the contract fee. Making a return available in such cases allows the party a meaningful opportunity to decide to accept or reject that contract. Section 112. The right to return expires if the party assents to the license. Of course, if a party accepts a contract but the information is defective, the aggrieved party may have a right to reject the product and obtain restitution of the contract fee.

Return must be sought within a reasonable time. What constitutes a reasonable time depends on the contract or, if the contract is silent, the facts and circumstances of the commercial context. Section 114.

The definition deals with the difficult problem of administering a return right in "bundled" information products (products that include separate items of information transferred as a whole for a single fee). Pricing in bundled transactions is not based on a mere sum of the fees required for each product in an unbundled setting and, often, include information products that are provided for no charge, even though the information may have a discernible price in other transactions. If the products are separately priced, a return is for the contract fee for the item in question. Otherwise, return must be of the entire bundled product and reimbursement of the entire price, if any is attributed to the bundled software. For the former, the price must be separately stated in the sense that the agreement identified an amount for the particular information. A court cannot unbundle the products and estimate appropriate pricing in what is often a complex distribution arrangement premised on the bundling of multiple products.

52. "Scope." This term refers to contract terms that define the central elements of a license relating to aspects of use of the information. Scope provisions in a license define the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read a contract to determine that. That is not the case in computer information. The same information has entirely different commercial characteristics depending on the scope of rights granted. For example, a license that allows use of a word processing program in a single computer is not the same product (even though the copy of the information may be exactly the same) as a license to make and distribute copies of that word processing software throughout a region. Further, neither license is the same as a license that transfers the a copy under a license to use it for three days at home. They are all different even though the software is identical, and in each case the differences can only be determined by reading the license.

53. "Send." This definition adapts Uniform Commercial Code § 1-201(38)(1998 Official Text) to cover electronic notices. In modern 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 make it available in a system shared or accessible by the recipient and the person or electronic agent creating the message. 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 the details of an atypical system configuration. 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. Use of the phrase "in addition" makes it clear that the electronic sending must also comply with relevant criteria for other media, such as in use of a commercially reasonable carrier. Finally, 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.

54. "Standard form." The definition refers to forms, not standard terms. A form consists of record containing a <u>group</u> of terms prepared for frequent use as a group. 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.

55. "Term." This 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 in reference to an agreement.

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

57. "Transfer." This word is used with respect to conveyances of contractual interests and 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.

58. "Usage of trade." This 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 a contract 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. This

Act rejects cases which see evidence of "custom" as representing an effort to displace or negate "established rule of law." 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 usages and for usages 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.

59. *Subsection b.* Contains references to a variety of provisions of the Uniform Commercial Code which contain definitions of additional terms used in this Act. Unless otherwise expressly indicated, the reference is to the Official Texts of the respective provisions 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:

1. *General Structure.* This section states the scope of coverage 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 forth exclusions from the Act. Subsection (e) defines "enhanced sound recording," a term used in subsection (d).

2. *Transactions in Computer Information.* This Act concerns contracts and not property rights. "Computer information transactions" are agreements that deal with the creation, modification access to, or distribution of computer information. Section 102(a)(11).

As stated in subsections (b) and (c), with limited exceptions, 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." "Computer information" is information that is 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). Agreements can pertain to informational rights in computer information and this Act governs those contracts but does not create property rights. For example, subsection (b)(2) concerns transactions where computer information or informational rights are involved but are not the primary subject matter of the transaction. In such a case, this Act merely covers the part of the transaction involving contract issues pertaining to the computer information or rights, including all matters that can be addressed by contract and the contract's performance and enforcement, but does not pertain to the creation of property rights.

In transactions in computer information, 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 original diskette or tape unless the information remains on that media and nowhere else. In online use and distribution, there may be no tangible media involved at all.

The scope of this Act turns initially on the definition of "*computer information transaction*." The mere fact that communications about a transaction are sent or recorded in digital form does not place it 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 from one location to another. 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 in 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 whose terms 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. This Act does not apply to the many cases in which a person provides information to another person for purposes of another transaction such as making an employment or loan application.

a. *Contracts to Create or Develop Computer Information.* This Act applies to contracts to develop 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 transactions involving independent contractors, thus resolving conflicts in prior case law. The Act does not cover contracts to develop or create motion pictures, sound recordings, or broadcast programs. These are excluded by subsection (d).

b. *Computer Programs.* This Act applies to transactions involving the distribution of, or grant of a right to use, a computer program. Section 102(a)(11). These transactions are covered whether they involve a license or a sale of a copy. The difference between a license and an unrestricted sale of a copy, however, is relevant; as reflected in various provisions of this Act, a license may involve either a more substantial retention of rights by the licensor, or a greater transfer of rights, than in a sale. Most provisions of this Act apply to unrestricted sales and licenses, but others are limited to licenses. The coverage of each section in this regard is explicit in the section.

c. *Access and Internet Contracts.* This Act covers agreements involving access to or information from a computer system. Section 102(a)(39). This includes Internet and similar systems for access to or use of computer information. The Act, however, does not cover broadcast or similar distribution of programming, or distribution of digital motion pictures, sound recordings or the like and should not be applied by analogy to such transactions. Section 103(d).

d. *Digital Multimedia Works.* This Act applies to agreements for the creation and distribution of digital multimedia works. Section 102(a)(11). Multimedia products are those which, through digital technology, involve an integration of 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 a multimedia work is, 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)(39).

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 the 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, motion picture, broadcast, sound recordings). 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
- 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
- Print books, magazines, or newspapers
- Motion pictures, sound recordings, musical works
- Broadcast or cable programs.

This Act does not apply to "information," but to contract transactions (agreements regarding 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 (U.C.C.) such as Article 2 and 2A. In modern commerce, most contracts are governed by multiple sources of contract law. The consequences of a contract to produce a motion picture or distribute it are governed by Article 2, the common law of services, common law relating to information, federal and state labor law, copyright and other intellectual property law. A sale of a toaster is governed by Article 2, common law, consumer law, and various federal regulations.

This Act does not **create** "mixed contracts." 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) tailor the answer to the issue presented, the type of transaction, and the applicable commercial policies. The primary distinction is between cases where the other subject matter is governed by articles of the Uniform Commercial Code (U.C.C.) and cases involving subject matter not governed by the U.C.C.

a. *Computer Information and U.C.C. Subject Matter.* Where a transaction includes computer information and subject matter governed by an article of the U.C.C., the policy expressed in this Act is that, in the absence of contrary agreement, the codified rules of the U.C.C. should apply to its subject matter and this Act should apply to its subject matter. That principle is express in subsection (d)(6). Thus, U.C.C. Article 8, and not this Act, deals with investment securities and rights or remedies with respect to them. The same applies for Articles 4 and 4A: payment systems, checks, and funds transfers. Similarly, subsection (c) indicates that if a provision of U.C.C. Article 9 conflicts with this Act, Article 9 controls.

The primary context in which this issue arises involves transactions that include goods, as defined for Article 2 and 2A, and computer information. "Goods" is defined Section 102(b). Generally there is no overlap since computer information and informational rights are not goods. See, e.g., *United States v. Stafford*, -- F.3d --, 1998 U.S. App. Lexis 1794 (7th Cir. 1998). If there is a diskette, it is a tangible object but the information on the diskette is not a good just as the information in a book is not goods or governed by the law of goods laws even if the binding is. This Act includes the media in which computer information is fixed within the definition of computer information, and thereby avoids any conflict with U.C.C. Article 2.

When a transaction involves goods and computer information (e.g., acquisition of a computer and software), in most cases Article 2 applies to the goods, but this Act applies to the computer information. Section 103(b)(1) expresses that rule. Some courts describe this rule as the "gravamen of the action" standard. Law applicable to any part of a transaction depends on whether the disputed issue pertains to the goods or to the computer information. Each governs its own subject matter.

As noted, there are two exceptions. First, the media (e.g., tape, diskette) that is the carrier of the computer information is within this Act. This Act applies to the copy, documentation, and packaging of the computer information; indeed, these are within the definition of computer information itself. See Section 102. They are mere incidents of the transfer of the computer information.

Second, in some cases, a computer program is embedded in and sold or leased as part of goods, such as a computer program that controls timing in a car. These cases may support a narrow exception to the gravamen of the action test. 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. The approach to this issue in Uniform Commercial Code Article 9 (1998 Official Text) deals with applicability of creating and perfecting security interests under that statute and is not adopted here. The rules here center on the importance of the program and access to it in the transaction.

First: This Act applies to the computer program and the copy of it if the good in which the copy is embedded is a computer or a computer peripheral. The computer or peripheral often cannot function without the computer information (computer program). The computer information itself is important to the transaction and a commercial choice to distribute the program in embedded form, rather than in a form that requires loading into the computer or peripheral does not change the applicability of this Act. For example, the software for a medical imaging system that relies largely on software capabilities would be within this Act, whether the software is embedded in the system or loaded into it after purchase. Of course, this rule does not mean that this Act applies to the computer itself this Act only to the programs embedded in the computer or peripheral

Second: In other cases where a copy of a computer program is sold or leased as part of goods, this Act applies to the program and the copy of it 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 looks at materiality in an objective sense, centered on transactions of the type, rather than the subjective goals or intent of the particular parties. Materiality focuses on the particular good 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 particular program automated system is a small part of a transaction involving many other assets does not take it out of this Act if, as to that particular system, access to the program is a material aspect of the deal.

In determining whether using the program is a material purpose in obtaining the goods, courts should examine the overall context. Factors suggesting that access to or use of the program is material include the extent to which the program's capabilities is the dominant appeal of the product, the extent to which negotiation focused on that capability, and the extent to which the agreement makes the program a separate focus for agreed terms. Materiality is ordinarily clear if the program is separately licensed as part of the transaction. On the other hand, the fact that ordinary functions of ordinary goods may rely on a program embedded in the goods does not indicate that program is governed by this Act.

Thus, some functions of an automobile sold at retail may be operated by embedded programs; if the automobile's functionality rather than the program that operates the brakes is the purpose of the transaction, this Act would not apply. On the other hand, upstream contracts to develop or supply the program to the manufacturer are within this Act. Separately licensed programs for a digital camera that enable the camera to link to a computer are within the Act.

b. Computer Information and Subject Matter not Within U.C.C. If a computer information transaction also involves other subject matter and that other subject matter is not governed by the U.C.C., subsection (b)(2) states how to determine the extent of applicability of this Act. The basic rule is that this Act applies to aspects of the agreement concerning the computer information and informational rights but not to aspects involving the other subject matter unless, pursuant to subsection (b)(2), this Act applies because the computer information is the primary purpose of the agreement. In applying this rule, it is appropriate for courts to recognize that, unless the computer information is the primary purpose of the deal, the other subject matter will be covered by common law or other law, rather than a uniform statute.

Under subsection (b)(2) (in cases not involving U.C.C. subject matter), if computer information or informational rights is the primary purpose of a transaction, this Act applies to the entire transaction except subject matter excluded by subsection (d). Otherwise, under subsection (b)(2) this Act applies only to the contract issues pertaining to the aspect of the transaction involving computer information or rights.

Variations of this test have been used for years in cases involving a combination of 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. In doing so, the court should consider the type of transaction envisioned by the parties. While cases under Article 2 provide guidance on answering this kind of questions, 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 involved in computer 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 regulatory rules outside this Act apply to the other subject matter, 3) the extent to which clear allocation of liability risk is a concern, and 4) 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, the license which is within this Act is the primary purpose of that agreement.

The statutory test in subsection (b)(2) applies only if the transaction is not entirely excluded under subsection (d). This means that the computer information is more than de minimus and not involved simply as a method of communicating about the contract.

The rules of subsection (b) do not apply if the agreement specifies what 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. Ordinarily, a court should not apply this Act by analogy to excluded subject matter, but should refer to other law such as Article 2 or Article 2A of the Uniform Commercial Code or the common law.

a. *Core Financial Functions.* Subsection (d)(1) excludes core banking, payment and financial services activities. These are regulated by federal and state law and are largely within the scope of the U.C.C. The term, "financial services transaction" is defined in Section 102. This is an "activity" exclusion not an "entity" exclusion.. Regulations, such as federal Regulation E 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 (whether conducted by a bank or a non-bank). On the other hand, banks engage in many activities identical to computer information transaction and these transactions, when not covered by this exclusion, are within this Act. Examples could be contracts involving on-line shopping and database access.

b. *Core Entertainment and Broadcast.* Subsection (d)(2) excludes agreements relating to motion pictures, musical works, sound recordings, enhanced sound recordings, and broadcast and cable programming. The exclusion covers the traditional core activities of these industries or, in the case of enhanced sound recordings, a slightly enhanced version of a traditional activity. It is intended to be comprehensive as to those core activities and reflects the existence of a regulatory overlay for some (cable and broadcast) and the different nature of transactional issues as contrasted to computer information industries. The exclusion of agreements pertaining to motion pictures, sound recordings, and the listed broadcast or cable activities leaves liability, contract formation, and other issues to general law, including Article 2 or Article 2A of the Uniform Commercial Code, as applicable. Because these transactions differ from those within this Act, this Act should not be applied by analogy to transactions in these areas of practice.

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. The exclusion includes creation or distribution of these works in digital form. The Copyright Act and the registration system it enacts 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 new term, “enhanced sound recording”, to cover digital products that have elements slightly beyond ordinary sound recordings (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.

”Motion picture” includes motion pictures regardless of how distributed, even in digital form. These products are not governed by this Act and either Article 2 or Article 2A, along with common law, apply. For purposes of this Act, the term “motion picture” does not include an interactive computer game, multimedia product, or similar work, nor does it include audio visual effects included in such interactive works. The term refers to the work as a whole and not 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 federal Communications Act and associated regulations define the terms associated with this exclusion and the intent is to adopt that terminology as of the indicated date.

c. *Compulsory Licenses.* Subsection (d)(3) excludes compulsory licenses, such as that provided under the Copyright Act. These transactions, as the term implies, 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. 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 existing law unchanged.

e. *Voluntary Use of Computer Information.* Under Subsection (d)(5) an agreement is not within 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 submission by E-mail does not thereby bring the contract into this Act. A developer required to deliver information in a form other than as computer information, does not bring the transaction within this Act merely by electing to develop the product using digital systems.

f. *Form is Insignificant.* This Act generally applies a gravamen of the action approach for when this Act applies to its subject matter and other law governs other subject matter in one transaction. 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. Subsection (d)(5) provides a court with the basis to reach this judgment if the form of the information as computer information is insignificant (de minimis) to the deal. This is a narrow exception to the general rule, applicable where the form of the information as computer information is a trivial part of the relationship. This exception does not ask a court to contract the allocated cost of the computer information to the overall cost of the transaction. What must be insignificant is the fact that the information is provided in the form of computer information. If it could not be provided in any other way and still fulfill its role in the transaction, as where the computer information is an operating computer program system, its form can never be insignificant.

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 it. This rule, of course, deals with applicability of this Act and not other law, including law that supplements this Act.

2. *General Rule.* This section expressly acknowledges a contractual capability that has been assumed to exist under general law. The capability to opt into or out of a contract statute is important in this Act because the narrow scope of this Act may create uncertainty or differences in coverage that the parties should be able to avoid by agreement.

Under this section, parties can agree to apply or to bar application of this Act if a material part of the transaction involves computer information or subject matter excluded under Section 103 (d)(1) or (d)(2). The materiality requirement should be liberally construed to enable agreements. It does not establish a standard relating solely to relative cost or value or a standard that asks 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 transaction. Materiality is not met if the computer information is a trivial or otherwise insignificant aspect of the transaction. Failure to meet the materiality requirement does not preclude an agreement being enforceable under other law, but any agreement to opt-in or opt-out is governed by the limitations stated in subsections (1) to (5). Failure to meet the materiality standard does not it indicate that parties cannot otherwise alter the effect of any contract rule under this Act or other law by agreement, if the rule is variable by agreement.

In determining whether an enforceable agreement was formed, a court should apply the contract formation rules of this Act since a material part of the agreement involves computer information. Agreement can be found in the express terms of the contract, in course of dealing, usage of trade, or as inferred from the circumstances. In a mass-market transaction, a term of an agreement 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 an agreement to opt into or out of this Act.

a. *Opt-In Agreements: General.* Subsection (1) deals with agreements that provide that this Act governs aspects of a transaction to which it would not otherwise apply ("opt-in agreements"). It confirms the applicability of any rules in other law that reflect a policy that the effect of the rule cannot be varied by agreement or that restrict what procedure must be used to vary the rule. Of course, for this limitation to apply, the non-variable rule must be applicable to the transaction in the absence of the opt-in agreement.

In addition, an agreement to opt-in to this Act cannot alter the effect of otherwise applicable consumer protection statutes or of a law dealing with rights in a copy of printed information (e.g., a book on paper) distributed in the mass market. In each of case, the policy is that the idea of contract choice should not apply in the face of important, expressed policies of the state. A consumer protection statute is a provision of a statute that applies specifically to consumers and creates a more protective rule for the consumer than for other parties in similar transactions.

b. *Opt-In Agreements: Embedded Programs.* Subsection (4) follows the exclusion stated in Section 103 for some computer programs embedded in goods. If a computer program is excluded from coverage of this Act the parties cannot use the program 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 the embedded program is within this Act under Section 103.

c. *U.C.C. Rules.* Under subsection (5) an agreement to opt-in to this Act cannot alter rules stated in the indicated articles of the Uniform Commercial Code. This refers to rules specifically dealt with in those parts of the Commercial Code, not the general subject matter of the UCC. The agreement can, for example, affect contract formation and other principles to the extent not dealt with by specific rules in those articles.

d. *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. Recognizing this, subsection (2) places only limited restrictions on what aspect 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, an agreement to opt in or opt out of coverage by this Act is governed by general standards of unconscionability and 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 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 owner 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 owner, but also in some contexts against the world-at-large.

The effort to balance the rights of owners of information against the claims of those who want access is very 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 rights of owners that may be imposed in a copyright regime where rights are conferred that bind 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, while 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. If federal law invalidates a state contract law or contract term in a particular setting, federal law controls. See, e.g., *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9^{th} Cir. 1996) (patent license not transferable); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984) (copyright license not transferable); *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993) (copyright preempts rule on licenses terminable at will); *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9^{th} Cir. 1989) (federal policy controls over state contract law interpretation rules; interpretation must protect the rights-holder). Subsection (a) refers to preemptive federal rules, but other doctrines grounded in First Amendment, copyright misuse and other federal law may preempt enforcement of some contract terms in some cases. In general, however, 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). No effort is made in this Act to define whether or to what extent such a preemption may arise.

3. *Public Policy Invalidation.* Contract terms may be unenforceable because of federal preemption under subsection (a) of this section or because the term is unconscionable under section 111. In addition, subsection (b) acknowledges the general legal principle that, in certain limited 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. It is a supplementary legal principle incorporated under Section 1-103 and applies to all contract law and all articles of this Code. Subsection (b) is designed to clarify the nature of the policies that have particular relevance to the subject matter governed by this Act.

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 this subsection, courts should consider a variety of 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 the parties have negotiated terms of their agreement courts will be even more reluctant to set aside terms of the contract. In light of the national and international integration of the digital environment, courts should be reluctant to invalidate terms based on purely local policies. In applying these , courts should consider the position taken in the *Restatement (Second) of Contracts § 178, comment b* ("In doubtful cases … a decision as to enforceability is reached only after a careful balancing, in light of the circumstances, of the interests in the enforcement of the particular promise against the policy against the enforcement of such terms. … 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.").

The public policies most likely to be applicable to transactions within this Act are those relating to innovation, competition, and fair comment. Innovation policy recognizes the need for a balance between conferring property interests in information in order to create incentives for 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.

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 and such restrictions are enforced to a much broader degree arising out of contractual arrangements than if 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 recognizes the commercial necessity of also enforcing mass market transactions that involve the use of standard form agreements. 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 education or criticism purposes, or that preclude a non-profit library licensee from making an archival 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. The most recent national statement of policy on the relationship between reverse engineering, security testing, and copyright in digital information creates an express treatment of reverse engineering and security testing in connection with circumventing technological measures that limit access to copyrighted works. It recognizes a policy to not prohibit some instances of reverse engineering in cases 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 in many circumstances 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. This recognizes the independent role of state consumer protection statutes and the diversity that exists nationally in those statutes. A statute can be fairly described as a consumer protection statute or a provision thereof only if contains protections or rights specifically earmarked for consumers, but such provisions 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 law has been defined 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 [or regulations] trump the general contract law of this Act. Thus, for example, 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, are 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 protection statute itself. If the statute could 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 the treatment of this issue in digital signature laws and in electronic signature legislation, and is appropriate and necessary to facilitate the cost savings and expanded access to information that electronic commerce offers. The rules are limited to transactions within this Act. For computer information transactions generally, this Act supplants other law as to contract issues and this section merely reflects that. For consumer transactions, substantive statutes inconsistent with or in addition to those of this Act, such as the content, timing, and manner of a disclosure or warning, are preserved. As to four stated electronic commerce rules, however, this Act selectively replaces limited procedural rules but does not otherwise alter the substantive terms of the consumer law.

