

DRAFT

FOR DISCUSSION ONLY

**UNIFORM COMMERCIAL CODE
ARTICLE 2B ¶ LICENSES**

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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**UNIFORM COMMERCIAL CODE
ARTICLE 2B ¶ LICENSES**

WITH PREFATORY NOTE AND COMMENTS

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By

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ON UNIFORM STATE LAWS

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**UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES**

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1 **UNIFORM COMMERCIAL CODE**
2 **ARTICLE 2B – LICENSES**

3
4
5 **PREFATORY NOTE**

6
7 **INFORMATION AGE IN CONTRACTS**

8
9 **Introduction**

10 Article 2B deals with transactions in information; it focuses on transactions
11 relating to the “copyright industries.” This project lies at the heart of maintaining
12 the UCC at the center of commercial contract law.¹

13
14 Article 2B deals largely with transactions and subject matter that have never
15 been directly covered by the UCC. Of the transactions treated here, only software
16 contracts have previously been considered within the UCC. Even for computer
17 software, coverage under the UCC is limited. But *Article 2B is not just a software*
18 *contract statute*. The other subject matter of licensing are today governed not by
19 the UCC but by a complex mixture of common law, federal property law, and some
20 regulation. Part of the project involves making accommodations between Article 2
21 premises and the assumptions or features of commercial practice in these other
22 fields.

23
24 Yet, in the modern digital economy, these industries and subject matter are
25 rapidly converging around the digital technology that dominates the information
26 industry and, even, much of the goods sector. The lines of demarcation will, and
27 already have, become less and less significant while businesses converge into a
28 multi-faceted industry with common concerns.² That converged industry far

¹ The significance of Article 2B has been recognized. See Intellectual Property and the National Information Infrastructure, The Report of the Working Group on Intellectual Property Rights, at 58 (“[the] challenge for commercial law . . . is to adapt to the reality of the NII by providing clear guidance as to the rights and responsibilities of those using the NII. Without certainty in electronic contracting, the NII will not fulfill its commercial potential.”). That report endorsed the Article 2B project. Subsequent statements by the White House embody the assumption that private contract, rather than regulation should guide the new economy and that the basis for this lies in the development of a “commercial code” for electronic and other information contracts, both within the United States and internationally.

² Motion pictures, books and records are now often digital in content and provided through various digitally enabled systems, such as Internet access. Thus,

1 exceeds in importance the goods manufacturing sector in our economy. Unlike
2 manufacture of goods, the information industry is growing rapidly and commands
3 large portions of the national economic product. The copyright industries and
4 information transactions affected by Article 2B involve subject matter entirely
5 unlike the traditional transactional framework which focuses on transactions in
6 goods. In Article 2B transactions, the value of the subject matter lies in the
7 intangibles, the information and associated rights to use that information.

8
9 This Article is being developed through extensive consultation among many
10 groups. When completed, Article 2B will provide a framework for contractual
11 relationships among industries at the forefront of the information era and permeate
12 the global economy. In the short term, however, the test of the project lies in its
13 ability to accommodate the parties involved and the practices that are driving this
14 vital part of the economy. Evaluating the balance achieved hinges on one's
15 perspective, yet, as the following indicates, the Draft distributes benefits among the
16 various parties.

17 18 **Benefits and Positions in Draft Article 2B by Party**

19 General Benefits

- 20 + creates balanced structure for electronic contracting
- 21 + reduces uncertainty and non-uniformity of software and online contract law
- 22 + provides contract law roadmap for converging industries with differing
23 traditions
- 24 + confirms contract freedom in commercial transactions
- 25 + innovates concept of mass market transaction that extends UCC consumer
26 protections to businesses
- 27 + establishes strong protection encouraging dissemination of published
28 informational content
- 29 + recognizes layered contract formation occurring over time
- 30 + clarifies enforceability of standard forms in commercial deals
- 31 + proposes solution for battle of forms
- 32 + applies "material breach" concept corresponding to common law
- 33 + sets standards relating to access and Internet contracts
- 34 + establishes contract default rules for idea and content submission
- 35 + adjusts statute of frauds to information transactions

for example, a recently successful motion picture ("Toy Story") was in effect a lengthy computer program, entirely digital in development and presentation. Various publishers, such as the New York Times, the Wall Street Journal, and West Publishing, provide their basic information resources on-line as well as in paper form. They do business in the same environment in which Oracle Software provides its commercial software products to end users.

- 1 + provides ownership rules for outsourcing and development contracts
- 2 + creates understandable implied warranty for commercial deals
- 3 + outlines relationship between retailer, publisher and end user
- 4 + refines standards for enforcement of liquidated damages rule
- 5 + allows parties to contract for specific performance
- 6 + provides standard interpretations for often litigated grant terms

7

8

Licensor Benefits

- 9 + establishes licensing framework consistent across **converging** industries
- 10 + workable **choice of law** rules for Internet
- 11 + fully enforceable choice of **forum** clause in commercial contracts
- 12 + establishes guidance for enforceable **attribution procedure** in electronic
- 13 contracts
- 14 + settles enforceability of **mass market licenses** subject to refusal term concept
- 15 + creates method for contracting in **Internet** and similar contexts
- 16 + excludes **consequential damages** for published informational content
- 17 + establishes guidance on the meaning of license **grants**
- 18 + establishes control and protections for licensors on **transferability** of a license
- 19 + deals with effect on warranty of **modification** of code in a copy of a program
- 20 + limits **infringement warranty** to knowledge but expands it to cover use
- 21 + codifies contractual treatment of electronic **limiting or management devices**
- 22 + reconciles inspection concepts with presence of vulnerable **confidential**
- 23 material
- 24 + establishes guidance on procedures to **modify** on-going contracts
- 25 + confirms that **exceeding** a license as a breach of contract
- 26 + establishes standard on connection of **remedy** and consequential damages
- 27 limits

28

29

Licensee Benefits

- 30 + gives court a right to invalidate undisclosed **refusal terms** in mass market for
- 31 consumers and businesses
- 32 + creates duty of reasonable care to avoid **viruses** in copies that cannot be waived
- 33 in mass market
- 34 + enables **financing** licensee interest in a non-exclusive license without licensor
- 35 consent
- 36 + creates refund right from two sources and procedural steps to give real option to
- 37 withdraw as a precondition for **creating a contract** in mass market
- 38 + gives licensee a right of **quiet enjoyment**
- 39 + codifies that **advertising** can create an express warranty
- 40 + creates a warranty for **accuracy** of non-published informational content
- 41 + creates implied **system integration** warranty
- 42 + extends infringement warranty to a warranty that **use** does not infringe

- 1 + requires **disclaimers** of implied warranties be in a record (e.g., writing)
- 2 + expressly recognizes **implied licenses**
- 3 + creates broad **scope** presumptions
- 4 + makes mass market licenses presumptively **transferable**
- 5 + **perfect tender** rule for mass market transactions which does not exist in
- 6 current law except for goods
- 7 + right to demand a **cure** for accepted imperfect tender in commercial contracts
- 8 + requires **affirmative acts of assent** to a record instead of mere passive
- 9 retention
- 10 + creates direct contract with **remote publisher** in mass market
- 11 + increases **class of people** to whom warranty runs for all types of damage
- 12 + enforces **releases** without consideration
- 13 + enforces term providing that a license cannot be **canceled**
- 14 + creates warranties and rights against **retailer** independent of publisher license
- 15 + places substantial limitations on electronic **self-help** for consumers and
- 16 businesses
- 17 + presumes **perpetual term** in single payment software license
- 18 + prohibits choices of **forum** that unfairly disadvantages a consumer
- 19
- 20

21 **PART 1**

22 **CONTEXT: LAW REFORM AND THE UCC**

23

24 **Modern Economy and Law Reform**

25 The current UCC affects contract practice and law throughout the economy,
26 but it was based primarily on a transactions in "goods" model and a financing
27 structure that to that model. It reflects a 1950's economy. At that time, clear
28 distinctions between goods, intangibles and services in commercial relationships
29 were clear and sharply differentiated. Sales of goods dominated then. They no
30 longer do so. In addition, in the 1990's computerization blurs those once clear
31 models. "The distinction that used to be drawn between "goods" and "services" is
32 meaningless, because so much of the value provided by the successful enterprise
33 . . . entails services [and information]."³ Contracts involving information are not
34 equivalent to transactions in goods.⁴

³ Robert Reich, *The Work of Nations* 85-86 (1991).

⁴ Many court decisions place software licensing in Article 2 even though software is licensed and not sold and even though the focus of the transaction from the standpoint of both parties centers not on the acquisitions of tangible property, but on transfer of capability and rights intangibles. See *Advent Systems Ltd v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991); *RRX Industries, Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604

1
2 The 1990's witnessed a shift in the source of value and value production in
3 the economy. The service sector now dominates.⁵ The information industry
4 exceeds most manufacturing sectors in size. The entertainment industry was the
5 first post war international industry in the United States. The on-line industry is the
6 most recent. The software industry, which provides the basic fuel for the
7 information age, did not exist in the 1950's. Today, its products challenge
8 traditional law in international trade, tax, intellectual property, and contract.
9

10 Project History

11 Although it today involves active participation by motion picture,
12 publishing, and online industries and deals extensively with issues of electronic
13 contracting, the Article 2B project began with a focus on the contract issues
14 associated with computer software licensing as many of those transactions were
15 brought within the scope of Article 2, a statute dealing with **sales of goods**.
16

17 Under modern copyright law, software and most other digital products are
18 governed by an intellectual property rights regime under which the copyright
19 owner holds the exclusive right to authorize or make additional copies of the work,
20 distribute the work in copies, engage in public display or performance of the work,
21 and make modifications of the work (a so-called derivative works). This copyright
22 regime (along with other intellectual property rights) creates property law much
23 different from that associated with goods and places importance on the contractual
24 terms relating to a grant conveyance or restriction of rights in the intangible subject
25 matter. In this regard, software and other digital products are treated in law more
26 like manuscripts and motion pictures, than television sets and cars. Even though a
27 purchaser acquires a copy of the work, the producer retains rights and control with
28 respect to various uses of the copy, including uses that make additional copies or
29 alterations.
30

31 This underlying difference coupled with the ease of copying involved in
32 modern digital products causes sharp differences in contracting practices. The
33 differences are only enhanced with the development of the Internet and online

F.2d 737 (2d Cir. 1979); *In re Amica*, 135 Bankr. 534 (B.R. ND Ill. 1992). Cases excluding software and data processing from Article 2 include: *Data Processing Services, Inc. v. LH Smith Oil Corp.*, 492 N.E. 2d 1329, 1 UCC Rep. Serv.2d 29 (Ind. Ct. App. 1986) (software development); *Micro-Managers, Inc. v. Gregory*, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988) (development contract).

⁵ See Karl P. Sauvant, *International Transactions in Services: The Politics of Transborder Data Flows* (Westview Press 1986).

1 services as an important feature of contemporary commerce since these systems
2 allow for transfer of information without the intermediation of tangible objects.
3 Indeed, in the modern marketplace for information, a major conflict looms between
4 systems in which the end user has in its own machine the software and other
5 information assets needs for its business as compared to systems that use rapid
6 communications and Internet capabilities to enable that end user to seamlessly
7 employ software and other information assets located hundreds or thousands of
8 miles away in "cyberspace."
9

10 Over several years, committees of NCCUSL, the ABA and other groups
11 examined the consequences of what appeared to many to be a mismatch in concept
12 between contract law aimed at defining relationships relating to the sale of goods
13 (Article 2) and contract relationships in which information (or more generally,
14 intangibles) were the centerpiece of the transaction and the contractual format most
15 often involves a license, rather than a sale. The conclusion reached by these
16 committees and by representatives of the information industries entails two basic
17 observations:
18

19 **1. Distinct From Sales.** Information transactions and, especially,
20 transactions involving licensing of digital information, differ substantively from
21 transactions involving the sale or lease of **goods**. The differences are
22 manifested in both the conditional nature of the transaction and that the value
23 obtained or conveyed lies not in the tangible property, but in the information
24 and rights that are severable from the tangibles. Indeed, it will continue to be
25 increasingly the case that no tangible items are needed to convey information
26 on-line or in electronic transactions. Because of the differences, a body of law
27 tailored to transactions whose purpose is to pass title to tangible property can
28 not be simply applied to transactions whose purpose was to convey rights in
29 intangible property and information. A separate treatment of this commercially
30 important class of transactions was needed.
31

32 **2. Commercial Significance.** The commercial importance, both currently
33 and in the future, of the information industry is obvious. Software and related
34 information technologies currently account for in excess of 6% of the gross
35 national product and the size of the industry continues to grow. Adding in the
36 other industries (publishing, motion pictures, on-line systems) swells the figure
37 to a huge share of the economy. The treatment of digital information, both in
38 intellectual property law and in contract law, has become a major focus of
39 contemporary debate. These industries and the transactions they engage in are
40 major factors in the commercial landscape more than sufficient to justify
41 coverage in a **commercial** code.
42

43 **Deliberative Process**

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

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

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

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

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

Working Drafts

From the outset, the Article 2B process has reached out for the widest range

1 of input and commentary possible. To a greater extent than in any other recent
2 UCC project, this has led to an active engagement of the views of many different
3 groups and individuals. During the period of from March, 1994 through today, the
4 Reporter and various members of the Committee have met with representatives or
5 members of a wide range of groups to review provisions of various interim Drafts.
6 More than thirty organizations have had representatives at Drafting Committee
7 meetings including:

8
9 ABA Business Law Section
10 ABA Section on Intellectual Property
11 ABA Section of Science and Technology
12 ABA Law Practice Management Section
13 American Film Marketing Association
14 American Intellectual Property Law Association
15 Association of American Publishers
16 American Electronics Association
17 Association of Scientific, Technical and Medical Publishers
18 Commercial Law League of America
19 Consumer Project on Technology
20 Consumers Union
21 CBEMA
22 Equipment Leasing Association
23 ITAA
24 Information Industry Association
25 Licensing Executives Society
26 Information Technology Council
27 Interactive Digital Software Association
28 Software Publishers' Association
29 Business Software Alliance
30 Silicon Valley Software Industry Coalition
31 Society of Information Management
32 Motion Picture Association of America
33 California Bar Association
34 Association of the Bar of the City of New York
35 Chicago Bar Association
36 Texas State Bar Association
37 Recording Industry Association of America
38

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

1
2
3 **PART 2**
4 **BASIC THEMES**

5
6 **Licensing Law and Practice**

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

8
9 [License] means a contract that grants permission to access or use information
10 if the contract expressly conditions, withholds, or limits the scope of the rights
11 granted, grants only non-exclusive rights, or affirmatively grants less than all
12 rights in the information, whether or not the contract transfers title to a copy of
13 the information.⁶

14
15 The transaction is characterized by (1) the conditional nature of the rights or
16 privileges conveyed, and (2) the focus on information, rather than tangible
17 property.

18
19 A license is not a lease or a sale. Both of those terms apply to transfers in
20 **goods**, rather than rights in intangibles. The Supreme Court described a patent
21 license as [a mere waiver of the right to sue.]⁷ The Federal Circuit Court of
22 Appeals stated:

23
24 [A] patent license agreement is in essence nothing more than a promise by the
25 licensor not to sue the licensee. . . . Even if couched in terms of [L]icensee is
26 given the right to make, use, or sell X, the agreement cannot convey that
27 absolute right because not even the patentee of X is given that right. His right
28 is merely one to exclude others from making, using or selling X.⁸

29
30 These descriptions refer to a [pure license] in which the licensor does nothing
31 more than simply grant the licensee a privilege to use patented technology or
32 copyrighted expression without additional commitments or steps to make that use
33 possible.

⁶ UCC § 2B-102.

⁷ *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 181 (1938).

⁸ *Spindelfabrik Suessen-Schurr v. Schubert & Salzer*, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. denied, 484 U.S. 1063 (1988). See also *Cohen v. Paramount Pictures Corp.*, 845 F.2d 851 (9th Cir. 1988).

1
2 Many licenses regulate rights in intellectual property. There are many
3 situations, however, in which a license occurs in the absence of intellectual
4 property. A license also exists in situations in which one party receives permission
5 to enter the physical premises or computer of another or where property owned by
6 the licensor is made available to the licensee.⁹ That model exists in the digital
7 world in reference to the many transactions in which parties are licensed to use
8 computer or other information resources of a licensor. In this Draft, that model is
9 encompassed in the concept of an "access contract" which, as to rights to access a
10 facility, is treated in current law and this Draft as generally analogous to is a more
11 complete transfer of property rights. Section 2B-102 defines such contracts as:

12
13 for electronic access to a resource containing information, resource for
14 processing information, data system, or other similar facility of a licensor,
15 licensee, or third party.
16

17 These are contracts for online access and services. The focus centers on licensed
18 access to a resource or facility. This relationship creates a variety of ongoing
19 obligations of the parties (e.g., the obligation to pay for access, the obligation to
20 maintain accessibility) not present in other licenses.
21

22 Licenses are common commercial transactions. The key fact is that the
23 value resides in the intangibles, rather than goods. One does not purchase a book
24 to admire the paper (goods), but to use the information. One does not acquire
25 software to enjoy the diskette, but to use the program, encyclopedia or other
26 content.
27

28 Licensing is a dominant means of commerce in digital information and in
29 commercial information transactions. In distributing information products, as with
30 goods, several different transactional options exist, licensing is a primary option,
31 especially in digital information industries. Typically, as a simple matter of
32 contract law, license restrictions are enforceable even though their terms do not
33 mirror the "exclusive rights" in copyright or patent law. Indeed, while many courts
34 use Article 2 to resolve contract disputes relating to themes covered by that article,
35 Article 2 has never been applied to determine the effectiveness of use restrictions.
36 Courts consistently apply licensing law paradigms to issues involving software and
37 online contracts where the issues involve enforcing restrictions on use of
38 information.
39

⁹ See *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92 C 0911, 1993
WESTLAW 214164 (ND Ill. June 17, 1993); *Soderholm v. Chicago Nat'l League
Ball Club*, 587 N.E.2d 517 (Ill. Ct. App. 1992).

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

11
12 Article 2B does not change the balance between contract and federal law. It
13 could not do so even if that were the intent. Article 2B does not *create* contract law
14 here □ contracts have long been used to control distributions. Article 2B merely
15 provides a more coherent and workable basis for contract issues.

16 17 **Commercial Practice**

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

21
22 For purposes of illustration, it is useful to distinguish various types of
23 licensing. One factor differentiates between licenses that relate to information
24 physically transferred to a licensee, as contrasted to licenses that enable a licensee
25 to access a location (i.e., a computer) in which information resides. The latter
26 access contract is used widely in modern Internet and online transactions. What is
27 licensed is a right to have access to an environment that the licensor owns or
28 controls.

29
30 In transactions in which information is made available on diskette or
31 otherwise to a licensee subject to licensed conditions, a variety of transactional
32 formats exist. In some, a licensor deals directly with the end user. In others, a
33 chain of distribution intervenes and the copyright owner does not deal directly with
34 the end user. In each case, the basis of the license transaction resides in either the
35 existence of intellectual property rights in the information or, more simply, the fact
36 that the licensor has control over a source of the information that the licensee
37 desires to utilize.

38
39 In areas covered by Article 2B, copyright law is a dominant source of

¹⁰ As discussed below, the Draft excludes most trademark and patent licensing.

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

11
12 One method of distribution occurs when the copyright owner (or its agent)
13 contracts directly with the licensee. This is common in markets involving software
14 for large or complex computer systems and databases with significant commercial
15 value and cost per use. It is also characteristic of licensing in the publishing and
16 entertainment industries. In the software industry, direct licenses (commonly in
17 standard form agreements) may transfer of a copy of the software to the licensee
18 subject to express contractual restrictions on use. Increasingly, rather than on a
19 disk, copies are moved to the licensee's site electronically. In the near future, an
20 additional licensing format will involve not delivery of software, but licensed
21 access to and use of elements of software for brief periods as needed. Even today,
22 in many license relationships, data is transferred from the licensee to the licensor,
23 who utilizes its own software and systems for processing, examining and otherwise
24 handling the licensee's data.

25
26 Common, but not necessarily uniform contract terms limit use to a
27 designated system, for specific purposes (e.g., internal use only), subject to
28 confidentiality conditions, transferability limitations, and similar restrictions
29 applicable to the commercial deal. A central element of this distribution method is
30 to recognize that cases uniformly hold that loading software into a computer and,
31 even, moving it automatically from one part of memory to another part, constitutes
32 making a copy of the software that falls within the copyright owner's exclusive
33 rights.

34
35 Direct licensing also involves many contractual relationships in which
36 information (software, text, movies) is developed for the licensee. Here, it is
37 common for smaller companies or individuals to be licensors with large corporate
38 licensees. This, of course, illustrates an important point in the overall mix of rights
39 and contract issues. While large software providers are important factors as
40 licensors, the overall software industry consists of large numbers of small licensors.
41 This is equally clear in entertainment and publishing venues.

42
43 As in other areas, commercial licensing also occurs in context of broader

1 distribution and utilizes distribution chains. These are not analogous to distribution
2 chains employed in the sale of goods marketplace because of the intangible subject
3 matter and the overlay of intellectual property rights which include the exclusive
4 right to **distribute** copies. While it greatly over-simplifies the matter, it is useful to
5 discuss two distinct frameworks.

6
7 The first involves use of a master copy and is common in the movie
8 industry and in software contracts. Under this framework, a "distributor" receives
9 access to a single master copy of the information work and a license to make and
10 distribute additional copies or to make and publicly perform a copy. For example,
11 Correl Software may license a distributor to allow its software to be loaded into the
12 distributor's computers or video games. The contract will contain a number of
13 terms. Correl may limit the distributor to no more than 1,000 to be distributed only
14 in the computers and only if subject to an end user license. Since both the making
15 of copies and the distribution of copies are within the scope of the owner's
16 copyright, acts that go outside the contractual limitations are infringements as well
17 as contractual breaches.

18
19 An alternative methodology uses actual copies of the software. Here, for
20 example, Quicken may license a distributor to distribute its accounting software in
21 packages provided to the distributor by Quicken. A license is used in the software
22 industry here, although some other industries may sell copies to the distributor for
23 resale. In the license, the distributor may be allowed to distribute copies to
24 retailers, provided that certain conditions are met, such as terms of payment,
25 retention of the original packaging, and making the eventual end user distribution
26 occur subject to an end user license. Since the distribution right is an exclusive
27 right in copyright law, distributions outside the license infringe the copyright.

28
29 In both sequences, the information product eventually reaches an end user.
30 If it does so in an ordinary chain of distribution complying with the distribution
31 licenses, the end user is in rightful possession of a copy. If the distribution
32 involved sales of copies, nothing more is required. The end user is the owner of the
33 copy. Copyright law spells out limited rights that flow to the owner of the copy
34 (e.g., to distribute it, make a back-up if it is software, make some changes essential
35 to use if its software). There is no direct contractual relationship between the
36 copyright owner and the "end user."

37
38 If, however, the copyright owner elected a licensing framework, given the
39 structure of the transactions, the end user's right to "use" (e.g., copy) the software
40 depends on the end user license. Typically, this is characterized as a license from
41 the producer to the end user. It creates a direct contractual relationship that would
42 not otherwise exist and which, in light of concepts of privity, might not be implied
43 as between **these** parties. The contract, then, at this point, jumps past the chain of

1 distribution and creates a direct link to the producer by the end user. It is also, in
2 this sequence, the only contract that enables the end user to make copies of the
3 software in its own machine.

4 5 **Nature of a Commercial Statute**

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

13 14 **Informational Content**

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

30
31 The thought that information content becomes something entirely different
32 if the provider or author distributes it commercially can hardly be a premise.
33 Commercialization (that is controlling who receives the information or charging a
34 fee for its receipt) is not inconsistent with the role of information in political, social
35 and other venues of modern culture. If it were, newspapers, books, television,
36 motion pictures, video games, and other modern sources of information content for
37 the general public or for specialized groups could not exist. What we do in Article
38 2B in creating (or avoiding) liability risk, in allowing (or precluding) author's to
39 control distribution of their ideas, or in allowing (or denying) the right to contract
40 for licenses of information has a significant impact on the future of information in
41 new and in older systems of distribution.

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

Freedom of Contract

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

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

Default Rules

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

The principal objects of draftsmen of general commercial legislation . . . are to

¹¹ UCC 2A-101, Comment.

¹² See Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821 (1992); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 Yale L.J. 729, 734 (1992).

1 be accurate and not to be original. Their intention is to assure that if a given
2 transaction . . . is initiated, it shall have a specified result; they attempt to state
3 as a matter of law the conclusion which the business community apart from
4 statute . . . gives to the transaction in any case. But achievement of those
5 modest goals is a task of considerable difficulty.¹³
6

7 To be accurate and not original refers to commercial practice as an appropriate
8 standard for gauging appropriate contract law unless a clear countervailing policy
9 indicates to the contrary or the contractual arrangement threatens injury to third-
10 party interests which social policy desires to protect. Uniform contract laws do not
11 regulate practice. They seek to sustain and facilitate it. The benefits of
12 codification lie in defining principles consistent with commercial practice which,
13 because of their codification and their relevance to actual practice, can be relied on
14 and are readily discernible and understandable to commercial parties.
15

16 How one decides what rules will best facilitate contracting practice is a
17 matter of dispute in literature. In this context, the best source of substantive default
18 rules lies not in a theoretical model, but in reference to commercial and trade
19 practice. This is not simple faith in empirical sources for commercial law. It stems
20 from the reality that, even though we may not know how law interacts with
21 contract practice, decisions about contract law will continue to be made. In those
22 decisions, we should refer for guidance to the accumulation of practical choices
23 made in actual transactions. The goal is a congruence between legal premise and
24 commercial practice so that transactions adopted by commercial parties achieve
25 commercially intended results.¹⁴ Background rules tied to the ordinary, but actual
26 commercial context tend both to provide a legal base that falls within the tacit
27 expectations of the parties and to ameliorate problems from lack of knowledge by
28 supplying common sense outcomes.
29

30 Yet, in Article 2, Article 2A, and Article 2B, a wide range of transactions
31 exist and a variety of diverse industries are affected. The transactions range from a
32 casual deal between two individuals at a garage sale to transactions between

¹³ Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 Yale L.J. 1341 (1957).

¹⁴ Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261, 266 (1985). See also Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821, 822 (1992) ([default rules [that reflect the conventional or common sense in the relevant community] are likely to reflect the tacit . . . agreement of the parties and thereby facilitate the social functions of consent.]).

1 sophisticated businesses employing multiple lawyers and affecting billions of
2 dollars of business. The approach needed is not to draft rules that an individual
3 party would draft tailored to each case, but to select an intermediate or ordinary
4 framework whose contours are appropriate, but whose terms will be altered in the
5 more sophisticated environments. A UCC article designs default rules that are
6 acceptable in ordinary transactions where they can be frequently used without
7 disruption or costly negotiation.

8 9 **Intellectual Property Overlay**

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

20
21 As stated in the Copyright Act, federal property law precludes state law that
22 creates rights equivalent to property rights created under copyright.¹⁵ But as both a
23 practical and a conceptual matter, copyright (or patent) do not generally preclude or
24 preempt contract law.¹⁶ Indeed, contracts are essential to use one's own property,
25 even when the property is tangible, let alone when it is intangible. A contract
26 defines rights between **parties to the agreement**, while a property right creates
27 rights against **all the world**. They are not equivalent.