Subsection (d)(1) allows an electronic record to suffice for a writing required in a transaction within this Act. This 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, in some cases, a consumer protection statute requires that the consumer be able to retain the writing; this subsection does not alter that requirement. Similarly, in some consumer statutes requiring a writing, the requirement is that the consumer actually initial particular terms of the record. Subsection (d) does not alter that rule (although under other paragraphs of subsection (d), electronic "initials" can suffice for handwritten initials); the record that substitutes for a writing must be meet the other 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, of course, affect other type of disclosure rule. For example, a consumer protection rule which requires disclosure before a transaction occurs is not affected. Similarly unaffected is any rule that refers to the content of the required disclosure or which regulates the specific timing, form or manner in which it must be made. This over-ride does not apply to statutes that relate to advertising or the like – such statutes are not within the scope of this Act or are preserved.

6. *Digital And Electronic Signature Statutes.* Subsection (e) allows states with existing laws regarding digital signature, electronic signatures, and other similar statutes that apply or attribute acts of performances of a party in computer information transactions, to list any provisions of such statutes that the State that will 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 216 of this Act but instead simply attribute a contract made in compliance with statutes to the consumer regardless of error. If a State wishes to afford consumers the protections of Section 216, it should not list its other statutes. 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).

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 procedure. 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 several fundamental principles relevant to enabling electronic commerce in computer information. The rules apply only to transactions within this Act and do not directly pertain to other transactions or to subject matter excluded under Section 103, such as transactions involving motion pictures and sound recordings.

2. *Equivalence of Electronics.* Subsection (a) is an express recognition that the fact that a message, record or authentication is electronic does not alter its legal impact. This equivalency refers to the form of the authentication or record, and not to its content. See also Section 105(d). Subsection (a) merely states an affirmative legal principle: it does not address questions of proof or attribution of the record or authentication. In particular, the subsection does not alter evidence rules 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) makes clear that nothing in this Act requires parties to use electronic processes. In some cases, the parties may wish to require traditional writings and this Act does not disturb that choice. It merely builds the proper legal framework for electronic commerce, consisting of a legal regime in which electronics and paper records are equivalent in law. Parties may determine to use, or not to use, that framework.

4. *Establishing requirements.* Consistent with the idea of contractual freedom and personal choice, subsection (c) makes it clear that parties can set their own requirements regarding records or authentication that are acceptable to them. They are not required to deal electronically or to accept an electronic record or authentication. This principle, of course, does not authorize one party unilaterally to change requirements that were established by an agreement between the parties. On the other hand, the principle does not require the parties to establish requirements or make an agreement regarding same – the section simply clarifies that they are free to do so if they so choose. Subsection (c) also recognizes that 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, parties are free to require a different form of authentication, such as a digital signature utilizing public/private key encryption. Nothing in this Act disturbs that 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.* Subsection (d) states the general principle that operations of an electronic agent bind the party that used the agent for that purpose. 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.

Electronic agents enable important reduction in transactional costs and broaden the ability to search and interact with the myriad sites found on the Internet and similar systems. The concept stated here embodies principles like those in ordinary agency law. The electronic agent must be functioning within its intended purpose. For human agents, this is often described in terms of whether the agent acted within the scope of its authority. Here, since we deal with automation, the focus is more accurately placed 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 directly address to whom the authentication is attributed.

2. *Method of Proof.* Proof of authentication can occur in any manner. In the anonymous world of electronic commerce, one of the most important means of proving authentication is by showing that a process existed that required an authentication in order to proceed in an automated system. To satisfy the idea of authentication, however, it is not sufficient merely to show that some act was required to proceed. The act required to do so must constitute an authentication.

3. *Authentication Procedure.* Under Subsection (b), compliance with a commercially reasonable procedure for authentication removes questions about whether an authentication was intended or occurred. This is true both because the procedure is commercially reasonable and because the parties have adopted or agreed to using the procedure for that purpose. The attribution procedure must be one for authenticating a record and must be complied with. Compliance with such a procedure does not necessarily resolve issues regarding to whom the authentication is attributed, but obviously has some weight on that question. See Section 213. On whether an attribution procedure is commercially reasonable, see Section 212.

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 the enforceability of a contract term selecting applicable law and with what law applies in the absence of such terms. Subsection (a) honors an agreement by the parties, but establishes a consumer protection rule. Subsection (b) and (c) provide needed certainty for electronic commerce on what law applies in the absence of a contract term.

2. *Contractual Choice of Law.* Contract terms that select law applicable to the contract are routine in commerce. The information economy accentuates their importance because it allows remote parties to enter and perform contracts using systems spanning multiple jurisdictions and operating in circumstances that do not depend on physical location of either party or the information. The rule in subsection (a) enables small entities actively to engage in multi-national business; if an agreement cannot designate applicable law, even the smallest business could be subject to the law of all fifty states and all countries in the world. That would impose substantial cost and uncertainty on an otherwise efficient system and raise barriers to entry. This section is critical to the electronic commerce rules in this Act.

a. *General Rule.* This Act generally provides for enforcement of choice of law agreements in commercial contracts. This follows the rule adopted in a majority of 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). The *Restatement (Second) of Conflict of Laws* § 188 has a similar rule, validating contract terms as to all issues that can be resolved by agreement and even validating many agreements as to otherwise non-waivable terms in many cases. Subsection (a) does not follow U.C.C. § 1-105 (1998 Official Text) which permits contract choices only if the selected law is of a jurisdiction with 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 intentionally and 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 law may have no relationship at all to the transaction – that is why it was chosen. *See, e.g.,* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997, ("The U.S. should work closely with other nations to clarify applicable jurisdictional rules and to generally favor and enforce contact provisions that allow parties to select substantive rules governing liability.").

b. *Limitations.* Contractual choice of law terms are subject to this Act's general limitations on terms such as the doctrine of unconscionability, which might exclude a term that unreasonably makes a highly prejudicial choice of law in a contract of adhesion. Also, some agreed terms may be unenforceable under the overriding fundamental public policy of the forum state. Section 105(b). See *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) creates a new, additional limit on these contract terms, providing that, in a consumer contract, the agreed choice of law cannot override an otherwise applicable rule which could not be altered by agreement under the law of the state whose law would apply in the absence of the contractual choice. This rule will impose significant costs on Internet commerce, but the policy here is that the fundamental policy of freedom of contract should not permit overriding the consumer rule if a state, having addressed the cost and benefits, determines that the consumer rule is nonwaivable.

3. *Choice of Law: no contract term.* Subsection (b) states the choice-of-law rules that govern in the absence of a contract term. 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) deals with electronic commerce. It is especially important to have consistent rules among the states. Subsection (b)(1) specifies that in an access contract or a contract involving electronic delivery of information, the agreement is governed by the law of the jurisdiction in which the licensor is located (in the absence of a contract term). "Located" is defined in subsection (d). This rule enhances certainty in a transactional context where, because of the distribution system, an on-line vendor, large or small, makes Internet access available to the entire world. The licensor's location does not depend on the location of the computer that contains the information. Any other choice of law 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.

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 was to be delivered governs. Thus, if a consumer is to receive delivery of a physical copy of software in Chicago, the transaction is subject to the law of Illinois unless the agreement indicates otherwise. This rule 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 its expectations in the transaction and avoids surprise to the provider because the copy provided is, by definition, to be delivered into that state.

The rules in subsection (b), of course, deal only with contract law. They do not affect choice of law in tax, copyright, or other fields of law. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (tax nexus); *Allarcom Pay Television, Ltd. v. General Instrument Corp.*, 69 F.3d 381 (9th Cir. 1995) (copyright).

4. *Most Significant Relationship.* In the absence of an agreement and except for the rules in subsections (b)(1) and (b)(2), subsection (b) adopts a "most significant relationship" test. The *Restatement (Second) of Conflicts of Law* uses a similar test and 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 the 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) promoting 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 substantially similar protections to those available under this Act. As under subsection (b), the reference is solely to contract law, including the provisions of this Act and the general contract and related equity law of the jurisdiction. The general principle in (c) is especially important in Internet commerce. The rule allows a court to use a different choice of law principle. In applying subsection (c), 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 contractual choice of an exclusive judicial forum. It deals only with choice of a judicial forum. Arbitration and other non-judicial forum choices are governed by other law.

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

3. *Limitation.* As with any other term of an agreement, terms which select an exclusive forum are subject to the doctrine of unconscionability in Section 111 and the fundamental public policy standard described in Section 105. In addition, a choice of an exclusive forum is not enforceable if it is unreasonable and unjust. This rule follows the approach established under *Breman* and its progeny and corresponds to the limitation suggested in the *Restatement.* The term is unenforceable if it has no valid commercial purpose and has severe and unfair affects on the other party. This precludes enforcement of forum selection clauses that choose a forum solely to defeat the other party's ability to contest disputes. Such terms may be unreasonable in that they have no commercial purpose or justification and their impact may be unjust in that the term unfairly harms the other party. On the other hand, a contractual choice of forum based on a valid commercial purpose is not invalid simply because it adversely effects one party, even in cases where bargaining power is 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.).

Choice of forum terms are especially important in electronic commerce. Decisions on the issue of jurisdiction in the Internet reveal an uncertainty about when doing business on the Internet exposes a party to jurisdiction in <u>all</u> states and <u>all</u> countries. The uncertainty affects both large and small enterprises, but has greater impact on small enterprises which are the lifeblood of electronic Internet commerce. Choice of forum terms here serve a significant commercial by allowing parties to control the uncertainty and the risk or costs it creates. Courts have recognized the importance of the issue. 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*., -- N.E.2d -- (N.J. Super. Ct. 1999). The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute,* 111 S.Ct. 1522 (1991) on choice of forum in a different, but similarly international 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, 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) adopts the traditional contract interpretation rule that a choice of judicial forum term in an agreement makes a non-exclusive choice unless the agreement expressly provides otherwise. Requiring express exclusivity terms provides notice and reflects what, in most cases, is the expectations of the parties in the absence of such language. The enforceability of non-exclusive forum selection clauses is not addressed in this Act. Presumably, absent unconscionability or other over-riding restriction, these clauses present less reason for intruding on 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 unconscionability doctrine as applied in Uniform Commercial Code § 2-302 (1998 Official Text).

2. *Basic Policy and Effect.* This section and Section 114 allows 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 of the making the contract. 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. 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 and 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 of the contract because of a procedural breakdown in the automated contracting process that 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 which are so tainted or which 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 which result from the court's action on these matters 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," important concepts for making contracts in electronic commerce. In this Act, "opportunity to review" a record is a precondition to manifesting assent to it. "Manifesting assent" as a concept has several roles in common law and this Act. It is: 1) one method by which a party agrees to (accepts) a contract; 2) a method by which a party may adopt 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 acts accomplish both the first and second result.

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

The basic principle is that words are not the only means of indicating assent to a contract or its terms and that conduct can often convey assent as, or more clearly as, can words. This is an important principle in electronic contracting where most interactions involve conduct, rather than spoken words. 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. Subsection (b) adapts the principle to use of electronic agents. Manifesting assent does not require any specific formality of language or conduct.

In this Act, determining whether a person manifested assent to a record or term requires analysis of three issues:

- <u>First</u>, the person must have knowledge of the record or term or an opportunity to review it before assenting. As described in subsection (e), 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) also requires a right of return if the record is not presented before initial performance.
- <u>Second</u>, given an opportunity to review, the person must do something that assents to the terms. The person may authenticate the record or term, express assent verbally, or intentionally engage in conduct with reason to know that in the circumstances the conduct indicates assent. *Restatement (Second) of Contracts* § 19. Conduct manifests assent only if the party's behavior was intentional and with knowledge or reason to know that the other party would infer assent from it. As in the *Restatement* the conduct can include inaction if the circumstances so indicate.
- <u>Third</u>, the conduct, statement, or authentication must be attributable to the person. General agency law and Section 213 provide standards for attribution.

3. *Manifesting Assent.*

*a***.** *Assent by Statements or Authentication.* As under common law, a person can assent to a record or term by stating its consent or by "authenticating" the record or term. Authentication either is a "signature" or an electronic equivalent. The term "authenticate" is adopted to enable electronic commerce, but the underlying concepts relating to signature remain the same. See Section 102 (definition of authentication).

*b***.** *Assent by Conduct.* Assent occurs if a person acts (or fails to act) having reason to know its behavior will be viewed by the other party as indicating assent. Whether this occurs depends on the circumstances. As in common law, assent does not require proof of a person's subjective intent or purpose, but focuses on objective factors, 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 effective even though the actor may subjectively intend otherwise. This follows traditional contract law of "objective" assent. It is especially important in electronic commerce where many transactions do not involve contact between individuals. Parties on both sides must rely on objective <u>acts</u> indicating acceptance. Doctrines of mistake as well as the law relating to fraud and duress apply in appropriate cases.

Assent in common law and in this Act does not require that a party be able to negotiate or modify terms. But the assenting behavior must be intentional (voluntary). This is satisfied if the alternative of refusing the deal or terms exists even if refusing terms leaves no alternative source for the subject matter of the contract. It is not satisfied if the act treated as assent is one which the assenting party cannot reasonably avoid doing even if it refuses the contract, such as blinking one's eyes. Under this same general standard, common law courts have used common sense in applying this test and will do so under this Act. Similarly, an act that does not bear a relationship to a contract or a record might fail under the general standard. Acts that occur in context of a mutual express reservation of the right to defer agreement do not manifest assent to a contract that neither party intended; neither party has any reason to believe that its conduct will suggest assent to the other party.

Actual knowledge that particular conduct will be viewed as assent suffices. Also, actions are treated as assent if a person has "reason to know" that they will lead the other party to the inference that there was assent. Factors that relate to this issue include: the ordinary expectations of similar persons in similar contexts; language on a display, package, or otherwise that is made available to the party before it acts; the fact that the party can decline and return the information without using it, but decides to use the information; information about contract terms communicated to the actor before conduct occurred; standards and practices of the business, trade or industry of which the person has reason to know; and other relevant factors.

The reason to know standard is not met where 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 and, therefore, the threshold for manifesting assent is not met.

c. *Assent by Electronic Agents.* Assent may occur through automated systems, described in this Act as "electronic agents." Either or both parties (including consumers) may use electronic agents. The reduced transaction costs from the technology are immense for consumers and for providers of information. However, when dealing with electronic agent assent, that assent cannot be based on knowledge or reason to know of the principal since programs are capable of neither and since the remote, automated nature of the interaction may preclude either individual party from any awareness (this does not, however, preclude persons who program agents from having reason to know of usage of trade and the like or preclude that knowledge from being programmed into the agent – the issues is not relevant under subsection (b) because the subsection focuses on the acts, not the knowledge, of the agent). Subsection (b) focuses on whether there was an authentication or whether in the overall circumstances, the electronic operations indicate assent. For both electronic agents and individuals, manifesting assent requires a prior opportunity to review. Subsection (e)(2) buttresses this automated assent by providing that, for an electronic agent, the opportunity has been made available only if the record or term is 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 more appropriate measures of assent than concepts of knowledge or reason to know.

d. *Assent to particular terms.* This Act distinguishes assent to a record and, when required by this Act or other law, assent to a particular term within the record. Assent to a record relates to the record as a whole and generally encompasses all terms of the record. Section 208. Assent to a particular term, if required, requires acts that specifically relate to that particular term. This is like a requirement that a party "initial" an individual clause of a record 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 to the party that doing the act is also assent to the particular term.

4. *Assent and Terms of an Agreement.* Manifestation of assent to a record containing contract terms is not the only way in which parties establish their bargain. This Act does not alter recognition of those other methods of agreeing to terms. For example, a product description can become part of an agreement without a manifestation of assent to a record repeating that description; in appropriate cases, the product description defines the bargain itself. This is implicit in the basic principle that this Act, like Article 2 of the U.C.C., defines the agreement based on the commercial circumstances. A party that markets a database of names of consumer attorneys can rely on the fact that the product need only contain consumer attorneys because this is the basic bargain it proposes; the provider is not required to seek manifest assent to a record stating that part of the deal. Similarly, the licensee can rely on the fact that the database must contain consumer attorneys, not other lawyers. The described nature of the product defines the bargain if the party makes the acquisition on that basis. If a product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective without requiring language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent to a contract defining that nature or other agreement to it, such conditions might not become part of the agreement.

In many cases, copyright or other intellectual property notices restrict use of a product, regardless of assent to contract terms. For example, common practice in video rentals places a notice on screen of limits on the customer's use under applicable copyright and criminal law, such as by precluding commercial public performances. The enforceability of such notices typically does not depend on compliance with procedures of assent.

5. *Proof of Assent.* A wide range of behavior and interactions in commerce establish consent to a contract or particular terms. It is not possible to state the variety of options that might manifest assent. In the anonymous world of electronic commerce, however, one of the most important is by showing that a process existed that required an authentication or other assent in order to proceed in an automated system. This is recognized in subsection (d). Of course, the procedure not only must exist, but be in place in a manner that the person must have engaged in it.

Subsection (d) also contains language to encourage use of duplicative consent procedures when appropriate. 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 alternative does not impair the effectiveness of a single indication of assent, by an electronic or other act; it simply provides a safe harbor for those obtaining electronic assent and a opportunity to confirm or deny assent for those who provide assent.

> **Illustration 1:** The registration screen for NY Online prominently states: "Please read the License. It contains important terms about your use and our obligations with respect to the information. If you agree to the license it, 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 which, if selected, promptly displays the license. A party that indicates "I agree" manifests assent to the license and adopts its terms.
>
> **Illustration 2:** The first display screen of an on-line stock-quote service requires that the potential licensee enter their 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 above hidden in other small print, is the statement: "Terms and conditions of service; disclaimers" indicating a hyperlink to the terms. The customer's attention is not called to this sentence, nor is the customer asked to react to it. Even though entering name and identification, coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this Act and usage of trade.
>
> **Illustration 3:** The purchase order screen of an on-line software provider's service 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 confirming its order, or canceling it. Under this subsection (d), this double assent sequence satisfies subsection (a)(2) regarding the intentional conduct and reason to know standard. 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 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 exposed to loss: the relying party (e.g., licensor) risks loss of its terms, while the purported principal ("licensee" using information not obtained through a proper agent) risks that use of the information infringes a copyright or patent. There must be an adequate connection between the individual who had the opportunity to review and who manifested assent and the person one whose acts constitute assent. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly 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 a screen license.

Questions of this sort arise under agency law as augmented in this Act. In appropriate cases, rules in this Act on attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 213 deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. Other law governs questions of ordinary agency.

7. *Third Party Service Providers.* Assent requires conduct by the party to be bound or its agents. In many Internet situations, a party is able to reach a particular system because of services provided by a third party communications or other service provider. In such cases, the services provider typically does not intend to engage in a contractual relationship with the provider of the information. While the "customer" activity may constitute assent to terms, it does not bind the service provider since the service provider's actions are in the nature of transmissions and making information access available, 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, 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 under this Act cannot occur unless there was an opportunity to review the record or term to which the assent is directed. Common law is not clear on this requirement, but it reflects simple fairness and codifies or adapts concepts preventing 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, of course, is clearly met if the person actually knows the terms of the record or has reason to know that the record or term exists in a form and location that in the circumstances permits 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.

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 foregoes the opportunity. Contract terms offered for review during an over-the-counter transaction or made available in a binder as may be required under federal law give an opportunity to review even if the person does not use that opportunity. 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 intentionally manipulates the circumstances to induce the other party not to review the record.

b. *Permits Review.* How a record is made available for review differs 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 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.* In commerce, there are many circumstances when terms in a record are not available until after there is a commitment to the transaction. As indicated in subsection (e), in most such cases 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 contained in the record. This rule does not exist in prior law but creates important protection for the party asked to assent. When the right to return is established by agreement, rather than by operation of law, it must be part of the express terms such that the person can become aware of it.

This rule provides strong incentive for a licensor to make the terms of the license available up-front if commercially practicable. Doing so avoids the obligations regarding a right of return stated in this section and in Sections 209 and 613. In addition, under Sections 208 and 209, when presentation of initial terms is deferred in this manner, the terms cannot become part of the contract unless the other party had reason to know that some terms would be later presented. Thus, a decision to defer presentation of terms without an important commercial reason to do so, may result in substantial costs and uncertainty. The required return right exists only for the first licensee.

Failure to provide a right to return in cases of records 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. The enforceable 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. Section 210. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment regarding the conditions or terms of the agreement. An agreement whose payment and other agreed terms reflect 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 or alter law on modification of an agreement or the law regarding the agreed right of a party to specify particulars of performance. Similarly, as outlined in subsection (e), the return right does not apply in commercial contexts where parties begin performance in the expectation that a record containing contract terms will be presented and adopted later. This is a common occurrence in development and other complex contracts and this Act does not disturb that commercial practice.