28
29 Important issues exist here. Federal intellectual property law, as well as
30 other federal law and regulation, place some specific, existing, and recognized
31 limits on contract. These include restrictions on transferability, recording
32 requirements in some cases, a statute of frauds concept, and enforceability of
33 property rights against good faith purchasers. A state law developed in context of
34 these **specific** and existing rules *cannot* ignore them. While state commercial law
35 themes **might** prefer a rule that a secured creditor can create and enforce a
36 creditor's interest in a licensee's rights, federal law precludes any transfer of a
37 licensee's rights in a non-exclusive license without the licensor's consent. A
38 default rule that ignores this preemptive provision creates true traps for the unwary.

¹⁵ 17 U.S.C. § 301.

¹⁶ See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

1 In this Draft, they are avoided insofar as possible, although in several situations,
2 there are provisions that push against explicit federal rules insofar as reasonably
3 possible.
4

5 This interaction of state law and specific federal yields default rules that, in
6 some cases, do not correspond to the treatment of analogous issues in other parts of
7 the UCC. This is true, for example, with respect to the transferability of a
8 licensee's interest in a non-exclusive license. Federal law reflected in a series of
9 cases holds that the licensee's interest is **not** transferable without the licensor's
10 consent.¹⁷ The rationale for this rule is discussed in relevant notes in this Draft, but
11 the principle, which contradicts some state law assumptions about transferability, is
12 followed in the Draft. Similarly, in patent and copyright law, no concept of good
13 faith purchase exists against a claim of infringement and this principle limits the
14 ability of a party taking outside of the terms of a license to claim insulation from
15 infringement and other property claims based on making or retaining unauthorized
16 copies or uses.¹⁸ The Draft corresponds to this federal law approach. Also,
17 copyright law precludes a transfer of ownership of copyright in the absence of a
18 writing conveying ownership. In discussing development contracts, this Draft
19 reflects that limitation, but attempts to ensure that the agreement of the parties is
20 enforced to the extent possible within that federal law constraint.
21

22 These provisions reflect a policy of correspondence of rules in addition to
23 simple recognition that federal law preempts contrary state law. There are other
24 situations where federal law and policy shapes contract law and practice, but the
25 nature of that role is less clear and typically more controversial. The Draft adopts a
26 position of neutrality on such issues, leaving determinations about their content to
27 be determined under federal law, the appropriate venue for such discussion.
28

29 This occurs primarily in respect to federal policies managing competition
30 under antitrust and similar theories of intellectual property misuse and to the
31 application of federal policy about the availability of publicly distributed
32 information for fair use and public domain applications. Typically, in determining
33 whether or when such policies apply, courts accept that contract law generally
34 prevails, but ask whether a particular contract clause in a particular setting conflicts
35 with federal policies when balanced against the general role of contracts in the
36 economy and legal system. How far the federal policies reach remains in dispute.
37 Not surprisingly, in light of the transformations and economic shifts yielded by
38 digital information technology, defining the proper scope of rights as a matter of

¹⁷ See *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996).

¹⁸ See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994).

1 federal property law has been controversial; it remains unresolved despite
2 extensive periods of negotiation and political discussion. Two disputed settings
3 deal with reverse engineering of copyrighted, but unpatented technology and with
4 the scope of educational or scientific fair use of digital works. The issues are
5 questions of federal law and policy. They must be resolved by courts and
6 Congress, rather than through state legislation. Article 2B takes no position on
7 these policy questions, but merely provides a generic contract law framework to
8 augment and bring to modern form the existing complex network of common law,
9 code and general industry practice.

10 11 12 **PART 3** 13 **THEMES IN THE DRAFT** 14

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

17
18 The fundamental theme entails a recognition of the differences in goods and
19 information as subjects of commercial transactions. In the world of goods, the goal
20 of the purchaser involves acquisition and use of specific, tangible property. That
21 focus yields a number of transactional principles in article 2 and 2A and also shapes
22 the nature of the remedies developed in those articles. It yields a focus on the
23 manner and condition of **delivery** and, in the case of breach, on the disposition of
24 the particular items or their replacement. In the world of goods, while many
25 replications of a particular product are placed on a mass market, each product
26 provides and constitutes the unit of exchange. In the world of information, that is
27 no longer true. Many resulting principles and remedial provisions differ as a result.

28
29 In the world of information, the goal is to acquire the knowledge,
30 technology, or other intangibles along with the right to use the intangibles. Unlike
31 in goods, information cannot always be returned, nor need the same copy be
32 transferred in order to establish the harm caused by breach. Thus, remedies differ
33 from those for goods. Also, because of its intangible character, information can be
34 transferred in many different ways: a telephone call, a electronic message, a
35 delivery of a diskette. Article 2B seeks transfer method irrelevance. How a
36 transfer occurs should not alter the applicability of the article or, in general, what
37 substantive rules apply. Some information transactions involve remote access to a
38 computer, while others occur by delivery of a diskette or a book. This does not
39 place one transaction within the UCC, while the other is under common law. In
40 some cases, the method of transfer and the market in which the transfer occurs
41 affects what default rules apply, but this should only be true if the commercial
42 practices are different or if there are substantive policy concerns that indicate a
43 different result is proper.

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

Scope: Licenses and Information

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

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

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

"Information" means data, text, images, sounds, computer programs, databases, literary works, audiovisual works, motion pictures, mask works, or the like, and any intellectual property or other rights in information.¹⁹

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

¹⁹ Section 2B-102.

1 bringing both into the same statutory mix enables the development of stable and
2 consistent contract law rules. The consistent theme has been that the "rules
3 applicable to . . . electronic information will be the same as the rules applicable to
4 their printed counterparts."²⁰

5
6 The Committee opted to focus on licensing of information and software
7 contracts. For transactions in information other than software, this allows a
8 distinction between transactions involving a license and transactions involving the
9 sale of a copy. This leaves undisturbed major segments of the traditional
10 information industry that may not need treatment in a uniform law, such as
11 contracts involving a sale of a copy of a book or a newspaper. The distinction
12 between a license and a sale of a copy in the information industry may be as
13 explicit as the distinction between a sale and a lease in reference to goods. Except
14 for the paper or other material used in the copies, law dealing with such
15 information products arises under a body of common law tort and contract. The
16 scope as to these products utilizes a transaction based characterization consistent
17 with practices in those industries.

18
19 For computer software, the more important factor involves the nature of the
20 product. Except for a few cases where no copyright protection exists, all
21 transactions are subject to either express or implied limitations on the use,
22 distribution, modification and copying of the software. These limitations are
23 commercially important because the technology makes copying, modification and
24 other uses easier to achieve in forms that can yield commercially harmful results.
25 Bringing all transactions involving this subject matter into Article 2B reflects the
26 functional and commercial similarity of the transactions and the need for a focused
27 body of law applicable to these products. In addition, as a relatively new form of
28 information transaction involving products with distinctive and unique
29 characteristics, no common law exists on many of the important questions
30 regardless of whether a transaction constitutes a license or a sale of a copy (e.g.,
31 what limitations are appropriate on use of software to report information about the
32 licensee's computer environment?).

33 34 **Overlap Within the UCC**

35 Obviously, many transactions entail mixed subject matter, including both
36 information and goods (either sold or leased). Article 2B handles this overlap in
37 two ways. The primary approach applies a variation of the gravamen of the action
38 test. Article 2B covers aspects of a mixed transaction involving information, copies
39 and documentation. Article 2 (or Article 2A) covers other goods in the same
40 transaction. Which Article applies to a particular dispute depends on the focus of

²⁰ Section 2B-103, Reporter's Note 1, February, 1996 Draft.

1 the dispute. No predominant purpose test is intended.

2

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

7

8

Patent, Trademark and Services

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

12

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

20

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

28

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

37

38

Electronic Contracts

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

42

1 The basic approach holds that contracts created using computers should be
2 enforceable and that contract law principles establishing a stable basis for such
3 contracts provides an important, facilitating services for developing commerce in
4 this field. The provisions of Article 2B on these issues will provide a model for the
5 other articles of the UCC and, eventually, a framework for national electronic
6 commerce. There are three issues: formation, attribution, and enforcement. The
7 Preface deals with enforcement issues later.

8 9 **Formation Issues**

10 Formation questions present mechanical as well as deeply philosophical
11 issues about the treatment of electronics in contract law. At the most simple
12 mechanical level, Article 2B uses of "record" (see Section 2B-102) in lieu of the
13 traditional reference to "writing" as a reflection of the fact electronic recordation
14 and transmission stands parallel to or more significant than writings in modern
15 practice. This term, first used in revised Article 8, is now standard UCC
16 terminology. In this Draft, a record:

17
18 means information that is inscribed on a tangible medium or that is stored in an
19 electronic or other medium and is retrievable in perceivable form.²¹

20
21 The idea divorces concepts associated with writings from the traditional paper
22 environment, making electronic records fully equivalent to paper records. The
23 language here relates to language in the federal Copyright Act defining a "copy."
24 Article 2B also contains a separate definition of a "copy" since, at least in current
25 technology, transfers of copies are an important method of distributing information.

26
27 Article 2B also changes terminology in the idea of signature. The Draft
28 replaces signature with "authentication." That term encompasses electronic actions
29 to encrypt electronic records and is defined in a manner independent of concepts of
30 a handwritten signature. The Draft follows the emerging consensus that actions
31 other than handwriting can suffice. The definition provides:

32
33 "Authenticate" means to sign or to execute or adopt a symbol, including a
34 digital identifier, or encrypt a record in whole or in part with present intent to
35 adopt, establish the authenticity of or signify a party's acceptance of a record or
36 term that contains the authentication or to which a record containing the
37 authentication refers.²²

21 Section 2B-102.

22 Section 2B-102(2).

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

6
7 Under the Draft, if the parties agree to a commercially reasonable method of
8 attributing a document to a party, compliance with that methodology per se gives
9 the status of a signature.²³ The idea of an "attribution procedure" is adapted from
10 UCC Article 4A, security procedure. This parallels digital signature statutes in
11 that, if the parties agree to use digital signature procedures, that choice is validated
12 in the Draft as conclusively constituting a signature. The requirement that the
13 procedure be commercially reasonable allows a court an opportunity to consider
14 the nature of the system adopted in any cases where the accuracy of the attribution
15 is contested.

16
17 A more significant proposal deals with an "electronic agent." This concept
18 refers to a computer program or similar automated device established to act on
19 behalf of a party. While not an "agent" in traditional senses, the use of
20 programmed surrogates to make contracts, find information, and otherwise interact
21 with computers of other parties is increasingly important in electronic commerce
22 and will be even more so in the future with respect to information assets where no
23 specific need ever exists for a human being handling the transaction or its result in
24 a digital world.²⁴

25
26 Article 2B deals with the fact that electronic contracts, driven by computer
27 capabilities, will increasingly involve arrangements entered into and performed
28 without there being any necessity for human intervention or decision making on
29 both ends of the transaction. This yields a number of questions about offer and
30 acceptance, notice and the like. Article 2B adopts the view that electronic contracts
31 can be formed without human choices being made to offer and accept a particular
32 transaction and that notice can occur without a human review of the subject matter.

33 If a party creates a situation in which an electronic agent is to act on its behalf,
34 then that party is bound by the actions of the "agent."²⁵

35
36 An aspect of this concept is that contracts can be formed by the interaction
37 of such agents with or without the active involvement of an individual representing

²³ Section 2B-110.

²⁴ Section 2B-102.

²⁵ In Article 2B, this is a question of "attribution." Section 2B-111.

1 the contracting party.²⁶ In an electronic world of information-based transactions,
2 human review of particular transactions and reaction to that review will often be
3 displaced by electronic review within preprogrammed parameters with
4 programmed or "learned" responses. These provisions, and other similar sections,
5 are aimed at identifying and validating these commercial practices under
6 appropriate standards.

7
8 There are risks of fraud and error, of course. Article 2B deals with these
9 through a concept of "attribution." The idea that a computer can act on behalf of a
10 party assumes that it serves as an electronic agent, selected, created or otherwise
11 made available by the party for that purpose. More generally, attribution implies
12 that a party will be charged with responsibility for a particular message or
13 performance rendered electronically. There are three methods of attribution: actual
14 involvement of either the person or its electronic agent, compliance with an
15 attribution procedure, and lack of reasonable care resulting in loss to the other
16 party. These concepts parallel international developments relating to the more
17 closed-end use of Electronic Data interchange. They balance between a number of
18 potential, other regimes for allocating loss or risk in electronic deals.

19 20 **Mass Market Definition and Use**

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

28
29 The "mass market" paradigm in Article 2B creates a number of important
30 policy issues. The issues entail distinguishing "mass market" and "consumer"
31 transactions. While the one incorporates the other (e.g., consumer transactions
32 occur in the mass market), the idea of a mass market transaction goes far beyond
33 the idea of a consumer transaction. Indeed, with respect to transactions that fall
34 within this concept, a significant percentage if not a majority of licensees will be
35 businesses, rather than consumers (e.g., commercial grade word processing;
36 network operating software, database products, project management software).
37 Some of these will be small businesses, but under current licensing practice, many
38 of the licensees will be large business entities, larger than the licensor from whom
39 they are "protected."

26 Section 2B-203.

1 **Definition**

2 The definition of mass market has been elusive.

3
4 Part of the difficulty lies in the fact that, while many have an intuitive
5 understanding of what constitutes a mass market transaction, the concept has not
6 been used in any other statutory provision. Most contract statutes focus on the
7 consumer-commercial dichotomy. Some consumer protection rules broaden the
8 idea of “consumer” to include some business purchasers, but typically do so in
9 terms of dollar amount limitations. Federal law provides mostly a focus on
10 consumers, but in the Magnuson Moss Act uses a concept of “consumer product”
11 which focuses on the general or most common purchaser of a product and then
12 applies the federal regulations to the product, regardless of whether the specific
13 purchaser was or was not a consumer.

14
15 As these concepts indicate, one way to conceptualize the “mass market”
16 involves identifying a marketplace in which most participants are consumers in the
17 traditional sense. Thus, for example, transactions made in general retail store
18 environments are typically mass market transactions and also very often
19 characterized by predominantly consumer transactions. On the other hand,
20 purchases from wholesale distributors are often not equivalent to a mass market.
21 Additionally, a characteristic of a mass market is that the party acquiring the
22 relevant material is typically the end user, rather than a person acquiring for
23 redistribution.

24
25 As drafted, the idea of a mass market centers on small transactions directed
26 to the general public in a retail marketplace. In light of the risk allocation issues
27 involved and new nature of the undertaking, the goal is to focus on relatively small
28 transactions. This Draft incorporates most consumer transactions within the ambit
29 of mass market. For non-consumer transactions (e.g., transactions between two
30 businesses in a retail market), the definition utilizes a combination of a retail,
31 general public reference point and a monetary cap to achieve the intended focus.
32 The monetary cap proposed (\$500) does not limit consumer inclusion in the
33 concept. It has not yet been voted on by the Drafting Committee but based on
34 various empirical data covers essentially all consumer software licensed at retail
35 and the vast majority of modern retail software packages. It excludes sophisticated
36 business software.

37
38 **Applications**

39 The critical issue with reference to the idea of a mass market in this Article
40 goes beyond the definition and deals with how the concept is applied. The two
41 general approaches to using this concept are: (1) treating the marketplace definition
42 as a surrogate for consumer protection and thereby extending consumer protections

1 to business transactions, or (2) using the concept primarily as a marketplace
2 identifier which keys into various expectations about the nature of transactions in
3 that market.

4
5 In contract law statutes, the idea of a "consumer transaction" has
6 traditionally been associated with a theme of protection and enhanced notice
7 requirements justified largely by the assumption that many consumers will be
8 unsophisticated and lacking in economic power to negotiated terms or seek
9 alternative sources of supply. That term and that tradition are present in various
10 articles of the UCC. Clearly, in Article 2B, use of a reference to a consumer
11 transaction should signal similar concerns.

12
13 The idea of a mass market transaction, on the other hand, could better be
14 viewed as identifying a marketplace in which particular assumptions might be
15 made about the nature of the transaction and the expectations of the parties. Thus,
16 a mass market is typically an anonymous market and one in which the purchaser-
17 licensee anticipates being able to retransfer its purchase and to use it in ordinary
18 ways in its own machines. It is a market in which multiple copies of identical
19 information or products are transferred to multiple purchasers without
20 customization, making it possible to ask questions about what are the
21 characteristics, for example, of an ordinary database system or word processing
22 system. One view, quite simply, is that the term mass market is appropriately
23 used when the article identifies a particular marketplace assumption, rather than a
24 rule of purchaser protection in the classic consumer sense.

25
26 In theory, the differentiation between consumer and mass market constructs
27 as to when they should apply turns on whether the goal is to protect individuals
28 who presumably lack the expertise to understand contract issues (e.g., consumer)
29 and cases where the goal is to identify and define a marketplace by reflecting
30 presumed assumptions applicable in that marketplace. The Committee opted to
31 apply the concept of "mass market" as the theme in all but a few sections in which
32 the issue arises.

33
34 "CONSUMER" APPLICATIONS:

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

36 Section 2B-107 (choice of forum): contract choice limited

37 Section 2B-303 (effect of no-oral modification clause): contract method
38 restricted

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

40
41 "MASS MARKET" APPLICATIONS:

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

1 consumer
2 Section 2B-304 (modification of continuing contracts): withdrawal right
3 required in mass market
4 Section 2B-308 (notice of terms): terms unenforceable in mass market, rather
5 than just consumer
6 Section 2B-313 (viruses): effect of disclaimer limited in mass market, rather
7 than just consumer
8 Section 2B-403 (implied warranty of quality): merchantability in mass market
9 Section 2B-406 (disclaimer of warranty): conspicuous required in mass market
10 Section 2B-502 (transferability of license): mass market presumed transferable
11 Section 2B-504 (security interest without consent): allowed in mass market
12 Section 2B-601 (perfect tender): required in mass market, rather than just
13 consumer
14 Section 2B-607 (perfect tender): required in mass market, rather than just
15 consumer
16 Section 2B-610 (refusal for imperfect tender): allowed in mass market rather
17 than just consumer

18 **Relationship to Existing Consumer Law**

19
20 Although the idea of “mass market” goes past traditional concepts of
21 consumer protection, the combined effect of using that term and covering some
22 transactions involving consumers specifically produces a Draft that, in general,
23 retains all existing UCC consumer protections and in fact creates some protections
24 that are not present under current law.

25
26 For mass market transactions, the Draft retains the idea of perfect tender,
27 important for consumer transactions as a means of allowing a simple remedy for
28 products that do not meet standards. In addition, the Draft retains the implied
29 warranty of merchantability in the mass market, applicable to consumers and
30 businesses purchasing in that marketplace. As under current law, the warranty can
31 be disclaimed, but Article 2B goes beyond existing UCC law to require that the
32 disclaimer be in writing (a record) and by requiring a plain language disclaimer that
33 gives the consumer more notice of what its rights are.

34
35 There are several situations in which the Draft creates rights beyond current
36 Article 2. One involves so-called electronic viruses in the mass market setting.
37 The Draft creates obligations to exclude viruses and make disclaimer of that
38 obligation in the mass market more difficult than disclaimer of general warranties.

39
40 In addition and more importantly, as discussed below, the Article allows a
41 consumer to object to terms of a mass market license based on arguments that the
42 term would have caused a refusal of the licensee had it been brought to the
43 licensee’s attention. This incorporates ideas from the *Restatement*, but brings them

1 to a general commercial marketplace where they have generally not been
2 previously accepted. This rule covers both consumers and businesses who acquire
3 information in the mass market.

4 5 **Standard Forms and Manifested Assent**

6 In Article 2B makes a direct effort to deal with standard form contracts.
7 The basic principle lies in the fact that in commercial agreements, standard form
8 use is widely and broadly acceptable. It provides a number of economies in
9 transaction costs and, quite simply, provides a strongly supported commercial
10 practice. Article 2B adopts the position that standard forms used to document an
11 agreement are enforceable so long as the party being charged with the terms of the
12 form manifested its assent to the form.²⁷ No other position would be workable in
13 modern commercial practice.

14
15 The *Restatement (Second) of Contracts* § 211 generally supports enforcing
16 standard forms except as to **terms** that fit the following:

17
18 Where the other party has reason to believe that the party manifesting such
19 assent would not do so if he knew that the writing contained a particular term,
20 the term is not part of the agreement.

21
22 *Restatement (Second) of Contracts* § 211(3). The *Restatement* emphasizes whether,
23 as viewed from the vantage of the provider of the form, the terms are such as would
24 cause a refusal by the other party if brought to that party's attention. For that to
25 occur, of course, the terms must not only be surprising, but also highly adverse to
26 the deal. Only a small minority of States have adopted the *Restatement* test on this
27 issue, but many States have rules that provide for closer scrutiny of standard forms
28 in contracts of adhesion, especially consumer contracts.

29
30 The UNIDROIT *Principles of International Commercial Contracts*,
31 reflecting a similar background, deals with **standard terms** (not forms) and
32 invalidates terms that the "party could not reasonably have expected." For such
33 terms, there must be specific agreement to the term. UNIDROIT art. 2.20. Unlike
34 the *Restatement*, this emphasis is on the reasonable expectations of the assenting
35 party and creates, one suspects, an impossible burden for a licensor who must
36 structure its forms to fit diverse transactions and diverse contexts, especially in the
37 mass market. This approach is particularly suspect because it centers on **terms** that
38 are standard, rather than terms in standard forms. The UNIDROIT standard has not
39 been adopted in any country, or any State of this country.

40
²⁷ Section 2B-307.

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

9
10 A party can “manifest assent” to a form or a term only if they previously
11 had an opportunity to review it and its terms. No assent to unknowable terms is
12 effective. Beyond that, a party who had an opportunity to review the record and
13 any specific terms for which assent is required, manifests assent if it engages in
14 affirmative conduct that the record conspicuously provides will constitute
15 acceptance of the record or of the particular term. Merely retaining the
16 information or the record without objection is not a manifestation of assent. Also, a
17 party’s conduct does not manifest assent unless the record was called to the party’s
18 attention by before the party acts. In cases where the form is available only after
19 the original agreement and during the period of initial use, manifestation of assent
20 cannot occur unless, if it declines the agreement, the licensee can obtain a refund of
21 any fees paid.

22
23 In a mass market, the transaction is anonymous and for often not fully
24 considered by the transferee. In mass market transactions, Article 2B applies the
25 concepts of manifesting assent and opportunity and goes further to invalidate some
26 terms, even if there was an opportunity to review the overall form, unless there was
27 assent to the particular term.

28
29 In invalidating refusal terms, Article 2B adapts the *Restatement* test. The
30 basic theme is that, if the licensor should know that a term is surprising and would
31 cause refusal of the license if the licensee knew of the term, that term is not
32 enforceable unless the licensee expressly manifests assent to the term itself. This
33 rule accommodates concepts about adhesion contracts, unfair surprise and the like.
34 It protects against unfair surprise in a mass market transaction, but enables use of a
35 contract in that setting. Manifestly, parties in the mass market enter into contracts.
36 The issue is what are the appropriate terms of the contract. This approach places
37 procedural protections on the creation of terms and allows a court to exclude unfair
38 terms, but generally accepts that a party (even in the mass market) who assents to a
39 form is bound by that form.

40 41 **Informational Content**

42 Article 2B deals with a large number of informational content transactions
43 that are not transactions involving computer programs per se. In dealing with

1 contracts pertaining to information content, however, choices must be made about
2 the applicability of Article 2 sale of goods concepts. In many respects, these
3 concepts do not comfortably fit practices and relevant interests involved in
4 handling contracts about informational content.

5 6 **Transactional Aspects**

7 This Draft contains two sections dealing with informational content
8 transactions that had not yet been reviewed as of March when this material was
9 prepared. The one section deals with the application of Article 2 concepts of
10 tender, rejection and revocation to information industries. Unlike general rules in
11 common law and the *Restatement*, the Article 2 model contains an explicit focus on
12 a particular transactional framework. If applied to entertainment and publishing
13 sectors at the upstream level, this model would introduce new and often
14 undesirable standards in the manuscript, script and other aspects of the information
15 content industries. The proposed solution lies in the concept of "information
16 submissions" that applies to cases involving contracts where the submission is
17 reviewed in terms of aesthetics and market suitability.

18
19 The insight that supports separate treatment for these cases is that it is a
20 mistake to assume that submission of a manuscript is equivalent to tender of
21 delivery of a product. It is not. Rather than requiring or anticipating immediate
22 acceptance or rejection, submissions of content initiate a process of review and
23 revision leading to a later decision to accept or reject the submission. Section
24 2B-602 reflects that reality; it places these transactional situations entirely outside
25 of the tender-acceptance rules, relying heavily on common law themes (as
26 implemented in Article 2B) and trade practice to define the rights of the parties.

27
28 One consequence is that, in idea or information submission contexts,
29 acceptance does not occur unless and until there is an express indication of
30 acceptance (or rejection) by the licensee. This corresponds to commercial practice
31 in this context.

32
33 A second setting in which Article 2 concepts of tender, inspection, etc.
34 create an uneasy fit with practice in information industries arises with respect to
35 transactions in which, by merely viewing information, the licensee receives all the
36 value of the transaction and because of the nature of the performance, that value
37 **cannot** be returned in the sense that a defective toaster can be returned. This might
38 involve, for example, a Dun and Bradstreet report on a company, a license of a
39 formula for Coca Cola, a credit report, or a screening at home of a pay per view
40 motion picture. In these cases, the idea of a right to reject is not relevant. What is
41 relevant is ensuring that the recipient can recover if the received performance was
42 not consistent with the contract.

1 Forcing an Article 2 framework on these transactions creates a
2 dysfunctional change from common law principles, especially in the Article 2 right
3 to inspect before payment. Inspection in such cases in effect transfers the value and
4 the licensee **cannot** return (a basic requirement of rejection) the value even if it
5 desires to do so.

6
7 Section 2B-608 proposes an treatment of such transactions that exists
8 outside the sale of goods framework on tender, inspection and rejection. It places
9 the transaction under the general rules of Section 2B-601 which parallel common
10 law; the law currently applicable to such transactions. The common law principle
11 does not describe a right of rejection, but allows one to avoid paying anything for
12 performance that constitutes a material breach or to recover back the full payment
13 previously made and allows recovery of damages for lesser breaches.

14 15 **Liability Issues**

16 This Draft creates a concept of "published informational content" and relies
17 on First Amendment and related policies to avoid the creation of expansive liability
18 risk under contract law for distributions of information to the public. The issue
19 here involves drawing a balance that allows for the continued, vibrant
20 dissemination of content for use by people in an open society.

21
22 Published informational content is exempted from any implied warranty
23 under Section 2B-404. This is critical insulation for such information providers
24 and also corresponds to what rules exist under current law, such as in the
25 *Restatement (Second) of Torts* § 552 as applied by the courts. The Draft also
26 proposes an exclusion of third party product liability claims with reference to
27 published information under Section 2B-409. This brings the Article into
28 correspondence with the *Restatement* and with better reasoned cases. Liability for
29 information content is generally restricted to special relationships of reliance.