10. *Modification of Rules.* Section 113(a) precludes alteration of some portions of Section 211 by agreement. Subsection (f), however, allows parties, by a prior agreement, to restructure what does and does not constitute assent with respect to future conduct; this restructuring may call for more or fewer protections than are found in Section 211 or this Act. This is important for the many cases in which electronic commerce occurs through repeated exchanges pursuant to prior agreements. The requirements of assent in such cases can just as well be found in the original agreement as in subsequent conduct. In most cases, the prior agreement would satisfy the requirements of this section in full even as to the subsequent transactions.

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 that relate to determining the effect and meaning of an agreement. They generally follow the Uniform Commercial Code (1998 Official Text).

2. *Contract Choice.* Subsection (a) states affirmatively at the outset that freedom of contract is a fundamental principle of this Act. See Uniform Commercial Code § 1-102(3), *Official Comment* 2 (1998 Official Text). With narrow exceptions, the agreement of the parties will be honored. The effect of all provisions of this Act may be varied by agreement unless otherwise expressly stated as being non-variable. The absence of the phrase "unless otherwise agreed" or similar language does not have any negative inference or change this principle. An "agreement" does not require a formal record, but refers to the bargain of the parties in fact. Of course, to be enforceable under Section 201, a record may be required. The agreement is determined giving full appropriate effect to usage of trade, course of dealing and course of performance. An agreement altering the effect of any section of this Act may be as easily found in express terms as in course of dealing, course of performance, or usage of trade.

An agreement to vary the effect of a provision of this Act must be between the parties to which the provision applies. Several provisions 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 provisions insofar as they pertain to protecting the licensor and its rights. Such an agreement would not be between the affected parties. On the other hand, an agreement between the financier and the licensor may alter the effect of those provisions as between those parties, but cannot alter rights of the licensee.

Subsection (a) lists cases in which a provision of this Act overrides agreement. In each case, a policy judgment was made that the Act provision reflects policies that should not be altered except as indicated in those sections or here. Paragraph (a)(1) follows U.C.C. § 1-102(3) (1998 Official Text) in precluding complete waivers of good faith and other stated requirements, but in allowing parties by agreement to establish standards under which performance of the obligation is measured. Paragraph (a)(2) likewise recognizes the policy basis of unconscionability doctrine and the doctrine described in Section 105(b). In both cases the idea of setting standards is not applicable because the doctrine itself limits the ability to make contract choices.

Exceptions to contract choice should be sparingly applied. For example, subparagraph (c)(3)(C) prohibits variation of certain aspects of manifest assent and opportunity to review. Obviously, that prohibition is designed as a protection to persons who manifest assent. However, parties are free to agree for *greater* protections when they so desire and, in appropriate cases, to provide lesser assent standards under an agreement with respect to future transactions as indicated in the section on manifesting assent. Section 112(f).

3. *Usage of Trade, etc.* This Act follows basic principles of contract law established in the Uniform Commercial Code 1998 Official Text) and generally throughout U.S. contract law. The first is that the terms of an *agreement* must be found by looking to the commercial context in which the transaction occurs. Subsection (b) states this principle and derives from U.C.C. § 1-205 (1998 Official Text). Agreements can include and must be considered in light of the commercial context, which includes usage of trade, course of dealing, and course of performance; these furnish the background and give particular meaning to language used. They set a framework of common commercial understanding that controls rules of law which apply only if there is no such understanding. . Similarly, the meaning of the terms of any agreement must be viewed 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 practical context. See Section 302 (relationship between express terms and among the sources of commercial interpretation).

4. *Gap-filler Rules.* With the exceptions stated here, all rules in this Act are "default" or "gap-filler" rules which apply only in the absence of contrary agreement or meanings supplied by trade usage, or course of performance or dealing. Freedom of contract is especially important for converging industries or 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, for example, this Act expressly imposes a requirement such as that a term be conspicuousness or that there be manifested assent to the term. Such requirements exist only if made express in this Act or if they are created in consumer protection statutes or regulations as described in Section 105.

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

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 basic principles of contract law followed in this Act. They generally follow the Uniform Commercial Code (1998 Official Text).

2. *Supplemental Rules.* Subsection (a) derives, with modifications, from Uniform Commercial Code § 1-103 (1998 Official Text). There are many common law contract rules with which this Act does not deal and which remain in place to supplement this Act unless displaced by the Act. Ordinarily, the appropriate supplementation comes from general common law, rather than from contract statutes addressing subject matter different from that covered in this Act. Supplementation does not imply that a common law rule can over-ride express rules or clear policies adopted in this Act, such as a policy that requires or does not require, a particular formality 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 listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended to at any time to suggest the negation of the general application of the principle of this subsection. There are a range of 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 a particular type of contract term invalid under that law, this Act does not alter that result. A similar proposition is outlined for consumer protection statutes in Section 105, which govern in the case of any conflict with this Act.

This Act does not deal with computer viruses and does not alter existing criminal, tort, or other law on that subject. In most jurisdictions, knowing or intentional introduction of a computer virus is a criminal act. See Raymond Nimmer, *Information Law* ¶ 9.04 (1997). Any remedy in contract is determined by the rules of this Act or by the 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 definition of "good faith" that is consistent with U.C.C. § 2-103 (1998 Official Text). This subsection adopts the rule that good faith is a relevant to the performance due under all contract relationships within its scope, thus expanding the idea of good faith in states that have not adopted this view in their common law. What is meant by good faith is defined in Section 102. 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). A lack of good faith is not shown simply by the fact that the party insisted on compliance with terms. The fair dealing concept does not alter the rule that good faith obligations do not over-ride, 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. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create 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); 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 this section, the relevant substantive section, or in applicable case law or procedural rules.

4. *Legal Effect.* Subsection (d) derives from Uniform Commercial Code Article 1, moving this legal principle from the definition of "agreement" to a separate substantive section, but without 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. In this regard, nothing is stronger evidence of a reasonable time than the fixing of such time by an agreement between the parties. However, the subsection makes provision for disregarding a contractual term which by inadvertence or over-reaching 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 obviously unfair as judged at the time of contracting. The agreement which fixes the time need not be part of the main agreement, but may be separate. Under the definition of "agreement", the circumstances of the transaction, including course of dealing, course of performance, or 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 which in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing. 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, the inference would be that there is such a substantial chance that the fact does or will exist that, exercising reasonable caution regarding the matter in question, 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 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 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:

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.

2. *Relationship to Federal Law.* Federal intellectual property law may in some cases require formalities for enforceability of a contract. These not affected by this section. The Copyright Act, for example, requires a signed writing for some transactions, but not for a nonexclusive license. *See e.g., Radio Television Espanola S.A. v. New World Entertainment*, **--** F.3d. **--** (9th Cir. 1999) (faxes, letters and memos referencing a licensing deal were insufficient to satisfy federal law). As federal law, copyright law controls when applicable. Where both apply, state law cannot permit enforceability if federal law does not, but state law can require additional formalities. As a general rule, state law controls for non-exclusive licenses.

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. This basic standard focuses formality requirements on transactions of commercial significance without requiring unnecessary formality in the numerous small transactions that occur in ordinary commerce.

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 statute of frauds, which centers on the duration of the contract, and the fact that for licenses duration of rights is a significant, independent measure of value. A license for a perpetual duration, whether that duration comes from an express term or from the default rules of this Act, 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. On the other hand, a license for an indefinite term subject to termination at will does not exceed one year duration. An option to extend the duration of the license does not bring the contract within the statute unless the option is mandatory or is effectively mandatory because of the economics involved.

b. *Record Required.* The 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 particular formalities or form are required.

This section does not require that the record be retained or contain all material terms of the contract or even be designated as a contract. Nor must such material terms as are required be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real agreement. A memorandum that fulfills the stated conditions suffices. The record must reasonably indicate that a contract was formed, and not merely that a contract was being negotiated. This section does not establish contract terms: if this section is met, terms can be determined under other sections of this Act (see e.g., Section 301).

Merely because a record that satisfies this section exists does not establish that a contract exists. Fulfilling this section merely allows a party to pursue its assertion that a contract allows it to bring an action or raise 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 disputes 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. A party can prove the existence of an authenticated record by showing that a procedure existed by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity.

d. *Subject Matter or Copy.* The record must describe the copy or subject matter covered by the alleged contract. "Subject matter" refers to defining to which information the agreement refers. This does not require a description of the scope of a license. For example, a reference to a film clip taken from the motion picture "Wise Choices" satisfies this section even though the record does not describe what rights were granted. Determining the full scope and terms is addressed under other sections of this Act, including Section 307. Similarly, a record is adequate for this section if it refers to one copy of the word processing software "Word Perfection." There is no requirement that the record describe the quantity or contract fee or, even, the specific copy since this description adequately meets the "subject matter" requirement.

Subsection (b) provides a rule adapted from Uniform Commercial Code § 2-201 (1998 Official Text). The required designation of copy or subject matter, if met, cannot be defeated <u>for purposes of the statute of frauds</u>, by showing that the designation was incorrect. However, the contract is not enforceable beyond the number of copies or subject matter shown in the authenticated record.

4. *Exceptions to the Basic Rule.* There are four cases in which this section permits exceptions to the basic rule. These are based on the conclusion that transactional circumstances render the protective policies of a statute of frauds moot.

a. *Partial Performance.* Under subsection (c)(1),one exception occurs with tender of performance by one party and acceptance or access by the other. These acts by both parties adequately establish that a contract may exist and the authenticated record required under subsection (a) is unnecessary. This section rejects the Article 2 rule and holds that 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 in subsection (c)(1) requires tender <u>and</u> acceptance or access. A party relying on the exception must show both. Mere possession of a copy does not meet this exception, which depends on there being an authorized source for 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.

Part performance under this subsection only takes away the formalities barrier and allows the party to attempt to prove the existence of a contract. It does not prove that a contract exists or, if it does, which 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 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.* A 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 the rule in Uniform Commercial Code Article 2 (1998 Official Text), however, the admission satisfies the section only to the extent of the contract subject matter or copies admitted.

c. *Confirming Memoranda.* Subsection (d) follows the rule in U.C.C. § 2-201 (1998 Official Text). Between merchants, failure to answer a record that confirms a contract within ten days of receipt of the record satisfies this section with respect to both parties. This 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.

The memorandum removes the statutory bar to enforcement. The only effect, however, is to take away from the party who fails to answer, the defense of this section. The burden of persuading a trier of fact that a contract was actually made prior to the confirmation is unaffected by this rule. The confirming memorandum does not of itself establish the existence or terms of the contract, which terms must be established under other provisions of this Act.

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 writings. 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 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 section describes basic contract formation rules and is subject to specific rules on offer and acceptance in subsequent sections of this Act. This Act separates the issue of whether a contract was formed from the issue of contract. terms This section deals with formation. Sections 208, 209 and 210 deal with establishing the terms. Often, of course, the same acts form a contract and 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, oral, written, by conduct or inaction or otherwise. Of course, no contract is formed without an intent to contract. The rule in this section does not impose a contractual relationship where none was intended. In determining whether conduct or words establish a contract or whether they do not, courts must look to the entire circumstances, including any 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 sustaining electronic commerce and gives force to choices made 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.* Subsections (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 are deferred for delineation by one party. This rule reflects a dominant principle in contract law, focusing courts and parties on the commercial context and whether there was an intent to contract, rather than on whether form or format comply with abstract concepts of when a contract should be recognized.

4. *Open Terms and Layered or Rolling Transactions.* Subsection (c) recognizes that if the parties intend to enter a binding agreement, that agreement is binding despite missing or otherwise open terms so long as any reasonable basis exists for granting a remedy in the event of breach. This rule does not apply if the parties do not intend to be bound unless or until the remaining terms are agreed. This rule exists under Article 2 and common law. *See Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd 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."); *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2d Cir.1986).

There must be an intent by both parties to be bound. If that intent exists, enforceability does not require certainty on all terms, what the parties were to do, what obligations they assumed, what acts they agreed to perform, or what damages arise on breach. Rather, commercial standards can apply to these questions, reflecting the fact that in many contracts terms are defined over time, rather than on the occurrence of one specific event. Contract formation is a process, rather than a single event. Being bound at one point subject to changes and further agreement is a common circumstance in commerce. However, as a matter of fact, the more terms the parties leave open, the less likely it is that they intended to be bound.

Subsection (c) assumes a difference between preliminary negotiations and actions or statements made with intent to be bound even though terms are left open. If parties intend a contract, it can be formed despite terms remaining to be agreed and left open. On the other hand, if there is no intent to contract, no contract exists and this Act does not create one.

This subsection lays a foundation for the layered contracting that typifies many areas of commerce and is recognized Uniform Commercial Code § 2-204 (1998 Official Text), as well as in the common law and practice of most states. The foundation laid here is further developed in Sections 208, 209 and 305. Any concept that contracts arise at one single point in time and that this single event defines all terms is not consistent 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 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 new terms would be provided. If the parties did not intend to be bound to any contract unless terms were agreed to, subsection (e) gives guidance for unwinding the relationship.

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. Agreement may be found in express terms, or through application of usage of trade or course of dealing, or inferred from other conduct of the parties. In layered contracting, the agreement is that there are <u>no terms</u> on the undecided issues until they are made express by the parties. Applying a default rule would be applying the rule <u>despite</u> 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 no intent to enter a contract exists. The "scope" of the 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. Indeed, in many respects, the scope is the product. Disagreements about this fundamental issue indicate fundamental failure to agree on a contract. The reference in subsection (d) to disagreement, of course, relates to this type of failure to agree and does not refer to a dispute about the meaning of a term.

6. *Failure to Agree.* Subsection (e) follows Uniform Commercial Code § 2-305(4) (1998 Official Text). While many cases involve layered contracting, in some cases, the parties intend not to be bound unless they agree to terms later. Subsection (e) states rules that apply where the parties condition agreement on subsequent specification of terms, but that later determination does not occur.

The basic theme 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. In addition, if the parties agreed to restrictions on the information or copies, those contractual use terms continue as to that information or those copies. They do not extend to authorized copies obtained from other sources. For example, a preliminary agreement containing use restrictions regarding data compression software from a wholesale provider of the software remains binding, but may not preclude the licensee from an agreement with another source of a copy of the same software, if the first transaction failed to create a binding agreement.

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 and, when applicable, control over this section to the extent of a conflict.

2. *Reasonable Methods of Acceptance.* A party has a right to control the terms for accepting its offer, if it does so expressly. In many cases, this will occur through insistence on its terms or on the method of expressing acceptance. However, if an offeror does not limit the method of acceptance, any reasonable manner of acceptance suffices. This rule reflects commercial and ordinary practice and follows the rule in *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) and should be interpreted consistent with that section. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment, unless the offer otherwise provides. The second sentence accommodates the fact that, in some cases, it is useful commercially to accommodate a request for product 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 offeror (licensee) that the shipment is offered only as an accommodation to the licensee.

4. *Beginning of Performance.* The beginning of performance by an offeree can be effective as an acceptance. 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. To be effective as an acceptance, beginning of performance must unambiguously indicate an intent to be bound.

5. *Electronic Responses.* Paragraph (4) clarifies the situation where electronic messages and performances constitute the acceptance. It adopts a time of receipt rule for the effectiveness of 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 by the offeror.

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 by offer and acceptance where the acceptance contains terms that vary the offer, but neither the offer nor the acceptance is made expressly conditional on acceptance of all its own terms. Conditional offers and acceptances are covered in Section 205.

2. *Basic Rule.* Subsection (a) recognizes that, when neither the offer nor the acceptance are expressly conditioned on acceptance of their own terms, an acceptance may form a contract even though it contains terms that do not match the offer. Ancient common law followed a "mirror image" rule that required a perfect match between an offer and acceptance. That rule was rejected in Article 2 and no longer is followed as common law in most states. It ignores commercial practice. Subsection (a) follows and clarifies the rule established in Uniform Commercial Code § 2-207 (1998 Official Text).

There must be an intent to contract and enough similarity between the expressed acceptance and the offer to conclude that the offer was accepted. For this to occur, a record containing the acceptance with the varying terms must be a *definite* expression of *acceptance.* Anything less is at most a counter-offer and perhaps nothing more than negotiation. This condition for treating a varying "acceptance" as creating a contract is seldom met except in cases involving routine use of standard form purchase orders or invoices. In most other cases, an expression containing varying terms constitutes a counter-offer, rather than an acceptance.

Subsection (a) also recognizes that, no matter how labeled, a purported acceptance is not an acceptance in law if it materially alter the terms of the offer. This rule is implicit in Article 2 and in commercial practice. One does not accept an offer 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, it must be based on other facts, such as conduct of the parties that establishes a contract or circumstances that clearly show that one party accepted the terms of the other.

What is a material alteration depends on the context. Comments to Article 2 describing a nonmaterial alteration refer to "an acceptance [that] adds further minor suggestions or proposals." 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. A material change is one that would result in surprise or hardship if incorporated without express agreement by the other party. An "acceptance" that seeks to alter basic elements of the bargain proposed by the offer is not an acceptance and, in the absence of conduct creating a contract, no contract is formed by that "acceptance" unless the new terms are accepted by the other party. Standards of materiality in this context include whether the additional terms involve unreasonable surprise measured against the commercial context, including usage of trade and course of dealing, or whether they so change the effect of the other terms of the offer such as to significantly alter the bargain reached. Any change in an offer that is expressly described as conditional on acceptance of all of its terms is a material change.

4. *Immaterial Alteration.* If an acceptance does not match the offer, but also does not materially vary it, the acceptance creates a contract under subsection (d) based on the terms of the offer and other terms as indicated. Section 210 does not apply because the contract is formed by offer and acceptance, not conduct. Under subsection (d), 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 the acceptance 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; for subsection (d) to apply, the term must not materially alter 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 offer and acceptance on these issues.

2. *Basic Rule.* A person can state and insist on preconditions for its offer without being forced into a different contractual relationship because the conditions are ignored. That basic contract law principle is stated in subsection (a). The most common conditional offer or acceptance limits the other party to acceptance of all of its terms or to rejection of the offer. 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 form records since the conditions for the offer being accepted have not been met. However, in practice, it is often true that the parties nevertheless 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. This means that there are two scenarios recognized in this "battle of forms." The first is where behavior is inconsistent with the conditions. In this case, 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.

The second scenario is where the party's behavior is consistent with its conditional terms, such as by refusing to perform, refusing to permit performance, or refusing to accept the benefits of the contract, until the terms are accepted. Here, there is no contract by the exchange of forms unless the one party accepted the other party's terms. However, 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 indicating that its order is conditional on the Licensor's assent to the terms on the form. Licensor ships with an invoice or other documents conditioning the contract on assent to its terms. Purchaser accepts shipment. Neither party acted consistent with the language of condition. A contract exists but neither condition is enforceable. Section 204 or 210 applies.
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> **Illustration 2.** In Illustration 1, Licensor refuses to ship unless Purchaser agrees to the Licensor's terms. Until that occurs, there is no contract. A similar result occurs if Licensor ships, but includes in the information a code that prevents use of the information unless the Purchaser assents to the Licensor's terms.
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> **Illustration 3.** In Illustration 1, Licensor ships pursuant to a conditional form, but when the shipment arrives, Purchaser refuses it. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language.

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. In this context, the test for whether a contract is formed focuses on the operations of the agents. The basic test 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 applying restrictions analogous to common law concepts of fraud and mistake is appropriate in this automated context to prevent abuse or clearly unexpected results. 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. 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 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 which 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.

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. It merely describes one setting in which the interaction entails two elements:1) an electronic agent is programmed to make contracts, and 2) an individual having the ability to not do so, engages in conduct or makes 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, 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 1.** Tootie is a computer program used to receive and accept orders at Home Shop. A voice instructs the customer to indicate a credit card number, the item number, quantity, customer's location, and other data. In one transaction, customer, after entering the data, verbally states that he will only accept the information if there is a 120 day "no questions" refund right. Otherwise: "I don't want the silly things." Customer has reason to know that the program cannot react to this verbal condition. There is a contract. The verbal condition or term is ineffective.
>
> **Illustration 2.** Officer dials the telephone information system using his 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, having located it in the database. User's "counter offer" is ineffective. The charge to user's company 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 an agreement that the releasing party will not object to, or exercise any remedies to limit, the use of 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 recording assent and all forms of records, such as by filmed assent. The rule clarifies the enforceability of releases in a record, but does not alter other law making releases enforceable, whether or not supported by consideration.

> **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.* Duration of a release is determined by the agreement. If there is no agreed 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 default rule is that a 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 conduct that forms a contract and conduct that establishes its terms, although most often the same conduct establishes both. This section is the primary section when a party adopts terms of a record as the terms of a contract. Section 209 limits terms in mass-market licenses and their method of presentation. Section 210 deals with when records do not create terms, but a contract exists because of conduct.

2. *Adopting Terms.* If a party agrees to a record, including by manifesting assent to it, 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 between adopting terms of a customized record or of a standard form. Standard forms are commonly used in commercial practice and provide efficiencies for both parties. Treating them in law as less than other contracts would put commercial law in conflict with commercial practice and reduce the efficiencies. Standard forms will increasingly not be the province of only one party to the deal. This section rejects decisions and the rule of *Restatement (Second) of Contracts* § 211(3) which hold that a term that is not unconscionable or induced by fraud may be invalidated because a court holds after-the-fact that a party could not have expected it to be in the contract. Absent unconscionability, fraud or similar conduct, subject to Section 209, parties are bound by the terms of the contractual records to which they assent.

a. *Knowledge of Terms.* As under virtually universal common law, under this Act it is not necessary that the adopting party actually read, understand, or negotiate the terms of a record. Assent to the record encompasses assent to its terms unless the terms are unconscionable.

b. *Modes of Assent.* A party is bound by the terms of a record only if it agrees to the record, by manifesting assent or otherwise. The party may authenticate (sign) the record. The party's conduct may indicate assent to a record or a contract. Section 112. However, a party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. The party seeking that assent must ensure that this opportunity is created.

3. *Later Terms: Layered Contracting.* Subsection (2) adopts 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 agreement exists, but terms are clarified or created over time. That fact is recognized in this section and elsewhere in this Act.

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 an initial agreement or initial performance. It adopts the rule in cases that recognize the commercial reality that terms 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). Subsection (b) qualifies that rule by requiring as a precondition for later terms, that the parties have reason to know that terms will follow.

Under subsection (2) contract terms can be proposed and later agreed to as part of completing the initial contract, even though 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 agreed would provide elaboration of their contract. If, instead, the parties consider the deal to be closed at the outset, subsequently proposed terms from either party are treated as a proposed modification of the agreement, effective only under concepts applicable to such modifications. A third alternative is that the initial agreement leaves terms open and allows one party to specify what those terms are at some later date. There, specifying the terms is, in effect, merely a performance of the contract.

Subsection (2) differs 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 a proposal for agreement, since the specified terms are part of the original agreement. Where 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.

Under subsection (2), a layered contracting process occurs if the parties had reason to know that this would occur. Reason to know does not require specific notice or specific language in an original agreement, although such factors may play a role in determining reason to know. It can also be inferred from the entire circumstances, including ordinary practices of which a party is or should be aware. In Section 208, the time over which the record can be proposed is referenced to the expectations of the parties under the reason to know standard. At some point, the deal has been closed, but specifying when this occurs in terms of a fixed time standard is impossible in general commerce. It requires an analysis focused on the context and circumstances.

The standard set out in subsection (2) is also reflected in similar transactions in the mass market under Section 209. Section 209, however, 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.

4. *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 had a right to a return if it chooses to refuse the subsequently proposed terms. Section 112. This obligation applies in mass market and shrink-wrap transactions where the licensor's performance is merely delivery of a copy with a standard for included, but 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 and the more specific terms of Section 202(e) give guidance on the obligations that arise where the parties did not intend to have a contract in the absence of agreeing to the later terms.

5. *Adoption of Terms.* Subsection (3) states a principle found in the *Restatement* and in general common law. Assent to a record adopts all of the terms of the record and there is no requirement that the party read 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 in *Restatement (Second) of Contracts* § 211(3) regarding invalidation of some terms. Concerns about unfair surprise and the like dealt with in that *Restatement* proposal are addressed in this Act in Section 209 and under the doctrine of unconscionability.

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 places limits on enforceability of contract terms provided in mass-market licenses, including consumer contracts. The section should be read in connection with Sections 208 and 112.

Many mass-market licenses are presented and agreed at the outset of a transaction; some are presented afterwards. This section deals with both. The costs imposed in subsection (b) provide strong incentives for terms to be presented at the outset when practicable. Many mass-market transactions involve three parties which are also addressed in Section 613.

2. *General Rules.* There are various ways in which terms of a consumer or other contracts can be specified. An agreement unrelated to any record containing specific terms suffices, as would an agreement to terms presented at the start of the relationship, even if the assenting party does not read the terms. In other cases, the parties may agree that the terms or particulars of performance may be specified later by one party. Section 305. This section deals with assent to a standard form record containing terms for a mass market license – either at the outset of the transaction or after the transaction begins. Three limiting concepts govern in this context.

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 assents. 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. 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 assents and it had reason to know that terms would be proposed. Even if reason to know exists, however, for mass-market licenses, this section requires that the terms be made available not later than the initial use of the information and that, if the mass-market license was not made available before the initial agreement, the person is given a right to a return if it refuses the license.

b. *Unconscionability and Fundamental Public Policy.* Even if a party adopts the terms of a mass market license, a court may invalidate unconscionable terms. Unconscionability doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. See Section 111. For example, a term in a mass-market license that default under the mass-market contract for $50 software cross defaults all commercial licenses between the parties may be unconscionable, if there was no reason for the licensee to anticipate that breach of the small license would constitute breach of an unrelated larger license negotiated 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 between the parties would ordinarily be unconscionable. A court may also refuse to enforce a term if it violates a fundamental public policy under Section 2B-105(b).

c. Conflict with Agreed Terms. In addition, this section 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 agreement becomes part of the bargain. Paragraph (a)(2) preserves the bargain of the parties. 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 over-ridden by the agreement for a network license. Similarly, in a consumer contract where the consumer requests a "90 day refund for any or no reason" and the vendor agrees to provide such a refund, the standard terms cannot alter that agreement. 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 cannot alter the agreement between the end user and the retailer unless expressly adopted by them as their own agreement. This section rejects the test in *Restatement (Second) of Contracts* § 211(c).

Paragraph (a)(2) preserves the bargain of the parties. For example, if a librarian acquires software for children under an 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 over-ridden by the agreement for a network license.

3. *Terms Prior to Payment.* If a mass-market license is presented before a 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). However, 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. The existence of a license is important to both the licensor and the licensee. The license terms define the product, for example, in distinguishing between single user and network use, consumer use and commercial use, and ordinary private use or rights to public display or performance. Often, the license and its enforcement benefit the licensee, giving it rights that would not be present in the absence of an enforceable license or that could not be exercised without permission of the owner of informational property rights. See, e.g., *Green Book International Corp. v. Inunity Corp.*, -- F. Supp. – (D. Mass. 1998). In that event, the license can allow the licensee to avoid infringement.

4. *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 can occur before, but must occur no later than during the initial use of the information. This limits layered contracting in the mass market and reflects customary practices in the software and other industries applicable to that market.

b. Cost Free Return. Under subsection (b), if terms are not made available until after initial agreement, the party being asked to assent must have a right to reject terms with a commensurate right to return the information product acquired. This Act refers to a return right, rather than a right to a refund, because, under developing technologies, this right may apply to either the licensee or the licensor, whichever is asked to assent to the record.

Most decisions enforce contract terms presented in this manner. This subsection enforces terms only if there is assent after a chance to review terms and only pursuant to the rule that a party who 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 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 initial agreement. The return right 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 initial agreement.

Exposure to potential liability for expenses of reinstating a customer's system after review, creates an incentive for licensors 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 in Section 112(e). In this section, it is cost free in that the return requires reimbursement for reasonable costs and, if installation of the information was required to review the license, to reasonable costs in returning the system to its initial condition. The fact that this section states an affirmative right in mass market licenses to a cost free refund does not affect whether under other law outside of this Act, a similar right exists in other contexts.

The expenses incurred in return of the subject matter of the rejected license 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 airplane tickets, lost income or the like unless such expenses are required by 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. The expenses do not cover consequential damages. They must be foreseeable. A party 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 reason to know. 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 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 and not by offer and acceptance or agreement to a record. Of course, most contracts created by conduct also involve exchanged records. If the records or an oral agreement form the contract, this section does not apply. Contracts formed by conduct arise in various settings. One is where the parties begin and complete performance without making an agreement and without reducing their agreement to a record. Another involves a "battle of forms" that, under Sections 204 and 205 did not result in an effective offer and acceptance and neither party agreed to a record signifying terms of agreement, but both parties engaged in conduct indicating that a contract was formed.

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, and applicable trade usage or course of dealing. No hierarchy is established. Given the fluid nature of the context, usage of trade and course of dealing have special importance; as in any other context, these elements of the agreement trump supplemental default rules contained in this Act. Consideration of all these factors requires a practical interpretation of the relationship. *Restatement (Second) of Contracts* § 202(1) (2) (1981); 2 *Farnsworth, Contracts* § 7.10 (1990). Formalistic rules cannot account for the contextual nuances that exist in the rich environment of transactional practice in the computer information industries. This section rejects the so-called "knock-out" rule where terms in writings cancel out being replaced by default rules of this Act; that rule is too rigid for information transactions where contract terms often are essential to 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 to that contract 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 party. When this occurs, the terms of the resulting 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) in such cases directs the court to review the entire circumstances regardless of which form was first received or last sent, but including the terms of the exchanged records and established trade usage, course of dealing, and course of performance as relevant circumstances.

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 (scope). 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), among the relevant circumstances is the information or informational rights involved. Where there is a significant disagreement about an important element of scope, a court should be careful to not make a determination that creates rights or imposes obligations beyond those actually agreed 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 argues for rejecting any expansive interpretation of ambiguous conduct. Absent a clear agreement to the contrary, the court should consider the following principles:

(1) The court should avoid creating a scope that requires the licensor to acquire rights it did not own or have the right to license at the time of contracting, or that would exceed the rights that the licensor then had. Thus, if at the time the contract was created by conduct, the licensor only had the right to grant a license limited to 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 might 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 such exercise was made 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 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. 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; this section acts as an incentive or safe harbor. When this section is not used, whether an opportunity to review has occurred should be viewed under the general standards set out in Section 112.

3. *Disclosure and Downloading.* The disclosure rules in this section are modeled after and adapt 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 the license of the type involved. This section enables shopping for generic terms and thus focuses on standard terms of standard forms. 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 n 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 be assure that it would be called to the attention of a 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 most present technology does so. It does require that there be nothing further 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 easily distributed without authority 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. On the other hand, if the licensor links the person to another location under the control of a third party and at that location, affirmative steps are taken to prevent download, 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 if an attribution procedure is commercially reasonable.

2. *Decision of the Court.* Issues of whether a particular procedure is commercially reasonable or otherwise about its efficacy in the particular context are decisions made by the court under general standards of law as augmented in this Act. This Act, however, 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.* This Act does not dictate what constitutes 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. This Act relies primarily on the parties to select or use an appropriate procedure. In most cases, an attribution procedure is established by agreement or otherwise adopted by both parties. Assent is then a predicate for the creation of procedures that affect substantive rights. A procedure of which one party is not aware does not qualify. On the other hand, parties dealing for the first time may adopt a procedure for authentication or other purposes.

In some cases, statutes or regulations define a particular procedure as appropriate. 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 commercially reasonable within the scope of their coverage.

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 of identifying the party, detecting or preventing changes, or of achieving any other relevant purpose to which the procedure is addressed. This does not require proof that the procedure was state of the art, the most reasonable procedure, or an infallible procedure.

What is an effective or commercially reasonable procedure takes into account the choices of the parties and the cost relative to 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), but that is not a requirement of this Act. 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 fully negotiated agreement of the parties, it should receive deference in terms of its reasonableness applicable to their situation. This flows from the principle of assumed risk and that the parties' agreement should ordinarily be enforced. The same principle may apply if the two parties, aware of the risks of a particular procedure, nevertheless agree to use the procedure for a particular transaction. In effect, the parties then have concluded that it is 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., under some state electronic signature statutes her contract with the issuer of the password can allocate liability 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 in this context varies depending on the character of the procedure. Compliance with an attribution procedure that has a level of effectiveness suitable to that context or is commercially reasonable in the context may be treated by the court as carrying the burden of establishment 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 enter an agreement establishing 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 the procedure was commercially reasonable. Having done, the burden then passes to other party to establish that neither he nor a person with authority to act were responsible for the message, contract or performance. On the other hand, a procedure with very limited effectiveness and not reasonably suited to the context might have no effect at all in the evidentiary mix.

4. *Role of Agreement.* The section is subject to contrary agreement. An agreement here may have the initial 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 trump 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 a form of attribution procedure. Absent agreement such as this, the effect of its use would be controlled under this section. In this 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 not bound by an error that would have been detected through compliance by the 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 common law of mistake or alter law concerning transactions that do not involve a consumer.

2. *Electronic Errors: Defined.* An electronic error in this section contemplates situations in which a consumer’s human conduct causes an error in an electronic message. The rule here 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 itself reasonably provides a means to correct errors. Thus, a consumer’s mistake in entering “11” as the quantity 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 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 merely 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.

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.

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 Sales 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. The defense is grounded in equity principles. 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 or destroy 10 copies at the Consumer's expense; he does not use the games. Under this section, there is no obligation for 11 copies but there is an obligation for 1. Jones bears any difference in costs for delivery of 11, vs. 1 game, and the inventory and return processing, while the consumer has the obligation to pay for the intended order and any cost of returning the extra products.

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" since the procedure reasonably allowed for correction of the error. The conditions for application of this section are not met.

4. *Transactions Not With Consumers.* 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 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.

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 liability for errors.

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. 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. While the message is "effective" when received, being effective does not create a presumption that the message contains no errors or any presumption regarding from whom it was sent. 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 be a sufficient recognition also to be treated as an acknowledgment. Acknowledgment confirms receipt. Questions about the accuracy or the general content of the received message are not treated here. Of course, by agreement the parties can do so.

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 source for determining the agreement of the parties. This section excludes evidence of alleged terms or agreements that contradict the terms of a record intended as a final expression of the agreement on the terms covered or on terms on which confirmatory memoranda agree. The record need not be intended as the only statement of the agreement, but must be intended as final on the terms covered.

An alleged term or agreement is contradictory if its substance cannot reasonably co-exist 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 co-exist 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. Of course, 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 carefully 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 reduced to a 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.

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 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 have 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, beyond that, course of performance provides an important component of the factors that determine the meaning of the "agreement" of the parties. Course of performance (as well as usage of trade and course of dealing) are relevant to determine the meaning and content 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 of the other to object, and a pattern of acceptance or acquiescence by that other party. Since it provides a basis for understanding the agreement of the parties, the events creating it must have mutual elements. Unilateral conduct unknown to the other party, such as by making uses of information beyond the terms of a license, cannot establish a course of performance. Similarly, a single occasion of conduct does not fall within this concept, although a single event may affect the parties' rights in other respects.

4. *Relationship to Waiver.* A particular pattern of action may provide insight into the meaning of the agreement or represent a waiver of a term of an agreement. 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 preserves the flexible character of commercial contracts and prevents surprise or other hardship. A waiver by conduct may be retracted as to future conduct. An interpretation of the agreement measures the meaning of a contract binding on both parties and which cannot be retracted by one.

5. *Order of Interpretation.* Subsection (a) sets out the order of preference in interpreting an agreement among express terms, course of performance, course of dealing, and usage of trade. Express terms always govern. Course of performance and course of dealing are the next preferred, respectively, because each relates to the behavior of the particular parties.

6. *Place of Performance.* Subsection (b) provides guidance indicating that, as applied to a performance, any applicable usage of trade is determined in reference to that place. Of course, however, the alleged usage of trade must meet the definition of that term in reference to its being known to all parties to the contract.

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 issues about lack of consideration. The modification must be in an agreement, however, indicating 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. However, there must be agreement. This protects against over-reaching and extortion-like demands in cases of abuse, allowing courts to apply ordinary concepts related to fraud or duress in appropriate cases.

3. *Contract Terms Prohibiting Oral Modification.* Subsection (b) recognizes the general enforceability of a contract term that bars modification or rescission of an agreement except in an authenticated record. This type of contract term has great importance in commercial relationships especially when the relationship involves on-going performances. Contractually preventing modifications not contained 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 through later terms that do not require authorized authentication by the recipient. For example, a "no modification without authentication" term should prevent modification of a basic agreement through a later provided mass-market license that is 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.

Subsection (b) adopts the policy stated in the Uniform Commercial Code Article 2 (1998 Official Text) that in consumer transactions such terms are enforceable only if the consumer assents specifically to the term. Article 2 requires a consumer to sign the term. This Act substitutes the requirement of manifesting assent to the term to better fit modern 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) requirements or that alters the requirements of 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 film clip license for a multi-media product to include an entirely different clip outside the subject matter in the original record. 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 the Section 201 constitutes the contract of the parties.

The modifications must, of course, 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 term requiring a signed record for valid 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-oral 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. The better 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 on-going performances by one or both parties. It clarifies enforceability of agreed methods allowing changes in terms in on-going performance.

2. *Continuing Terms.* Subsection (a) states two important principles. The first is that initial contract terms cover all performance under the contract. This rule applies whenever the agreement includes subsequent performances. Thus, a warranty disclaimer in a contract for on-going use of a website applies to all subsequent performances and uses pursuant to that contract. On the other hand, if separate access to a system involve separate agreements for access or for information, the terms of the first agreement do not cover the second.

Subsection (a) recognizes that contract terms can be changed pursuant to procedures established by the contract. The procedures might rely on third party actions (e.g., changes in regulations), an external private standard (e.g., a price index), or changes made by a party pursuant to a contractual procedure. The ability to change terms is subject to general common law principles about a contract requiring mutuality of obligation. 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.

3. *Changes in Terms.* Subsection (b) creates incentives to provide more protections to the party that is not changing the contract. When parties contract to make changes pursuant to a specified procedure, if the provisions of this subsection are met the changes are effective and this section excludes any argument that a contract establishing a procedure like that outlined here fails for lack of mutuality. If the terms of subsection (b) are not met, however, neither the contract nor the changes are made unenforceable by this Act, but the parties do not receive the benefit of the certainty provided by complying with the subsection.

The subsection states some conditions under which an agreed procedure used by the parties is effective under this Act. It addresses important practices in online and other contracts, such as outsourcing agreements. This section does not alter prior agreements or consent orders dealing with particular parties which may limit, or expand, the ability to make changes in terms of an on-going contract. This subsection deals with agreements that permit changes in terms, but does not create a unilateral right to change terms when the parties have not previously agreed to an applicable procedure.

Long term on-line contracts frequently involve changes in terms of service. Separate notice or negotiation of each change is not feasible or desired by the parties, especially where the change affects a large number of users. Commercial practice must accommodate efficient methods of making changes by providing in the original agreement for a right of one party to alter terms during the contract period. Subsection (b) authorizes two contractual procedures that create effective changes. This does not preclude other methods or imply that other contractual arrangements are unenforceable.

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 the agreement leaves the particulars of performance to be specified by one party. See U.C.C. Article 2 and Section 305. The need for and enforceability of such changes is recognized in other law.. It is especially important in electronic commerce to recognize this right because this area of commerce is subject to evolving rules and circumstances that are not predictable, but may require adjustment of performance, risk allocation, and other characteristics of the relationship. For example, in an out-sourcing contract, a provider may make significant investments relying on a five year contractual term, but the circumstances may require reservation of the right to change terms as technology changes. In such contracts, notice is appropriate, but it would not be appropriate to require a blanket rule that the change yield a right to withdraw from the contract. The requirement that the change be made in good faith prevents the party making the change from taking undue advantage.

a. *Relationship to Other Rules.* The procedures described in subsection (b) must be pursuant to a contract term authorizing a procedure for changes. The terms of an on-going contract may, of course, be effectively altered in other ways. For example, the parties may agree to modify the contract. Similarly, general principles of waiver affect the terms of the agreement.

b. *Contracts.* Subsection (b)(1) provides that 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 authorized procedure reasonably notifies the other party of the change.

Subsection (b)(1) requires that the procedure reasonably notify the other party of the change. What constitutes reasonable notification depends on the circumstances. This Act preserves substantive consumer statutes (Section 105); thus if a consumer statute specifies a method for notice of changes, this Act does not displace that specification. Under this Act, posting at an agreed location designated for that purpose would ordinarily suffice; there is no requirement that individual changes be separately singled out, although such may be appropriate for especially 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 that calls for posting changes in an accessible location of which the other party is aware will ordinarily satisfy this requirement. The overall context of the contract must be considered.

Subsection (c) clarifies that the standards for notification can be established by agreement, so long as the terms are not manifestly unreasonable. Ordinarily, in a negotiated commercial agreement, standards set by agreement are not to be considered manifestly unreasonable.

c. Mass-Market Transactions. In mass-market transactions, subsection (b)(2) authorizes an agreed procedure only if standards of good faith and reasonable notification apply and the consumer has a right in good faith to withdraw from the contract with respect to future performances. This additional element is not appropriate as a rule for commercial contracts. 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, 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 beneficial change does not require a right to terminate.

Withdrawal must be without penalty, but the licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due). In many mass-market licenses that entail continuing performance, the contract itself may be subject to termination at will. Subsection (b) does not alter that rule.

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 rights to materials as changed by the licensor over time. Unless an express contract term provides otherwise, 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 of performance.

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 so to specify 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).

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 contract issues not covered by the agreement or other sections of this Act. It follows the approach in Article 2 of the Uniform Commercial Code (1998 Official Text).

2. *Commercial Context.* Construction 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 default 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.

What is reasonable in such cases 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 time or performance that is in fact reasonable in the unforeseeable judgment of a later trier of fact. In such cases, 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, see Section 202(e).

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 issues of interpretation and enforcement of a license, establishing the basic premise that a license should be interpreted in a commercially reasonable manner and providing specific interpretation rules that reflect commercial practice.