30
31 Section 2B-402 on express warranties leaves current law in place without
32 change for published content. It declines to transport Article 2 express warranty
33 rules into this environment, allowing courts to continue to work out under what
34 conditions a content provider should be held liable for alleged breach of contractual
35 representations.

36 37 **Material Breach**

38 Article 2B proposes a model for performance obligations derived from the
39 *Restatement (Second) of Contracts* and common law. As described in Section
40 2B-601, that model requires that a party conform to its contractual obligations and
41 that a failure to do so constitutes a breach of contract. However, in determining the
42 remedies available for breach, the common law model distinguishes between

1 material and non-material breach. While any deviation from the terms of a contract
2 is a breach, only “material breach” allows the other party to cancel the agreement
3 or refuse to provide its agreed, reciprocal performance. The idea of material
4 breach, defined in Section 2B-108, comes directly from common law. It bifurcates
5 the remedies available to either the licensee or licensor by allowing recovery of
6 damages for minor problems, but cancellation only in the event a major failure of
7 performance.

8
9 In adopting a theme of material breach, this Article parallels common law
10 and modern international law. The Convention on the International Sale of Goods
11 (CISG) refers to “fundamental breach,” which it defines as follows: “A breach . . .
12 is fundamental if it results in such detriment to the other party as substantially to
13 deprive him of what he is entitled to expect under the contract, unless the party in
14 breach did not foresee and a reasonable person . . . would not have foreseen such a
15 result.” CISG Art. 25. The UNIDROIT Principles of International Commercial
16 Law state: “A party may terminate the contract where the failure of the other party
17 to perform an obligation under the contract amounts to a fundamental non-
18 performance.” UNIDROIT art. 7.3.1(1). Article 2 and Article 2A are essentially
19 alone in modern law in requiring so-called “perfect tender.” Even then, these
20 statutes do so in reference to a single fact situation only: a single delivery of goods
21 not part of an installment contract. Outside that single context, the use of
22 materiality as a performance standard for when the reciprocal performance is not
23 required is virtually unanimous.

24
25 Section 2B-601 derives from the *Restatement* and states this basic premise.
26 However, out of concern for the desirability of a “perfect tender” rule in consumer
27 transactions, the Draft retains the perfect tender rule in mass market transactions as
28 it exists under current sale of goods law.

29
30 For all other transactions, however, as under common law, substantial
31 performance is sufficient to trigger the injured party’s contractual obligations to
32 perform. Unless a breach is material, it cannot be used as an excuse to void or
33 avoid the contract obligations. A licensee who receives substantial (but imperfect)
34 performance from the licensor, cannot reject the initial tender or cancel the contract
35 on that account, but it can obtain financial satisfaction for the less than complete
36 performance. The substantial performance standard tends to draw the transaction
37 to a completion in which the party who receives substantially what it contracted for
38 pay for that value. Even current Article 2 uses a substantial performance standard
39 for defining when a party can revoke acceptance and for when it can reject a
40 delivery that is part of an installment contract.

41 42 **Warranties and Performance Obligations**

43 Article 2B blends previously disparate areas of contract that have a different

1 mix of policy considerations and commercial practice with respect to implied
2 assurances of quality in performance.

3
4 Transactions governed as sales of goods historically carried an implied
5 warranty of merchantability that focuses on the quality of the product received, but
6 can be and is routinely disclaimed. The warranty sets out the premise that the
7 **product** conforms to ordinary expectations for products of similar type.

8
9 Different traditions exist in transactions outside Article 2. Under current
10 law, many of the contracts covered in Article 2B would be services (or information)
11 contracts. In many States, these contracts carry no implied warranty. In other
12 States, and under *Restatement* law, an implied obligation or warranty exists, but
13 does not guaranty an accurate result. It entails an assurance of workmanlike or
14 reasonably careful **effort**. In transactions in information, tort and contract law
15 implied obligations, when they exist, typically hinge on assurances that no false
16 information is provided as a result of a failure by the provider to exercise
17 reasonable care in a context where the provider supplies information for the
18 business guidance of a particular client. *Restatement (Second) of Torts* § 552. Case
19 law typically limits this concept to relationships such as consulting contracts,
20 accountant audits, professional client services, and the like; in the vast majority of
21 reported cases, the obligations do not apply to information products distributed
22 outside such relationship and in a form not tailored to a particular client (e.g.,
23 newspaper distribution, books). That decisional pattern reflect fundamental and
24 long-standing policy. Contracts involving information content are infused with
25 First Amendment and related concerns about not impeding the free flow and
26 production of information.

27
28 To reflect the different traditions and the subject matter addressed in Article
29 2B, several tailored warranty rules are developed.

30 31 **Computer Programs**

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

36
37 The merchantability standard follows existing Article 2. It compares the
38 particular program to programs of similar kind and asks whether the program meets
39 ordinary standards for its description. As in Article 2, the warranty can be
40 disclaimed in Article 2B. In current practice, few cases arise in which disclaimer
41 does not occur. There are almost no reported cases on the meaning of
42 merchantability in computer software.

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

14 15 **Informational Content.**

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

21
22 Information content refers to factual data, images, sounds and the like,
23 intended in the ordinary course to communicate to human beings. (Section
24 2B-102) This is information in the classic sense of what one reads in the
25 newspaper, sees on television, or obtains by reference to an encyclopedia. This
26 Draft proposes a new term: "published information content" to identify content
27 distributed on an general, non-tailored basis outside any special relationship.

28
29 No implied warranty exists in Article 2B about the aesthetic merit or
30 marketability of information content. These are matters of taste and judgment, not
31 of warranty, unless the parties seek and receive express commitments.

32
33 Implied warranties relating to the accuracy of factual information are
34 created with respect to information distributed to a client in a special relationship of
35 reliance or in a situation where the author or publisher tailors the information
36 content to the particular contract. In cases where the warranty exists, there is no
37 absolute assurance of accuracy, but a commitment that no inaccuracies are created
38 by the provider's failure to exercise reasonable care. These provisions parallel
39 existing law under contract and tort theory. They neither expand, nor restrict
40 liability risk for the information provider except to the extent that the current Draft
41 applies this obligation in cases of non-business information, unlike the
42 *Restatement*.

1 **Viruses and Damaging Code**

2 Digital products and on-line services create various risks relating to
3 inadvertent (or intentional) introduction of computer viruses into the system of
4 another party to an electronic transaction. The risk runs in both directions. A
5 licensor may introduce viruses into its system or a licensee may inject a virus into a
6 licensor's system. In fact, most virus issues arise in on-line systems or on-line
7 access as compared to distributed software products on diskette.

8
9 No current case law provides guidance on how to allocate risk for viruses in
10 a contractual context. No cases have arisen under Article 2. Under criminal law in
11 many States, a party has liability for knowingly (not negligently) introducing
12 harmful code or viruses into a computer system of another person. The cases under
13 these statutes make it clear that this does not entail liability without fault, but
14 focuses on intentional and knowing conduct.

15
16 Because the issues runs in both directions, an issue arises about whether to
17 treat questions about virus obligations as a warranty, or as a contractual obligation.

18
19 **Disclaimers of Implied Warranties**

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

22
23 As to merchantability, in mass market transactions, Article 2B requires a
24 conspicuous disclaimer in a record. It indicates that a disclaimer complying with
25 the terms of Article 2B is not unconscionable. This codifies current law in the
26 majority of jurisdictions under the UCC. Where disclaimer language is invalidated
27 despite compliance with conspicuousness rules in the UCC, this typically occurs
28 because of specific *consumer* protection laws in a given State. Those laws on this
29 point are not altered by Article 2B.

30
31 Article 2B continues current law to allow enforcement of "as is" language
32 in non-mass-market transactions. In mass market transactions, it requires the
33 following language or its equivalent: "The information [or computer program] is
34 being provided as is or with all faults and the entire risk as to satisfactory quality,
35 performance, accuracy, and effort is with the user." To be effective, this language
36 must be conspicuous. This plain language approach makes disclaimers more
37 informative.

38
39 Article 2B allows disclaimer of infringement warranties. Under current
40 Article 2, the warranty can be disclaimed by "specific language" or by
41 circumstances that give the buyer reason to know that the vendor is transferring
42 only the rights it has. Current Article 2A uses the same approach.

Transferability and Financing

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

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

Allowing free assignability . . . would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute number of licenses in existence under a free-assignability regime, it would lose the very important ability to control the identity of its licensees. Thus, any license a patent holder granted "even to the smallest firm in the product market most remote from its own" would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be absolutely unwilling to license.²⁸

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

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

²⁸ *Everex Systems, Inc. v. Cadtrack Corp.*, 89 F.3d 673 (9th Cir. 1996).

1 this Article.²⁹

2
3 A basic principle is that state law rules should not create a misleading
4 impression by contradicting partially preemptive federal law. This shapes Part 5 on
5 transfers and how financing can be accommodated. In both settings, the Draft
6 contains suggested provisions that push close to limits. They accommodate
7 financing by allowing creation and enforcement **against the licensee**, but not sale
8 or control as **against the licensor** without consent of the licensor. (See Section
9 2B-504) Article 2A, not faced with the over-riding gloss of federal intellectual
10 property policy, recognized a similar right of an owner to control its property,
11 noting that the [lessor is entitled to protect its residual interest in the goods by
12 prohibiting anyone other than the lessee from possessing or using them.] Section
13 2A-303, Comment 3.

14
15 This Draft allows creation of a financing interest in a licensee's interests,
16 but limits enforcement without consent of the licensor. Resale is excluded because
17 of support for the licensor's intellectual property rights. The Draft also proposes
18 an integrated concept of "financier" which includes both a security interest and a
19 financing lease. **It does not include unsecured interests.** The concept, defined in
20 Section 2B-102, is applied in the two sections on financing. The first is Section
21 2B-504. The second, Section 2B-618, contains a limited discussion of the relative
22 relationship between a licensor, a financier, and a licensee (debtor).

23 24 Remedies

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

33
34 The damages formulae give either party a right to recover for consequential
35 damages. An earlier Draft of Article 2B proposed adoption of what was thought to
36 be the more common commercial approach: that consequential damages are
37 routinely disclaimed in commercial contracts. That experiment has been
38 abandoned. The new rule reflects common law. The *Restatement* uses a licensing
39 illustration in describing its general damages approach:

²⁹ See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994).

1
2 A contracts to publish a novel that B has written. A repudiates the
3 contract and B is unable to get his novel published elsewhere. Subject to the
4 limitations stated [elsewhere], B's damages include the loss of royalties that he
5 would have received had the novel been published together with the value to
6 him of the resulting enhancement of his reputation.³⁰

7
8 For both licensees and licensors, the remedies provisions allow contract
9 flexibility to define remedies, but absent agreement, they draw two distinctions: (1)
10 a distinction between material and non-material breach, and (2) a distinction
11 between default as to particular events or performance in a contract and default as
12 to the entire contract. Faced with a breach by the other party to the contract, the
13 injured party has an array of options, including continuing to perform the contract
14 but seeking or reserving the right to redress for the particular breach. Materiality
15 can be defined in the contract and a contract definition is definitive.

16
17 In digital information, the technology enables automated enforcement
18 techniques that are not available in other contexts. The automation allows a
19 provider of digital information to limit its uses consistent with a contract and, when
20 that permitted use expires, to cancel the capability to use the material in the future.

21
22 This Article deals with electronic controls in three different respects. In
23 each, the theme is that the licensor's contractual interest sustains appropriate
24 controls, but that the licensee's interests requires protection in the form of notice,
25 contractual assent in some cases, and an clear reason to act in others. The basic
26 model allows electronic remedies subject to significant restraints.

27
28 Section 2B-314 deals with electronic monitoring devices, such as
29 programmed limits on the number of users, number of uses or the like. It enables
30 passive monitoring and restriction. That is, restrictions that simply prevent extra-
31 contractual activity, but do not otherwise alter the information. Beyond that, such
32 devices are generally allowed only if notice is given and their use is assented to.

33
34 The more controversial restriction deals with cases of breach. A licensor
35 retains an interest in the intangible subject matter of the transaction. This interest is
36 different from that of a lessor because is applies to an intangible rather than goods.
37 In Section 2B-716, in cases involving a license (as contrasted to an unrestricted
38 transfer of information), the licensor's remedies include a form of repossession or,
39 at least, taking steps to preclude further use of the information by the licensee.
40 This right is sharply circumscribed. It does not exist in cases where the
41 information was so commingled that it cannot reasonably be extracted from the

³⁰ *Restatement (Second) of Contracts* § 347, illustration 1.

1 other information assets of the licensee. There are also limits couched in terms of
2 damage to the **property** of the licensee. The right to prevent further use will
3 generally be exercised only through court action. Self-help, such as through the
4 use of electronic methods to disable software can occur only in very limited cases.

5
6 To use a remedy based on an electronic device enabling disablement of the
7 software or other digital information asset, a licensor must have authorization to do
8 so in the contract and must be acting on a breach that is material independent of
9 contract terms defining materiality. That is, the remedy only exists for important
10 (material) breaches.

11
12 Self-help here contrasts to the far broader provisions in Article 9. A secured
13 party can exercise a right of self help so long as the exercise of that right does not
14 result in a breach of the peace. Material breach is not required and there are no
15 limitations on possible damage to property; it allows repossession of [equipment]
16 by disabling it. Article 2A remedies are similarly broad.

17
18

1 **UNIFORM COMMERCIAL CODE**
2 **ARTICLE 2B – LICENSES**

3
4
5
6 **PART 1**

7 **GENERAL PROVISIONS**
8

9
10 **SECTION 2B-101. SHORT TITLE.** This article may be cited as Uniform

11 Commercial Code – Licenses.

12 **Uniform Law Source:** Section 2-102.

13
14 **Reporter’s Note**

15 The scope of Article 2B is outlined in Section 2B-103. While the scope
16 covers more than licenses, the transaction used to develop this article involves
17 licensing of information. The title follows the approach in Article 2 which is
18 designated “sales” because that was the primary transaction format used to develop
19 provisions for that Article, but the actual scope extends to all “transactions” in
20 goods.
21

22
23 **SECTION 2B-102. DEFINITIONS.**

24 (a) Unless the contract otherwise requires:

25 (1) “Access contract” means a contract for electronic access to a
26 resource containing information, resource for processing information, data system,
27 or other similar facility of a licensor, licensee, or third party.

28 (2) “Activation of rights” means an initial grant of a contractual right
29 or privilege as between the parties for the transferee to have access to, modify,
30 disclose, distribute, purchase, lease, copy, use, process, display, perform, or
31 otherwise take action with respect to information, coupled with any actions initially

1 necessary to enable the transferee to exercise the right or privilege.

2 (3) "Authenticate" means to sign, or to execute or adopt a symbol, or
3 encrypt a record in whole or in part with present intent to identify the
4 authenticating party, or to adopt or accept a record or term, or to establish the
5 authenticity of a record or term that contains the authentication or to which a record
6 containing the authentication refers.

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

9 (5) "Computer program" means a set of statements or instructions to be
10 used directly or indirectly to operate an information processing system in order to
11 bring about a certain result. The term does not include any informational content
12 created or communicated as a result of the operation of the system.

13 (6) "Consequential damages" includes compensation for losses of a
14 party resulting from its general or particular requirements and needs which at the
15 time of contracting the other party had reason to know would probably result from
16 a breach of contract and which are not unreasonably disproportionate to the risk
17 assumed by the party in breach under the contract and could not have been
18 prevented by the aggrieved party by reasonable measures. The term includes losses
19 resulting from injury to person or property proximately resulting from breach of
20 warranty. The term does not include direct or incidental damages.

21 (7) "Conspicuous", with reference to a term, means so displayed or
22 presented that a reasonable person against whom it operates ought to have noticed

1 it or, in the case of an electronic message intended to evoke a response without the
2 need for review by an individual, in a form that would enable a reasonably
3 configured electronic agent to take it into account or react to it without review of
4 the message by an individual. A term is conspicuous if it is:

5 (A) a heading in all capitals equal or greater in size to the
6 surrounding text;

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

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

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

14 (E) language readily distinguishable in another manner.

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

22 (9) "Contract fee" means the price, fee, or royalty payable under a

1 contract under this article.

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

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

9 (12) "Court" includes an arbitrator or other dispute-resolution officer.

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

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

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

22 (16) "Electronic agent" means a computer program or other electronic

1 or automated means used, selected, or programmed by a party to initiate or respond
2 to electronic messages or performances in whole or in part without review by an
3 individual.

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

8 (18) "Electronic transaction" means a transaction formed by electronic
9 messages in which the messages of one or both parties will not be reviewed by an
10 individual as an ordinary step in forming the contract.

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

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

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

20 (i) inspection, receipt, transportation, care, or custody of
21 property;

22 (ii) stopping delivery, shipment, or transmission;

1 (iii) effecting cover or return of copies or information;
2 (iv) reasonable efforts to minimize or avoid the consequences of
3 breach; and
4 (v) actions otherwise incidental to the breach.

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

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

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

13 (24) "[Intellectual] [Informational] property rights" includes all rights
14 in information created under laws governing patents, copyrights, trade secrets,
15 trademarks, publicity rights, or any similar law that permits a party independently
16 of contract to control or preclude another party's use or disclosure of information
17 because of the rights owner's interest in the information.

18 (25) "License" means a contract that expressly authorizes, prohibits, or
19 controls access to or use of information, limits the scope of the rights granted, or
20 affirmatively grants less than all rights in the information, whether or not the
21 contract transfers title to a copy of the information and whether or not the rights
22 granted are made exclusive to the licensee. The term includes an access contract

1 and a consignment of copies of information. The term does not include a contract
2 that assigns ownership of intellectual property rights, that reserves or creates a
3 financier's interest, or a transfer by will or operation of law.

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

7 (27) "Licensor" means a transferor in a contract under this article,
8 whether or not the contract constitutes a license. The term includes a provider of
9 services. In an access contract, as between a provider of services and a customer,
10 the provider of services is the licensor, and as between the provider of services and
11 a provider of content for the service, the content provider is the licensor. If
12 performance consists in whole or in part of an exchange information, each party is
13 a licensor with respect to the information it provides.

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

16 (29) "Mass-market transaction" means a transaction in a retail market
17 for information involving information directed to the general public as a whole
18 under substantially the same terms for the same information, and involving an end-
19 user licensee that acquired the information in a transaction under terms and in a
20 quantity consistent with an ordinary transaction in the general retail distribution.

21 The term does not include:

22 (A) a transaction between parties neither of which is a consumer in

1 which either the total consideration for the particular item of information or the
2 reasonably expected fees for the first year of an access contract exceeds [];

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

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

7 (D) a commercial site license or an access contract between two
8 businesses.

9 (30) "Merchant" means a person that deals in information of the kind
10 involved in the transaction, a person that by occupation purports to have knowledge
11 or skill peculiar to the practices or information involved in the transaction, or a
12 person to which knowledge or skill may be attributed by the person's employment
13 of an agent or broker or other intermediary that by its occupation purports to have
14 the knowledge or skill.

15 (31) "Nonexclusive license" means a license in which the licensor or
16 other person authorized to make a transfer or license is not prohibited from
17 licensing the same rights in information within the same scope to other licensees or
18 from having previously done so in a license that remains in force at the time of the
19 contract. The term includes a consignment of copies.

20 [(32) "Present value" means the amount as of a date certain of one or
21 more sums payable in the future, discounted to the date certain. The discount is
22 determined by the interest rate specified by the parties in their agreement if that

1 rate is not manifestly unreasonable at the time the transaction was entered into.
2 Otherwise, the discount is determined by a commercially reasonable rate that takes
3 into account the facts and circumstances of each case at the time the transaction
4 was entered into.]

5 (33) "Published informational content" means informational content
6 that is prepared for, distributed, or made available to all recipients or a class of
7 recipients in substantially the same form and not provided as customized advice
8 tailored for the particular licensee by an individual acting on behalf of the licensor
9 using judgment and expertise. The term does not include informational content
10 provided within a special relationship of reliance between the provider and the
11 recipient.

12 (34) "Receive" means to take delivery of a copy of information. An
13 electronic record is received when it enters an information processing system in a
14 form capable of being processed by a system of that type and the recipient uses or
15 has designated that system for the purpose of receiving such records or
16 information. "Receipt" has a corresponding meaning.

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

20 (36) "Release" means an agreement not to object to, or exercise legal
21 or equitable remedies against, the use of information if the party granting the
22 release is not required to act affirmatively to enable or support the other party's use

1 of the information by providing copies of the information or access or otherwise.

2 The term includes a waiver of intellectual property rights and a covenant not to
3 sue.

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

6 (38) "Scope", with respect to a license, means the terms of the license
7 that define the licensed subject matter or copies; the uses authorized, prohibited, or
8 controlled; the geographic area, market, or location in which the license applies;
9 and the duration of the license.

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

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

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

22 (42) "Substantial performance" means performance of an obligation in

1 a manner that does not constitute a material breach of contract.

2 (43) "Termination" means ending a contract or a part thereof by an act
3 by a party under a power created by agreement or law, or by operation of the terms
4 of the agreement for a reason other than for breach by the other party. "Terminate"
5 has a corresponding meaning.

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

8 **Committee Votes:**

9 1. Adopted the term "authentication" to replace "signed" by a **consensus**
10 without a formal vote.

11 2. Voted to retain the concept of "mass market" licenses as in prior Drafts,
12 subject to revision of the definition of this term and consideration of its use in
13 specific sections as contrasted to use of the term "consumer." Vote: 13-0
14 (September, 1996)

15 3. Voted to adopt a definition of "mass market license" that utilizes a reference
16 to a market involving the general public and that centers on small retail transactions
17 including most consumers and excluding special primarily business transactions.
18 (December, 1996)

19 4. Voted to move references in definition of consequential damages to the
20 Comments except for the personal injury reference. Vote: 8-5 (Feb. 1997)

21 5. Rejected a motion to delete "intellectual property rights" from the definition
22 of "information." Vote: 3-5 (Feb. 1997)

23 6. Voted 10-2 to retain the mass market concept pending consideration of its
24 application in the Article. (Feb. 1997)

25 7. Voted to delete the language in mass market definition that provided explicit
26 coverage of all consumer transactions. Vote: 8-4 (Feb. 1997)

27 8. Voted to utilize a dollar limitation to cap the risk factor created under the
28 definition of mass market. Vote: 10-3 (Feb. 1997)

29

30 Reporter's Notes

31 *Changes Since the June Meeting:*

32 A number of revision were made in the definitions as a result of the
33 Harmonization meeting, designed either to conform to language being used by
34 other drafts revisions, or to more specifically conform to current law. The
35 definition of "contractual use restrictions" was moved to this section n that it is

1 used in more than one section in the remainder of the Draft. The definition of
2 [direct] damages was modified to more fully cover damage theories of that nature.
3 A definition of [present value] has been added based on current Article 2A.]

4
5 *General Notes:*

6 1. **Access contract** includes the relationship that arises when there is a
7 single access to the resource (e.g., web site) if, under ordinary contract law
8 principles, access creates a contract. The relationships include contracts for use of
9 E-Mail systems, EDI services by a provider, as well as web site contracts. The
10 term refers solely to electronic access situations and does not cover attending
11 movie theaters or the like. The term includes situations where a database in the
12 possession of a licensee automatically updates by accessing or being accessed by a
13 remote facility as in the following situation: Lexis provides an integrated
14 environment where the software first queries an on-site copy of a CD-ROM then
15 checks a local network update and obtains the latest information in a seamless
16 Internet or dial-up updating.

17
18 As outlined in the definition of [licensor], the model followed in three
19 party access transactions, such as where the content provider makes content
20 available through a third party access provider, entails two and, in some cases,
21 three separate contracts. The first is between the content provider and the on-line
22 provider. This license may be an ordinary license to use the information or an
23 access contract in itself. The second is between the on-line provider and the end
24 user or other client. This is an access contract. The content provider is not
25 necessarily party to or beneficiary of the contract. The third contract occurs when
26 the content provider contracts directly with the end user or client.

27
28 2. **Authenticate.** This article replaces the traditional idea of [signature]
29 or [signed] with a term that incorporates modern electronic systems, including **all**
30 forms of encryption or digital symbol systems. Basically, the fact of authentication
31 can be proved in any manner including proof of a process that necessarily resulted
32 in authentication. Use of an [attribution procedure] agreed to by the parties per se
33 establishes that a symbol or act constitutes an authentication.

34
35 Authentication differs from manifesting assent in this article.
36 Authentication (signing) always constitutes manifesting assent, but the reverse is
37 not true. For example, tearing open a package or clicking on an icon indicating
38 assent may manifest assent, but does not constitute a signature.

39
40 3. **Computer program.** This definition parallels the federal Copyright Act
41 with additional language reflecting the distinction drawn in this Article for
42 [informational content].

1 **4. Consequential damages.** This article follows existing Article 2.
2 Personal injury and property damage are a form of consequential damages; all other
3 requirements being met. This section makes clear that, **as under current law**,
4 property damage and personal injury damages are treated under a standard of
5 proximate causation, rather than simply foreseeability. *Proposed Article 2*
6 *revisions* treat property damage differently, placing it within the general standard of
7 consequential damages, rather than under the proximate cause standard used for
8 personal injury. This Draft follows current law. The Article 2 Draft also expressly
9 places the burden of proof of disproportionate damages on the breaching party.
10 This Draft is silent.

11
12 The basic premise of consequential loss other than for personal injury and
13 property damage is that it is attributable to a breaching party only if some level of
14 foreseeability can be proven. Beyond that, the basic test for whether a type of loss
15 falls within direct or consequential damage as a measure lies in the degree to which
16 the loss is directly associated with a reduction in the value received through
17 contract performance as contrasted to what was anticipated as measured by the
18 values assigned to events under the contract itself. Thus, consequential damages
19 include damages in the form of lost profit or opportunity, damages to reputation,
20 lost value in confidential information because of wrongful disclosure or misuse,
21 damages for loss of privacy interests associated with the contract, loss of data as a
22 result of the operational defect, and like damages.

23
24 Most commercial contracts deal with exclusion or inclusion of
25 consequential loss in practice and that negotiation process should be supported by a
26 delineation, insofar as possible, of what falls into this category and what does not.
27 The illustrations suggested above cover many relevant situations providing clarity
28 for negotiation. The theme here is that consequential losses go outside the
29 principle that the performance itself was less in quality than was agreed to by the
30 parties.

31
32 This Draft follows draft revisions of Article 2 on disproportionality. Draft
33 Article 2 allows a court to reduce consequential damages if unreasonably
34 disproportionate to the risk assumed by the breaching party. A motion to delete that
35 phrase was defeated on the floor of the Conference in 1996.

36
37 **5. Conspicuous.** This definition follows existing law and adds new themes
38 to deal with electronic contracting. As under current law, under Section 2B-115
39 whether a term is conspicuous is a question of law.

40
41 Current law in UCC § 1-201(10) contains three safe harbors for making a
42 clause conspicuous; these have been part of law for over fifty years. They serve a
43 critical role in planning and drafting documents. As a general rule, a term that

1 conforms to a "safe harbor" provision is held to be conspicuous. Many cases hold
2 that failure to conform to a safe harbor may invalidate any claims to being
3 conspicuous.