2. *License Grant.* Subsection (a) provides a state law rule that 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. This implied license applies only to rights within the control of the licensor at the time of the license. For example, a license to use a photograph in a digital product implies a right to transform that photograph into digital form assuming this right was within the licensor’s control at the time. A license of software to create visual presentations for public speaking implies a right to publicly display images from the software in such presentations because that right is necessary to the expressly granted right. The implied rights, however, pertain only to rights, 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. Additionally, the implied rights must be necessary to the express grant and do not include rights merely because they are desired, common or even helpful, unless necessary to the expressly granted uses. Express terms creating greater rights or lesser rights, of course, over-ride any implied rights

Subsection (a) expresses a state contract law interpretive rule. Some cases hold that federal policy requires interpretation of the scope 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 applied in cases such as *Bourne v. Walt Disney Co.,* 68 F.3d 621 (2d Cir. 1995), which treat interpretation issues as ordinary commercial contract questions. Of course, to the extent a mandatory federal policy precludes different state law on this issue, that policy over-rides the standard in subsection (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.”. There are two rules. First, when the contract limit term is express, actions different from the expressly limited grant are a breach of contract. This refers to the grant as interpreted, including consideration of course of dealing, usage of trade and subsection (a). Second, 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 of contract. This rejects case law that requires express limiting language for this result, such as a license that allows the licensee "*only* to 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. Independent of infringement issues, 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 commercial 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 of contract if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a quotation from licensed material not subject to trade secrecy restraints, if a fair use under federal law, would not conflict with the implied limitation. However, even if a license does not use the word "only" and gives a right to use software at a designated location, a licensee that does something that is not included in that grant, such as making multiple copies for sale, infringes the copyright and 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 by stating a specific number or by referring to all users at a particular location. In the absence of 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, network use concepts are more appropriate. Given the diversity of the marketplace, no single presumed number of users or uses would fairly meet all circumstances.

Of course, as with all default rules in this Act, 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 simultaneous 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.

Subsections (f)(1) and (f)(2) provide guidance on important license terms. Subsection (f)(1) adopts the majority rule on when a grant covers future technologies and rights. Use of statutory or other language that implies 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 the other default 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 use of such broad grants, but merely provides guidance regarding what language achieves the indicated result when it is agreed by the parties.

Subsection (f)(2) resolves a conflict in case law. It clarifies that an exclusive license that does not otherwise deal with the issue, conveys exclusive rights that include restrictions on rights of the licensor. Thus, the licensor may not license or 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 original 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 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. The section applies only if there is a contract, but the contract does not state its duration. In some cases, failure to agree on duration indicates that no contract exists.

2. *Basic Rule.* Subsection (1) follows the common law of most states and Uniform Commercial Code Article 2 (1998 Official Text) by adopting a rule of commercial reasonableness to define the duration of contracts of indefinite duration. What time is reasonable for any given arrangement is defined by the commercial circumstances. See Section 114. A contract running for a commercially reasonable time can continue indefinitely since, if the parties continue to perform, the contract will not terminate until notice is given. The basic policy, however, is that a person making an indefinite commitment can be required to perform over a time that is reasonable, but cannot be placed in a position of perpetual servitude.

The commercial circumstances that determine what is a reasonable time include licenses or third-party rights which place limitations on the licensor of the information. The licensor should not be presumed to have given a license that exceeds the duration of its own rights (such as the licenses by which it is bound to third parties). More generally, the reasonable duration should reflect the rights involved. Various federal policy considerations affect duration. 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. For a copyright license of an indefinite term, however, duration may be subject to preemptive copyright law rules. *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993).

3. *Termination at Will.* An indefinite duration contract can be terminated at will by either party, except as provided in subsection (2). This follows common law (except for the expansion of licensee protections). 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. Treatment of the licensed rights is handled differently under subsection (2).

At will termination enables a non-judicial method of ending the contract. Parties to a contract are not required, in giving notice of termination, to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later 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 or a source of liability risk. If, on the other hand, a party's communication sets a proposed time limit for termination of the contract, that proposal calls for a response and failure to reply will infer acquiescence. If objection is made on grounds that the proposed time 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 and 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 provides for a specific 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 licensed rights and the term of obligations requiring on-going, 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, commitments to "lifetime" service or support are 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 the common law and Article 2 in two contexts by providing that the duration of an indefinite license, other than for source code, is perpetual as to the licensed rights and use restrictions, subject to cancellation for breach or contrary agreement. The exception for source code acknowledges commercial practice that denies long term rights in confidential material in the absence of express agreement.

A perpetual term is the default rule if a license transfers ownership of a copy or delivers a copy of software 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. This rule seeks to identify situations in the mass market and other similar settings where the transaction commercially may convey implicit long term rights to the licensee. The default rule is over-ridden in cases where the circumstances suggest that, despite a single fee or similar terms, there is no agreement for perpetual rights.

The second situation deals with cases where the licensed information is incorporated into a product for distribution to third parties, such as an art clip 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.

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.

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 ordinarily should be interpreted as requiring measurement under an objective or reasonable person standard. The issue is whether the tender would be acceptable to a reasonable person. This rule precludes arbitrary demands. It 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 specifically so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard.

Also, subsection (b)(2) presumes a subjective standard if the contract involves informational content evaluated on aesthetics, appeal or the like to the satisfaction of the party. As the subsection makes clear, this is referring to cases where the evaluation on these factors is to reflect subjective criteria and judgment. A reasonable person standard in such cases lacks content 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 relating to non-infringement, exclusivity, and enjoyment. These warranties cannot be disclaimed except as stated in this section.

2. *Non-Infringement Warranty.* Subsection (a) comes from Uniform Commercial Code Section 2-312 (1998 Official Text). When the information is part of the normal business subject matter of the licensor and is provided in the normal course of its business, it is the licensor's duty 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, a transfer by a person other than a dealer in information of the kind, raises no implication of such a warranty. .

a. 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 clam must be valid. As in Uniform Commercial Code Section 2-312 (1998 Official Text), the warranty refers to circumstances and claims existing in reference to the information as it exists at the time of delivery. This warranty does not pertain to future events or uses, such as a subsequently issued patent; or infringement claims that result from a licensee's decision to use the information with other information or property, the composite of which infringes a third party right; or a decision to use multi-functional software for an infringing use. *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. The warranty does not cover future performance or uses in that performance which infringe unless these uses are the sole ones for which the information was designed. 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 involve employing is capability to be tailored to particular functions may not infringe another's rights. See, e.g., *Matthew Bender & Co., Inc.. v. West Pub. Co.*, 158 F.3d 693 (2d Cir. 1998) (no infringement even if program and data could be used to recreate copyrighted work, when this was not the sole or necessary use). Under Section 805, the limitations period for breach begins when breach was or should have been discovered, rather than on delivery of the information.

b. 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 in those cases where 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 *software* , the subsection (a) warranty is breached if the software as delivered infringes a third party patent. If a licensor gives a licenses the *patent* itself, subsection (a) does not apply.

c. Specifications and Hold Harmless Duty. 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 a tacit representation by the licensee that the licensor will be safe in following the detailed specifications and required method. *See Bonneau Co. v. AG Industries, inc.,* 116 F.3d 155 (5th Cir. 1997) (applying similar 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 of developmental choices and has the duty to see that no claim of infringement will mar the licensee's interest. More generally, the licensee is entitled to rely on the technical expertise and judgments of the licensor, even when the parties are working together. That entitlement 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 detailed contractual 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.

This Act also clarifies that a licensor presented with specifications and required 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 notice of a non-infringing alternative (if any) of which the licensor has reason to know is required; the section does not impose a duty of investigation and consequences of using the alternative must be handled under rules regarding amendments and the like, not this section. 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.

d. Non-Infringement and Passive Transmission. The warranty in subsection (a) is only made by licensors of information. It does not apply to persons who merely 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 but is not created by this Act. This Act takes no position and has no effect on federal questions about what constitutes 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 issue 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 part as a warranty of non-interference 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 it's contractual interest. "Enjoyment" refers to authorized exercise of contract rights in the 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 more adequately assess risks. Infringement and misappropriation claims are excluded from this subsection because they are dealt with in subsection (a). The warranty reflects that the nature of the limited interest in a license – the right to use the information or informational rights – results in a need of the licensee for protection greater than that afforded to a buyer of goods. The warranty is limited to rightful claims or interests that arise from acts or omissions of the licensor. 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.

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 or the licensee receive truly exclusive rights. The second involves whether a portion of the rights covered by the license are vested in another person because co-authors or co-inventors were involved, or a prior license exists. In an exclusive license, the licensor implicitly warrants that this is not true. The reasoning on both points is similar: if the implied circumstances are not present, the meaning of "exclusivity" is altered. A similar concern does not exist for non-exclusive licenses because such a condition does not alter the licensee's ability to use the licensed rights as described.

A special rule governs patents, again reflecting practice in patent law. When the exclusivity warranty applies at all, it is restricted to the licensor's knowledge at the time of contracting. The warranty is inapplicable to patent licenses excluded under subsection (c)(3).

Exclusivity and validity are warranted only to the extent recognized in the law that applies 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 holds the secret information. A trade secret gives no rights against independent discovery and, thus, the warranty does not purport to claim that no one else may use the secret information. 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 these 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. These off-setting rules, however, must be embodied in law.

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) similarly 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 risk of a 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, the 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 Uniform Commercial Code Article 2 (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 so clearly to the essence of that bargain that, as indicated in Section 406(a), words of disclaimer in a standard form cannot alter their terms. "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 Uniform Commercial Code §§ 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 underlying 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 and define 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 bargains and this rule does not impose liability in contract for all statements a licensor makes about information, even if not brought to the attention of the licensee.

As in Article 2 of the Uniform Commercial Code (1998 Official Text), Section 402 deals with affirmations of fact, descriptions of information, exhibitions of samples, documentaton, and manuals in the same manner as any other part of the interaction that results in a contract. No specific intent to make a warranty is necessary if any of these are made part of the basis of the bargain. In actual 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 reliance on the specific statement need be shown in order to weave it into the fabric of the agreement. Rather, once made, to take such affirmations out of the agreement requires clear affirmative proof. 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 Article 2 and in this Act, in appropriate cases the assurance may be treated as a further elaboration of the terms of the contract if the parties had reason to know this would occur. Section 208.

3. *Advertising as an Express Warranty.* Paragraph (a)(1) is new and is not found 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. This expands the scope of express warranty law.

However, 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, as well as influence and in fact become part of the basis of the bargain under which it acquired the computer information. If this does not occur, there is no express warranty. Also, many statements made in advertising are, of course, puffing or mere expressions of opinion and do not create an express warranty. In appropriate cases, there may be liability for false advertising, but that does not arise under contract law, but under tort or advertising 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 against the applicable trade usage and in light of the concepts or general rules as to merchantability resolving 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 cup-full of beans communicates one inference, 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. 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 on the distinction 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 reflects 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 justify a remedy 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 of informational 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 the 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 which purports to show that they are tasteful or artistically pleasing creates an express warranty to that effect.

7. *Relation to Disclaimers.* Express warranty rules focus on determining what it is that 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 an information 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 published informational content, but 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 Article 2 "basis of the bargain" standard. See 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 deal with obligations for published informational content as questions of express contractual obligation, rather than warranty. For example, 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 the informational content under contract law, 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). In some other cases, liability may arise under tort, such as in *Hansberry v. Hearst*, 81 Cal. Rptr. 519 (Cal. App. 1968). 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. Where a contract obligation is breached with respect to published informational content in a transaction covered under this Act, remedies under this Act apply and replace remedies under the common law. This includes all provisions of Part 8 of this Act, including rule regarding the measure and exclusion of damages.

9. *Third Parties.* This section does not deal with the enforceability of representations made by remote parties and relied on by an ultimate user of information under tort law. 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 establish, expand or exclude such third party liability.

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, even though under prior law, in many computer program transactions there are no implied warranties. Disclaimer or modification of the implied warranty is dealt with in Section 406. Obligations regarding informational content are described 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. **One**, 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 quality 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 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 and product. The one (merchantability) applies to the program and its functions, while the other (accuracy) applies to the data.

3. *Merchantability.* Merchantability sets out an implied obligation based on a measure of expectations about ordinary meanings and ordinary transactions in commerce. The warranty turns on the ordinary meaning of an agreement 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 in sales of 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 is on the ordinary purposes for which such programs are used, not other purposes. Thus, use of ordinary, mass-market programs in the context of highly sensitive or commercial applications does not change the warranty into one that assures fitness for ordinary purposes of that sensitive use.

Merchantability does not require a perfect program, but the subject matter of the warranty must 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 the merchantability standard. 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 relevant in computer programs and goods, it is not a requirement of an implied warranty in either context.

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 the 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. Typical consumer goods contain fewer than one hundred parts and a typical book has fewer than one hundred fifty thousand words. It is virtually impossible to produce software of complexity that contains no errors in instructions that intermittently cause the program to malfunction, so-called "bugs." The presence of errors in is fully within common expectation – the question for merchantability is not whether there are errors but whether given the errors the program still comes within the middle belt of quality, i.e., fit for the ordinary purposes for which such programs are used.

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 outs 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. Subsection (a)(3) confirms that merchantability includes conformance to descriptions of fact contained on labels or containers. This is consistent with the function of this warranty, which is to give implied assurance that the product is generally the ordinary meaning of what is promised. The statements must be statements of fact, not mere puffing. In this aspect, the implied warranty arises from fact that will often also constitute an express warranty of description. Again, the meaning of any descriptive statement must be interpreted in light of the commercial context.

4. *Disclaimer.* As in in Article 2 of the Uniform Commercial Code (1998 Official Text), the implied warranty of merchantability may be disclaimed as a matter of general contract law 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 state 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 informational content, including the aesthetics of a product. This follows case law under the Uniform Commercial Code. Aesthetics, as used here, 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, express warranty or other rules can be relevant to whether the computer program is what it purports it to be and is merchantable. For example if a claim about images created by a program is that they are not attractive or well-executed, merchantability does not apply. If the complaint is that the commands contained in the program do 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 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 under 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. This expectation cannot properly be understood to anticipate perfectly accurate data unless the agreement so indicates in its express terms. The warranty is limited to inaccuracies caused by a failure to use reasonable care. One who hires an expert cannot expect infallibility. Reasonable efforts, not perfect results, provide the appropriate standard in the absence of an express terms to the contrary. The discussion of the New York court in an analogous setting states 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. On the other hand, a data provider involved in a context where major loss of human life is possible has a higher degree of care than a provider in other, less demanding 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 so as to potentially breach this warranty is based on expectations gauged by ordinary standards of the relevant trade under the circumstances. In most large commercial databases, ordinary expectations assume 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 twenty percent for a particular type of database, an error rate of fifteen percent does not create an inaccuracy within this section and does not breach the warranty. On the other hand, in other commercial contexts, greater of lesser error rates may be ordinarily expected.

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 the aesthetics, subjective quality, or marketability. These are subjective issues. Assurances on these issues require express agreement.

3. *Reliance Relationship.* In addition, the information must be provided by a merchant in a "special relationship of reliance" between the licensor and the licensee. If 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 the implied obligation and to balancing the interest of protecting client expectations while not imposing excessive liability risk on informational content providers in a way that might chill their 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 (a merchant) 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 in 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. The court in *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 it subscribe to an information service that they believe 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. The implied warranty 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 listing information of local restaurants, their prices and their quality, as well as services that provide data about current stock or monetary exchange prices to subscribers.

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 addresses computer information product analogously to print newspapers or books which are not exposed to contractual liability risks based on mere inaccuracy; treating the new computer information products 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).

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 the 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. In these cases, however, the third party may not be contractually obligated to the licensee. Whether or not a contract exists, however, 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 analogous to the theory of negligent misrepresentation. As in the common law, the obligation in this warranty may be disclaimed. Section 406 and see *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993). The warranty is that there are no inaccuracies in the information caused by a lack of care. Subsection (c) makes it 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) of this Act. 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 implicitly relied on by the licensee to achieve its purposes. They reconcile diverse case law. Subsection (c), imposes a new implied warranty.

2. *General Approach.* Subsection (a) applies where 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 the Uniform Commercial Code, apply a standard which creates an implied warranty that the product will be suitable to the purpose. Others, treating a contract as services rather than a sale hold that no enhanced performance obligation exists unless there are express terms to that effect. 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.

2. *Warranty of Fitness.* Subsection (a)(1) applies to cases analogous to transfers involving products and adopts a standard akin to 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 information products are used are under concept of merchantability. Normally, this 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 must implicitly undertake to fulfill them.

As in Article 2 of the Uniform Commercial Code, no express 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 if it has been recommended by the licensor as adequate for the licensee's purposes.

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. 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.

3. *Services Warranty*. Subsection (a)(2) applies if the transaction more closely resembles services contracts and carries forward the type of implied 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 in some cases may also indicate that the parties intended a services obligation as delineated in subsection (a)(2). What constitutes reasonable effort depends on the project involved 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, as well as the others in this section, may be disclaimed. See Comments to Section 404.

4. *Aesthetics and Published Information.* The warranty in subsection (a) does not apply to aesthetics and the like. Subsection (b) nevertheless repeats a theme of the Act, which is that implied warranties do not apply to the aesthetics of information or to published 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. On the other hand, warranty standards are appropriately addressed to whether the information is what its description purports it to be and whether it is useable by the transferee.

5. *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 5 software applications, the warranty is that all 5 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. Other warranties can operate additionally to this 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 of warranties, except statutory warranties which may only be disclaimed under Section 401. The 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 while this Act, reflecting modern terminology, speaks of "disclaiming" or "modifying" warranties; no substantive difference is intended. This Act does not alter consumer protection statutes that in some states preclude disclaimer of implied warranties in consumer cases. Section 105. The section follows fundamental U.S. law which recognize that implied warranties are default rules and parties may disclaim or limit them to control what risk each undertakes.

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. While, in effect, an express warranty cannot be disclaimed, a representation that might otherwise be an express warranty can be excluded from the bargain. The agreement controls. For example, language of the agreement, including language styled as 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 precise 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 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 though a disclaimer may eliminate contractual warranty liability. A failure to disclose known material problems in a product being provided pursuant to a license may constitute fraud if 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 may foreclose a claim in fraud by eliminating the element of fraud that requires reasonable reliance on a material misrepresentation.

4. *Disclaimer of Implied Warranties.* Subsection (b) states particular rules for disclaimer of implied warranties. These are subject to subsections (c), (d) and (e). The purpose of the disclaimer rules is to provide a means in which the parties can clearly achieve their intended result in either disclaiming or not disclaiming a warranty, and which means also assures 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) in providing that disclaimer of implied warranties of merchantability (Section 403) or accuracy (Section 404) need not be in a record. Disclaimer of the "fitness" warranty and the general language for disclaiming all implied warranties in subsection (b)(3), however, must be contained 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 the disclaimer, the language must be conspicuous. These rules follow Uniform Commercial Code § 2-316 (1998 Official Text). Use of "quality" is allowed for the merchantability warranty, but not required. Alternative words must reasonably achieve the purpose of clearly indicating that the warranty is not given. The rules here, however, 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 be conspicuous. This applies the rule in Article 2 of the Uniform Commercial Code for the "fitness" warranty to both this Act's "fitness" warranty and its new systems integration warranty.

d. *Disclaimer of All Warranties.* Subsection (b)(3) recognizes that in some cases all implied warranties are disclaimed. The subsection 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 that will avoid traps for parties in contracts involving mixed subject matter. The intent is to avoid requiring parties to make a priori determinations about which law governs. Language adequate to disclaim a warranty under one of these statutes is adequate to disclaim the equivalent warranty under this Act.

5. *Disclaimers of Implied Warranties By Circumstances.* Subsections (c), (d) and (e) deal with situations in which the circumstances surrounding the transaction are in themselves sufficient to call the licensee's attention to the fact that an implied warranty is not made or is excluded. These methods 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 under Uniform Commercial Code Article 2, recognition of the effectiveness of these terms here is a specific application of rule in subsection (e) which provides that implied warranties for exclusion of modification of implied warranties by usage of trade. The terms also accommodate electronic commerce which may require "short" or 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. Thus, "examination" is not synonymous with inspection before acceptance of information tendered pursuant to a contract or inspected at other time after the contract has been made. It goes to the nature of the responsibility assumed by the licensor in making 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 the existence of a warranty on a subject which examination did or should have reveals. In the event the contract is made, the resulting damages may be found to result from the licensee's own action rather than from a breach of warranty.

For a transaction to be within the scope of 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 the information. This puts the licensee on notice that it is assuming the risk of defects which the examination ought to reveal. On the other hand, this result can be altered by statements made by the licensor at the time. Thus, if the offer of examination is accompanied by words giving assurance about their merchantability or about specific attributes and the buyer indicates clearly that it is relying on those words rather than on an examination, the words may give create an "express" warranty. In such case, disclaimer of an express warranty is governed by subsection (a).

The licensee's skill and the normal method of examining information in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious 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 as to 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 precise and complete specifications for an informational product, implied performance warranties may be excluded. The warranty of fitness will not normally apply because there is no reliance on the licensor. The warranty of merchantability in such a transaction 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 as to the information or program, 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 of Section.* This section deals with the effect of modifications by the licensee to computer programs of 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. The rule applies only to a modified copy. If the defect existed in the unmodified copy, modifications have no effect. Also, the warranty only relates to performance **--** it does not apply to title and non-infringement warranties.

2. *Policy Basis.* The complexity of computer programs means that even small changes may cause unanticipated and uncertain results. Also, 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.

3. *Application.* The section covers cases where the licensee makes changes that are not part of the program options. If a user employs a menu of options to tailor a computer program to the user's needs, 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 where the parties jointly develop a program, with each authorized to change code created by the other. Who is the licensor in such cases is not clear, but the joint project takes the case out of this section. What warranties arise is determined by who the licensor is and by the agreement of the parties, which is construed in light of the circumstances of the transaction.

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 inter-relationship of various types of warranties. The section follows Article 2 of the Uniform Commercial Code (1998 Official Text).

2. *Cumulative Warranties.* The basic premise of this section rests on the policy of this Act that no warranty is created except by some conduct by the licensor. Therefore, the presumption is that all warranties are cumulative unless this construction of the contract is impossible or unreasonable, or the terms of the agreement indicate otherwise.

3. *Inconsistent Warranties.* Paragraphs (1), (2) and (3) derive from Article 2 and deal with interpretive rules applicable to determining the intent of the parties as to which of several inconsistent potential sources of warranties that have arisen from the circumstances of the transaction prevail. These rules do not displace concepts of equitable estoppel, but apply where the licensor has in good faith engaged in conduct or made representations that might establish warranties but which later turn out to be inconsistent. To the extent that the seller led the buyer 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 the factor which probably claimed the attention of the parties in the first instance. Thus, express warranties displace inconsistent implied warranties and exact technical specifications displace the import of an inconsistent sample. In both cases, the more specific or explicit terms are presumed to be the dominant factors defining the agreement. These rules are not absolute but 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 *Restatement (Second) of Torts* § 552 dealing with the liability to third parties for a provider of information. It expands both as to uses within the licensee's household.

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 third party. The liability covers use in transactions that the licensor intended to influence and does not include liability for published informational content.

> **Illustration:** Licensor contracts 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 (who did not evidence that it intended the warranty of reasonable care to run to anyone other than the Publisher)) makes a warranty to a general buyer of the book.

Dealing with informational content, the California Supreme Court in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

> By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

To impose liability under contract law, the information provider must have known of and clearly intended to have an effect on third parties. 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 sensitivity to the risk 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 products liability or other tort issues. It neither expands nor restricts tort concepts that might apply for third party risk, leaving development or non-development of any appropriate liability doctrine to common law courts. Indeed, few courts impose third party tort liability in transactions involving information. The *Restatement (Third) on Products Liability,* recognizing this, 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. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in other contexts. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. *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 use of 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 law 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, and any tension between merchantability in warranty and defect in tort where 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 however, 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 under this Act.

4. *Household and Family Use.* Subsection (b) modifies intended beneficiary concepts to per se include the family of an individual, consumer licensee. This covers both personal injury and economic losses and applies to consumer use by the indicated persons. To apply, the use by the family members 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 data compression system licensed to a professional, this section does not create or extend any warranties to that household member because the predicate warranty 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.* Subsections (c) and (d) reflect that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to affect third parties excludes liability under this section. This follows current law. See, e.g., *Rosenstein v. Standard and Poor's Corp.,* 636 N.E.2d 898 (Ill. App. 1993).

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 transfers of ownership of intellectual property rights, not transfers of title to a copy.

2. *Copy vs. Rights 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 federal 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 media that constitutes the copy is merely a conduit for use, but not ownership, of rights.

3. *Rights Ownership.* Subsection (a) deals with when and where 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). If federal law requires a writing for a transfer of ownership, state law is subject to that rule and subsection (a) should be read as conditional on compliance with such federal law requirement. Section 105. Similarly, while most copyright works for hire are not within this Act, if copyright law doctrines regarding a work for hire apply, they control over this section to the extent of any inconsistency.

The agreement controls when and where ownership of rights passes to the other party. The agreement may be found in express terms of the contract or usage of trade, course of dealing, or the circumstances of the particular transaction. In the absence of terms of agreement, under this section, 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 it stands for the proposition that ownership cannot pass until actual delivery of the completed work.

Identification 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 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, the agreement controls. 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.

While identification to the contract controls in the absence of contrary agreement, the agreement ultimately controls. 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, of course, a court may 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, if there was no intent to transfer title of 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. The agreement controls. 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 and is an application of the basic principle that the agreement controls, rather than any formal placement of title.

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 default 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 and distribution of the manuscript as computer information, reserves title only to the delivered copy and not to the digital copies produced by the publisher. On the other hand, this concept does not apply where the expectation is that the licensee will transfer copies to others subject to a license mandated by the licensor. In that case, distribution is contemplated, but under license and not transfer of title to copies. In any case, of course, the agreement controls and express terms on this issue displace the default 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 such 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. This Act takes a neutral position.

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 both transferability when the agreement is silent and the effect of a term prohibiting or limiting transfer.

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 perform the contract through a delegate in that, in the former circumstance, 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 is silent, transfer of contract 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. *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 lease, loan or rental of a computer program, even by the owner of a copy, without the permission of the licensor.

When applicable, these federal rules will preempt contrary state law, including the rule in paragraph (1). The federal policy regarding 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 but it does set a default rule that creates a contrary starting point.

b. *Material Harm to Other Party.* The second limit on transferability (when the contract is silent) is that the contract cannot be transferred without consent if such would impair the other party's position in the contract or expectation of performance. In addition to the preclusion of transfers that cause material harm, 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 is often associated with cases in which the transfer is made by a party owing executory or on-going performance and the transfer either purports to shift that performance to a third party or otherwise undermines its occurrence. For example, a transfer of contractual rights under which the transferee holds and has use of trade secret information of the other party will ordinarily be barred because it would place that information in the hands of another person to which the licensor never agreed. 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.

Material harm should be interpreted here 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 law suit. 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 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, for example, 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. There, the presence of confidential information may foreclose non-consensual transfers because the transfer jeopardizes the other party's enforceable interests in confidentiality. The fact that the interest can be protected by a lawsuit for damages dues 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.

Mass market licenses 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 defects in the software calculations, repeated transfers of the license multiple times during a tax preparation season may increase in the burden or risk. A transfer of the license along with a single copy by a licensee that retains other copies subject to the same license may also have an adverse impact.

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 *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 that 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).

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. Further, while an ineffective transfer creates no rights against the licensor, that does mean that the transfer automatically creates a cause of action for infringement by the licensor against the transferee. Whether that exists is determined by other law. Copyright law would allow a claim of infringement against the transferee if the transferee's conduct infringes exclusive rights under copyright. Trade secret law would often allow a bona fide transferee for value to take free from a remote party's claims. This Act does not change either result.

If information is not protected under copyright, trademark, or patent law, the fact that the transfer is ineffective does not 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 in violation of trust. 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 the party who did not participate in the transfer. However, if there in not proprietary information involved, the absence of those contractual rights is not meaningful. The transferee was not a party to and did not breach the original contract, nor is it subject to an infringing proprietary rights of the non-transferring party.

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 cancels the license against SL. The rule making the transfer ineffective preserves the original bargain. As between the SL and AT&T, AT&T would be entitled to refund of the consideration paid for the transfer.

5. *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 does not affect the Article 9 rule that, in itself, the contract term cannot preclude such transfer, while also preserving the underlying rule of law that precludes transfers that materially harm the other party.

6. *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 altogether or that preclude all transfers without consent of the licensor; it does not refer to terms that allow transfer but under stated conditions or restrictions, such as permitting transfer if the licensee transfers or destroys all copies in its possession that are subject to the transferred license.

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 Article 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 a consent by that party to a novation. Mere transfer does not create a novation eliminating the otherwise enforceable contractual rights created between the original parties to the contract.

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 substitutes the transferee for the transferor both 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 is only to create a security interest and not to delegate duties and rights of the transferor 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.

2. *Transferee Interests.* Subsection (a) provides that a transferee of the license acquires only the rights that the license and this Act allow. This rule applies to purchasers of contractual interests, including persons who acquire an nterest 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 information that is subject to the license. If the transfer is effective, the transferee 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. This important principle from intellectual property law differs from transactions involving sales of goods. It reflects the fact that one of the property rights created under copyright law is the exclusive right to distribute a work in copies. A transferee that receives a transfer not authorized by the rights-holder does not acquire greater rights than its transferor was authorized to transfer, even if the party made the acquisition in good faith and without knowledge. As regards intellectual property rights, an unauthorized transfer may itself be a violation of the distribution or other rights of the copyright owner. Ideas of entrustment and bona fide purchase, which play a major role in handling goods, have no similar role in most areas of intellectual property law.

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. Transfers that exceed or are otherwise unlicensed by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase 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 such 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 simply 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 section deals with circumstances in which a financier engaged in a transaction with a licensee does not, as part of that relationship, become a licensee of the license.

2. *Financier.* In this Act, a "financier" is a person who makes a financial accommodation related to a license, but is not the licensor or a secured party. A secured party's position is governed by Article 9 of the Uniform Commercial Code. 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.

2. *Rights of Financier.* If the financier does not become 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 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 alter or expand the licensee's rights under the license.

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 licnse-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 or express 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.

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. This section is self-executing; no special provision need be added to 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. Thus, on the licensee's acceptance of the license the licensee's promises to the financier under become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith.

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. This is appropriate because the license is made to and provides the benefit of the licensor's promises and warranties to the licensee. Despite this balance, this section excludes a finance license that is a consumer contract.

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 <u>that</u> contract. Subsection (a) sets out aspects of the financier's rights on such 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 over-riding 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, upon breach of the financial accommodation contract the financier has access to the remedies created under this Act, subject to Act restrictions. 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 contained 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, upon 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 right does not give this type of financier a right to possess 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 written as a transfer of a contractual right that would invoke Section 503. Accordingly, 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 of the financier. 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, subject to restrictions in federal law. Thus, the financier, notwithstanding any contrary rights under the financial accommodation contract, 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.

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 of computer information, subsection (a) makes clear that creating a financier's interest places no obligations on the licensor, nor does it alter the licensor's rights. An example lies in whether the licensor can, despite the existence of the financier's relationship with the licensee, exercise rights to cancel or otherwise enforce the license. The answer is that 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. The 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 pertaining to performance of a contract. In cases 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 of this Act 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. See *Restatement (Second) of Contracts* § 237. This contingent relationship described in subsection (b) does not refer to contractual use terms. A breach by one party does not allow the other to ignore those restrictions on use. This is true even if the aggrieved party has a duty to mitigate loss. A breach by the licensor does not give the licensee unfettered 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 and 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. While minor problems may indicate a breach, the remedy lies in recovery of damages. The policy underlying the idea of material breach 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 by the terms of their agreement. The material breach standard applies to both the licensor and the licensee. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem, nor can the licensee that receives imperfect performance from the licensor. In both cases, the imperfect performance may yield a right to damages.

4. *Conforming Tender: Mass Market.* Under subsection (b)(1), the material breach standard does not apply as a precondition to refuse a performance or cancel a contract in mass-market transactions involving mass market tenders of delivery of a copy. See Section 704(b). Instead, this Act adopts the rule followed in Article 2 and Article 2A of the Uniform Commercial Code. These statutes stand alone in contract law in not using the material breach concept, but do so but only in one situation: a single delivery of goods not part of an installment contract.

This Act adopts the conforming tender rule as a basis to refuse a performance or cancel a contract for cases involving delivery of a copy in mass-market transactions, thereby creating a rule that parallels Article 2. The "conforming [perfect] tender" rule is not a "perfect" tender rule even in Article 2. What is a conforming tender is restricted by legal considerations regarding merchantability, and by principles such as usage of trade and course of performance. It is further limited by principles of waiver and a right to cure. As one leading treatise comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ."

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 presumed 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. The rule is stated in general terms here. Of course, if the tendered performance is a material breach, the party receiving the tender 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 fails to conform to the contract and consists of 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. Thus, for example, a payment that is one-half the required amount is a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the 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 depends on the agreement, but in most cases in commerce it consists of two elements: making the information available (if necessary) and giving authority or permission to use the information. The alternatives in subsection (b) conform to that dual requirement.

2. *No Acts Required.* In computer information transactions. a licensor may or may not be required to deliver anything. Instead, in many cases, it will suffice to authorize use of information that the licensee obtained from other sources or to authorize access to information. Paragraph (b)(1) recognizes the importance of 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 under the agreement 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 patterned after rule for 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 excludes sale of goods standards in such cases, and focuses on industry practices . The section deals only with contract issues and does not address liability or rights under other law.

2. *Tender-acceptance Rules Not Applicable.* Under paragraph (1), rules in this Act regarding tender, acceptance and rejection of copies do not apply where the transaction involves information submitted under terms providing for approval to the satisfaction of the licensee. The rules dealing with copies in this Act are modeled on rules regarding the sale of goods. There, the focus is on making 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 in these fields.

3. *Express Choices.* Acceptance or rejection 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, of course, prevent use for the purpose of reviewed, correcting, or otherwise adjusting the information to meet the recipient’s satisfaction.

4. *Demand for Decision.* Under paragraph (3), express choices supplant rules that might operate from failure to reject or from delays in submitting changes. However, 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, of course, 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.

This section applies, for example, in a case where the licensed subject matter is the results of a database search for the top selling consumer product in May. Once performed and revealed to the transferee, the subject matter cannot be returned. The subject matter of the contract involves informational content that, once seen, has communicated the value that exists in the performance.

2. *General Rules Govern.* For these transactions, the 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. Reliance on the sections of this Act dealng 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 reality and 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 its 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 <u>preventing</u> breach, but 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 a breach or with enforcement concerning information that is outside the subject matter of this Act. The restraints here derive from contract terms and limit use consistent with the contract or the termination of a license at its natural end. The basic principle is that a contract can be limited to its terms and that it is appropriate to do so through automated means.

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 keyed 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 accessible by other systems – incompatibilities are not “restraints” as used in this section. Rather, “restraints” 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.* Subsection (b) states alternative bases that permit use of automated restraints. The alternatives are co-equal; 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).

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 with 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. 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 of the information at the unauthorized location. The licensee still retains the information at the appropriate location. 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 multiple concurrent users is not authorized by this subsection. The agreement must support the restraint. . A restraint inconsistent with the contract is a breach of contract.

c. *Enforcing Informational Rights.* Subsection (b)(2) also allows use of passive devices that preclude infringing informational rights. Merely preventing the act does not require a contract or other 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. Termination 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).

5. *Cancellation.* Cancellation means ending a contract because of breach. Subsection (f) makes it clear that nothing in this section authorizes or otherwise deals with electronic or other devices used to enforce rights in the event of breach and cancellation.

> **Illustration.** A license requires monthly payments on the first and runs for one year. Licensee makes one payment five days late. Licensor uses an electronic device to turn off the software since payment was late and breach has occurred. That act is not authorized under this section since it is an action that 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.

Note that while Section 816 on electronic self-help can be used electronically to enforce rights after breach, in the example, Section 816 also would not authorize the licensor's actions (e.g., licensor failed to provide the notice and comply with the other limitations of Section 816).

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 tender of delivery of a copy. It corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) with changes that reflect information as the subject matter.

2. *Shipment vs. Destination Contracts.* Subsection (a) maintains the traditional 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 as to determining when a contract is a shipment or a destination contract. The norm is for a shipment contract; destination contracts are the exception which require an explicit agreement or use of destination contract shipping terms in the computer information contract (use of trade terms in a contract of carriage may carry different meanings than the terms described here). 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 agreement is to make the copies available at the licensor's site (in Incoterms, the "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" (Article 2-504), "C.I.F.", "C.I.F. destination" and "C.&F." (Article 2-320). Under the international 1990 Incoterms, shipment contracts include the "F" terms and the "C" terms such as "FCA" (Free Carrier),_CIF (Cost, Insurance and Freight),_but not the "D" terms such as "DAF" (Delivered At Frontier). The "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 cpy be put and held available at the appropriate place and the other party notified of the tender.

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 various a variety of rules from Article 2 of the Uniform Commercial Code (1998 Official Text) and from the Restatement (Second) of Contracts as applicable, to transfers involving delivery of a copy.

2. *Basic Rule.* The basic approach adopted here is consistent with Section 601 and follows Article 2. A tender of a performance (in this case, delivery of a copy) is a condition to the duty to accept the copy and to the obligation to pay for that copy on delivery. This is a default rule that is subject to contrary agreement, including the implications of the transaction and 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 default 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 inferred from 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 the copy. Acceptance in this sense refers to acceptance of the copy and not to agreement to or adoption of contract terms. A contract ordinarily exists before delivery or an opportunity to inspect the product delivered. 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 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 and corresponds to Article 2 and Article 2A. 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 unless acceptance is revoked, acceptance does not in itself impair any other remedy for nonconformity.

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 (if the party had a right to inspect the information or copy under the agreement or the default rules of this Act) unless they occur after a reasonable opportunity to inspect.

a. *Commingling.* Paragraphs (a)(3) and (a)(4) focus on two circumstances significant in reference to computer information that raise issues different 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 a refusal of 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 refers to 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 or information integrated into a database or knowledge base from which it cannot be separated.

b. *Non-returnable Benefits.* Subsection (a)(4) treats as acceptance the receipt, use or exploitation of the value of the information provided by the licensor. In information transactions, in many instances merely being exposed to the factual or other material transfers the significant value. See Comments to Section 604. Often, use of the information does the same. Again, 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 faced with such conduct an option to either treat the acts as acceptance, or as a rejection followed by acts of conversion or the like.

In information transactions, however, the options are less clear than in sales of goods, since a licensee can avoid explicit acceptance of the information, but then act in a manner that is 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 modifies the Article 2 rule and recognizes that if the licensor decides to treat the acts as acceptance, it need not also ratify actions of a licensee's 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 signifyin 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 contractually authorized district, but also sue for infringement as to uses or distribution outside the contract terms.

4. *Delivery in Stages.* Subsection (c) deals with an important setting in computer information transactions - 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 as a default rule that each acceptance is implicitly conditional on the eventual acceptance of the whole. While this rule can be varied by contrary agreement, it represents the most likely expectation of the parties in such on-going 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 with 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. As with acceptance of any performance, 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 alter the accepting party's remedies. Ordinarily, 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 that in Article 2 and should be interpreted with that in mind.

3. *Burden of establishing."* A party that has accepted a copy and cannot or does not revoke that acceptance has the burden of establishing the breach. "Burden of establishing" has the meaning set forth in niform Commercial Code Article 1, 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 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 rule is that notice must be given within a reasonable time after the defect should have been discovered. If a defect is neither known nor knowable for an extended period, the reasonable time to notify extends from when it should have been discovered. What constitutes a reasonable time and to what extent it can be determined by agreement 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 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 (assuming the contract does not restrict access to specified hours or days). This is a modern application of traditional concepts of licensed use of resources applied to electronic contexts.

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)..

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 a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v. Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

c. *Use of Received Information.* The access contract may or may not contain terms that 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).

In contrast, 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, of course, the terms of the agreement. Once information is received by the licensee, it is ordinarily no longer appropriate to treat the relationship as an access contract, but it is simply a license. For example, if licensee uses the access provided by its contract with ABC Corporation 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 default rules of this Act regarding software licenses. 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) (on-screen limitation precluding commercial use of software enforced; court did not clarify whether the notice was a license or merely limited permission granted by posting the software on the Internet).

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)). The rules here are default rules that may be varied by agreement..

2. *Nature of Obligation to Correct Problems.* Obligations under agreements to correct performance problems differ from an obligation to provide updates or new versions of software or to cure warranty breaches. 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.* Most agreements to correct performance problems are services contracts. The contract obligation is stated in subsection (a)(1). It parallels the obligation that a 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. This section measures that by reference to standards of the relevant trade or industry.

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. The prototype is a limited express warranty created a duty to "repair" the defective product. The agreements are under subsection (a)(2). 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 make available advice or consulting services relating to the information. Subsection (b) provides a default rule regarding support agreements. As a form of 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. The section only applies to retail distribution of physical copies. See Section 102(46) for a discussion of retail.

2. *Parties.* Subsection (a) contains three definitions that apply solely within this section. A "dealer" is essentially the retailer or other distributor that receives information for redistribution, e.g., a store that stocks its shelves with computer information products. The "end user" is the end-customer at reatil, i.e., the consumer or other person who acquires for use (as opposed to re-distribution) a copy of the information from the Store. A "publisher' is a licensor other than the dealer, e.g., the copyright owner who licensed the dealer to distribute the information. If a licensor of a word processing program distributes physical copies to Store for acquisition by 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 in the cases considered in this section, 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 distribution and the end user's rights are subject to a publisher's license with the end user. Unlike in distribution of goods by sale, under copyright law, the end user's rights to use the copy (i.e., to allow his computer to make copies of the information in order to use the copy) do not flow simply from delivery of the copy to it, but depend on the dealer's compliance with the distribution license. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994). This is because, for example, the rights to make copies and distribute copies are exclusive rights of the copyright owner (the publisher) and are only conditionally licensed to the dealer.