4
5 The idea of being conspicuous in a message to an electronic agent the
6 reference is to whether the agent has the ability to act on the term; the term must be
7 in a form that can be processed and understood by the computer. It need not be
8 otherwise separated out. Computers do not respond differently to capital letters or
9 lower case. The electronic message suffices if it is designed to invoke such a
10 response from a "reasonably configured" electronic agent, a concept that will be
11 spelled out in the commentary to indicate that it intends an analogous construct that
12 parallels the reasonable man standard used for the general concept of conspicuous.

13
14 Revisions of Article 2 propose abolition of the safe harbor concepts present
15 in current law. Article 2B follows existing law. The theme of conspicuousness
16 blends both a notice function and a planning function giving certainty to the party
17 preparing and using the term. It is equally important to ensure that the recipient of
18 a record receives notice of the contents and that the party who reasonably desires to
19 rely on the terms of the record can do so. Taking out all safe harbor language
20 eliminates the second objective and jeopardizes the first.

21
22 6. **Consumer.** Existing Article 2 does not define "consumer." Article 9
23 focuses on persons acquiring property primarily for personal or household uses.
24 European law uses a different approach and defines a "consumer" as one entering
25 into a contract **outside** her business or profession.

26
27 This Draft focuses on the time of contracting to define the status of a party.
28 The term "consumer" triggers restrictions on contracting. While most often, intent
29 does not change from the time of contract to the time of delivery, when changes
30 occur, a time of delivery focus would retroactively change the rules. The issue is
31 important in Article 2B since many contracts in Article 2B are on-going
32 relationships; a **delivery** concept might provide different characterizations of the
33 same transaction at different points in time.

34
35 The Article 9 definition provides a template for this Draft. The Article 9
36 definition creates serious interpretation issues when used for transactions that are
37 not security interests that have been encountered in case law outside Article 9. This
38 Draft clarifies the focus and resolves some of those problems. Some personal uses
39 are not consumer uses (see, e.g., a stock broker using database software to
40 "personally" track billion dollar investments). Distinguishing these personal
41 business uses and truly consumer uses holds great importance in Article 2B because
42 software and other information can be used "personally" in traditional business
43 contexts. The exclusions in the definition apply to profit-making, profession, or

1 business use. In the modern economy where individuals can and often do engage
2 in seriously significant commercial enterprises without the overlay of a large
3 corporation, the personal use idea needs to respect and reflect the modern practice,
4 especially in this area. The proposed definition distinguishes between persons
5 using information in profit making and business uses and personal or family uses
6 such as ordinary asset **management** for an ordinary family.

7
8 This issue has been considered in many areas of law that have evolved since
9 the original definition of Article 9. The issues have proven to be difficult and
10 subject to litigation under the Article 9 concept in lending, bankruptcy and other
11 contexts. For example, a number of reported decisions focus on whether or when a
12 purchase of stocks or limited partnership assets for **investment** purposes would be
13 considered a consumer purchase since it might fall within the general reference to
14 "[personal]" purposes. See, e.g., *Thomas v. Sundance Properties*, 726 F.2d 1417 (9th
15 Cir. 1984); *In re Manning*, 126 B.R. 984 (M. D. Tenn. 1991) (UCC definition "[not
16 especially helpful on its face]"). Some courts emphasize the difference between
17 acquisition for "[consumption (consumer)]" and acquisition or use "[for profit-
18 making]". This approach comes in part from the Truth in Lending Act which uses a
19 definition of consumer debt much like the definition in Article 9 of consumer but
20 additionally contains an express exemption for business transactions. The "[profit-
21 making]" test has been applied in bankruptcy cases interpreting a Bankruptcy Code
22 provision identical to the standard UCC definition. For example, the Fifth Circuit
23 commented that "[The] test for determining whether a debt should be classified as a
24 business debt, rather than a debt acquired for personal, family or household
25 purposes is whether it was incurred with an eye toward profit." *In re Booth*, 858
26 F.2d 1051 (5th Cir. 1988). See also *In re Circle Five, Inc.*, 75 B.R. 686 (Bankr. D.
27 Idaho 1987) ("The farm operation is a business for the production of income. Debt
28 used to produce income is not consumer debt "[primarily for a personal, family or
29 household purposes.]").

30
31 7. **Copy.** This definition was designed to correspond to copyright law. In
32 the Copyright Act, cases hold that a copy does not require permanence, but cannot
33 be purely transitory, such as an image on a screen. Moving information into a
34 computer memory makes a copy of that information.

35
36 8. **Court.** This definition extends the power to make choices to officers of
37 non-judicial forums.

38
39 9. **Direct damages.** The Draft defines "[direct damages]" to provide
40 guidance on the distinction critical to commercial practice that differentiates types
41 of damages for disclaimer and other contract language. Direct damages are losses
42 associated with a reduction of value or loss of value **as to the contracted for**
43 **performance itself**, as contrasted to losses caused by intended uses of the

1 performance or use of the results of the performance by the recipient outside the
2 contract. Direct damages are measured in the damages formulae in this Article.

3
4 The definition rejects cases where courts treat as direct damages losses that
5 relate to anticipated advantages outside the contract that were to flow from the use
6 of the product. These are consequential damages. Thus, one case held that defects
7 in a system under a contract that disclaimed consequential damages included all the
8 lost benefits that the party expected from the deal (a total far in excess of the
9 purchase price and incorporating what would ordinarily be consequential loss).
10 The issue is: if we have software purchased for \$1,000 which, if perfect, would
11 give profits of \$10,000 and the thing is totally defective, should the "value" of the
12 software be considered to be "\$10,000 or \$1,000 as "general" damages? The
13 answer here is \$1,000. Similarly, if a virus in a program causes a \$10,000 loss, but
14 the program otherwise fully performs, should that \$10,000 be direct or
15 consequential loss? The Draft adopts the view of most courts and treats this as
16 consequential loss.

17
18 **10. Electronic Agent.** An electronic agent is a program designed to act on
19 behalf of the party without the need for human review. As a general rule, a party
20 adopting use of such agents is bound by (attributable for) their performance and
21 messages. The term plays an important role in shaping responsibilities and how
22 parties comply with various conditions, such as an obligation to make terms
23 conspicuous. Courts may ultimately conclude that an electronic agent is equivalent
24 in all respects to a human agent, but this Draft does not go so far, making specific
25 provisions relating to electronic agents when needed. In this respect, the Draft is
26 consistent with Article 4A as well as with modern practice. The accountability of a
27 party for actions of a computer program may hinge on different issues than
28 accountability for a human agent.

29
30 **11. Electronic Message.** This term has been broadened to parallel a
31 definition used in the draft UNCITRAL Model Law and to expressly include
32 reference to fax, telex and similar electronic transactions. The expansion serves an
33 important purpose in reference to issues about when a contract is formed through
34 electronic messages. The new terms, however, refer to qualitatively different
35 subject matter in that pure electronic messages assume that a human will eventually
36 read or react to the transmission. The expansion creates ambiguity in reference to
37 defining whether contracts are formed when a human interacts with a computer or
38 two computers interact with each other in the absence of human direct guidance.

39
40 The definition does not refer to a transfer from one system to another. In
41 many cases, host computers handle data (e.g., email files) for both parties, and the
42 message moves within the computer from one file to another. That type of
43 transmission engages no policy issues different from the case of an actual

1 communication of digital information from one location to another.

2

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

11

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

20

21 **13. Good Faith.** The definition follows current Article 2 law and also
22 extends the duty of good faith and fair dealing to consumers. That formulation was
23 supported by a vote of the Conference at the 1996 Annual Meeting.

24

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

33

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

1 *defamation or similar tort claims.*

2

3 **16. License.** The essence of this definition lies in the conditional or limited
4 nature of the contract rights. At least some conditions must be express, rather than
5 implied. The distinction between an unrestricted sale of a copy and a license
6 revolves around the terms of the contract as expressed, rather than on implied
7 conditions. In an unrestricted sale of a copy, the transferee receives ownership of
8 the copy, but if intellectual property rights apply to the information on the copy, is
9 subject to implicit restrictions on use of the information derived from intellectual
10 property law. In a license, whether or not ownership of the copy is transferred, the
11 transferee is subject to express contract restrictions or receives a contract grant that
12 expressly gives less than all rights in the information.

13

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

27

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

35

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

43

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

5
6 The definition contemplates a retail marketplace where information is made
7 available in pre-packaged form under generally similar terms. It applies to
8 information that is aimed at the general public as a whole, including consumers. It
9 would not cover products directed at a limited subgroup of the general public, such
10 as members of a club or persons whose income exceeds a specified level. Where
11 the line will be drawn in determining the size of the subgroup that would qualify
12 for a general public distribution cannot be answered absent judicial consideration
13 of specific cases. However, the intent is that the products covered here do not
14 include specialty software, information directed to specially targeted limited
15 audiences, or professional use software, but materials that appeal and intend to
16 appeal to a general public audience as a whole where the identity and status of the
17 eventual licensee is irrelevant

18
19 This captures most of a true retail setting, such as transactions in
20 department stores or the like. Article 2B will be the first UCC article to extend
21 consumer-like protections to business transactions in any form and the first to tailor
22 at least some default rules based on that concept. The goal is to do this in a limited
23 manner, reflecting the innovative nature of the concept, while confining the risk
24 created by focusing on small transactions for information oriented toward the broad
25 general public.

26
27 The dollar limit should be selected based on empirical evidence relating to
28 the pricing structure of modern software transactions. In a review of several
29 sources, few items of consumer software exceed \$200. The price curve is
30 downward, rather than increasing. A \$500 limit would far exceed the average cost
31 of retail **business** software. As of the date that this Draft was prepared, the
32 Committee had not voted on the dollar amount.

33
34 The definition excludes any non-consumer transaction that exceed the
35 dollar limit as to the **particular item**. In a situation where items of software are
36 bundled together and with hardware, the dollar limitation applies to each item
37 separately. In this bundled transaction respect, however, it should be noted that the
38 decision in Article 2 to not utilize a mass market theory creates a potential
39 anomaly: The items of software will most likely be mass market and subject to the
40 provisions of Section 2B-308, while unless the purchaser is a consumer, the
41 hardware would not be subject to the analogous provision in Article 2.

42
43 The other business exceptions identify situations involving site licenses,

1 typical performance licenses (e.g., ASCAP, Broadcast Music) and situations where
2 the licensor provides customization of the product, rather than transferring it
3 essentially of the shelf.

4
5 This Draft proposes a bifurcated treatment of on-line (Internet) transactions.
6 Most consumer transactions on Internet fall within the definition and a vast
7 number of consumer transactions occur on Internet. It is especially important
8 however, with this new transactional environment, to not regulate business
9 transactions.. The approach in this Draft is to exclude from the definition of mass
10 market any online transaction not involving a consumer. This gives the online
11 industry room for expansion and growth not subject to unintentional regulations,
12 while preserving consumer protections in that environment.

13
14 20. **Receive.** This definition covers receipt of messages and performance
15 in an information contract. Electronically, the occurrence of receipt hinges on
16 sending the electronic record or information to a designated system in a form
17 capable of being processed by that system. The Draft places the burden of
18 determining what format is appropriate for that system on the person sending the
19 message or performance. One Commissioner suggested that this should be
20 reversed to place the burden on the recipient to designate the form and, failing that,
21 to allow receipt even if not capable of being processed by the system. Consider: I
22 order a copy of Lotus Notes from IBM and direct them to transfer the copy
23 electronically to my computer which is a Compaq, but I forget to mention that fact.
24 They do so, but the software is in Apple format. Have I received performance?

25
26 21. **Sale.** With respect to information, a distinction is made between title to
27 the copy and title to the intellectual property rights. Title to information essentially
28 means that the transfer is free of any restrictions, express or implied, on the use,
29 reproduction or modification of the information.

30
31 22. **Standard form.** Standard forms are a major part of consumer and
32 commercial practice. As to questions about the enforceability of particular terms
33 and questions of assent to the overall form, standard form issues are expressly dealt
34 with in the *Restatement (Second)* and in the *UNIDROIT Principles*. Existing
35 Article 2 does not contain any express treatment of forms. In the revision process,
36 initially both Article 2 and Article 2B contained provisions dealing with when a
37 party assents to a form. Subsequently, the Article 2 Committee deleted the concept.
38 Subsequently, ALI Council recommended that this decision be reversed. Article
39 2B has contained provisions dealing with standard forms since the beginning of the
40 drafting process.

41
42 The reference in this definition is to forms (e.g., **groupings** of standard
43 terms) whose use in modern commerce is not only widespread, but virtually

1 ubiquitous. The idea expressed does not hold that a record that contains language
2 previously used in other transactions falls within the term and it does not focus on
3 individual "standard terms." The record, which contains a composite of terms,
4 must have been prepared for repeated use is a standard form whose legal
5 significance is judged accordingly.

6
7
8

SECTION 2B-103. SCOPE.

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

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

19 (c) If a transaction involves both information and goods, this article applies
20 to the information and to the physical medium containing the information, its
21 packaging, and its documentation, but Article 2 or 2A governs standards of
22 performance of goods other than the physical medium containing the information,
23 packaging, or documentation pertaining to the information. If a transaction
24 includes information covered by this article and services outside this article or
25 transactions excluded from this article under subsection (d)(1) or (2), this article

1 applies to the information, physical medium containing the information, and its
2 packaging and documentation. A transaction excluded from this article by
3 subsection (d)(3) is governed by Article 2 or 2A.

4 (d) This article does not apply to:

5 (1) a contract of employment of an individual who is not an independent
6 contractor, a contract for performance of entertainment services by an individual or
7 group, or a contract for performance of professional services by a member of a
8 regulated profession;

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

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

16 **Committee Votes:**

17 1. Voted 10-3 to reject a proposal to limit the scope of the article to "coded",
18 "digital", "electronic" or similar concept.

19 2. After initially rejecting the motion, on reconsideration, the Committee voted
20 10-0 to limit scope to licenses of all information and software contracts.

21 3. Voted 9-3 to reject a motion to include all patent and trademark licenses in
22 the Article.

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

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

25

26 Reporter's Notes

27 1. This article deals with transactions involving the copyright industries.

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

12
13 2. As in every context in which digital and other modern information
14 technologies have had significant impact, they create difficult problems of placing
15 the new technologies and technology products within existing legal and social
16 categories. That issue affects tax law, communications law, intellectual property
17 law, and many other fields. It affects the delineation of Article 2B scope. This
18 article reflects extensive discussion by the Committee. The Committee rejected
19 proposals to limit the scope to digital information. Modern convergence of
20 information technologies makes reference to digital or a similar term an
21 unworkable scope definition and its linkage to a specific technology makes the long
22 term viability of such a focus suspect. The Committee opted to focus on licensing
23 and software contracts. Common to these transactions is that the focus concerns
24 information (rather than goods), even if transferred in a tangible copy (e.g.,
25 newspaper, diskette, book/manual) and that there are conditions on use or access in
26 the transaction.

27
28 3. For transactions in information other than software, this article
29 distinguishes between a license and a sale of a copy. Exclusion of sales of copies
30 of information leaves undisturbed major segments of the traditional information
31 industry, such as contracts involving a sale of a copy of a book or a newspaper.
32 The distinction between a license and a sale of a copy in the information industry is
33 as explicit as the distinction between a sale and a lease in goods. This section uses
34 a transaction characterization consistent with practices in those industries.

35
36 For computer software, the more important factor involves the nature of the
37 product. With the exception of some limited types of software products, all
38 transactions whether licenses or sales are subject to either express or implied
39 limitations on the use, distribution, modification and copying of the software.
40 These limitations are commercially important because (unlike in reference to
41 newspapers and books) the technology makes copying, modification and other uses
42 easy to achieve and essential to even permitted uses of the software. Bringing all
43 transactions involving this subject matter into Article 2B reflects the functional

1 commercial similarity of the transactions and the need for a responsive and focused
2 body of law applicable to these types of products. In addition, as a relatively new
3 form of information transaction involving products with distinctive and unique
4 characteristics, no common law exists on many of the important questions with
5 reference to publisher and end user contracts regardless of whether a transaction
6 constitutes a license or a sale of a copy.

7
8 4. Subsections (b) and (c) discuss issues pertaining to the interface between
9 Article 2B and other UCC Articles. For transactions governed within the trio of
10 UCC transactional articles (Articles 2, 2A, and 2B), the primary rule applies each
11 to its particular subject matter. *This is the "gravamen of the action" test.* It rejects
12 the "predominant purpose" test used under current law for allocating coverage
13 between transactions governed by Article 2 or law outside the UCC. The primary
14 exception involves embedded software as discussed in (d)(3). Based on a
15 suggestion from the floor of the 1996 Annual Meeting, Comments will make it
16 clear that manuals delivered in connection with software are covered under Article
17 2B.

18
19 5. **Subsection (d) exclusions.** Because Article 2B brings into the UCC a
20 variety of transactions that were previously covered under common law, the broad
21 scope of inclusion has been tempered by the development of specific exclusions.
22 These are brought together in subsection (d). While some exclusions have been
23 suggested based on industry-specific activities, the exclusion in general refers to
24 particular types of contractual activities in a more generic form.

25
26 a. **Subsection (d)(1)** deals with individual services contracts, including
27 employment contracts and entertainment services (e.g., actor, musical group
28 performance, producer, etc.). The excluded cases involve personal services and
29 require much different default rules than here. The entertainment services
30 exclusion covers both direct contracts with individuals and the various
31 structures under which a party hires services of an individual or group through
32 a loan contract with a legal entity with whom the individual or group is
33 employed. This subsection also excludes professional services to avoid
34 confusion between and the regulatory standards of regulated professions. The
35 exclusion only pertains to regulated services and not to other contracts or
36 services (e.g., law firm web site where legal advice is not given is treated the
37 same as any other web site).

38
39 The motion picture and publishing industries have suggested that the
40 Committee consider exclusion of author and other upstream contracts generally,
41 but at this point have not pressed that issue, preferring to work toward a Draft
42 that accommodates the characteristics of those contracts. Indeed, while
43 sometimes involving different practices, the issues in upstream contracts across

1 the various areas of commerce discussed in Article 2B are very similar.
2 Upstream software contracts are clearly included. Illustrations of the
3 provisions resulting from discussion of this topic include the treatment of "to
4 the satisfaction" clauses in Section 2B-305 and submissions of information in
5 Section 2B-602.
6

7 **b. Subsection (d)(2)** excludes patent and trademark licenses not associated
8 with the other subject matter of the Article. The rationale lies in the differences
9 between copyright and digital licensing and practices in unrelated areas of
10 patent law. Patent licensing relating to biotech, mechanical and other industries
11 entails many different assumptions and standard practices that are not
12 contemplated by this Draft. This is also true for trademark licensing. A similar
13 analysis may also be true, to an extent that needs further discussion and
14 clarification either in text or Comments, for merchandising transactions and
15 commercial tie-ins, such as those involving the use of images, film indicia, or
16 graphics on a toy, apparel, or other tangible goods. Whether these licenses
17 should be specifically excluded from the scope of this Article requires further
18 analysis in like of concerns expressed by the affected industry and the fact that
19 trademark licensing is current excluded.. As to trademark licensing, there is the
20 additional consideration of coverage of aspects of that industry under federal
21 and state franchising laws
22

23 While the Article excludes patent and trademark licensing, in practice,
24 however, courts are likely to apply Article 2B by analogy to other fields of
25 licensing. The Comments will discuss the role of application by analogy of this
26 Article in context of the history of reasoning by analogy in other contexts. See,
27 e.g., Article 2A Comments
28

29 **c. Subsection (d)(3)** excludes computer programs such as airplane
30 navigation or operation software, software that operates automobile brake
31 systems, and the like. Issues relating to this type of software are governed by
32 the law governing the transaction in the entire product (e.g., Article 2 or Article
33 2A).
34

35 **6. Banks as licensors.** Prior to the May, 1997 meeting, a Commissioner,
36 representing Citibank, communicated a proposal that Article 2B exclude any
37 transaction involving a bank as the licensor. The argument for this refers to the
38 regulatory structure that controls core banking activities and approves non-
39 traditional business activities for banks. The proposal was strongly resisted by
40 others present at the meeting in May based on the fact that, outside the specifically
41 regulated activities, banks are engaged in many of the same licensing and
42 processing activities as are all other industries involved in Article 2B.
43

1 Article 2B as drafted does not cover transactions governed under other law
2 (e.g., Article 4A, Article 4). It is preempted to the extent of specific controls under
3 federal or state banking regulation. In implementing this exclusion, the Committee
4 recognized that modern developments in digital cash and similar systems place
5 many companies other than traditional banks in the same situation. Regulations,
6 such as Regulation E on funds transfer, do not apply solely to banks, but to any
7 holder of a depository account and, depending on regulatory decisions, non-bank
8 entities will be included (e.g., a digital account created on a "smart card" for use to
9 purchase a total of \$100 of coffee from a coffee shop, a card containing frequent
10 flier mileage for airline use).

11
12 Equally important, modern banks engage in many commercial activities that
13 are identical to companies whose licensing practice and online systems are clearly
14 within Article 2B, such as Netscape, Westlaw, Home Shopping, Microsoft Network,
15 America On-Line, and others. As the information industries converge, so too is the
16 banking industry converging into fields identical to that of the information
17 industries. Bank **entry** into these fields is regulated "a bank must obtain approval
18 under Regulation Y to do so. But this is scope regulation, not content regulation. A
19 review of bank websites, for example, reveals that some deal only with on-line
20 banking, while others do not. The Wells Fargo site, for example, offers a general
21 shopping mall, a link to purchase software and various other information services.
22 Complete exclusion of banks is not warranted.

23
24 **7. Motion pictures.** The motion picture industry has expressed concern
25 about the impact of Article 2B on established licensing practices in that industry,
26 especially in reference to its core business of developing, producing, distributing,
27 exhibiting and performing motion pictures, which can be defined as audiovisual
28 works that are primarily intended for viewing in a predetermined, continuous and
29 sequential manner (e.g., those that do not rely on interactivity). The industry has
30 raised this issue, but has devoted substantial time and resources to working with the
31 Committee and that work has yielded significant improvements in the Draft. At
32 this point, the industry has not determined whether to seek a carve out for these
33 transactions, but has circulated draft language to the foregoing effect to the
34 Drafting Committee.

35
36
37 **SECTION 2B-104. TRANSACTIONS SUBJECT TO OTHER LAW.**

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

40 (1) a law of this State establishing a right of access to or use of

1 information by compulsory licensing or public access or a similar law;
2 (2) a law of this State regulating purchase or license of rights in motion
3 pictures by exhibitors; or
4 (3) any law of this State that establishes a different rule for consumers.
5 (b) If a law referred to in subsection (a) existing on the effective date of
6 this article applies to a transaction governed by this article, the following rules
7 apply:
8 (1) A requirement that a contractual obligation, waiver, notice, or
9 disclaimer be in writing is satisfied by a record.
10 (2) A requirement that a record or a contractual term be signed is
11 satisfied by an authentication.
12 (3) A requirement that a contractual term be conspicuous or the like is
13 satisfied by a term that is conspicuous in accordance with this article.
14 (4) A requirement of consent or agreement to a contractual term is
15 satisfied by an action that manifests assent to a term in accordance with this article.
16 (c) With respect to this article, failure to comply with a law referred to in
17 subsection (a) has only the effect specified therein.

18 **Uniform Law Source:** Section 9-104(1)(a); Section 2A-104(1).
19

20 **Committee Votes:**

21 1. The Committee voted 11-1 to approve the section subject to adjustments of
22 subsection (b)(4) which have subsequently been made. (September, 1996)
23

Changes Since the June Meeting:

The language in subsection (c) was added as a result of the Harmonization Meeting. Also, it has been suggested that the Committee determine whether a legislative note should accompany the final Draft highlighting that each State should examine existing law to determine if the changes in subsection (b) should not apply to particular existing rules. Subsection (b) is part of the electronic commerce provisions developed in the Article 2B project and proposed for inclusion in Article 2 and Article 2A revisions.

General Notes:

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

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

2. **Subsection (b)** implements a balance between the modernization themes in Article 2B relating to electronic commerce and existing law regulating consumer contracts. It adopts a limited, circumspect reconciliation approach that contrasts to the many non-uniform digital and electronic signature statutes that have been

1 enacted in Utah, Washington, Florida, Texas, Minnesota, and a number of other
2 States. Many of these other non-uniform statutes take the approach of replacing or
3 amending all signature and writing requirements with a rule that allows a digitally
4 encrypted record or other electronic indicia of a signature to satisfy writing,
5 signature, certification and other formalities. Digital signature laws adopted in
6 Washington, Utah, and as proposed in other States, adopt a similar reconciliation
7 approach, defining acts that comply with their requirements broadly to comply with
8 writing, signature and similar requirements in **all state laws**. This Draft is more
9 limited in impact, narrowing the changes to center on manageable and identified
10 parameters of existing law without attempting to alter the entire world.

11
12 The problem addressed here involves the fact that literally thousands of
13 potentially relevant statutes may affect electronic commerce transactions. For
14 transactions governed by Article 2B (or revised Article 2), the provisions of this
15 Article would ordinarily replace the other law. That is not true for consumer
16 transactions. Yet, the policies that led to a required "writing" most often did not
17 consider the digital alternative. The balance must preserve important policies
18 (thus, the principle of general non-reversal) of these laws, but should extend the
19 effectiveness of innovations in electronic contracting. The approach here sets out a
20 presumption that the other law controls, but identifies some aspects of UCC
21 electronic commerce rules where it is appropriate to reverse that presumption. In
22 final form, the structure of Article 2B must reflect some State's constitutional and
23 other laws that preclude general revision without specific authorization, of laws
24 beyond the particular enactment. This will be through a legislative note.

25
26 The goal is to facilitate electronic commerce and to implement concepts
27 concerning electronic trade. Article 2B expands the idea of a writing and a
28 signature to include, respectively, a record and an authentication. Conspicuous is
29 defined to deal with electronic contexts and expanded by an enhanced concept of
30 manifestation of assent. In these respects, electronic concepts that were not at issue
31 when existing consumer law developed, require adjustments appropriate to promote
32 uniformity and certainty in commerce that is truly national in nature, while
33 preserving the intent of the regulations. There is no effort to alter content terms,
34 such as whether a disclaimer can be made, what language must be used, and like
35 issues.

36
37 Based on concerns expressed by consumer groups, subsection (b)(4) was
38 altered and does not cover cases where state law requires negotiation of a term.
39 Negotiation requirements entail a mandate that a party actually dicker over a term
40 with there being an actual and direct exchange and alteration of positions, the
41 concept of manifesting assent does not meet this.

42
43

1 **[SECTION 2B-104A. RELATION TO FEDERAL LAW.** A provision of this
2 article preempted by federal law is unenforceable to the extent of such preemption.]

3 **ALI Action:**

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

8

9

Reporter's Note

10 1. This section has not been reviewed by the Drafting Committee.

11

12 2. Article 2B deals with general contract law, not with the issues faced in
13 federal property law and regulation. The relationship between federal law and state
14 contract law on transactions involving information is complex. The approach of
15 Article 2B has been to correspond to clear rules of federal law and to take no
16 position regarding controversial or context determined rules whose application
17 cannot be predicted. The Comments to this section will make clear that Article 2B
18 is not intended to alter federal law and will discuss illustrations of cases where the
19 interaction of contract and federal policy occurs.

20

21 3. The complexity of the interaction is heightened by the fact that many
22 property rights that underlie transactions in this field are created by federal, rather
23 than state law (e.g., Copyright Act, Patent Act). Also, beyond property law, many
24 situations involving disclosure, access, and transfer of information are subject to
25 federal regulations, such as in Regulation E, the Electronic Communications
26 Privacy Act, the Communications Act of 1996, the Freedom of Information Act, the
27 Food and Drug Administration Act, and various other regulations or statutes.

28

29 4. The basic principle is that federal law controls if it preempts. When or
30 whether that occurs is not a question of state law. State law, including the UCC,
31 cannot alter that balance and does not intend to do so. Thus, a federal law
32 determination that a specific form of disclosure creates an enforceable term cannot
33 be altered by state law. Similarly, a limit on liability mandated by federal law
34 cannot be abridged by state contract law. A requirement of a writing to transfer a
35 copyright in federal law cannot be altered by abolishing a state statute of frauds. A
36 mandatory rule that prevents transfer of a non-exclusive license without the
37 licensor's consent as a matter of federal law precludes a contrary state law rule.

38

39 5. The basic principle of preemption is supplemented in licensing law by
40 the fact that federal competition, antitrust, and intellectual property rules provide a

1 basis for courts to monitor some practices in licensing involving the use of
2 particular terms in particular setting that may be viewed as abusive. State law
3 cannot control or alter those rulings. They involve determinations about federal
4 law and policy that go beyond state law. Article 2B takes no position on the
5 complex competition, social policy and other issues present here. It simply sets out
6 basic contract principles governing the contractual relationship in information
7 transactions. It governs the contractual relationship, federal law and policy
8 determines whether a particular contract in a particular setting is barred by federal
9 law.

10
11 6. In respect to these issues, Article 2B does not alter the relevant policy
12 equation. Even without Article 2B's clarification of complex and often out-dated
13 contract rules, contract law and practice already controls much of distribution of
14 information. The contract law regime exists and in most cases and with respect to
15 most issues, contracts control as the method by which parties obtain value from
16 information. As stated in the Copyright Act, federal property law precludes state
17 law that creates rights equivalent to property rights created under copyright. 17
18 U.S.C. § 301. But as both a practical and a conceptual matter, copyright (or patent)
19 do not generally preclude or preempt contract law. Indeed, contracts are essential
20 to use one's own property, even when the property is tangible, let alone when it is
21 intangible. A contract defines rights between **parties to the agreement**, while a
22 property right creates rights against **all the world**. They are not equivalent.

23
24 7. With the transition from print to digital media as a main method of
25 conveying information, major policy disputes have erupted concerning the
26 redistribution of rights in light of the fact that the media of distribution allows
27 many different and potentially valuable (for users or authors) uses of information
28 products. The difficulty of balancing fundamental rights in this context is
29 demonstrated by the fact that disputes about underlying social policy have erupted
30 and been left unresolved in numerous contexts in the U.S. and internationally.
31 These fundamental questions are beyond the scope of this Article. State law that
32 conflicts with the resolution of those questions in federal law may be preempted if
33 that is the policy choice made in federal law.

34
35 8. Typically, in determining whether or when such policies apply, courts
36 accept that contract law generally prevails, but ask whether a particular contract
37 clause in a particular setting conflicts with federal policies when balanced against
38 the general role of contracts in the economy and legal system. How far the federal
39 policies reach is uncertain. Not surprisingly, in light of the shifts caused by digital
40 technology, defining the proper scope of rights under federal property law has been
41 controversial; it remains unresolved despite extensive negotiation and political
42 discussion. Some disputed issues deal with reverse engineering of copyrighted, but
43 unpatented technology and the scope of educational or scientific fair use of digital

1 works. These are questions of federal policy. They must be resolved by courts and
2 Congress, rather than through state legislation. Article 2B takes no position on
3 these or similar questions, whether a preclusion potentially stems from antitrust law
4 or from intellectual property law or other source of federal preemption. Article 2B
5 merely provides a contract law framework.

6
7

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

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

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

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

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

18 **Committee Vote:**

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

20

21 **Selected Issue:**

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

25

26 **Reporter's Notes**

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

1 barriers precluding use of these rules, the choice of law made by contract governs.

2

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

14

15 3. Subsection (a)(2) deals with an issue raised by several observers where
16 transactions involve mixed law and permits an opt in/opt out option where the
17 parties may desire to be entirely governed by one or the other body of law. The
18 language in subsection (a)(2) has not yet been reviewed by the Drafting
19 Committee, but was included in the May, 1997 Draft.

20

21

22 **SECTION 2B-106. LAW IN MULTI-JURISDICTIONAL**

23 **TRANSACTIONS.**

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

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

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

31 (2) A consumer contract not governed by subsection (b)(1) which
32 requires delivery of a copy on a physical medium to the consumer is governed as to

1 the contractual rights and obligations of the parties by the law of the jurisdiction in
2 which the copy is located when the licensee receives possession of the copy or, in
3 the event of nondelivery, the jurisdiction in which receipt was to have occurred.

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

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

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

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

18

19 **Committee Votes:**

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

24

25 **Reporter's Notes**

- 26 1. There are two questions addressed in this section. The first deals with
27 enforceability of contract provisions choosing the applicable law for a contract and

1 the second deals with choice of law in the absence of a contract term dealing with
2 the question.

3
4 2. Choice of law clauses are routine in commercial licenses. They select
5 what State's law applies. Subsection (a) validates choice of law agreements, thus
6 adopting a strong, contract choice position. Law outside this statute might restrict
7 the ability of commercial parties to choose their law if the choice infringes
8 fundamental policy of the forum State. This Article does not alter that policy or the
9 applicable over-riding law. But few of the cases discussing this deal with anything
10 other than a consumer transaction. A prior section of this Article makes clear that
11 those consumer policies and rules are not disturbed by Article 2B.

12
13 A rule that validates choice of law agreements states an important policy
14 choice in a context where an increasing number of modern information transactions
15 occur in cyberspace, rather than in fixed environments. Because many transactions
16 in this field are not easily related to tangible locations, the ability to fix an
17 appropriate choice of law provides an important contract drafting premise. The
18 Committee in January, 1996 expressed strong support for this premise and, indeed,
19 it reflects the clear trend of modern law. The rule enhances certainty of contract on
20 choice of law rules in Article 2B under the principle of freedom of contract. It was
21 strongly supported by ABA representatives.

22
23 Subsection (a) makes the clause enforceable, subject, implicitly, to concepts
24 of unfair surprise, conscionability, duress, and other general law theories. Except
25 in Article 2A and cases of consumer regulatory statutes, no current uniform law in
26 the U.S. precludes enforcement of contract choice of law on issues that a contract
27 could control. Neither the *Restatement*, current Article 1 or Article 2, nor revised
28 Article 2 place special restrictions on choice of law.

29
30 3. Common law generally enforces contractual choice of law in
31 transactions involving intangibles. See *Finch v. Hughes Aircraft Co.*, 57 Md. App.
32 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471
33 U.S. 1049 (1985) (patent license); *Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir.
34 1984); *Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products*, 229
35 U.S.P.Q. 335 (D. Md. 1985); *Northeast Data Sys., Inc. v. McDonnell Douglas*
36 *Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993). The major exception occurs
37 where the choice contradicts the basic policy of the State that would otherwise have
38 its law apply, but reported cases outside of consumer or other regulated contracts
39 often go relatively far to avoid finding such fundamental policies. *Shipley Co., Inc.*
40 *v. Clark*, 728 F. Supp. 818, 826 (D. Mass. 1990). The *Restatement (Second)* allows
41 choice of law terms to govern in any case (including consumer contract) where the
42 issue could be resolved by contract. In addition, even if contract rules might not
43 otherwise govern, under the *Restatement*, the contract choice is presumed to be

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

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

23
24 The residence rule does not exist under Article 2, Article 1 or the
25 *Restatement*. As a consumer protection, it assumes that the domicile is more
26 protective than any other state law. As a matter of logic, that **cannot** be true in all
27 cases. In an information marketplace and especially in cyberspace transactions, the
28 residence rule harms the consumer as often as it helps her. In Internet environments,
29 it clearly frustrates goals of providing uniformity and being able to control the
30 number of divergent laws with which a contract must comply.

31
32 **Illustration 1:** AOL provides on-line services throughout the United States and
33 has its chief offices in Virginia. Under the proposed Draft, in a contract with a
34 consumer who resides in Oklahoma, the contract may choose the law of
35 Virginia (licensor location) or Oklahoma (licensee residence). If it purports to
36 choose Alaska law, that choice of law is enforceable except to the extent that it
37 denies the licensee fundamental protections that would be available to it under
38 Virginia or Oklahoma law outside this Article.

39
40 5. The second issue involves choice of law in the **absence of contract**
41 **terms** and is covered in subsection (b). The purpose of stating choice of law rules
42 is to enhance certainty against which the parties can bargain for different terms if
43 they so choose. Under general law, choice of law principles are often driven by

1 litigation concerns and refer to questions about “reasonable relationship”, “most
2 substantial contacts”, and “governmental interest.” In the online environment, this
3 does not support commercial development and creates substantial uncertainty.

4
5 6. The most important rule is in (b)(1). It deals with electronic
6 transactional environments and creates a presumptive choice of law based on the
7 location of the licensor. This concept has been extensively discussed in reference
8 to online environments. Where an on-line vendor automatically provides direct
9 marketing to the world through Internet, any other formulation would require the
10 vendor to comply with the law of fifty States and 170 countries since it will often
11 not be clear where the information is being sent. Some States or countries mandate
12 such compliance through local laws, such as for example, recent amendments to
13 California warranty law applicable to the sale of goods. By opting for a more
14 stable, identifiable source of underlying law is an important step toward facilitating
15 electronic commerce in digital products. As described in this section, the
16 licensor’s location refers to its chief executive office (as in Article 9), rather than
17 the location of the computer that contains or provides the information.

18
19 7. Subsections (b)(2) and (b)(3) deal with more traditional environments.
20 Subsection (b)(2) creates a consumer rule for cases of physical delivery of copies
21 (not involving online contracts). The rule chosen focuses on the location where the
22 copy is received. In most, but not all cases, of course, this will be the State in
23 which the consumer resides. That location would typically be chosen under any
24 choice of law regime, but this section makes the choice clear. Thus, for example, a
25 consumer acquiring software in Chicago will be subject to the law of Illinois in the
26 absence of contract terms. That rule is consistent with concerns about the “place of
27 performance” and like considerations under current law. It is also followed in
28 many European consumer protection rules relating to contract choice of law
29 involving sales of goods and services. This rule deals with situations in which the
30 licensor will know where delivery will occur because it delivers a physical copy
31 and is not engaged in an electronic communication. This allows electronic
32 transactions to be governed by a choice of law rule that enables commercial
33 decision-making based on an identifiable body of law and does not impose costs on
34 the transaction by requiring that the electronic vendor determine what physical
35 location corresponds to an electronic location.

36
37 The language in subsection (b)(2) only deals with contract issues. It does
38 not affect tax or other relevant concerns. In *Quill Corp. v. North Dakota*, 504 U.S.
39 298 (1992) the Supreme Court held that no adequate nexus for tax purposes was
40 established where the only contact of an entity with a State was advertising and
41 delivery through common carrier. This Article, of course, deals only with contract
42 issues.

1 Subsection (b)(3) states the residual rule, applicable to consumer cases
2 where no copy is delivered and the deal is not an online performance, and to
3 commercial contracts where no choice of law clause was agreed to by the parties.
4 The section adopts the *Restatement (Second)* test. The *Restatement (Second) of*
5 *Conflicts* uses a “most significant relationship” standard to be judged by
6 considering a variety of factors that include: (a) the place of contracting, (b) the
7 place of negotiation of the contract, (c) the place of performance, (d) the location of
8 the subject matter of the contract, and (e) the domicile, residence, nationality, place
9 of incorporation and place of business of the parties, (f) the needs of the interstate
10 and international systems, (g) the relevant policies of the forum, (h) the relevant
11 policies of other interested States and the relative interests of those States in the
12 determination of the particular issue, (i) the protection of justified expectations, (j)
13 the basic policies underlying the particular field of law, (k) certainty, predictability
14 and uniformity of result, and (l) ease in the determination and application of the
15 law to be applied. *Restatement (Second)* §§ 6, 188.

16
17 This rule is not uniformly accepted. Many States use principles from the
18 *Restatement (First)* or theories evolved by academic authors. One text states:
19 “[C]hoice-of-law theory today is in considerable disarray” and has been for
20 some time. [It] is marked by eclecticism and even eccentricity. No consensus
21 exists among scholars. . . . [Like] revolutionaries who can unite only to
22 eliminate the existing government, they cannot agree on the establishment of a
23 new one. The disarray in the courts may be worse. Four or five theories are in
24 vogue among the various states, with many decisions using “openly or
25 covertly” more than one theory.” William Richman & William Reynolds,
26 Understanding Conflict of Laws 241 (2d ed. 1992). The disarray argues for giving
27 guidance for contracts in cyberspace.

28
29 8. Subsection (c) provides a rule in cases of foreign choices of law where
30 the effect of using the licensors location would be to place the choice of law in a
31 harsh, under-developed, or otherwise inappropriate location. This is intended to
32 protect against conscious selections of location designed to disadvantage the other
33 party and forum shopping by U.S. companies who have virtually free choice as to
34 where to locate. It is especially important in context of the global Internet context.

35
36
37 **SECTION 2B-107. CHOICE OF FORUM.** The parties may choose an
38 exclusive judicial forum. However, [other than in an access contract for
39 informational content or services,] in a consumer contract the choice is not
40 enforceable if the chosen jurisdiction would not otherwise have jurisdiction over

1 the consumer and the choice [unfairly disadvantages] the consumer. A choice-of-
2 forum term is not exclusive unless the agreement expressly so provides.

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

4

5 **Committee Votes:**

6 1. Rejected a motion to delete the section. Vote: 4-9 (February, 1997).

7 2. Voted to adopt the term consumer and not "mass market" Vote: 8-5
8 (February, 1997)

9 3. Consensus that Draft should deal separately with arbitration clauses if at all.
10 (February, 1997)

11

12 **Selected Issue:**

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

14

15 **Reporter's Notes**

16 1. This section deals with choice of an exclusive judicial forum. It does not
17 cover contract terms that **permit** litigation to be brought in a designated
18 jurisdiction, but do not require that result. Although earlier case law viewed forum
19 choices with some disfavor, the trend of modern case law enforces choice of forum
20 clauses, even if in standard form contracts, so long as enforcement does not
21 unreasonably disadvantage a party. Since 1972, courts have shown an increasing
22 willingness to enforce this type of contract provision, subject to due process
23 restrictions. See *Bremen v. Zapata Offshore Co.*, 407 U.S. 1, 10 (1972) (choice of
24 forum clauses are "prima facie valid"). This case law does not differentiate
25 between standard form and nonstandard contracts. See *Carnival Cruise Lines, Inc.*
26 *v. Shute*, 111 S.Ct. 1522 (1991). However, constitutional concerns about fairness
27 and notice may provide a limiting role. Thus, the US Supreme Court held that a
28 choice of arbitration under New York law in a standard form contract could not be
29 enforced to apply New York law prohibiting punitive damage awards in arbitration
30 where that substantive effect was not highlighted or brought to the affected party's
31 attention. Similarly, some courts hold such clauses to be unenforceable where they
32 impinge on concepts of fundamental unfairness. See also *Perkins v. CCH*
33 *Computax, Inc.*, 106 N.C. App. 210, 415 S.E.2d 755 (1992); *Lauro Lines v.*
34 *Chasser*, 490 U.S. 495 (1989); *Sterling Forest Assocs., Ltd. v. Barnett-Range Corp.*,
35 840 F.2d 249 (4th Cir. 1988).

36

37 2. The importance of choice of forum provisions in transactions in
38 cyberspace was highlighted by a series of cases involving jurisdictional issues on
39 Internet and related online environments. See, e.g., *CompuServe v. Patterson*, 89
40 F.3d 927 (6th Cir. 1996). (allowing jurisdiction of Texas provider in Ohio because

1 of contract contacts with Ohio online provider). The Supreme Court enforced a
2 choice of forum in a standard form contract even though the choice effectively
3 denied a consumer the ability to defend the contract and the choice was contained
4 in a non-negotiated form and not presented to the consumer until after the tickets
5 had been purchased. See *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522
6 (1991). The Court's comments have relevance to Internet contracting:

7
8 [It would] be entirely unreasonable to assume that a cruise passenger would or
9 could negotiate the terms of a forum clause in a routine commercial cruise
10 ticket form. Nevertheless, including a reasonable forum clause in such a form
11 well may be permissible for several reasons. Because it is not unlikely that a
12 mishap in a cruise could subject a cruise line to litigation in several different
13 fora, the line has a special interest in limiting such fora. Moreover, a clause
14 establishing [the forum] has the salutary effect of dispelling confusion as to
15 where suits may be brought. . . . Furthermore, it is likely that passengers
16 purchasing tickets containing a forum clause . . . benefit in the form of reduced
17 fares reflecting the savings that the cruise line enjoys

18
19 The bracketed language relating to access contracts refines a concept that was
20 discussed without objection by the Committee in February, 1997.

21
22 3. This section provides separate protection for consumers where the risk of
23 over-reaching is more severe. Protection of this sort may already exist in
24 applicable state consumer protection law. The purpose of the exception is to
25 protect the individual, not to deal with a market place or transactional issue. This is
26 especially important as information commerce goes more and more online. If
27 online transactions in the Internet are generally equated to mass market
28 transactions, using that term here would seriously affect the ability of providers to
29 control risk in world wide distribution.

30
31 4. Article 2A restricts the validity of choice of forum in consumer cases.
32 Section 2A-106. Neither Article 2, nor Article 1 deal with choice of forum
33 contracts.

34
35 5. The bracketed language relating to "unfair disadvantage" retains an
36 issue that will be addressed over the summer. The intent is to conform to Supreme
37 Court holdings in reference to what type of limits on choice of forum are
38 appropriate. Language from *Cruise Lines* and other decisions will be examined for
39 what term should be used and for the elements of fairness that are considered.

40
41 6. This section does not deal with arbitration or other alternative dispute
42 resolution clauses. The law there is characterized by substantial federal preemption
43 and specific, existing state law rules that should not be disturbed here.

1
2
3 **SECTION 2B-108. BREACH OF CONTRACT.**

4 (a) Whether a party is in breach of contract is determined by the contract.

5 Breach of contract includes a party's failure to perform an obligation in a timely
6 manner, repudiation of a contract, or exceeding a contractual limitation on the use
7 of information.

8 (b) A breach of contract is material if the contract so provides. In the
9 absence of an express contractual term, a breach is material if the circumstances,
10 including the language of the agreement, reasonable expectations of the parties,
11 standards and practices of the trade or industry, and character of the breach,
12 indicate that:

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

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

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

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

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

23
24 **Committee Votes:**

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

Reporter's Notes

1. In this Article, as in general contract law, a party must perform in conformity with its contract. For purposes of remedies, this Article also follows common law and distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 in cases other than cases of a single delivery of a product. The reference to material breach corresponds to common law and the *Restatement (Second) of Contracts* which govern many of the transactions brought under Article 2B. Article 2 revisions use a different phrase ("substantial impairment") for a similar idea.

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

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

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

Breach entitles the injured party to remedies. What remedies are available depends on whether the breach is material or immaterial. The material breach concept rests on the common law belief that it is better to preserve a contract relationship in the face of minor performance problems and the related belief that

1 allowing one party to cancel the contract for minor defects may cause unwarranted
2 forfeiture and unfair opportunism. Materiality relates to the injured party's
3 perspective and to the value that it expected from performance. Faced with an
4 immaterial breach, the injured party can recover for damages that arise in the
5 ordinary course as a consequence of the breach, but cannot cancel the contract or
6 reject the tender of rights unless the contract expressly permits that remedy. Faced
7 with a material breach, a wider panoply of remedies is available to the injured
8 party, including the right to cancel the contract. This Article carries the distinction
9 throughout and with respect to both parties to a contract, except that a different
10 standard applies to mass market transactions involving a refusal of a single delivery
11 of software; there, the Article follows existing Article 2.

12
13 4. Material breach rules apply in current law to all transactions not
14 governed by the Article 2. For some licensing cases, see *Rano v. Sipa Press*, 987
15 F.2d 580 (9th Cir. 1993); *Otto Preminger Films, Ltd. v. Quintex Entertainment,*
16 *Ltd.*, 950 F.2d 1492 (9th Cir. 1991) ("breach . . . is material if it is so substantial as
17 to defeat the purpose of the transaction or so severe as to justify the other party's
18 suspension of performance"); *Compuware Corp. v. J.R. Blank & Associates, Inc.*,
19 1990 WL 208,604 (N.D. Ill. 1990).

20
21 5. The materiality standard parallels international laws which often use the
22 term "fundamental breach" to describe the same concept. The *Convention on the*
23 *International Sale of Goods* (CISG) states: "A breach . . . is fundamental if it
24 results in such detriment to the other party as substantially to deprive him of what
25 he is entitled to expect under the contract, unless the party in breach did not foresee
26 and a reasonable person . . . would not have foreseen such a result." CISG Art. 25.
27 *UNIDROIT Principles of International Commercial Law* state: "A party may
28 terminate the contract where the failure of the other party to perform an obligation
29 under the contract amounts to a fundamental non-performance." UNIDROIT art.
30 7.3.1(1). Article 2 and Article 2A stand alone in requiring "perfect tender", but do
31 so only in reference to a single situation: delivery of goods not part of an
32 installment contract. Outside that context, use of materiality is unanimous. An
33 ABA Software Contract Task Force recommended that the perfect tender rule be
34 abolished with respect to software contracts because of the complexity of the
35 software product and the fact that minor flaws ("bugs") are common in virtually all
36 software.

37
38 6. **What constitutes a material breach?** One cannot define materiality in
39 absolute terms any more than one can define concepts such as negligence,
40 reasonable care, merchantability, or the like. The key lies in defining an
41 appropriate reference point. Subsection (b) emphasizes two elements: contract
42 terms and the extent to which breach causes significant harm to the aggrieved party.
43 The *Restatement (Second) of Contracts* lists five circumstances as significant: (1)

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

10
11 The factors listed in subsection (b) are not exclusive. Courts should be free
12 to draw on common law cases. For example, the concept incorporates questions
13 about the motivation of the breaching party. A series of minor breaches may
14 constitute a material breach where the motivation for this conduct involves a bad
15 faith effort to reduce the value of the deal to the other party or to force that party
16 into a position from which it will be forced to relinquish either the entire deal or,
17 through re-negotiation, aspects of the deal that are otherwise important to it.

18
19 7. The strength of the materiality concept is also its weakness in
20 commercial cases. It provides a flexible standard that allows courts to deny
21 unwarranted forfeitures (cancellation for small, inconsequential problems). That
22 flexibility, however, creates potentially disruptive uncertainty in commercial
23 contracts. It is important, therefore, that ideas of materiality hinge on the terms of
24 the contract. As expressed in subsection (b), the contract terms can define what is
25 material. As drafted in this section, that can happen in three ways. The first two
26 involve either expressly providing a remedy for a particular breach (e.g., failure to
27 meet "X" test permits cancellation of the contract) or expressly defining a
28 particular breach per se material. The third context involves what, under common
29 law is described as "express conditions." These are express contract terms
30 conformance to which is implicitly or expressly a precondition to the performance
31 of the other party. Here, the nature of the express agreement itself conditions the
32 remedy.

33
34 **Illustration 1.** The licensee agrees to specifications for a new word processing
35 program. The standards expressly require a dictionary with no less than 5
36 million words. The actual dictionary has 4.99 million. The developer fails to
37 meet the standard within the agreed time. The failure to meet the **express**
38 standards constitutes a material breach. The licensee can refuse the product.

39
40 **Illustration 2.** A contract requires delivery of a database program but does not
41 expressly describe the characteristics required of the program. The database
42 program meets its own specifications, but fails to in a manner comparable to
43 other similar type programs. There is a breach. Materiality hinges on whether

1 the defect causes substantial harm to the licensee under subsection (b).

2

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

4

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

8

9

* * *

10

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

16

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

21

22

23 **SECTION 2B-109. UNCONSCIONABLE CONTRACT OR TERM.**

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

28 (b) Before making a finding of unconscionability under subsection (a), the
29 court, on motion of a party or on its own motion, shall afford the parties a
30 reasonable opportunity to present evidence as to the setting, purpose, and effect of
31 the contract or term thereof or of the conduct.

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

33

34

Reporter's Note

1 1. This Draft follows current law in Article 2. In doing so, in a number of
2 States, it expands the ability of courts to monitor transactions for purposes of
3 unconscionability determinations beyond the law that current governs. The intent
4 is to adopt in full modern contract law decisions on unconscionable contracts and
5 clauses of those contracts. An important expansion of judicial review, however, is
6 contained in Section 2B-308, which imposes procedural requirements on mass
7 market form contracts and allows courts to invalidate some terms even though they
8 are conscionable.

9
10 2. Against this background, this Draft does not follow proposed revisions
11 of Article 2 which also contain language regarding unconscionable *inducement* of a
12 contract. The inducement concept does not exist in current law in any context
13 other than in Article 2A. In Article 2A, the inducement concept is limited to
14 consumer leases; it does not apply to mass market or other commercial contracts.
15 The argument for extending the scope of conscionability doctrine is not clear and is
16 especially unpersuasive if extended beyond consumer contracts. In this article,
17 many of the situations where inducement may be an issue are dealt with by the new
18 concepts of manifesting assent, opportunity to review and statutory creation of a
19 right to exclude surprising terms. An ABA subcommittee recommended that the
20 inducement provision be rejected in Article 2B.

21 22 23 **SECTION 2B-110. ATTRIBUTION PROCEDURE.**

24 (a) An attribution procedure is a procedure established by agreement or
25 adopted by both parties for the purpose of verifying that electronic records,
26 messages, or performances are those of the respective parties or for detecting errors
27 in the transmission or informational content of an electronic message, record, or
28 performance, if the procedure is commercially reasonable.

29 (b) The commercial reasonableness of an attribution procedure is to be
30 determined by the court in light of the purposes of the procedure and the
31 commercial circumstances at the time of the agreement[, including the nature of the
32 transaction, sophistication of the parties, volume of similar transactions engaged in
33 by either or both of the parties, availability of alternatives offered to but rejected by

1 the party, cost of alternative procedures, and procedures in general use for similar
2 types of transactions]. An attribution procedure may require the use of algorithms
3 or other codes, identifying words or numbers, encryption, callback procedures, key
4 escrow, or any security devices that are reasonable under the circumstances.