Subsection (b) deals with the common situation in which the end user's right to use the copy depends on a license from the publisher to the end user. It thus does not concern a case where the publisher sold or authorized sale of copies not subject to a license. In the cases to which it applies, however, subsection (b) provides a basis to reconcile the position of the three parties which protects insofar as possible, the retail expectations of the end user.

a. *Contracts Separable.* Under paragraph (b)(3), the dealer is not bound by, nor does it benefit from any contract created by the publisher with the end user unless the dealer and end user adopt those terms as part of <u>their</u> agreement. This follows case law on manufacturer warranties and warranty limitations in other contexts, although that rule has been over-ridden in some states. See Cal. Civ. Code § 1791 ("as is" disclaimer disclaims warranties for manufacturer, distributor and retailer-dealer). Because the agreements are separate, warranties or other obligations of a dealer are not affected (reduced or expanded) if the publisher's license is accepted by the end user. The dealer is bound by its contract with the publisher.

b. *Dealer as Licensor.* Subsection (d) confirms that the dealer is a licensor with respect to the end user. It may have contractual obligations under this Act flowing from its own agreement with the end user. This corresponds to ordinary retail expectations; the retailer is not viewed as nothing more than a conduit with respect to recovery of the price in the event of default. As a result, in effect, the end user licensee may have separate recourse against two different parties (the dealer and, if it agrees to the license, the publisher).

c. *Conditional Rights.* Under subsection (b)(1) and (b)(2), the dealer's relationship with the end user hinges on the end user's ability to use the information supplied by the dealer. This depends on the license between the publisher and the end user. If the end user declines that license, it has a right to obtain a refund from, or to cancel payment to, the dealer. This creates a return *right*, rather than merely an option.

An alternative view of the relationship, which is not precluded by the section if it is created by the agreement of the parties, treats 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 entire terms of the relationship. This is an application of the right, long 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 here coming in the form of a 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 arrangement 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 also *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 with respect to 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 focuses on risk of loss; it does not alter rules of this Act about passage of title or tender of delivery. Each of these operate independently.

2. *Basic Approach.* This section follows Article 2 of the Uniform Commercial Code (1998 Official Text): 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 is a default rule 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, as between licensor and licensee, risk of loss 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. Subsection (a). 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. This rule places the risk of a loss that occurs during transmission on the sender and assumes that the transferor who sends the copy electronically also retains a copy that could be used for retransmission. This rule for electronic transfers of copies compares to the rule for delivery of tangible copies. It does not concern issues about when tender of delivery occurs which, in most cases is on delivery to a carrier or electronic transmission.

4. *Delivery of Physical Copies.* Subsection (b) deals with transactions in which the transfer of the copy is of a tangible copy to be shipped. The rules of this section are from U.C.C. Article 2 (1998 Official Text) and correspond to when a tender of delivery occurs. They distinguish between a shipment contract (Section 606(b)(2)) and a destination contract (Section 606(b)(3)). Most shipments of tangible copies involve shipment contracts, but the agreement controls. "Duly delivered" in the case of 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) states rules regarding transfers accomplished without moving a copy. It transfers risk of loss 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 cases 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 formulation of 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 Article 2-615 of the Uniform Commercial Code (1998 Official Text) and intends to adopt the decisions and policies reflected under that section. A party is excused from timely performance of a contractual obligation if that performance becomes commercially impracticable because of unforeseen supervening events not within the contemplation of the parties at the time of contracting. The standard of excuse in this section does not apply to an obligation to pay or conform to use restrictions. This does not displace general law on the effect of governmental regulations as an excuse for the obligation of payment. The section merely does not address that issue, leaving its resolution to general 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 of the contingency that occurred. 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) states a basic rule of fairness, requiring 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 allocation rules based on Article 2 and limited to cases involving a contractual obligation 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 over-riding 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 the licensor exercise care in making allocations and, in cases of doubt, current contract customers should generally be favored. Except for such considerations, however, 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 gives a partial list of 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.

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) from the other, the discharge that occurs from termination does not affect that earned obligation. If the obligations of one or both parties are partly, but not fully completed, the basic rule is that an obligation is executory for purposes of this section if it is not fully performed and the unperformed part is such that a failure to perform it would be a material breach that excuses the other party's contractual 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 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 the express terms of the contract 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 here 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 is notice is reasonable varies with the circumstances. For example, where the reason for termination involves unlawful conduct or a desire to prevent harmful acts, notice at or promptly after termination may suffice. In less exigent or harmful circumstances, giving prior notice ordinarily may be required. A function of the notice requirement when there are no exigent circumstances and there is no material breach that would justify cancellation, is to give the other party an opportunity to make other arrangements and to avoid use of the information after termination in a way that may result in further breach of contract or infringement of intellectual property rights.

The party terminating the contract must give notice. A requirement that notice be received would create uncertainty that is undesirable where the terminating party is merely exercising a contractual right. The uncertainty is especially great in online situations where the current or actual location of many users may be difficult or impossible to ascertain.

4. *Access Contracts.* Under subsection (c), termination of access in an access contract does not require notice even if based on exercise of discretion by the terminating party . Of course, 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 prior law for licenses of this type, although in many cases, a license to use resources or property of the licensor is subject to termination at will without notice. This section provides a limited exception to the common law rule and applies 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. What is meant here is ownership of the information. Thus if a customer provides information to effect a purchase, the customer transactional information is typically 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 contract principle.

a. First, an agreed waiver of notice is enforceable only 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 and winding down the relationship. 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 efforts. In some cases, circumstances may prevent or delay a their return. A reasonable effort, however, does not encompass intentional or knowing retention of copies. Similarly, it is subject to subsection (b) which makes clear that use of the information after the contract terminates is a breach of contract.

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 after termination breach 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 this 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 a breach of contract and provides 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.

2. *What is a Breach?* What is a breach 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 contract limits, and other breaches.

3. *What is a material breach?* This Act adopts the rule followed in common law and international law. Parties are entitled to the performance for which they bargain, but some breaches are so immaterial that they do not justify allowing cancellation of the entire contract. In such cases, it is better to preserve a contract despite minor problems than to allow one party to cancel for minor defects and thereby risk an unwarranted forfeiture or allow unfair opportunism. Materiality depends on the agreement or, failing that, 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 never 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 reference points: 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 thirty million dollar license, a ten dollar loss would likely be non-material.

The list in subsection (b) is not exclusive. 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 generally preclude unreasonable forfeiture of interests for minor defalcations; 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.

4. *Contract Terms.* The agreement defines what is a material breach in two ways. The first is 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 reasonably interpret that agreement. Thus, a term providing that *any* failure to conform to *any* contract term permits cancellation must be interpreted in light of commercial context that includes usage of trade, course of performance, or course of dealing. Section 113(b). That context may indicate that minor breach of some terms are nonetheless not adequate for cancellation. The second method involves enforcing express conditions. If a contract indicates 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 to not 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.

5. *What Remedies Apply?* If a party's performance breaches the contract, the aggrieved party is entitled to its remedies. The remedies available depend on the nature of the breach. 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. 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.

SECTION 702. WAIVER OF REMEDY FOR BREACH OF CONTRACT.

Uniform Law Sources: Uniform Commercial Code: Sections 1-207; 2A-107; 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. This rule in subsection (a) does not preclude other forms of waiver, but merely confirms that waivers within its provisions are effective. Oral waivers effective under common law remain effective under this Act.

3. *Waiver by Accepting a Performance.* Subsection (b) deals with waivers resulting from accepting a performance without objecting to known deficiencies in it. Waiver is implied 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 for the party to particularize the reasons for the refusal. Under subsection (c), however, a waiver results from a failure to particularize the reason for refusal if the other party could have cured the problem had it been seasonably given the 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 follows Uniform Commercial Code § 2-605 (1998 Official Text). 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 the past events whose consequences are waived. This principle is especially important in the continuing relationships often evidenced by licenses. It allows and encourages aggrieved parties to waive particular defective performances without forfeiting rights as to future performances, and thus supports an ongoing relationship.

Also, a waiver enforceable 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.

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 recognizes an opportunity to cure a breach and retain a contractual relationship. For licensees, cure often relates to missed or delayed payments or failure to timely give a required accounting or other report. For licensors, the issues often focus on timeliness of performance and adequacy of product. The section sets limits on the opportunity to cure, reflecting a balance between a goal of preserving contract relationships and a goal of giving the injured party the full benefit of its agreement. Subsection (b) creates a new rule: a limited duty to cure in cases where the injured party was required to accept a copy because it was not a material breach 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; U.N. *Sales Convention on the International Sale of Goods* art. 48.

3. *Right to Cure.* This section generally allows cure if it is prompt and in the circumstances avoids harm to the aggrieved party. The 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 recover damages, but prevents cancellation of the contract based on the cured breach.

A right to cure exists if the cure occurs before the time for performance expires under paragraph (a)(1). A party whose early actions created a breach has an opportunity to make a good tender within the contract time. What is the agreed time for performance is determined by the agreement at the time of performance, including any enforceable modifications.

Cure requires seasonable notice to the other party 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 giving notice and completing the cure. What constitutes seasonable notice depends on the context, including the importance of the expected performance and the timing and difficulty of obtaining substitutes. The notice does not constitute cure. Cure only occurs when a 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 initial performance would be acceptable.* Paragraph (a)(2) creates a rule that seeks to avoid injustice by reason of a surprise refusal of a performance. The 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. Such 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 agreement terms that strict performance is required, those indications control application of 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 show that expectations consistent with the trade usage or course of dealing are unreasonable.

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. Paragraph (a)(3) allows cure, but is restricted by the limitation that the cure must occur before the aggrieved party cancels the contract. This places control in the aggrieved party. In the mass market and in other cases of contracts involving rights in a copy, refusal of the copy may be cancellation because the entire transaction focused on providing rights associated with a copy. In such cases, no special notice or words of cancellation are required. As indicated in subsection (c), the aggrieved party is not required to withhold cancellation simply because of a notice of intent to cure received from the other party: whether cancellation will occur before the cure still is within the control of the aggrieved party.

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 fully compensate 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 by breach cannot be reversed and the provisions for cure under this section are inapplicable. A similar condition may arise where the agreement demands performance on a specific date or hour, but the performing 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 a 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 performance because there is no material breach even though a defect exists. It creates an obligation to attempt to cure. Failure to undertake the effort is a breach, but failure to correct the problem is not a breach. The obligation to attempt a cure is limited by proportionality. No obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five non-material names that reduce the value of the list by a small amount, it 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 principles that refusing a proffered performance is appropriate only if the performance entails a material breach of the agreement as to that performance, in this case the copy.

Refusal is the converse of "acceptance." A decision to refuse a tender ordinarily requires refusal of all of the tender. However, a licensee may accept some commercial units in the tender and reject the rest, if the commercial units are separable in light of the contracted performance. For example, if the vendor tenders thirty copies and ten are defective, the commercial unit is the copy and the licensee can accept the twenty and refuse the remainder. On the other hand, tender of of a single program where ten modules are defective and thirty are not does not create multiple commercial units and must be refused in whole or not at all. This section thus does not permit a party to disassemble an integrated or composite product, keeping what it desires and rejecting the rest. The part accepted (or rejected) must be a reasonable commercial unit; the issue is not whether some of the composite product could have been provided separately, but whether as provided pursuant to the agreement, it was reasonably a separable commercial unit. A partial acceptance must occur in good faith and in conformance with standards of commercial reasonableness.

Acceptance of a all or part of a performance does not generally waive the party's rights to a remedy for breach..

3. *Conforming Tender Rule.* Subsection (b) adopts the "conforming tender" rule for mass-market transactions that fit the circumstances under which that rule exists under Article 2 of the Uniform Commercial Code (1998 Official Text) **-** transactions where the only obligation entails providing a single delivery. In more complex transactions, neither Article 2, nor this Act require conforming tender as a precondition to the recipient's obligation to accept.

While sometimes described as a "perfect tender" rule, the "conforming tender" rule does not require tender of a "perfect" copy or "perfect" product. What performance conforms to the agreement depends on what the agreement entails, including the express terms as interpreted in light of usage of trade, course of dealing and concepts of merchantability. In addition, refusal of a tender may yield a right or opportunity to cure. Section 703.

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 corresponds to waiver rules under common law and this Act. It precludes arguments that silent "refusal" can be effective or coupled with active use of the information.

5. *Refusal and Cancellation.* Many transactions involve contractual commitments that go beyond the obligation to deliver 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.* This section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts. The similarity lies in that more than one performance by the licensor occurs. The difference is that the performances involve a grant of informational rights followed by delivery of a copy, while installment contracts deal with serial deliveries of copies.

2. *Transactions Covered.* The section distinguishes (1) agreements where a grant to use informational rights vests independent 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. In that context, the relationship between tender of a defective copy and cancellation of the entire contract or cure is that refusal of the 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 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.

3. *Nature of the Transaction.* The section applies only if the contract vests the right or permission to use informational rights without the transferee's receipt of a copy. Whether this circumstance exists depends on the agreement. When a vested rights transaction occurs, the parties view a copy as a mere conduit to complete an already vested grant. In such cases, a defect in a copy is not necessarily material to the entire contract. In contrast, if the agreement does not create a prior vesting of rights and the transaction is not an installment contract, a material defect in the copy tendered may be material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the informational rights vest by agreement independent of a copy, the licensee can refuse the copy and still expect and insist on performance and exercise rights under 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 for the delay, 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 June of the first the 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 the copy is technically defective and 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 permit or result in a decision to cancel the contract. Upon cancellation, Section 802 applies and 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 thus available.

The difference lies in the fact that cancellation requires both parties promptly to disengage from the entire contract, returning any material previously received and refraining from any use of the information that would have been allowed under the license. Cancellation ends the license. On the other hand, refusal without cancellation presumes that the contract continues to govern the rights and obligations of the parties, although the refused copy and related material will be returned to the tendering party, or any defect cured.

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 principle, limited use for purposes of mitigating loss caused by the breach of contract may be permitted. The use must be solely to mitigate and cannot extend to uses that more appropriately should be viewed as acceptance of the copy or to disclosure of confidential information, violation of a contractual use term, or sale or other transfer of the copies, including licensing. This section asks courts to reach the balance that was 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.* Unlike with goods, 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. *Confidentiality.* Both parties remain bound by contractual use terms, including confidentiality obligations. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The contractual use terms 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.

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 with revocation of acceptance of a copy and not other performances. 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. "Return" is described in section 102, and is not relevant in this section because it refers to rights on rejection of a contract, not a copy.

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 cases involving 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 law under Article 2 and Article 2A (1998 Official Text). Under subsection (b), effective revocation is conditioned on 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 of the accepting party 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 paragraph (a)(1) and (a)(2). Parties may engage in a mutual effort to resolve problems within the contract, rather than by ending it. Paragraph (a)(2) deals with a common issue in software litigation. In cases of continuing efforts to modify the software to fit the contract, both parties know that problems exist. This subsection allows revocation if the effort fails within a reasonable time and 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.

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) and should be interpreted in that light but with recognition of the different nature of computer information transactions.

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: 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.

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 relevant to contract law remedies. Like all other rules in this Act, unless otherwise expressly indicated, the effect of the rule can be varied by agreement.

2. *Cumulative Remedies.* Contract remedies aim to put an aggrieved party in the position that would resulted if performance had occurred as agreed. To that end, the remedies in this Act are cumulative to the extent consistent with the general goal; this Act rejects any concept of election of remedies. However, the parties by agreement may alter a remedy or make it unavailable, which agreement controls unless expressly invalidated by a provision of this Act.

3. *Aggrieved Party Choice.* An aggrieved party chooses the remedy, subject to substantive limitations applicable under this Act or the agreement. Beyond these express limits and its exercise of equity and the like, the court does not control the choice.

4. *Remedies Retained.* This Act is supplemented by various general sources of law, including equitable remedies. A remedy for breach does not displace a right of action under intellectual property law. Damage awards are limited, of course, 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.

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 what is the effect of cancellation.

2. *Cancellation.* "Cancellation" means that one party ends the contract for breach. Section 102. As with termination, it discharges executory obligations, but does not alter rights that were earned by prior performance or established by breach. Cancellation is a remedy for breach.

3. *When Permitted.* Subsection (a) states two cases when cancellation is permitted. First, it recognizes the general principle allowing cancellation if the agreement provides that cancellation is appropriate for the breach. Second, it allows cancellation in the event of a material breach. Unless there is contrary agreement, cancellation cannot occur in the event of a non-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. It may continue to perform, demand reciprocal performance, and collect damages. However, if it does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach.

4. *Notification.* Subsection (b) requires giving notification to the breaching party to make the cancellation effective. Section 102 (notify or give notice). This is a new requirement intended to avoid unfair surprise. It must be interpreted in light of the circumstances. Cancellation cannot occur unless there was a breach and either the contract gives a right to cancel for the particular breach or the breach was material. The equities favor the injured party, not the party in breach. No specific formalities are required. It is sufficient that the aggrieved party by its actions or words communicate its belief that the contract has ended because of the breach. Thus, for example, 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 that the contract is canceled. Similarly, commencing an arbitration proceeding based on cancellation is obvious notice of cancellation. The aggrieved party is not required to use formal legal terminology or procedures.

Giving notice to the other party does not require proof that the notice is received. See Section 102. The aggrieved party is not required at its risk to select a fail safe notification procedure.

Notification is not required for an access contract. This corresponds to termination of such contracts and general common law.

5. *Effect on Use Rights.* A license gives permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If a license is canceled, that "defense" dissolves. A licensee who continues to act in a manner inconsistent with intellectual property rights of the licensor exposes itself to an infringement claim. See *Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992). In some cases, information obtained under a contract is not subject to intellectual property rights. Then, cancellation does not create a risk of infringement.

6. *Obligations Regarding Copies.* In general, 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 narrow and solely for the purpose of allowing mitigation. See Comments to Section 706. It does not create an implied license, but merely implements a limited contractual remedy premised on the basic principle that there is a duty to act reasonably to avoid loss in the event of breach. Any use outside of that principle is wrongful.

7. *"No cancellation" clause.* Especially where information is licensed for inclusion in another product, a common remedy limitation provides that the licensor cannot cancel for breach, but is limited to other remedies. The clause is effective as a remedy limitation, but does not alter other remedies allowed by the contract or this Act. Assume a software license requiring five years of fixed payments and including a "no cancellation" clause except for violations of use restrictions. If the licensor breaches, the licensee cannot cancel and must continue to make payments but its remedies of recoupment, off-set, or damages remain intact. The licensee is not required to pay for information that it did not receive. If the licensee breaches, the licensor cannot cancel and must allow the licensee to use the software for the 5 year term, but its remedies of recoupment, off-set or damages also remain intact. The licensor is not required to provide rights under terms different than the license terms. In both cases, the remedies retained are subject to any modification made in the contract.

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 enforceability of agreed limitations on remedies for breach.

2. *Agreement Controls.* Parties may agree to fit their remedies to their particular deal. This is a fundamental facet of contract practice that influences and defines the product offered and the cost of a transaction. A party that agrees to accept all liability for breach may change the product it is willing to offer or charge more for a transaction than will a party that can contractually allocate liability or limit it to a particular amount or other remedy. Similarly, a party may not be willing to acquire a product unless it obtains particular remedies and recourse in particular or unlimited amounts, regardless of cost. How parties will order these needs and choices depends on the context, but no principle of law or policy suggests that the ability to control this attribute of a transaction should be generally precluded. This Act does preclude alteration of remedies for a right of return as defined in Section 102 and as used in Sections ____[xxx] and ____ with respect to rejected records; "return" as used in this section does not refer to a rejected record and thus is not included in the listing of defined terms.

3. *Exclusive Remedies.* An agreed remedy may be a modification or replacement for otherwise available remedies, or an additional right created by contract. To be an exclusive remedy, the terms of the agreement must expressly so provide. Subsection (a)(2) follows Article 2 of the Uniform Commercial Code (1998 Official Text) in this respect.

4. *Listed Illustrations.* Subsection (a) lists several remedies common in commercial practice. The illustrations, which are not an exclusive list,include:

a. *Replacement, Repair and Refund.* Agreed limited remedies that refer to replacement, repair, or refund are common. In end-user transactions for single copies of information, the reference to refund ordinarily refers to refund of the single license fee. The three different terms however, typically indicate entirely different remedies: replacement refers to supplying another copy of the same product, repair obligates the party to revise the product to eliminate defects that cause nonconformance with the contract, and refund obligates it to return money already paid. 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 the "refund" remedy is to reimburse moneys paid by the licensee for the product and to limit damages.