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

6

7

Reporter's Note

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

19

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

28

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

38

39 **Illustration:** General Motors creates a procedure with franchisees that requires

1 merely that a message contain the franchisee's E-mail address as an identifier.
2 A bad guy uses that system and causes loss of \$100,000 in the name of the
3 franchisee. If the contract controls, the franchisee is liable for the loss unless
4 the procedure is commercially unreasonable. It would most likely be
5 unreasonable in this case.
6

7 4. In subsection (b), the concept of commercially reasonable procedure
8 must take into account the cost relative to value of transactions such as the
9 Comments to Section 4A-203 suggest. This is implicit in the idea of commercial
10 reasonableness, but could be added to the text if appropriate language can be
11 developed. How one gauges commercial reasonableness obviously depends on a
12 variety of factors, including the agreement, the then current technology, the types
13 of transactions affected by the procedure and other variables. The impact of
14 conforming to a procedure that is not reasonable is outlined in the next section.
15

16
17 **SECTION 2B-111. ATTRIBUTION OF ELECTRONIC RECORD,**
18 **MESSAGE, OR PERFORMANCE.**

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

21 (1) it was sent by that party, its agent, or its electronic agent;

22 (2) the receiving party, in good faith and in compliance with an
23 attribution procedure concluded that it was sent by the other party; or

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

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

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

30 (C) the receiving party reasonably relied to its detriment on the

1 apparent source of the message or performance.

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

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

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

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

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

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

19 (d) Except as otherwise provided in subsections (a)(1) and (c), if a loss
20 occurs because a party complies with a procedure for attribution that was not
21 commercially reasonable, the party that required use of the procedure bears the loss
22 unless it disclosed the nature of the risk to the other party or offered commercially

1 reasonable alternatives that the party rejected. The liability under this section of
2 the party that required use of the procedure is limited to losses that could not have
3 been prevented by the exercise of reasonable care by the other party.

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

5

6 **Committee Votes:**

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

8

9

Reporter's Notes

10 1. This section deals with two different setting and may be split into two
11 separate sections in the final Draft. It states risk allocation rules relevant to the
12 anonymous nature of electronic commerce regarding information assets. The intent
13 is to balance making electronic commerce possible in an open environment (as
14 contrasted to the closed structures of funds transfer, credit cards, and EDI
15 transactions), while apportioning risk in a reasonable manner. It should be noted
16 here that the risk allocation rules do not apply to handling of funds, bank accounts,
17 or other subject matter outside the scope of Article 2B.

18

19 2. Subsection (a) refers to attribution of a message or performance to a
20 particular party. Subsection (b) refers to error detection issues. Subsection (a)
21 describes three circumstances under which one party is held to be bound by a
22 message. Subsection (a)(1) relies on general agency rules, but adds the idea of an
23 electronic agent. "Electronic agent" is a defined term, covering a computer
24 program programmed to respond or initiate without human review and selected by
25 the party for that purpose. The general approach holds that, to be bound by
26 electronic activity, a party must affirmatively create the agency. Having opted to
27 rely on an electronic device or system, the party becomes responsible for its
28 actions. The idea of an electronic agent does not exist under current law, but has
29 importance in electronic contracting for information because of the increasing use
30 of preprogrammed software to acquire information assets. The principle is that the
31 individual or company who created and set out the program undertakes
32 responsibility for its conduct. That result could be reached under agency theory,
33 but the goal is to eliminate uncertainty on this point. This treatment parallels that
34 adopted in the UNCITRAL Model Law. Article 13 provides that as between the
35 parties, a message is deemed that of the originator if sent "by an information
36 system program by or on behalf of the originator to operate automatically." The
37 Model Act also lists attribution when a message is sent by an authorized agent.

38

39 3. Subsection (a)(2) focuses on **agreed** procedures for authentication and

1 makes a message attributable to a party if the other used the procedures and
2 reached that conclusion. This covers, for example, the case in which a party
3 obtained a PIN or other identifier and used it without authorization. Liability in the
4 form of being bound by the message occurs without regard to fault so long as the
5 agreed procedure was used by the recipient party. As defined, "attribution
6 procedure" deals with a procedure adopted by the parties to verify source or detect
7 errors. In earlier versions of this section, the substantive treatment here was limited
8 to the verification or attribution of source issue. Bracketed language in this Draft
9 generally follows Article 4A in reference to error detection in messages (not
10 contract performance), leaving to common law the treatment of other situations
11 under general law of mistake.

12
13 4. Paragraph (a)(3) an important issue: when can a person be held
14 accountable for messages not sent by it, but on which the other party relied? The
15 answer in paragraph (a)(3) adopts a middle ground that parallels proposed
16 international law (UNCITRAL Model Act). It attributes the message to one party if
17 the means of making the identification occurred by way of an intrusion into a
18 source controlled by the "sender" and enabled by the sender's lack of reasonable
19 care. This occurs only if the receiving party reasonably relied. Thus, if the nature
20 of the message or performance clearly indicates or gives reason to doubt the source,
21 reliance that causes harm may not be protected, but where the reliance is
22 reasonable, the receiving party has a protected right under this article.

23
24 In current law, there are several approaches to analogous problems: (1) in
25 the telephone system, a party is responsible for any charges incurred for long
26 distance calls from its equipment and using its number; fault and authorization are
27 irrelevant; (2) credit card and electronic funds regulations limit liability for a
28 **consumer** for unauthorized use of its card or number; (3) in commercial funds
29 transfers, the presence or absence of a "security procedure" conditions risk; (4) in
30 check collections, an absolute risk rule is imposed on many recipients of fraudulent
31 instruments unless the party whose signature was forged contributed to the fraud by
32 its negligence.

33
34 In determining which approach to take, the Committee elected an
35 intermediate position and one that is consistent with international rules on this
36 issue. The provisions of subsection (a)(3) deal only with cases where access codes
37 or similar systems are in place to establish authentication of a message. The
38 Committee rejected a rule of liability without proof of fault. The issue requires
39 drawing a balance between senders and reliance interests of recipients of messages.
40 The Draft was modeled on the UNCITRAL Model Law: placing loss on the
41 alleged sender if the message "resulted from the actions of a person whose
42 relationship with the originator enabled that person to gain access to a method used
43 by the originator to identify the data message as its own."

1
2 5. The rule restricting consumer risk for credit cards and funds transfers is
3 appropriate where the protected party is always the less economically resourceful
4 party and the other party is typically a deeper pocket that can spread loss among
5 many transactions. It is not viable for an open system, heterogeneous environment
6 such as that dealt with in Article 2B. In cases where the electronic process involves
7 transactions between large businesses and consumers, allocation of the risk of fraud
8 or false attribution developed in a way that responds to the better ability of the
9 system operator to **spread loss** than the consumer. Our context requires a more
10 general structure that goes beyond consumer issues; the problems will not routinely
11 entail consumer protection questions or, even, a licensor with better ability to
12 spread loss. An individual may be an injured party or the wrongdoer. Transactions
13 will often involve two businesses or two individuals. Also, the transactions occur
14 in a public network, not owned, operated or controlled by a single operator. Also,
15 unlike in electronic funds transfers the messages here involve the creation or
16 performance of contracts and the risk of financial loss without reciprocal value will
17 typically be less.

18
19 Here, one could look to communications law for its allocation of risk. In
20 telephone systems, the proprietor of a system (telephone) is responsible for all calls
21 using that number, even if produced by a hacker engaged in entirely illegal and
22 unauthorized access. The loss allocation there, of course, is between the owner of
23 the system and the system operator. This Article adopts an intermediate position,
24 keyed to attribution systems and reasonable care.

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

33
34 6. Subsection (d) provides for allocation of loss caused by the situation in
35 which one party insists on a procedure for attribution, but that procedure is not
36 commercial reasonable. The loss for use of the procedure falls on the party
37 insisting on its adoption. The loss encompasses expectation, rather than merely
38 reliance.

39
40 **Illustration:** Jones insists that, in dealing with its software vendor, the vendor
41 electronically ship software whenever it receives an e-mail request using Jones's
42 name. An impostor places an order for software with a \$1,000 retail price. The
43 vendor ships. Jones would be responsible for the \$1,000 loss if the procedure

1 were commercially unreasonable.

2

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

5

6

7 **SECTION 2B-112. MANIFESTING ASSENT.**

8 (a) A party or electronic agent manifests assent to a record or term in a

9 record if, with knowledge of the terms or after having an opportunity to review the

10 record or term under Section 2B-113, it:

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

12 conduct or operations that the record conspicuously provides or the circumstances,

13 including the terms of the record, clearly indicate constitute acceptance of the

14 record or term; and

15 (2) had an opportunity to decline to authenticate the record or term or

16 engage in the conduct.

17 (b) Merely retaining information or a record without objection is not a

18 manifestation of assent.

19 (c) If assent to a particular term in addition to assent to a record is required,

20 a party's conduct does not manifest assent to that term unless there was an

21 opportunity to review the term and the authentication or conduct relates specifically

22 to the term.

23 (d) A manifestation of assent may be proved in any manner, including by a

24 showing that a procedure existed by which a party or an electronic agent must have

25 engaged in conduct or operations that manifests assent to the contract or term in

1 order to proceed further in the use it made of the information.

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

3

4

Reporter's Notes

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

9

10 **First:** In some contexts, it refers to when a party assents to a record. In
11 this sense, the phrase "manifesting assent" is used in the *Restatement (Second)* and
12 in the *UNIDROIT Principles* to define when a party is bound to the terms of a
13 standard form contract and, indeed, to any record. Similar themes are found in
14 judicial rulings. See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585
15 (1991) (cruise line ticket containing contract terms). In the *Restatement*, the term is
16 used, but not defined.

17

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

23

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

28

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

33

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

40

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

42

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

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

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

34
35 **Illustration 1:** In its pre-registration file, the New York Times on-line
36 provides: "Please read the license. Click here to read the **License**. If you agree
37 to the terms of the license, indicate your agreement by clicking the "I agree"
38 button. If you do not agree to the License, click on the "I decline" button."
39 The underlined text is a hypertext link which, if selected, displays the license.

I Agree

I Decline

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

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

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

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

WE CALL YOUR ATTENTION SPECIFICALLY TO:

**Contract Term No. 5, Precluding Use at Home, and
Contract Term No. 16, Imposing a \$100 Annual Fee if You Choose to
Use the Help Line.**

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

5. Manifestation of assent is not the only manner in which the parties define the terms and limits of their deal. For example, clear indications that the

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

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

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

33
34 7. Manifesting assent hinges on the opportunity to review the contract or
35 term; the record must be called to the party's attention before assent is obtained.
36 This excludes devices to create or modify a contract designed to mislead or conceal,
37 rather than to obtain assent. For example, a notation on the back of a check stating
38 elaborate license terms and sent to the cashier's office of a company would not
39 create terms when the check is cashed. The cashier lacks authority and the terms
40 have not been called to the attention of the company.

41
42

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

2 (a) A party or electronic agent has an opportunity to review a record or
3 term if it is made available in a manner designed to call it to the attention of the
4 party and to permit review of its terms or enable the electronic agent to react to the
5 record or term.

6 (b) Except for a proposal to modify a contract, if a record is available for
7 review only after a contract fee is paid, a party has an opportunity to review only if
8 it has a right to a refund of any contract fees paid or to stop any payment already
9 initiated if it refuses the terms, discontinues use, and returns all copies. For
10 multiple products transferred for a bundled price:

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

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

19 **Uniform Law Source:** None

20

21 **Selected Issues:**

22 1. How should opportunity for review and manifesting assent be coordinated
23 with applicable regulations concerning disclosure under consumer or other law?

24 2. How should we deal with restrictive notices (e.g., on a rented video) which
25 are not presented as a matter for review and assent, but rather as defining the terms

of use?

Reporter's Notes

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

2. Under this section, the opportunity to review can come at or before payment, or later. If the opportunity follows payment, there is no opportunity to review unless the party can return the product and receive a refund if it declines the terms of the record. This refund right does not exist in current law. See *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991); *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th Cir. 1997). It provides important protection for the licensee and, in effect, requires that the party be placed back into the position it would have been in had the record been presented and rejected prior to payment.

Illustration: Sam acquires a copy of the latest James Bond movie from Blockbuster on a three day rental agreement. When Sam places the copy on screen, a statement appears that the copy is for home and personal use only, and not for display to an audience for a fee. Looking around the room at his paying customers, Sam would be bound as a matter of contract by this limitation if he had a right to return the copy for a refund. Under current law, the restriction may also be effective as a matter of direct copyright law.

3. The concept of an opportunity to review contains an inherent element of reasonableness or fairness in that there must be a real opportunity to examine the record. What this requires may differ depending on whether one deals with a paper record or hypertext linked terms. If access to the terms becomes exceptionally cumbersome and difficult to achieve, there may be no opportunity to review. On the other hand, the mere fact that a person chooses to bypass or ignore the opportunity and go forward with the transaction does not mean that there was no opportunity to review. Thus, for example, contract terms presented over the counter or conspicuously made available in a binder as required for some transactions under federal law involve an opportunity for review even if the party does not avail itself of that opportunity.

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

1
2 5. While this section does not create an obligation to make a refund, it
3 conditions the creation of terms of contract between the licensor and the licensee
4 that arise after payment on that opportunity. The failure to provide a refund is not a
5 breach of contract, but results in failure of the terms to become part of the bargain.
6 Under Section 2B-616, a retailer is required to refund the price paid if an end user
7 declines the publisher's license. That right to a refund, if and when it occurs,
8 fulfills the refund option stated here.
9

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

18 **Illustration:** Producer transfers a copy of a copyrighted musical work to User,
19 subject to a license that restricts use to home use only. The license terms are
20 presented after delivery of the copy. User can either assent to the license or
21 obtain a refund of the fee. It assents. User later transfers the copy to Jones.
22 Jones need not have any refund right. If Jones uses the music in a commercial
23 context, the license is breached. Producer has contract recourse against User.
24 Producer may also have a copyright claim against Jones for use (performance)
25 that was not authorized. Producer has a contract claim against Jones only if
26 Jones took an assignment of the license or assented to a license from Producer.
27

28 6. Subsection (b)(1) and (2) deal with bundled products. For the supplier,
29 the refund relates to the entire bundled package unless the licensee agrees to an
30 allocation of the price based on the proportionality of cost measured by the
31 vendor's cost for the product bundle or the rejected licensor did not supply the
32 entire bundle. Thus, if the particular software being refused was attributable for
33 5% of the total cost of the bundled products for the vendor, the refund must be of
34 5% of the price of the bundle to the licensee. The bundled products here can
35 include both goods and information products, but the principle remains the same.
36 Based on comments by a licensee attorney, several consumer advocates, and others,
37 this Draft does not reduce the refund for "value received." We are dealing here
38 with an up-front contract creation and deductions would seldom be merited in any
39 event.
40

41
42 **SECTION 2B-114. AUTHENTICATION EFFECT AND PROOF;**

1 ELECTRONIC AGENT AUTHENTICATION.

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

- 4 (1) the party's identity,
5 (2) its adoption and acceptance of a record or a term, and
6 (3) the authenticity of the record or term.]

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

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

15 Reporter's Notes

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

28 2. Subsection (b) contains a specific application of the general principle
29 that actions of an electronic agent bind the party that selected and deployed the

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

10
11 3. This section is neutral as to the nature of the systems adopted for these
12 purposes. Current law in some States links so-called "digital signatures" to the use
13 of specific types of encryption technology. That is inappropriate in a general law
14 such as being developed here. Fingerprint, voice recognition, encryption and other
15 technologies as they evolve are equally acceptable.

16
17
18 **SECTION 2B-115. EFFECT OF AGREEMENT.**

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

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

24 (1) the right to relief from an unconscionable contract or clause;

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

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

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

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

- 1 (6) the limitation in Section 2B-625(e) on excuse by unexpected events;
2 (7) the restrictions in Section 2B-705(a) on the statute of limitations;
3 (8) the limits on inclusion of refusal terms in Section 2B-308(b);
4 (9) the limits on choice of forum in consumer contracts in Section
5 2B-107; or

6 *[other provisions to be added]*

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

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

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

17 **Uniform Law Source:** None.

18
19 **Note:** Sections 4A-202, 4A-305, and 4A-402(f) for the type of language used in
20 particular sections.

21

22 Reporter's Notes

23 1. This section implements the basic policy that all of the provisions of this
24 Article are subject to contrary agreement with the exception of listed sections or
25 rules that are not subject to contractual modification. It deals with an important
26 issue created by virtue of the drafting approach applied here. As a general rule,
27 sections in Article 2B (and Article 2) are drafted in apparently mandatory terms as

1 rules of law. This is subject to the over-riding principle, described in subsection
2 (b), that all of the terms of the article can be altered by agreement. The difficulty
3 rests in the fact that this general principle is, itself, subject to important limitations.
4 The difficulty thus created is how to provide guidance to persons drafting or
5 planning a transaction who are not aware of all of the nuances of when or whether a
6 particular statutory term can be varied and, indeed, even what one means by
7 varying the statutory terms by agreement. The section reverses decisions such as
8 *Suburban Trust and Savings Bank v. The University of Delaware*, 910 F. Supp. 1009
9 (D. Del. 1995) which applied the "plain meaning" of an Article 9 provision and
10 held that the specific terms of Article 9 rule supersede the general terms of UCC
11 "1-102 (permitting contractual variation of statutory rules).
12

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

20 3. Subsection (d) holds that conspicuousness is a matter of law. This
21 follows current law.
22

23 4. Subsection (f) deals with a major concern that arises from the drafting
24 style used in the UCC revisions. It resolves interpretation questions about the
25 existence of a so-called negative pregnant in many of the rules in this article. Thus,
26 if a section indicates that "If the originator of a message requests acknowledgment,
27 then the following rules apply: " that does not indicate what rules apply in the
28 absence of that request; in itself, it does not bar a court from adopting some or all
29 of the same rules in the absence of a request, but merely states the affirmative
30 proposition. Of course, in many cases, the more exclusionary result is intended.
31 This can be inferred from the context or the associated policies.
32
33

1 **PART 2**
2 **FORMATION**

3
4
5 **SECTION 2B-201. FORMAL REQUIREMENTS.**

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

14 (b) A grant or limitation governed by Section 2B-310 or 2B-502 may not
15 vary the terms of those sections except by a record authenticated or prepared by a
16 party against which enforcement is sought.

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

19 (1) if the agreement contemplates no or nominal consideration for the
20 rights acquired, or the total value of any payments to be made and any affirmative
21 obligations incurred, excluding payments for options to renew or buy, is less than
22 \$20,000;

23 (2) to the extent that a person authorized by the holder of intellectual
24 property rights delivered copies of the information or access materials to the

1 licensee or performance has been otherwise tendered by one party and accepted by
2 the other; or

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

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

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

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

10

11 **Votes:**

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

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

17 3. By a vote of 5-8, the Drafting Committee rejected a motion to remove the
18 dollar limitation in the exception contained in subsection (e)(1). (September, 1996)

19 4. By a vote of 3-11, the Drafting Committee voted to reject a motion to
20 exclude mass market licenses from the statute of frauds requirement. (September,
21 1996)

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

24

25 **Selected Issue:**

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

28

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

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

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

3. This section does not require that a record be retained. As in current law, one can prove the prior existence of a record by showing that a procedure exists by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity. In electronic environments, a "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information

1 must be in this form. Significant litigation has occurred in copyright law on this
2 question. The cases there do not impose a minimum time period; a "copy" occurs
3 when information is placed in a different part of memory in a computer than the
4 one in which it was stored. Copyright law, on the other hand, does distinguish a
5 copy and a ephemeral manifestation of information. Presumably, an ephemeral
6 copy is not a record in this Article.

7
8 4. Subsection (b) follows the basic principle that use questions are
9 significant and that some basic default principles should not be altered except by a
10 record. Section 2B-310 incorporates the primary default rules on scope in this
11 Draft: single user, no right to modifications, and implied right to uses necessary to
12 expressly granted uses. These three facets of the default rule provisions include
13 both licensor and licensee protections.

14
15 5. Subsection (c) contains of number of exceptions to the statute of frauds
16 rule. The \$20,000 limit was chosen to exclude coverage the large number of small
17 value transactions that do not require formalities. Focusing on dollar amount is too
18 narrow here; the Draft uses a "value" standard instead. The exception covers
19 transactions involving no payment, but which are otherwise enforceable contract
20 because there is other consideration present; these are excluded from the statute if
21 the dollar amount or obligations created are less than \$20,000. Subsection (c)(2)
22 reflects entertainment industry practice.

23
24 **Illustration 1:** ABP Corp. licenses movies for one and two week showings by
25 thousands of theaters. For each, it delivers a copy of the motion picture to
26 enable the showing. Regardless of the dollar value of the license and any
27 renewals, the license is excepted from the requirement of a record because a
28 copy was delivered to the licensee and subsection (c)(3) applies. The terms of
29 the license are determined by the actual agreement, the customs of the business,
30 and default rules of this Article.

31
32 **Illustration 2:** Booker acquires releases from various parties to enable
33 completion and publication of its books. The releases are often not acquired for
34 any payments to the releasing party. This section allows enforcement without
35 consideration and this section excludes the application of the statute of frauds
36 based on both subsections (c)(2) and (c)(1) (the latter being applicable because
37 the total payments were less than \$20,000, i.e., no payments).

38
39 6. Subsection (d) makes clear that trading partner or similar agreements are
40 enforceable to alter the statute of frauds issue. The parties can clearly agree to
41 conduct their further business without there being a need for additional,
42 authenticated writings.

1 7. **Current law.** The common law statute of frauds is contained in statutes
2 in 47 States. *Restatement (Second) of Contracts* ch. 5, Statutory Note, at 282
3 (1979). State law rules differ. In the final version of this Draft, legislative notes
4 must cover the partial revision/repeal of existing statute of frauds rules to achieve
5 the result noted in subsection (e) of this Draft.

6
7 Article 2A employs a statute of frauds for leases based in part on the
8 separation of possession and title in a lease, the content of which requires
9 documentation that goes beyond the mere transfer of possession of the goods. If
10 the distinction based on a separation of ownership and possession is accepted as a
11 reason for different treatment in the UCC for sales and leases, a similar reason for
12 not repealing the statute of frauds exists in intangibles.

13
14 Copyright law requires a written agreement for an enforceable transfer of a
15 copyright. 17 U.S.C. § 204. A similar rule applies for patents. 35 U.S.C. § 261. A
16 transfer of property rights occurs when there is an "assignment" or an "exclusive
17 license." The federal rules do not apply to transfers of rights in data. For
18 discussion of the difference between data and copyright in data compilations, see
19 *Feist Publications, Inc. v. Rural Telephone Service Co.*, 111 S. Ct. 1282 (1991).
20 Federal rules do not apply to nonexclusive licenses since a nonexclusive license is
21 not a "transfer" of copyright ownership. However, in copyright law, a
22 nonexclusive license that is not in writing may lose priority to a "subsequent"
23 transfer of the copyright.

24 25 26 **SECTION 2B-202. FORMATION IN GENERAL.**

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

30 (b) If the parties intend to make a contract, a contract may be found even if
31 the time that the agreement was made cannot be determined, one or more terms are
32 left open or to be agreed upon, one party reserves the right to modify terms, or the
33 standard forms of the parties contain varying terms. However, a contract is not
34 formed if the parties disagree about scope. If records exchanged by the parties

1 conflict on the scope of a license, an agreement exists only if and to the extent that
2 from all the other circumstances it appears that an agreement, including with
3 respect to scope, existed.

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

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

8

9 **Committee Votes:**

10 1. Committee voted unanimously to adopt the section in principle. (September,
11 1996)

12

13

Reporter's Note

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

26

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

35

36

1 **SECTION 2B-203. OFFER AND ACCEPTANCE.**

2 (a) Unless otherwise unambiguously indicated by the language of the offer
3 or the circumstances, an offer to make a contract invites acceptance in any manner
4 and by any medium reasonable under the circumstances.

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

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

14 (d) Subject to Section 2B-202, a definite expression of acceptance may
15 create a binding obligation even if it is in a standard form that contains terms that
16 vary from the terms of the offer. Language in a standard form which makes an
17 offer or acceptance expressly conditional on assent by the other party to the varying
18 terms precludes the formation of a contract in the absence of agreement to those
19 terms if the party proposing the form acts in a manner consistent with the stated
20 conditions, such as by refusing to perform until its terms are accepted. The terms
21 of a contract formed by records with varying terms are determined under Section
22 2B-309, if applicable, and under general law if that section does not apply.

1 (e) Subject to subsection (f), operations of one or more electronic agents
2 which confirm the existence of a contract are effective to form a contract even if
3 no individual representing either party was aware of or reviewed the action or it
4 results.

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

6 (1) A contract is formed by the interaction of two electronic agents if
7 the interaction results in both agents each engaging in operations that signify
8 agreement, such as by engaging in performing the contract, ordering or instructing
9 performance, accepting performance, or making a record of the existence of a
10 contract.

11 (2) A contract may be formed by the interaction of an electronic agent
12 and an individual. A contract is formed if an individual has reason to know that the
13 individual is dealing with an electronic agent and performs actions the person
14 should know will cause the agent to perform or to permit further use, or that are
15 clearly indicated as constituting acceptance regardless of other contemporaneous
16 expressions by the individual to which the electronic agent cannot react.

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

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

22

23 **Committee Vote:**

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

2
3 Reporter's Notes

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

9
10 2. This general approach leaves open the question of what is the effect of a
11 truly conditional offer. The subsection seeks to deal with one part of the "battle of
12 forms", that is the question of whether a contract exists. The general rule is in
13 subsection (a), which allows acceptance by any means and in the first sentence of
14 subsection (d) which allows for the expression of assent in the form of a standard
15 form that contains varying terms. The second sentence of subsection (d) sets out
16 the idea that terms of condition are enforceable even if in a standard form if the
17 party's behavior is consistent with those terms, insofar as the issue concerns
18 whether the parties have a contract. Subsection (d) coordinates with current law
19 and with the battle of forms treatment in Section 2B-309. The third sentence of the
20 subsection creates an important reference, clarifying that the creation of the
21 agreement does not necessarily mean that one party's form controls. Determining
22 what terms are included falls to either Section 2B-309 or to general contract
23 interpretation law in the case where the communications were not in conflicting
24 standard forms.

25
26 The approach validates conditional offers if the conditioning language is
27 followed with actual behavior sustaining its conditional nature. Thus, if a party
28 ships pursuant to an allegedly conditional form and its behaviors manifests the
29 existence of a contract, a contract exists despite the language of condition. If,
30 however, a party conditions its form and refuses to ship until the conditions are
31 accepted, that conditioning language and activity preclude the formation of a
32 contract. Section 2B-309 allows the conditional terms of a form to govern if the
33 parties execute an authenticated record containing the terms. In either case, the
34 condition is actual and enforceable.

35
36 **Illustration 1.** Purchaser sends a standard order form indicating that its order
37 is conditional on the Licensor's assent to terms contained on the reverse side of
38 the form. Licensor ships pursuant to a standard form invoice conditioning the
39 contract on assent to its terms. Purchaser accepts the shipment. Under these
40 circumstances, neither party acted in a way that was consistent with the
41 language of condition. There exists, however, sufficient indicia to indicate that
42 a contract was formed (e.g., shipment and acceptance). The terms of the
43 contract are governed by Section 2B-309 and general interpretation law,

1 including the actual terms of any affirmative agreement the parties may have
2 had. If Section 2B-309 applies, the primary rule is a knock-out rule where
3 conflicting terms in both forms drop out.
4

5 **Illustration 2.** In Illustration 1, assume that Licensor does not ship, but
6 telephones Purchaser and informs it of the conditions of shipment. It does not
7 ship until Purchaser agrees to those terms. Until that agreement occurs, there is
8 no contract. If the agreement occurs, the contract exists based, under ordinary
9 contract interpretation rules, on the terms actually agreed to (e.g., the
10 Licensor's terms) since, given that actual agreement, the conflicting forms no
11 longer purport to state the contract of the parties.
12

13 **Illustration 3.** In Illustration 1, assume that Licensor ships pursuant to its
14 "conditional" form, but then when the shipment arrives, Purchaser does not
15 accept it because the original conditional offer terms are now changed. In a
16 telephone conversation, Licensor agrees to Purchaser's terms. Until that
17 agreement, there is no contract since the Purchaser acted in a manner consistent
18 with its conditional language. When that agreement occurred, that agreement
19 sets the terms of the contract (e.g., the Purchaser's terms) since, given that
20 actual agreement, the conflicting forms no longer purport to state the contract
21 of the parties.
22

23 3. Subsection (f) deals with two contexts relevant in the electronic world:
24 (1) interaction between a human and an electronic agent, and (2) an interaction
25 between two electronic agents without human intervention. In both situations,
26 electronic methodology is in widespread use, but there are questions of under what
27 circumstances agreement is inferred from behavior and of to what terms an
28 electronic agent can agree. The following illustrations, although not within Article
29 2B scope, illustrate one aspect of the issue:
30

31 **Illustration 4.** Tootie is an electronic system for placing orders for Home
32 Shopping Network. When you dial the number, a voice comes on line
33 instructing you to indicate your card number, the item number you will
34 purchase, the quantity, your location, and other items. You indicate this by
35 striking keys and numbers on your telephone. Tootie automatically orders
36 shipment. Ray calls Tootie and, after entering his card number, verbally states
37 to Tootie that he will only accept the dresses being order if there is a 120 day no
38 questions return policy. Otherwise: "I don't want the damn things." Tootie
39 orders shipment.
40

41 There is a contract. The verbal addition or condition is ineffective. Stating
42 conditions clearly outside the capability of the electronic agent to make a reaction
43 does not eliminate the agreement reached by taking the steps needed to initiate the

shipment. Similarly, the verbal terms should be ineffective to alter the agreement since the Tootie system could not respond to the verbal condition.

Illustration 5. User dials the ATT information system. A computerized voice states: "If you would like us to dial your number, strike "1", there will be an additional charge of \$1.00. If you would like to dial yourself, strike "2". User states into the phone that he will not pay the \$1.00 additional charge, but would pay .50. Having stated his conditions, User strikes "1". The computerized voice asks User to state the name of the recipient of the call. User states "Jane Smith". The ATT computer dials Jane Smith's number, having located it in the database.

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

4. As between electronic agents a form of presumed intent within the programming of the electronic agents is sufficient for a contract. The idea here is that, even if the agents "negotiate", they are acting within parameters set by their party's and, if an "agreement" occurs within those parameters signified by performance, ordering performance, or instructing performance to occur, that suffices. The terms of the contract would be determined as indicated, allowing for prior agreement, terms reflecting "consensus" of the two agents, and default rules. Terms in one agent's system that are not capable of being reacted to by the other are not part of the contract.

SECTION 2B-204. ELECTRONIC TRANSACTIONS AND MESSAGES:

TIMING OF CONTRACT AND EFFECTIVENESS OF MESSAGE.

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

(1) when the response signifying acceptance is received; or

(2) if the response consists of electronically furnishing the requested

information or notice of access to the information, when the information or notice

1 is received unless the originating message prohibited that form of response.

2 (b) Subject to Section 2B-205, an electronic message is effective when

3 received, even if no individual is aware of its receipt.

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

5

6 **Committee Vote:**

7 1. Approved in principle.

8

9

Reporter's Notes

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

17

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

23

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

35

36

37 **SECTION 2B-205. ACKNOWLEDGMENT OF ELECTRONIC**

38 **MESSAGE.**

1 (a) If the originator of an electronic message requests or has agreed with
2 the addressee of the message that receipt of the message must be acknowledged
3 electronically, the following rules apply:

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

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

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

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

22 **Committee Vote and Action:**

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

2
3 Reporter's Note

4 1. This section sets out default rules interpreting the meaning in electronic
5 commerce of requiring or requesting electronic acknowledgment. Under
6 subsection (a), the impact of the request depends on whether the request made the
7 message conditional on acknowledgment or merely requested acknowledgment. As a
8 basic principle, the contents of the section recognize the right of the message
9 sender to control the legal effectiveness and required response to its messages.

10
11 2. Acknowledgment, of course, is not necessarily acceptance in cases
12 where the original message was an offer for a contract. Rather, the basic theme is
13 that the acknowledgment gives assurance of receipt. In modern communications
14 systems, this will often occur automatically and immediately on receipt of the
15 electronic message in the recipient's system. See comments to ABA Model
16 Contract; UNCITRAL Model Law.

17
18 3. This section deals with functional acknowledgments and, as outlined in
19 subsection (b), does not create presumptions other than that an acknowledgment
20 indicates that the message was received. Questions about accuracy of the received
21 message and about time of receipt, content and other issues are not treated. Of
22 course, by agreement the parties can extend this concept to cover such issues.

23
24
25 **SECTION 2B-206. FIRM OFFERS.** An offer by a merchant to enter into a
26 contract made in an authenticated record that by its terms gives assurance that the
27 offer will be held open is not revocable for lack of consideration during the time
28 stated. If a time is not stated, the offer is irrevocable for a reasonable time not
29 exceeding 90 days. A term providing assurance that the offer will be held open that
30 is contained in a standard form supplied by the party receiving the offer is
31 ineffective unless the party making the offer manifests assent to that term.

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

33
34 **Committee Actions:**

35 1. Committee voted unanimously to approve this in principle. (September,

1 1996)

2 2. Agreed to use 90 days as a standard in lieu of three months. (September,
3 1996)

4 3. Reviewed in April 1997 with no substantive changes.

5

6

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

8 (a) A release of intellectual property rights in whole or in part is effective

9 without consideration if it is:

10 (1) contained in a record to which the party giving the release

11 manifested assent and which identifies the rights released; or

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

13 other rules allowing enforcement of a release.

14 (b) A release continues for the duration of the rights released if the

15 agreement does not specify its term and does not require:

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

17 or

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

19 receiving the release except minor acts such as acts done in complying with an

20 agreement to give acknowledgments or credits in subsequent use of the information

21 or to provide a small number of copies of any new works.

22 **Selected Issues:**

23 1. Is the definition of a release sufficient distinct from the general idea of a
24 license to permit the special rules in this section (i.e., no authenticated record
25 required and presumption of a perpetual term), neither of which rule is appropriate
26 for licenses in general?

27

28

Reporter's Note

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

9
10 2. Subsection (b) relates to practices important in the entertainment and
11 multimedia industries involving acquisitions of rights clearances relating to
12 properties used in new works. The release or waiver does not relate to claims
13 based on breach of contract, but refers to releases of intellectual property and
14 similar rights. The section clarifies existing law concerning the enforceability of
15 releases in fully executed form. This section provides that release of rights in a
16 certain form is enforceable, but does not alter other existing law with respect to
17 when releases are enforceable.

18
19 Subsection (b) is a specific application of a rule previously expressed in
20 Section 2B-311, creating a presumption that some single or no-payment contracts
21 create perpetual rights if no term is specified. The broader rule was abandoned
22 based on extensive discussion at the April, 1997 meeting, but this specific
23 application was developed to deal with issues common in software, publishing and
24 other industries where parties develop products in part on reliance on general
25 releases or waivers that do not contain specific duration terms. Leaving those
26 cases to the general "reasonable time" standard in Section 2B-311 would create
27 unwarranted and potentially costly uncertainty.

28
29 **Illustration 1.** Film Co. is engaged in filming street scenes in New York City
30 for inclusion in its newest video game. As is common practice, it posts
31 conspicuous signs on the sidewalk informing people that the filming is
32 occurring and indicating that, if they are filmed, their voluntary participation
33 constitutes a release of intellectual property rights in the use of the film (e.g.,
34 rights of publicity). The voluntary participation manifests assent to the record
35 (the sign). As clarified in the text, this section also does not preclude
36 enforceability under other law such as estoppel or, even, traditional offer and
37 acceptance theory.

38
39 **Illustration 2.** Goods operates a website. The first page of the site states that
40 the user can download and use a copy of the art work by printing it. Wilson
41 charges for access to the website, but not for downloading. Is the release or
42 grant effective? There would be two analyses that would yield an enforceable
43 waiver or grant of a right here. One could conclude that the term giving the

1 right to download was an agreed part of the access contract, although there was
2 no procedure for manifesting assent to the term. Alternatively, under this
3 section, the release of the right to control the making of copies is enforceable
4 since the screen is a record to which the provider manifested assent by making
5 available to other parties, or other law supports enforceability (e.g., estoppel).
6

7 3. While the section refers to assent to a record, it does not preclude
8 modern means of recording assent, such as by filming assent by the participant as
9 part of the "record" itself. In this case, the film itself serves as the record. The
10 filmed assent is in effect no different from signing a writing. In both cases, the
11 included act or signing authenticates the record.
12

13 4. This section applies to releases that occur in common "chat room" and
14 "list service" activities on the Internet. In these situations, it is common to indicate
15 that participation in the service implicitly gives permission for the use of materials
16 submitted. Arguably, these relationships are supported by consideration; this
17 section makes clear that releases in such situations are enforceable based on the
18 existence of assent to the record containing the release terms.
19

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

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

- (1) course of performance, course of dealing, or usage of trade; and
- (2) evidence of consistent additional terms unless the court finds that the record was intended by both parties as a complete and exclusive expression of the terms of the agreement.

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

Committee Votes and Action:

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

Reporter's Notes

- 1. This Draft generally corresponds to current Article 2.
- 2. UNIDROIT Principles of International Commercial Contract Law provide that a: "contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing."

1 Art. 2.17.

2

3

4 **SECTION 2B-302. COURSE OF PERFORMANCE OR PRACTICAL**

5 **CONSTRUCTION.**

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

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

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

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

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

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

20 **Uniform Law Source:** Section 2A-207; Section 2-208; Section 1-205. Revised.

21

22 **Committee Vote:**

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

25

26

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

1 (a) An agreement which modifies a contract is binding without
2 consideration.

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

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

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

11

12 **Committee Vote:**

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

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

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

19

20 **Reporter's Notes**

21 1. The section generally parallels current law. In subsection (b), Article 2
22 and Article 2A require no oral modification terms to be signed by the consumer;
23 that concept appears here in the form of a requirement of manifestation of assent to
24 the term, rather than signature. This allows the concept to operate in electronic
25 environments where signatures/authentication is not feasible, while still providing
26 protection in the form of binding the consumer only to terms where the consumer
27 affirmatively and specifically adopted.

28

29 2. This section does not, of course, create a statute of frauds rule. Rather, it
30 confirms that, if the agreement of the parties limits enforceability to modifications
31 that are in a record, that agreement will be enforced. The rule is especially
32 important in the on-going relationships that characterize many commercial licenses
33 and development contracts.

1
2
3 **SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.**

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

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

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

13 (2) in a mass-market license, the procedure permits the licensee to
14 terminate the contract if the modification deals with a material term and the
15 licensee in good faith determines that the modification is unacceptable.

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

19 **Uniform Law Source:** None.

20
21 **Committee Action:**

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

24 2. Voted to delete limitation in former subsection (b)(2) that the *change* in fact
25 be materially adverse to the mass market licensee and substitute "unacceptable in
26 good faith." (7-5) (April, 1997)
27

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

2. Subsection (b) addresses a common practice in online or other continuing service contracts in which changes in service conditions occur by posting on the service from time to time. Subsection (b) provides one method for contractual modification procedures. It serves as a safe harbor, indicating that methods that comply with this are enforceable, without indicating that other methods are not available. See Section 2B-115(c). The general idea of modification of a contract is noted in Section 2B-303 and the related common law and UCC developments with respect to modifications. For example, under Section 2B-303, consideration is not required to modify an existing contract. What constitutes an effective modification may generally hinge on concepts of agreement and assent. Thus, for example, a signed modification would be effective. Similarly, some types of changes may not require even the procedural protections indicated here. For example, even in a fixed term loan and mortgage that are not subject to termination federal law allows unilateral changes in consumer contracts if the changes meet any of several criteria, including that they unequivocally benefit the consumer or make an "insignificant change" to the contract terms. FRB *Regulation Z*, 12 CFR § 226.5b. The contracts covered here which often involve contracts subject to termination at will present a clearer case to allow non-material modifications.

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

1 In addition, in mass market transactions, for changes in material terms,
2 there must be an option to withdraw if the party in good faith views the change as
3 unacceptable. On this point, the Committee voted to delete a concept of requiring
4 *that the change in fact be materially adverse* to the withdrawing party in lieu of a
5 rule focused on good faith.

6
7 4. This subsection deals with changes in contract terms and does not cover
8 changes in the content made available under an access contract, such as a
9 multifaceted database. Under Section 2B-614(a), an access contract grants rights
10 of access to materials **as changed and modified** by the licensor over time. Thus,
11 unless an express contract term provides otherwise, a decision to add, modify, or
12 delete an element of the databases made available does not modify the contract, but
13 merely constitutes performance by the licensor and is not within this subsection.
14 Withdrawal is without penalty, but the mass market licensee must, of course,
15 perform the contract to the date of withdrawal (e.g., pay all sums due at that time).

16
17
18 **SECTION 2B-305. OPEN TERMS.**

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

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

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

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

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

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

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

3 (d) An agreement that provides that the performance of one party be to the
4 satisfaction or approval of the other requires performance sufficient to satisfy a
5 reasonable person in the position of the party that must be satisfied. However, the
6 agreement requires performance to the subjective satisfaction of the other party to
7 the extent that:

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

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

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

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

2
3 Reporter's Notes

4 1. Subsections (a) through (c) bring together several rules relating to open
5 terms under current law.

6
7 2. Subsection (d) pulls out cases where performance is to be to the
8 satisfaction of the other party. Here, two different approaches reflect different
9 traditions and case law in the industries affected by Article 2B and differences in
10 qualitative standards that are appropriate to the commercial relationships. The
11 factor that distinguishes these industries is that many of the information products
12 that they obtain entail judgments about aesthetics and marketability, leaving it
13 important that the judgment of the licensee be unfettered. Here, to the satisfaction
14 clauses create a subjective standard, rather than one defined by reference to a
15 reasonable person test. The converse rule is more appropriate in cases involving
16 the development of computer programs and the like.

17
18 4. *Restatement (Second) of Contracts* § 228 [prefers] a reasonable man
19 approach **if** the context permits objective standards for determining satisfaction.
20 This leaves too much uncertainty for the information industries affected here. The
21 *Restatement* cites an entertainment industry example as one in which no reasonable
22 standard of satisfaction is possible. The language in subsection (d) attempts to
23 provide guidance for determining when the subjective standard is appropriate for
24 informational content performances.

25
26 5. Subsection (d) provides safe harbor language.

27
28 6. Subsection (e) deals with situations in which the parties agreement
29 contains an element requiring further agreement to a term. This section derives
30 from Section 2-305. The relevant policy is that, in the case of a failed agreement,
31 the parties must be placed into the same position as that would have been without
32 the tentative steps toward agreement having occurred and that no party should
33 retain a benefit for which it has not paid. Subsection (e) permits destruction of
34 copies of the information and other materials in lieu of returning them. In the
35 context of goods, return of the tangible items is essential to place the parties back
36 into the position that they were before the tentative agreement. In reference to
37 information, in most cases at least, the party having transferred the information
38 retains copies of it. The option of destroying the copies is subject to the consent of
39 the other party to cover the case in which recovery of the information by the
40 original transferor would be difficult or costly.

41
42
43 **SECTION 2B-306. OUTPUT, REQUIREMENTS, AND EXCLUSIVE**

1 **DEALING.**

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

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

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

14 **Committee Vote:**

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

19 Reporter's Notes

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

29 2. Subsection (b) accommodates the various bodies of law that pertain to
30 exclusive dealing relationships in information. Unlike for goods, the typical case
31 here does not necessarily entail production and delivery of copies for resale by the

1 other party. Article 2 and case law dealing with patent licensing create a best
2 efforts default rule. That rule, however, is not the law in other fields governed by
3 Article 2B and, in any event, uses a standard that has been difficult if not
4 impossible to define with reliability.

5
6 After extended discussion of the standard, no clear resolution was reached.
7 The basic choice was between reasonable commercial efforts and good faith. After
8 the April, 1997 meeting, the Reporter reviewed the possibility of employing a
9 business judgment standard, but that was rejected for several reasons, including
10 questions about with reference to which business and about how corporate law
11 decisions about conflict of interest handles situations where one party has two
12 products of similar type. The approach suggested here relies on a good faith
13 standard — honesty in fact and adherence to commercial standards of fair dealing.
14 This allows courts to draw appropriate balances in light of the commercial context
15 and the existing traditions of that context in the atypical case where the contract is
16 silent on the issue.

17
18
19
20 [B. FORMS]

21
22
23 **SECTION 2B-307. ADOPTING TERMS OF RECORDS.**

24 (a) If a party adopts the terms of a record, including a record that is a
25 standard form, the terms of the record become terms of the contract.

26 (b) Except as otherwise provided in Sections 2B-308 and 2B-309, a party
27 adopts the terms of a record if the party agrees, including by manifesting assent, to
28 the record before or in connection with the initial performance or use of or access
29 to the information. If the parties commence performance or use the information
30 with the expectation that their agreement will be represented in whole or in part by
31 a record that a party has not yet had an opportunity to review or that has not yet
32 been completed, the party adopts the terms of the later record if the party agrees to
33 or manifests assent to that record.

1 (c) A term adopted under subsection (b) becomes part of the contract
2 without regard to the knowledge or understanding of the individual term by the
3 party adopting the record and whether or not the party read the record.

4 (d) A term of a record which is unenforceable for failure to satisfy a
5 requirement of this article, such as a provision that expressly requires use of
6 conspicuous language or manifesting assent to the term is not part of the contract.

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

8

9 **Committee Votes:**

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

11 2. Rejected a motion to make specific reference to excluding terms that are
12 unconscionable in addition to general exclusion under Section 2B-109.
13 (September, 1996)

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

17

18 **Reporter's Notes**

19 1. Article 2B deals with standard form records in three separate sections.
20 This section and Section 2B-308 deal with standard forms in "single form" cases.
21 Section 2B-309 deals with cases involving an exchange of conflicting forms.
22 These sections do not address whether a contract exists. If no contract is formed
23 under other provisions of this Article, the sections are not applicable. What is
24 addressed here is, given an agreement, what are the relevant terms.

25

26 2. In single form cases, a balance is implemented involving two elements.
27 The **first**, contained in this section, solidifies the enforceability of standard forms in
28 commercial deals. This confirms an important aspect of commercial law. The
29 principle, already followed in the vast majority of modern commercial case law,
30 flows from the belief that in the absence of fraud, unconscionable or similar
31 conduct, commercial parties are bound by the writings to which they assent,
32 without being able to later claim surprise or a failure to read the language presented
33 to them. Assent is not conditional on the party actually reading the terms. The
34 **second** is that, in consumer or mass market transactions, protections can be created
35 altering the idea that a party is bound by the entire form to which it assents in a way
36 the accommodates the possibility of unfair surprise. This counterbalance arises in

1 Section 2B-308 with reference to mass market contracts. That section adopts the
2 approach of the *Restatement (Second) of Contracts* § 211, which creates a limited
3 basis to argue that a term in a record to which the party assents may have been so
4 surprising that it should not be enforced unless called to that person's attention.
5 The *Restatement* rule is seldom applied to commercial contracts not involving
6 insurance policies, and has been adopted fewer than ten States. Other States use
7 concepts of fraud, unconscionability, bad faith and similar devices to police, in a
8 limited way to preclude serious cases of abuse.

9
10 3. This section applies the principle of enforceability to all commercial
11 records. A party is bound by a record if it agrees to the record or if it manifests
12 assent to the record. Given the definition of manifesting assent, this gives three
13 ways of establishing that a record is binding. The most restrictive is "manifested
14 assent." This concept focuses on objective manifestations of assent and adopts
15 procedural safeguards allowing the party bound by the standard form an
16 opportunity to review terms and to reject the contract if the terms are not
17 acceptable. The two safeguards are in the concept of "opportunity to review" (see
18 Section 2B-114) and "manifests assent" (see Section 2B-113). A party cannot
19 manifest assent to a form or a provision of a form unless it has had an opportunity
20 to review that form before being asked to react. Except in contract modifications,
21 an opportunity to review does not occur unless the party has a right to return the
22 subject matter, refuse the contract, and obtain a refund of fees already paid (if any).
23 The second theme involves signing the record (authentication). Historically, this
24 has been sufficient to show assent. Third, there is the possibility of "agreement to
25 the record." This is more subjective and deals with the entire context. A party in a
26 context covered by this section would generally prefer to construct its transaction
27 to fall within the either of the other provisions.

28
29 4. Subsection (b) rejects the idea that a contract and all of its terms must be
30 formed at a single point in time. Case law adopts a more fluid conception of the
31 process of contracting, where parties define the agreement over a period of time
32 that is not constrained to an instantaneous "closing" in most cases. See, e.g.,
33 *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991); *Hill v. Gateway 2000,*
34 *Inc.*, 1997 WL 2809 (7th Cir. 1997). As a consequence, terms can be created by
35 agreement or assent after beginning performance. Thus, in the entertainment
36 industry and in many development contracts, contract terms are developed and
37 drafted **while** performance occurs, not before performance begins. Each party
38 anticipates an enforceable record will be created and agreed to, but neither waits on
39 performance until one is fully drafted. This section accommodates that process.

40
41 5. Subsection (d) simply clarifies that assent or agreement do not over-ride
42 statutory requirements that a term be conspicuous or that there be assent to the
43 particular term.

1
2
3 **SECTION 2B-308. MASS-MARKET LICENSES.**

4 (a) Except as otherwise provided in this section and Section 2B-309, a
5 party adopts the terms of a mass-market license if the party agrees, including by
6 manifesting assent, to the mass-market license before or in connection with the
7 initial performance or use of or access to the information.

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

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

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

20 (c) Subsection (b)(1) does not exclude a term that:

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

23 (2) was disclosed in compliance with any federal or state law; or

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

2 (d) A term that is unenforceable for failure to satisfy a requirement of this
3 article, such as a provision that expressly requires use of conspicuous language or
4 manifesting assent to the term, is not part of the contract.

5 (e) In a mass-market transaction, unless otherwise agreed, an obligation or
6 limitation that was reasonably disclosed on the product packaging or otherwise
7 before payment of the license fee, or that was part of the product description,
8 becomes part of the contract without manifestation of assent to a license or to a
9 term containing the obligation or limitation.

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

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

14

15 **Votes:**

16 1. During Article 2 discussion at the Annual Meeting in 1996, a motion to
17 delete special treatment there for consumer was defeated based in part on Article 2
18 Drafting Committee assurances that Article 2 would use an **objective** test.

19 2. The Drafting Committee adopted by a vote of 10-1 a motion to delete the
20 reference to terms consistent with "customary industry practice."

21 3. The Drafting Committee adopted by a vote of 12-0 a motion to delete a safe
22 harbor for terms giving no less rights than under a first sale.

23 4. The Drafting Committee voted 12-0 to support an approach (b) that focuses
24 on the perspective of the party proposing the form.

25 5. The Committee rejected a motion to adopt ABA proposal to substitute
26 refusal term concept with an affirmative, expanded refund right that covers cost of
27 return and return of system to original state. Vote: 2-6 (April, 1997)

28 6. The Committee failed to adopt a motion to add the expanded refund right
29 and restrict the refusal term concept to consumer transactions. Vote: 5-5 (April,
30 1997)

31 7. The Committee rejected a motion to limit the section to consumer licenses.

1 Vote: 2-8 (April, 1997).

2

3 **Selected Issue:**

4 1. Should the refusal term concept be limited to consumer cases coupled with a
5 more explicit mass market refund provision where contract terms are presented
6 after payment?

7 2. Should the bracketed language be adopted limiting the refusal term idea to
8 post payment contract terms?

9

10 Reporter's Notes

11 *Changes Since the June Meeting:*

12 1. Former subsection (c) on assent to particular terms was moved to
13 subsection (b) for clarity. The concept remains the same: refusal terms are not
14 excluded if the terms have been called to the attention of the assenting party and it
15 assents to the term. In such cases, the underlying purpose of preventing unfair
16 surprise is met and there is no reason to abrogate the contractual choices.

17

18 2. Subsection (c)(2) was added at the May, 1997 meeting, but has not been
19 directly discussed by the Committee. It responds to the potential of conflicting
20 regulations or disclosure demands and holds that disclosure of terms pursuant to
21 applicable federal or state regulations suffices for purposes of this Article. This is
22 based on the concept that direct regulations tailored to specific disclosure settings
23 should not be altered by the general rules of this section.

24

25 *General Notes:*

26 1. This section deals with all standard forms used in the mass market in
27 transactions governed by this Article. It states an exception to the general rule in
28 Section 2B-307 and creates what has been a controversial rule *allowing a court to*
29 *invalidate some terms of a mass market standard form even though the term is not*
30 *unconscionable* and was not obtained through fraud or duress unless the party
31 assenting to the form also assents to the particular term. These are so-called
32 "refusal terms," defined in subsection (b) as terms that the party proposing the
33 form should know would cause a refusal of the license by the licensee. As drafted,
34 the scope of the section is determined by the scope of the term "mass market."
35 This currently covers consumer transactions and transactions involving two
36 businesses. It is not limited to deals involving small businesses.

37

38 2. In the mass market, contract terms are created in several different ways.
39 This section deals with all standard forms in the mass market, including (1) forms
40 presented before a purchase fee is paid, (2) situations where terms are presented
41 online, and (3) situations where a publisher's terms are made available for assent

1 by the end user only after the end user pays the retailer. A failure to focus on the
2 differences clouds assessment of the provisions of this section.

3
4 **3. Forms assented to before payment.** Where the terms of a form (mass
5 market or other) are presented before a price is paid, determining the validity of the
6 form terms involves issues that have been presented to courts for years. In this
7 setting, the vast majority of case law on consumer or other grounds enforces the
8 contract. The fact that the terms are non-negotiable or represent a "contract of
9 adhesion" typically results in close scrutiny of terms and whether they violate
10 concepts of unconscionability, but it seldom results in a decision that invalidates
11 the contract itself. The fact is that, while neither party bargained for terms, the
12 vendor did not agree to sell under any other terms than those set out in its contract
13 and, as long as there is fairness, disclosure or notice to the other party, contract law
14 does not vitiate those terms.

15
16 Subsection (a) states a principle in the *Restatement (Second)*: by
17 manifesting assent to a standard form record, a party adopts the terms of that
18 record. Unlike common law, Article 2B places significant restrictions procedurally
19 on the idea of manifesting assent. These restrictions ensure that the record be
20 available for review and that the assenting party make some **affirmative** indication
21 of assent. Compare *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th Cir. 1997)
22 (assent to a form based on failure to object sufficient to enforce clause in that
23 form). In light of the nature of mass market transactions, the timing in which the
24 form can be made effective is limited to no later than the initial use of the
25 information.