A limited remedy may provide any adequate agreed remedy. While many transactions involve contract fees based on a single payment, others entail royalties or other fees to be paid in the future. In such cases, nothing in this section restricts the ability of parties to agree to return of a fixed maximum amount or portion of the expected fee. Furthermore, refund contemplates return of payments, not payment to cover all value that might have been received. Another example of a situation where less than all payments may be covered under a refund remedy is an on-going or other services-like contract where a breach does not occur untilthe third or fourth year of a five year relationship.

b. *No Cancellation*. Subsection (a) lists a remedy (barring cancellation) relevant in for a licensee when it commits resources to develop and exploit information licensed to it. 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. See comments to Section 802. The right has no adverse effect in consumer contracts since, even if a consumer agrees to not cancel, other remedies (refusal, recoupment, damages) allow it fully to protect its interest.

5. *Failure of Exclusive Remedy.* Subsection (b) and (c) follow Article 2 of the Uniform Commercial Code (1998 Official Text) but clarify an issue extensively litigated under Article 2.

a. *Failure of Remedy.* Under subsection (b), if performance of a limited or exclusive remedy causes it to fail of its intended purpose, the remedy no longer limits the remedies of the aggrieved party who may resort to any remedies available under this Act. This same rule is present in Article 2. To administer the rule, courts must ask what was the essential purpose of the agreed remedy. A difference exists for remedies limited to replacement or repair of a defective copy, and remedies that also include a refund right. In the latter case, the purpose of the remedy is to either provide a functioning product or return the other party's money. Performance of the refund remedy meets this purpose even if the licensee did not receive a functioning product. Whether performance of the refund remedy meets its essential purpose depends on whether the agreed amount agreed was actually provided. This contrasts to a situation in which the remedy requires replacement or repair, but does not allow a refund. An example would be a repair or replacement remedy for a product flaw **--** non-performance of the remedy leaves the licensee without what it expected under the contract – a functioning product. In situations where the defect cannot be corrected because, for example, it lies in the design of the product, the "repair" remedy fails.

b. *Related to Consequential Damage Limits.* Subsection (c) deals with the effect that failure of a limited remedy has on agreed limitations on or exclusion of consequential damages. The issue is whether one term (exclusion of consequential damages) depends on, or is independent of, another term (limited remedy). This section establishes a default rule that the two terms are dependent unless the agreement expressly indicates otherwise. This resolves a conflict under Article 2 of the Uniform Commercial Code.

This rule is favorable to licensees: a consequential damage limit fails if the limited remedy fails, unless the agreement makes the consequential damages limit expressly independent of the other limited remedy. This treats the two terms as a package unless the agreement indicates otherwise. If the agreement expressly states that the terms are independent, however, there is no reason in principle to preclude enforcement of that agreement.

A consequential damages limitation covers all obligations and remedies under the contract. Some commentators characterize the obligation to replace or repair in a limited remedy as a separate contractual obligation, breach of which creates a damages claim. Whether that is correct or whether the remedy clauses are better treated as a single overall transaction, is ultimately not relevant, except with respect to asking what default principles should apply to the agreement, which should depend on the actual expectations of the parties. This Act treats remedy clauses as part of an overall transaction and assumes that a consequential damages limitation applies to all loss. A failure of the remedy results in failure of that limitation unless the agreement expressly provides that the consequential damages limitation is independent of the remedy limitation. In that case, the consequential damage limit continues to apply to any and all consequential damages incurred in the overall transaction.

6. *Minimum Adequate Remedy.* An agreed remedy provision does not fail because the court believes that it 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.

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, after the fact, rewrite the contract for remedies rules. If a remedy is provided and 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. That result flows from the agreed allocation 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 rendered unenforceable because the licensee used the software and a defect caused loss of a $1 million satellite. The decision to set a limit affects pricing and risk and cannot be set aside because the risk 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 breach of any aspect of the agreement" may raise a question of whether the agreement had sufficient mutuality to establish a contract.

7. *Consequential Damage Limits.* Disclaimer or limitation of consequential damages are generally enforceable. In consumer transactions involving defective computer programs that cause personal injury, however, this section follows Article 2 of the Uniform Commercial Code (1998, Approved Drafrt) and makes disclaimer of personal injury damages prima facie unconscionable. This does not create liability where it would not exist under other law. In practice, most cases do not rely on contract law for liability for personal injury even in contracts involving goods. As to information, most cases reject personal injury claims against information providers even under tort law. This reflects that in reference to information products, courts must balance public interests in encouraging distribution of information against interests in creating new sources of recovery. This Act does not preclude courts using general theories of tort law to do so, if contrary to the prior development of such law, they conclude that such risk allocation is appropriate.

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 the enforceability of liquidated damages clauses. The basic approach is that agreed terms are enforceable unless unreasonable.

2. *General Standard.* A liquidated damages term sets both a minimum and maximum recovery, while for example, 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.

An agreed term liquidating damages in the event of breach is, in concept, no different than any other term. The presumption is that courts should enforce agreed terms . Under subsection (a), liquidated damages terms are enforced if the amount is reasonable in light of any of 3 factors. This section follows common law and expands the conditions that sustain enforceability of liquidation clauses. The clause is sustainable if 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 amount chosen by the parties based on their assessment of risk and cost at the time of the contract should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to enforceability.

3. *Remedies On Unenforceability.* If a liquidated damages term is not enforceable, the aggrieved party may pursue the remedies it would have had under this Act in the absence of the term. Those remedies are limited by other terms of the agreement. For example, if a liquidated damage clause fails in a contract that excludes consequential damages, the aggrieved party is still bound by that exclusion.

4. *Other Terms.* If a term is not a liquidated damage clause but is a limitation on damages, then the appropriate default rule is Section 803, not Section 805. Thus, if a term provides: "In no event shall either party be liable for damages exceeding $1 million dollars," it is a limitation on damages, not a liquidated damages term. It caps 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 introduces a uniform statute of limitations for computer information transactions, reconciling conflicting state law. **2.** *Limitations Period.* Subsection (a) blends the traditional rule that a cause of action accrues when the breach occurs with a discovery rule and a rule of repose. This section thus follows Article 2 of the Uniform Commercial Code (1998 Official Text) that bars a cause of action four years after the breach occurs. However, it also adopts a "discovery rule" that expands the time for bringing a cause of action beyond that applicable for sales of goods. The discovery rule extends the time for bringing the lawsuit to up to five years from the time of breach.

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) disallows agreements that permit a period of limitations longer than that stated in the Act, following the policy in Article 2 of the U.C.C. This does not prevent "tolling agreements" entered into during contract disputes. It only precludes extensions in the *original* agreement.

Subsection (b) does not preclude contracts that "limit" a warranty to a stated period of less than one year (e.g., ninety days). Such agreements define a term during which discovery of a breach and its effect must occur. Unless the agreement so states, this does not limit the time (the statute of limitations) in which a <u>lawsuit</u> may be brought. Thus, a ninety day warranty means that there is no breach unless the defect appears is discovered within ninety days after delivery, but if such occurs, the agreement does not restrict how long the aggrieved party may wait before bringing the lawsuit. That is determined by this section. The period to bring the lawsuit is 4 or 5 years, depending upon when breach occurred or should have been discovered unless, in a commercial contract, that period is reduced by agreement to not less than one year.

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 different rules for determining when the cause of action accrues. The primary rule is in 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 "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) requires a court to apply this language according to its terms. Breach of this warranty occurs if a defect appears within that ninety day period. Subsection (c) rejects interpretations of the Article 2 rule to mean 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. That approach subverts the intent of the "future" warranty. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

5. *Discovery Rule.* Subsection (d) describes cases in which the time of occurrence rule is replaced entirely by a 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 approaches for licensor damages are in Section 808 and for licensee damages in Section 809. Both sections are subject to the general principles stated here. **2.** *Mitigation.* Subsection (a) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. "Burden of establishing" means that the party with the burden of persuading 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 Section 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 market value reference in subsection (d) limits direct damages in a manner consistent with principles of mitigation. However, this Act also allows recovery of consequential as compared to direct damages and mitigation issues are relevant to such claims.

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 simple 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 on-line 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 customer should have no recovery at all, but if it can show a breach, the individual 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 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. Lost value does not easily fit into the idea of damages resulting from breach. Yet, compensation for such loss is important. Where the breach of confidence gives benefits to a third party that are not realized directly or indirectly by the party to the contract, recovery, if any, occurs under other law. The principle stated here, of course, is subject to the general ability of a court to exclude recovery that would put a party into a substantially better position than would have been true in the absence of breach and the basic principle that double recovery is not allowed. 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 that, as to damages awarded for eventualities that are in the future, 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 deals with licensor damages. It allows the licensor to choose among alternatives to fit the circumstances. The choice is subject to prohibition on double recovery. Section 807 provides that damages related to events in the future at the time of the award are based on their present value. It also provides for when and where "market value" is determined.

2. *General Approach.* The licensor may elect damages under any measure described in subsection (b). The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice enables double recovery. No order of preference is required.

Subsection (b)(1) measures "direct damages" by the difference in value between performance promised and received. Direct damages also include reimbursement for value already given to the other party and not paid for when appropriate. These damages are capped by the contract fee for the breached 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.

All damages recoverable under this section are subject to general principles of this Act. Section 807 disallows recovery of consequential losses in some cases, including damage claims that are speculative or claims for consequential damages based on the content of published informational content. Similarly, under Section 807, recovery may be limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss.

3. *Intangible Subject Matter: Substitute Transactions.* Licensor remedies differ from remedies for sellers under Article 2 of the Uniform Commercial Code. Article 2 focuses damage calculation on an assumption that the seller's loss lies in the disposition of the particular item. For computer information transactions, the particular copy is not the focus. In this Act. the basic principle is whether breach enables a substitute transaction that could not otherwise have occurred and the returns from which are properly considered in determining direct damages.

The term "substitute transaction" is central to the damages structure. A transaction is not a substitute simply because the transferor used a diskette or other media that might have been used to deliver the same information to the licensee in breach. The focus is on the information, not the tangible media, and on contractual use terms associated with the transaction. To be a substitute transaction, the transaction must involve the same information under the same contractual use terms applicable to the transaction in breach.

To be a substitute transaction it must be made possible by the breach. This rule has two effects. First, it 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. Second, if a similar transaction is possible, the licensor's ability to engage in it must be due to the breach and not simply because the other transaction would have been possible in any event. For example, in breach of a non-exclusive access contract, there would ordinarily not be a substitute transaction because the licensor has effectively unlimited capability to make access available to others. While another access contract may be made, it was not made possible by breach – the new license would have occurred with or without the breach. In most non-exclusive licenses, breach does not enable a new transaction. Information assets are available in relatively infinite supply. On the other hand, breach of an exclusive license to distribute a work in a geographic area may, if it leads to cancellation of the license, enable the licensor to make a substitute license for 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 <u>direct</u> damages and are capped in total recovery by the contract fee and the market value of other consideration to be received by the licensor. They yield the following results:

a. *Accrued Fees and Consideration.* Paragraph (b)(1)(A) recognizes that 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, if appropriate, are in the nature of consequential or incidental 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.* Paragraph (b)(1)(B) describes recovery measured by unaccrued contract fees and other consideration less the value of an 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. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. Speculative damages are not recoverable. *Restatement (Second) of Contracts* § 352. See Section 807.

The recovery is reduced by due allowance for the proceeds of a substitute transaction made possible by the breach measured either by an actual substitute transaction or the market value of a commercially reasonable hypothetical transaction. The substitute transaction must have been made possible by the breach. If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery if sought under this paragraph, is reduced by the market value (if any) of the hypothetical substitute made possible by the breach. As with actual transactions, market value of a hypothetical substitute must utilize a market for the same use restrictions for the same information.

(ii) *Recovery Measured by Lost Profits.* Paragraph (b)(1)(C) provides as an alternative that losses may be measured by lost profits caused by a failure to accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts should refer to common law cases on licenses. Unlike in Article 2 of the Uniform Commercial Code (1998 Official Text), however, this Act does not require proof that the alternative standards 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 merely 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. See discussion in comments to Section 102 on consequential damages. 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 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. The primary source is 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 property rights, or (b) the breach consists of acting outside the scope of the license and in violation of the intellectual property right. Intellectual property remedies 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 sets out damages measures for a licensee when the licensor breaches the contract. A licensee may choose among alternatives to fit the circumstances subject to the prohibition on double recovery. This rejects the hierarchy in Article 2 of the

Uniform Commercial Code (1998 Official Text). . Under Section 807, damages related to events in the future at the time of the award are based on their present value.

2. *Direct and Consequential Damages.* Subsection (a)(1) measures direct damages. Direct damages are capped by the market value of the performance plus restitution of fees paid for which performance was not received. Market value refers to what would be charged in a similar transaction for the performance. Section 807 provides for 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. If recoverable, those losses are consequential, not direct damages. This section rejects cases such as *Chatlos Systems, Inc. v. National Cash Register Corp.,* 670 F.2d 1304 (3d Cir. 1982) which, under a standard referring simply to "value", incorporate in direct damages an assessment of how valuable the use of the expected performance would have been to the aggrieved party.

All the damages recoverable under this section are subject to general principles of this Act. For example, Section 807 disallows recovery of consequential losses in some cases, including damage claims that are speculative or consequential loss associated with the content of published informational content. Recovery is also limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss. Section 807.

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 not reflected in the formula.

a. *Lost Value in Accepted Performance.* Paragraph (a)(1)(A) provides for recovery for performance accepted and 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 paragraph yields a recovery of $1,000 if the licensee accepts the software. The value is generally measured by the contract fee. Recovery for any loss that exceeds that amount is consequential damages. This rejects decisions that compute direct damages as benefits expected from use, a concept more appropriately entailed in computation of consequential damages. This section, however, 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 in reference to 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 the performance was not received. Performance has not been received if the licensor fails to make a required delivery or repudiates, or if the licensee rightfully rejects 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 Article 2 of the Uniform Commercial Code (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 replacing that performance with a reasonable substitute. In each case, 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) establishes cover as a way to fix the amount of damages and avoid further loss. 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 is obtainable from numerous sources, the similarity between goods and information is strong. On the other hand, in many commercial contexts, the information may not be available from any other source. In such cases, obtaining a replacement product involves obtaining a different product. The different product is treated as 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 through commercially reasonable substitutes, but does not allow cover with information products obtained under different contractual use terms than in the original contract. Use restrictions are important to defining the product itself and its price. They are sufficiently material that differences in such terms means that a different product is involved. Recovery when this occurs is left to "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, where 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. If proven with reasonable certainty, damages can include lost profits.

5. *Illustrative Cases.*

Illustration 1: LE contracts for a 1,000 person site license for database software from LR. The contract fee is a $500,000 initial payment and $10,000 for each month of use. The license 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 return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court 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 does not qualify as 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 rights of 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 from payments owed to the other, damages resulting from the other party’s breach. 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. No formal language is required; any language that reasonably indicates the party’s reason for withholding payment is sufficient. In the absence of notice, withholding payments is a breach and may also provide cause for insecurity and a right to demand assurances under Section 708.

3. *Non-material Breaches.* Subsection (b) limits the right in a 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 over-reaching 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 Uniform Commercial Code. It allows the parties to contract for this remedy, but also requires that any award of the remedy protect confidential information and informational rights of the parties.

2. *Contracted For Remedy.* Subsection (a) allows the parties to contract for specific performance if a court can administer the remedy and 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, in effect, an obligation to pay damages rather than perform.

3. *Judicial Remedy.* Subsection (a)(2) follows Uniform Commercial Code Article 2 (1998 Official Text). The standard thus differs from *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, in many cases, the contractual obligation does not constitute personal services because any person in the corporation can perform. Of course, even if the contract does not involve personal services, this does not require or necessarily permit an award of specific performance.

b. *Unique Subject Matter.* Specific performance can only be ordered if the performance is "unique" or "in other appropriate circumstances." The test of uniqueness requires that a court examine the total commercial situation. The test incorporates a commercially realistic interpretation of the importance or uniqueness of the particular performance. Despite the often unique character of information provided by a particular source, however, respect for a licensor's property rights and confidentiality interests often precludes specific performance of an obligation to create or a right to continue use of the rights or 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 the performance (non-disclosure) is commercially significant and cannot be adequately protected through an award of damages. Such an award is one potential illustration of the "other proper circumstances" referred to in this section and in current law.

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, Revised Draft). 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, Revised Draft). It gives several options to the licensor in proceeding after breach by the licensee. The licensor's choice is 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 primarily to situations where the licensor intends to rely on the measure of damages that involves 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 license breaches ordinarily 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 the question of whether the action was commercially reasonable 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 is that the licensor failed to mitigate loss.

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, in an appropriate case, to elect between canceling the license or retaining the contractual rights and obligations, while pursuing other remedies. It can continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. Cancellation, in contrast, eliminates all rights of use under the license. Section 802. If the licensee elects to continue use, it remains bound by the contract as if no breach occurred, except, of course, for its right to a remedy for breach.

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.

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 agreement entails permitted electronic access to a facility controlled by the licensor which can be ended immediately on breach. 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 properly canceled for breach. The section recognizes that 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 over-riding rights in the information. Cancellation triggers 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 the 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 resulting from the licensed information. 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 independently and 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 under standards consistent with Article 2A and Article 9 of the Uniform Commercial Code (1998 Official Text). Self-help cannot be used unless there was a breach and proper cancellation, and its use 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 the issue of breach of the peace.

4. *Expedited Hearing.* Subsection (d) gives each party a right to an expedited hearing to enforce or protect rights relating to possession and restrictions on use. This enables early review to reduce potentially significant risks for the licensee and the licensor, e.g., the risk to the licensee that a slow judicial process may cause an increased harm by inducing a licensor to use self-help to enforce rights, and the risk to the licensor that the delay may cause serious economic or other harm. 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 be applied. 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 limitation does not apply to the right to prevent use. For example, if trade secrets were provided to the licensee under contractual use terms, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is inseparable from other property of the party in breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license that results in use of an image in a video game by the party in breach does not prevent the licensor from barring use of the image after breach even if the image is inseparable from the game. Of course, as to end users of the game, the prior authorized distribution of copies containing the image is not 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 to prevent use by electronic means of the computer information after material breach and cancellation of a license. Under other law, the limits, if any, on electronic self-help right under state law are uncertain. This Act does not deal with rights arising under Article 9 or Articles 2 or 2A of the Uniform Commercial Code. There may also be federal issues under the Communications Privacy Act and under the Copyright Act regarding copyright security devices, but this Act does not alter federal law. Section 102 (“termination”).

The section does not deal with use of electronic restraints to enforce contract terms by limiting the licensee’s performance to the terms of the contract. Similarly, the section only deals with when a contract is canceled for breach, it does not apply to the use of electronics on termination of the license by its own terms or otherwise without breach.

2. *Nature of the Restrictions.* While electronic self-help is an efficient means of enforcing rights on breach that may be vital to protecting a licensor, the remedy requires restrictions to prevent abuse and to ensure that there is an opportunity to have issues resolved in court before action occurs. The basic 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 advance notice of no less that 15 days before the 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 of 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.* 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 electronic self-help option must be created with notice of the term by the licensee.

Subsection (c) requires that the licensee specify the person to whom notice of intended use of electronic self-help is to be sent. “Person” in this context does not necessarily refer to an individual, but includes designation of an office, such as the office of general counsel, as the designated recipient.

b. *Notice of Exercise.* Under subsection (d), even if authorized by the license, electronic self-help cannot be used unless the licensor gives a minimum of 15 days advance notice of its intent to exercise the right, which notice must state the nature of 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 problem and the risk of electronic self-help with sufficient time to react. The reaction may be an attempt to solve the problem or resort to the courts to forestall use of the remedy. Also, of course, during the notice period, if the licensee elects not to contest the cancellation, it will be able to make necessary, lawful adjustments to minimize the adverse 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. One illustration is where the licensed software is integral to the funds transfer or payment systems of a banking institution or where it pertains to national security systems. In such cases, the peremptory remedy of electronic self-help threatens disruption that far exceeds the benefits of allowing its use.

In cases where electronic self-help is prohibited, of course, the licensor's appropriate remedy is by a judicial action to enforce its rights. This section gives each party a right of rapid access to court. In a case where breach justifies cancellation, judicial remedies under Section 815 are appropriate.

3. *Damages for Wrongful Use.* Subsection (e) confirms that wrongful use of electronic self-help is a breach of contract entitling the injured party to damages under this Act. Wrongful use may also entitle the injured party to other remedies, but these are outside the scope of this Act.

In the event of wrongful use, the aggrieved party may recover direct, incidental and consequential damages as appropriate. In two contexts, the right to consequential damages cannot be altered by agreement. 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 context arises where the licensee gave a good faith notice of the general nature and magnitude of damages that might result from such action. The notice must be in good faith, but the section does not bind the licensee to only those damages indicated in its notice.

4. *Expedited Hearing.* Ultimately in cases of doubt as to the propriety of electronic self-help, the matter should be decided by the court before the fact. Subsection (g) follows this view, giving 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, except for additional provisions that are more favorable than the section to the licensee. A contractual provision precluding use of electronic self-help in all cases is more favorable to the licensee and is enforceable (subject to the limitations of this Act on enforceability of terms, such as unconscionability).