26
27 In this setting, however, courts express concern about the risk of over-
28 reaching and fraud or surprise in the form of hidden or otherwise unknown terms
29 that fundamentally alter the deal and vitiate the bargain. In most cases, courts
30 concerned about or presented with claims of this nature focus on whether the
31 contract is adhesive and, if so, on whether a particular term is "unconscionable."
32 *Few courts invalidate conscionable terms in the mass market. Section 2B-308*
33 *creates a right to invalidate terms that are not unconscionable.* It also applies that
34 result to business purchasers.

35
36 **The issue is whether new law is justified to avoid abuses in contracting**
37 **that are dealt with adequately under current consumer regulations, fraud**
38 **concepts, and the general rule avoiding unconscionable contract terms.**
39 **Should an otherwise "conscionable" term be excluded?**

40
41 In cases where the license arises through initial screens presented to the
42 licensee before it pays, the issue is identical to paper-based formats, except for the
43 automated nature of the contracting. The issues are whether there are adequate

1 indicia of assent and adequate protection against over-reaching.

2
3 In both cases, one view is that law should disallow the ability of a vendor to
4 insist on the terms under which it chooses to market its product or service. That
5 viewpoint challenges fundamental contract law. It argues that law defines terms,
6 conditions and risks under which information is transmitted to the general public.
7 **This is a regulatory structure that is not accepted in Article 2B.**

8
9 **4. Forms presented after payment.** In modern commerce, licenses and
10 other contract terms are often presented after a price is paid to a retailer. These
11 situations (which include so-called "shrink-wrap" licenses) invoke the same issues
12 present in ordinary use of forms in a mass market, but present two additional
13 questions.

14
15 **First:** Does the form contract give any advantages to the end user? The
16 answer here centers on the fact that, in most cases, the license presented after
17 payment is between the *copyright owner* and the end user, rather than between the
18 end user and *the retailer*. In this **three-party** setting (end user, retailer, copyright
19 owner), the post-payment license is important to the end user. In that case, the
20 standard form establishes *for the first time* a relationship between the copyright
21 owner and the end user. That relationship may be central to the end user's right to
22 use the information.

23
24 A copyright owner may elect to license distributors a right to sell copies of
25 its work. Alternatively, it may preclude a right to sell and instead authorize
26 distributors to license works under terms it specifies to the distributor. **Copyright**
27 **law** supports either choice. If the copyright owner authorizes others to transfer
28 copies, it is licensing its exclusive distribution right. If the distributor/licensee
29 exceeds that license, cases hold that its transferees are not protected under
30 **copyright law**. Thus, a common distribution situation is:

31
32 (1) copyright owner licenses distributor to distribute, but not sell, copies of
33 its work, and only subject to a license;

34
35 (2) distributor (retailer) transfers copies to end users for a price, but under
36 applicable case law, this cannot be a "first sale" unless the copyright owner
37 authorized sales;

38
39 (3) if it is not a first sale, end user has possession, but an uncertain status in
40 copyright until it assents to a license with the copyright owner

41
42 (4) if it is a first sale, end user has some statutory rights, but cannot make a
43 public performance, display or multiple copies of the work under copyright law.

1
2 The [post-payment] license is the first contract between the end user and the
3 copyright owner. It is the only setting in which the end user can obtain rights that
4 are in excess of rights to a first sale purchaser and, if that is barred, any rights to
5 copy at all under copyright law.
6

7 **Second:** In post-payment license terms, the unique issue is what
8 protections does the end user have if the license terms are unacceptable. Under
9 Article 2B, the post-payment terms cannot be made enforceable unless the licensee
10 has a right to a refund if it rejects the proposed agreement. This refund right is
11 enforceable against either the publisher or the retailer. If that right is not given, the
12 contract terms are entirely unenforceable. Section 2B-113.
13

14 This section will typically not apply to transactions involving information
15 provided in separate units pursuant to an overall agreement between the licensor
16 and the licensee. Such agreements are not part of a retail marketplace and, thus,
17 would not fall within the definition of mass market transaction. They would be
18 governed under the general rules of this Article.
19

20 5. Subsection (a) requires agreement or a manifestation of assent to the
21 form. Its impact is limited by subsection (b). It is also shaped by the existence of
22 other mechanisms that create terms in an agreement. One of these is described in
23 subsection (f). That subsection clarifies that information about a product disclosed
24 on packaging or otherwise or part of the product description itself, become part of
25 the deal in a mass market transaction without there being a need to obtain
26 manifested assent to a standard form. This clarifies the point that the standard form
27 and the manifesting assent requirements are not the exclusive methods of defining
28 the agreement in this marketplace, or indeed, in any other market.
29

30 6. This section deals with single-form cases. In that situation, case law
31 generally affirms the enforceability of standard forms. With respect to single form
32 cases, no appellate case law rejects the contract-based enforceability of the forms
33 and recent cases support it. See *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th
34 Cir. 1997); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Arizona Retail*
35 *Systems, Inc. v. Software Link Inc.*, 831 F. Supp. 759 (Ariz. 1993). Compare *Vault*
36 *Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th 1988) (applying a preemption
37 analysis to statute validating a particular term after the lower court held otherwise
38 the contract was invalid as a contract of adhesion; the appellate court did not
39 address the contractual enforceability issue). Case law is less clear in the
40 conflicting forms setting where, as in Section 2B-309 of this article, the presence of
41 differing terms creates questions about assent to either form. See *Step-Saver Data*
42 *Systems, Inc. v. Wyse Technology*, 939 F.2d 91 (3d Cir.1991); *Arizona Retail*
43 *Systems, Inc. v. Software Link Inc.*, 831 F. Supp. 759 (Ariz. 1993). These cases do

1 not contest the underlying enforceability of standard forms, but deal with
2 conflicting terms. See Douglas G. Baird & Robert Weisberg, *Rules, Standards, and*
3 *the Battle of the Forms: A Reassessment of* ¶2-207, 68 Va. L.Rev. 1217, 1227-31
4 (1982).

5
6 7. Subsection (b) places two general restrictions on the enforceability of
7 terms in the mass market license in situations where the term is not called to the
8 party's attention and assented to by the party. These are in addition to general
9 UCC rules invalidating unconscionable terms and requiring good faith. The
10 statutory restriction outlined in subsection (b)(1) seeks to prevent the creation of
11 terms that contradict the basics of the agreement without giving the assenting party
12 fair notice of the terms. Under current law, in most States, this function is served
13 by cases reviewing contracts of adhesion, interpreting them strictly against the
14 proposing party and excluding unconscionable terms.

15
16 The bracketed language in subsection (b) raises a question about whether
17 the exclusionary terms should be limited to cases where the form was not made
18 available to the licensee until after it paid the purchase price. This would be the
19 "classic" shrink wrap case where, unlike in the case of forms assented to at the
20 outset of the transaction, some arguments can be made about the equities in
21 allowing terms to arise after the initial retail acquisition. In most shrink wrap
22 cases, of course, the license is not an amendment of the agreement between the
23 retailer and the end user, but the creation of a relationship between the end user and
24 the publisher or copyright owner. In this Article, under Section 2B-616, the
25 retailer's contract is independent of the terms of the publisher's contract with the
26 end user (including disclaimers and the like). Article 2 revisions deal with this
27 third party relationship by validating so-called "warranties in a box" regardless of
28 assent by the consumer and independent of exclusion of refusal terms.

29
30 8. Subsection (b)(1) invalidates "refusal" terms unless, pursuant to
31 subsection (c), those terms are called out to the attention of the end user and
32 assented to by that party. "Refusal terms" are terms that the proposing party has
33 reason to know would cause a refusal of the license if the licensee were aware of
34 the terms. This subsection creates what, in most States, is a significant expansion
35 of protection for consumers and, for businesses who make contracts in the "mass
36 market." The section in part adopts principles of the *Restatement (Second) of*
37 *Contracts* ¶ 211. Since the *Restatement* test has been adopted in relatively few
38 States for transactions that do not involve insurance agreements, this substantially
39 expands licensee protection as contrasted to current law.

40
41 Subsection (b)(1) parallels the *Restatement*, but does not adopt the broad
42 interpretation that some courts have placed on that rule. Some courts have
43 confused the *Restatement* approach with a general authorization to review the terms

1 of a standard form to determine whether, in the view of the court, the contract term
2 was within the reasonable expectations of the recipient of the form and, ultimately,
3 whether the term was appropriate in the context of the deal as viewed by the court.
4 This, in effect, allows a court to rewrite the deal of the parties by excluding terms it
5 thinks are not reasonable. This broad approach reflects case law in a number of
6 States dealing with insurance contracts, but is neither appropriate in this
7 commercial context, nor consistent with the language of the *Restatement*, the
8 apparent intent of the developers of the *Restatement*, or the language of this
9 section. As applied outside of the arena of insurance contracts and divorced from
10 the insurance law concepts that influence the test in that setting, a broad
11 “reasonable expectations” test finds little support and is rejected here.

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

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

25
26 In addition to these themes, some cases emphasize that a term hidden in a form can
27 be invalidated if it takes away or contradicts affirmative expectations created by the
28 vendor in a deal that are basic to the value of the bargain for the other party.

29
30 It is in the more narrow, refusal term sense that the test is meant.

31
32 9. Subsection (b)(1) modifies the *Restatement* approach in several ways. A
33 major difference is that, in light of the mass market context, this Draft focuses on
34 the perspective of the party proposing the form with respect to an **ordinary** user of
35 the information. The *Restatement* permits a reference to the perception of the party
36 proposing the form as to the reactions of the **recipient**, and courts applying the test
37 conflict in their treatment of this issue. In the mass market, the assumption of a one
38 to one relationship creating an individualized perception would be unrealistic.

39
40 Subsection (b)(1) expressly connects the nature of the term to the refusal of
41 the entire deal. The issue presented is not whether a term would fall within general
42 expectation, but whether the vendor has reason to know that the term would be a
43 “deal breaker” in that it would so contradict the terms of the transaction or create

1 oppressive conditions that would cause refusal of the proposed deal itself and in
2 full.

3
4 As in the *Restatement*, subsection (b)(1) refers to the perspective of the
5 party proposing the form, not to whether the form is within the expectations of the
6 individual recipient. A review of reported cases on this point under the
7 *Restatement* indicates that the insurance law concepts have affected judicial
8 treatment of the *Restatement* and that not all courts concentrate on the form
9 provider's reason to know. The test as proposed here does not adopt the reasoning
10 of those cases.

11
12 10. A term is not excluded if the party manifests assent to the term. At the
13 heart of the *Restatement* test is the idea that unknown terms require some closer
14 monitoring to avoid surprising and oppressive terms. If the party is made aware of
15 and assents to the term, there is no room for argument about whether the term was
16 unknown to it. This does not create a mere formality, but rebuts a basic element of
17 the exclusionary standard. By disallowing "refusal terms" the intent is not to
18 invalidate terms **known** and assented to by the licensee. If the proposing party
19 calls the term to the licensee's attention, it is not an unknown refusal term. This
20 requires that the term be called to the licensee's attention and assent obtained by
21 signing or an action related to that term. The structure adopted here not only
22 attempts to balance the interests of licensor and licensee, it also attempts to create a
23 structure in which transactions can occur. This is not a litigation standard, but an
24 approach that says to the licensor: if you wish to impose a bizarre term, the only
25 safe procedure you can adopt entails one in which that term is brought to the
26 licensee's attention and assented to by the licensee.

27
28 **Illustration 1:** Assume that party A accesses the front "page" of party B's
29 online database of periodicals dealing with television shows and is confronted
30 with a legend stating that "These materials are provided subject to an
31 agreement relating to their use and reproduction that can be reviewed by
32 clicking on the "license" icon. By striking the [return] key you assent to all of
33 the terms of that license agreement, including the price to be charged for access
34 rights." Assume that this is a mass market license. A has an opportunity to
35 review the license (assuming that if A reviewed the license it could leave
36 without charge) and is provided with an instruction that a particular action
37 constitutes acceptance of the license. By doing so, A adopts the license even if
38 it did not review its terms.

39
40 **Illustration 2:** ABC Industries agrees with Software Co. to acquire a word
41 processing program. It does not contain reference to warranties. When the
42 package is opened and placed into a computer, the first screens state: "This
43 software is subject to a license agreement. To review the agreement, click

1 [here]. If you agree to be bound by the license agreement, click below on the
2 icon stating your agreement. If you do not agree, click on the icon stating your
3 non-agreement and return this product and all copies you have. We will give
4 you a full refund. Assume that by clicking to review the agreement, the entire
5 license is available on screen. Also assume that the licensee cannot proceed to
6 load the software without indicating its agreement. Does this license generally
7 define the agreement if the licensee clicks acceptance. Yes. The licensee had
8 an opportunity to review before taking steps defined as assent. The opportunity
9 to review includes, as it must, a chance to read the license, an opportunity to
10 decline it, and a right to a refund if the licensee declines. By clicking
11 acceptance, it assents to the form. The fact that there was a prior agreement is
12 not material since the license did not contradict negotiated terms.

13
14 **Illustration 3:** In the foregoing transaction, assume that the license provides
15 that the licensee indemnifies the licensor for any claims based on the licensor's
16 infringement of third party copyrights. Is this clause included in the agreement
17 for the word processing program? No. This indemnity would be unusual and
18 most likely a refusal condition in the mass market although, in some
19 commercial markets, it may be an ordinary clause.

20
21 11. Subsection (c) describes situations in which the exclusionary test does
22 not apply. The first states that a term stating limits that would exist under
23 intellectual property law are not refusal terms and do not fall within the provisions
24 of subsection (b)(1). The section does not validate specific terms or go outside the
25 scope of what rights the licensor would have under copyright and patent (including
26 any limitations on those rights under federal law or policy). The intent is to
27 validate contract terms that merely implement a copyright owner's exclusive rights
28 and reflect conditions already established by federal property law. The second
29 exception applies to a term which comes into the contract under other provisions of
30 the Article. The primary application of this lies in use of conspicuous terms. A
31 conspicuous disclaimer that conforms to rules on disclaimers cannot be avoided
32 under this section as a refusal term, nor could a conspicuous term limiting
33 damages. The more specific treatment governs. Disclaimers and ordinary remedy
34 limitations, of course, would not be refusal terms pursuant to the standards of this
35 section in any event. The third exception refers to terms presented in a manner that
36 complies with otherwise applicable federal or state disclosure rules (subsection
37 (c)(2)). This subsection was added before the May, 1997 meeting in response to
38 issues raised by the banking industry in connection with disclosure regulations to
39 which and other must comply (e.g., Regulation E). Where a specific decision is
40 made by regulators to mandate and enable particular disclosure rules, the general
41 standards of this section should not create an entirely separate compliance regime.

42
43 11. Subsection (d) states the obvious corollary to the fact that terms

1 conforming to this article are not to be excluded under (b). It indicates that terms
2 that do **not** comply with other provisions of this article are not part of the terms
3 adopted by the assenting party.

4

5

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

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

10 (1) If a party proposes a standard form containing language that
11 conditions assent on agreement to its terms and the conditions are enforceable
12 under Section 2B-205, the terms of that form govern if the other party by language
13 or conduct agrees to the form.

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

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

23 (b) Subject to subsections (c) and (d), in cases governed by subsection

24 (a)(2), the terms of the contract are:

- 1 (1) terms agreed to by the parties;
- 2 (2) terms included under subsection (a)(2);
- 3 (3) terms of the licensor's standard form governing scope of a license;
- 4 and
- 5 (4) supplementary terms included under this article.
- 6 (c) In the case of a conflict between terms included under subsection (b):
- 7 (1) terms under subsection (b)(1) govern as to all other terms;
- 8 (2) terms included under subsection (b)(2) govern terms under
- 9 subsection (b)(3) or (4); and
- 10 (3) terms under subsection (b)(3) govern terms under subsection (b)(4).
- 11 (d) Terms in a record authenticated by the party to be bound supersede the
- 12 inclusion or exclusion of terms under subsection (a) or (b).

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

14

15 **Committee Votes:**

- 16 1. Consensus to strike or rewrite former subsection (c) (rewritten as subsection
- 17 (b)(2)) to deal more effectively with terms that are basic to defining the product
- 18 and, thus, not subject to the knock out rule.
- 19 2. Failed to adopt a motion that in the battle of forms the presumption should
- 20 be no consequential damages apply. (4-4) (April, 1997)

21

22 **Reporter's Note**

- 23 1. This section deals with a limited, but significant problem: the limited
- 24 case of two or more conflicting standard forms exchanged by the parties, the
- 25 problem with which current UCC § 2-207 deals. Broader interpretation problems
- 26 involving exchanges of letters, E-mails and other communications are left to
- 27 general contract law. This Draft assumes that a knock-out rule of interpretation is
- 28 appropriate for an exchange of forms. This leaves those complex situations to
- 29 ordinary contract interpretation rules.
- 30

1 2. The battle of forms deals with a situation where the parties exchange
2 forms, but undertake a contract regardless of whether the forms agree. Where this
3 is true, the section states simply that, if the parties did not negotiate or limit their
4 conduct to reflect the form, law will not retroactively create a rule in which the
5 standard form terms have greater significance for either party than was suggested
6 by their behavior. In that respect, the section applies a “knock-out” rule; the
7 parties are governed by the supplementary principles of this Act to the extent that
8 their forms disagree. Discussing current UCC § 2-207, the Third Circuit Court of
9 Appeals noted:

10
11 The insight behind [Article 2] is that it would be unfair to bind [a party to the
12 standard terms of the other party] when neither party cared sufficiently to
13 establish expressly the terms of their agreement, simply because [one party]
14 sent the last form.

15
16 3. This section adopts a “knock out” rule which essentially excludes
17 conflicting terms in the forms, regardless of which form was the first received or
18 sent. The sole question here deals with what are the terms of the contract in the
19 battle of forms. The creation of the contract comes under Sections 2B-202 and
20 2B-203.

21
22 **Illustration 1:** In response to a standard order form from DuPont, Developer
23 ships software subject to a form. The two forms disagree on warranty terms.
24 Under this rule, both warranty terms drop out. If Developer sends an E-mail or
25 a letter objecting to the warranty terms, but goes ahead and ships without
26 obtaining assent from DuPont to any change, determining what terms govern
27 the contract poses a difficult, but ordinary contract interpretation issue inquiring
28 into the intent of the parties, rather than an automatic knock-out rule. If
29 Developer states its refusal to ship unless DuPont agrees to its warranty terms
30 **and** in fact refuses to do so until DuPont agrees, the provisions of subsection
31 (a)(1) apply. If Developer sends a form conditioning shipment on acceptance of
32 its terms, but nevertheless ships, subsection (a)(2) governs; the conflicting
33 terms drop out.

34
35 4. In cases of two conflicting records, this section controls over the prior
36 two sections on standard forms and mass market licenses which deal with cases
37 involving only one standard form. Varying or conflicting terms are excluded unless
38 a party manifests assent to a particular **term**. A party does not manifest assent by
39 mere silence or retention of a record. Assent requires an affirmative act that
40 reflects agreement to terms that the party had an opportunity to review and reject.

41
42 **Illustration 2:** Licensor and licensee exchange standard forms relating to an
43 acquisition of software. The terms conflict with respect to warranty. The

1 conflicting terms drop out. The licensee does not obtain its term (full
2 warranties) unless the other party assents to that term. Suppose that the
3 Licensee form states that, by shipping this package, you consent to all of my
4 terms and specifically to term 12 on warranties. Does shipping the package
5 assent to the term? No. The conduct does not relate to that term. The licensee
6 would have to require initials on the term, telephone assent to the term, or other
7 act clearly connected to the fact that the licensor knew of and assented to the
8 term itself.

9
10 5. This section identifies three cases where a knock-out rule would be
11 inappropriate even though the parties exchanged standard forms. The **first**
12 involves a case (subsection (a)(1)) where one party, by conduct **and** by its form,
13 conditions its agreement to a contract on the other party's assent to its forms.
14 Although a naked exchange of forms gives neither party priority, conditional offers
15 or acceptances must be recognized and enforced when appropriate, even if made by
16 a standard form. By matching the form with the behavior as required in
17 subsection (a)(1), a party expressly takes the transaction outside the battle of forms
18 by **actually** conditioning participation in the contract on agreement to the terms of
19 its form. Often, when this occurs, there is no agreement between the parties unless
20 the other party assents to the conditional offer. See Section 2B-202.

21
22 6. A **second** situation that takes the case out of the knock-out rule occurs
23 when the parties execute an authenticated record. Authentication (signature) of a
24 record supersedes the standard forms issue. The authenticated record can come
25 before or after the exchange of forms. The basic theme is that an executed
26 agreement better indicates intent and throws the case outside the knock out rule.
27 Clearly, it would be a major change in law to regard a signed writing as being no
28 different in substance than unsigned and conflicting forms. Consistent with this
29 section courts should use general concepts of contract interpretation to discern the
30 meaning of the contract incorporated in a signed record.

31
32 7. The **third** situation occurs when the **forms conflict about the scope of**
33 **the license**. Scope is a defined term in Section 2B-102 that refers to terms
34 restricting field of use, duration and similar terms that in effect define the nature of
35 the information product being licensed. The mere fact that one form disagrees with
36 the licensor's form on issues of scope cannot be held to throw the case back on
37 general default rules. A vendor who provides a consumer version of software
38 cannot be forced to have given an unlimited, license in the software for
39 development and other use simply because a competing form stated terms that
40 conflict with the consumer restriction. Unlike warranty and similar terms, scope
41 terms define the product being sold (e.g., multi-user or single user license).
42 Additionally, it is only the licensor who is aware of what can be granted (e.g., it
43 holds rights to a screen play only for use in television). In cases where forms

1 disagree on basic points, the true issue is whether a contract exists (that is, was
2 there agreement). A knock-out rule would expose intellectual property to the
3 vagaries of conflicting forms.

4
5 Taken together with the provisions on contract formation, the rule
6 contemplated here involves inquiry about three issues in cases of conflicts on
7 scope:

8
9 (1) Did the parties actually reach an agreement or was one purchasing a
10 Corvette while the other was selling a Ford? Under the general formation rules,
11 disagreement about scope means that there is no contract. Thus, in this section, the
12 reference to the licensor's scope provisions becomes an issue only if there was no
13 disagreement about scope.

14
15 (2) If an agreement exists, did the parties agree on scope and, if so, what
16 agreement was reached? If there is an affirmative agreement on scope terms, that
17 affirmative agreement governs and, pursuant to this section, the agreed terms take
18 precedence over any terms in the forms of either party.

19
20 (3) If a specific scope was not agreed to by the parties, what terms on scope
21 are contained in the licensor's form? As this indicates, rather than giving
22 dominance to the licensor's form per se, this treats the issue of scope as a central
23 aspect of the relationship and uses the licensor's terms only after concluding that
24 an agreement exists and that there was no specific understanding about scope. If
25 the parties agreed on scope, that agreement prevails over the forms of either party.

26
27 **Illustration 4.** Vendor offers two versions of its copyrighted directory and
28 commentary relating to restaurants. One is a license for consumer use only at a
29 price of \$50.00. The second, containing the same data and software is for
30 commercial use, including the right to make commentary available in
31 commercial publications. It is priced at \$10,000. Licensee sends a standard
32 form which contains the provision that the software must be available for **all**
33 uses, including commercial use. It orders one copy of the restaurant software.
34 Vendor ships, using a standard form limiting use to **consumer** purposes. The
35 vendor's scope limitation controls since there was no contrary negotiated term.

36
37 Disagreement on scope of the license often indicates a lack of agreement on what is
38 being purchased. In this section, terms of a form that conflict with a negotiated
39 agreement on scope do not control; the licensor's terms only control as against
40 other non-negotiated terms.

41
42 8. Subsection (a)(2) holds that silence in one form is not a conflict that
43 triggers the knock out rule. Subsection (a)(3) proposes alternatives to solve cases

1 of partial conflict. It would apply, for example, where one form provides "no
2 consequential damages for either party" and the second form provides "no
3 consequential damages for either party, except with respect to breach of
4 confidentiality provisions." In one view, this is a complete conflict and both terms
5 drop out (creating the unique result that both parties fail to exclude consequential
6 damages for most risks. The other approach allows the point of agreement to be
7 part of the contract, but creates a knock out rule with respect to confidentiality
8 damages in that hypothetical.

9
10
11
12 [C. INTERPRETATION]
13
14

15 **SECTION 2B-310. INTERPRETATION OF GRANT.**

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

24 (b) A license that does not specify the number of simultaneous users
25 permitted only authorizes use by one party at any one time. However, if the license
26 authorizes display or performance of the information, it permits viewing by any
27 number of persons but only of a single display or performance at any one time.

28 (c) Neither the licensor nor the licensee is entitled to any rights in
29 improvements or modifications made by the other party after the license becomes

1 enforceable, or to receive source code, object code, schematics, master copy, or
2 other design material, or other information used by the other party in creating,
3 developing, or implementing the information. A licensor's agreement to provide
4 updates to or new versions of information requires that the licensor provide only
5 such updates or new versions that are developed by the licensor from time to time
6 for use by third parties and made generally available unless the agreement
7 otherwise expressly provides.

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

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

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

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

22 (4) In a contract between merchants, a grant of a "quitclaim" of rights,

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

3 (5) A grant that states that it is an "exclusive license", or uses similar
4 terms, conveys to the licensee exclusive rights in the information as against the
5 licensor and all other persons to exercise the rights granted within the scope of the
6 license and affirms that the licensor will not grant rights in the same information
7 within the same scope to any other party and has not previously done so in a license
8 that is in force at the time of the contract.

9 Reporter's Notes

10 1. This section reflects a significant reduction of the default rules contained
11 in prior Drafts.

12
13 2. The first sentence in subsection (a) covers a classic implied license
14 dealing with rights necessary to achieve the purposes of the grant and with rights
15 that may not have been expressly granted. For example, a license to use a film clip
16 in a CD ROM product impliedly conveys the right to crop or modify the size of the
17 clip to fit the media unless that is expressly excluded. A grant of a license in
18 software conveys the right to use functions provided in the software in the ordinary
19 course to make modified versions of that software. The implied license relates to
20 rights transferred and to materials provided to the party; it does not require a
21 transfer of additional materials (such as source code), unless that transfer was
22 agreed to by the parties. Additionally, express contract terms precluding this
23 treatment are effective.

24
25 4. The second and third sentences in subsection (a) deal with a highly
26 important interpretation issue that is accentuated as information transactions
27 become more common outside areas expert in intellectual property rules. Unless
28 dealt with here, the interpretation issue creates a trap for unwary draftsmen. Under
29 current law, it is clear that uses of licensed information outside the express scope of
30 a license are breaches of contract if the scope is defined in terms of "this use **only**"
31 or otherwise expressly precludes the use. If the word "only" does not appear, the
32 cases are less clear and some case law suggests that the omission of the word in
33 formal grant language vitiates the contract claim. This concept is not universally
34 followed and some federal policy holds that the proper interpretation is that any use
35 not expressly granted is withheld.

1
2 Under the second and third sentences of (a), an affirmative grant of less
3 than all rights impliedly excludes other uses that exceed the grant. The implied
4 limitation, however, is not as strong as an express limitation. The implied
5 limitation does not preclude acts that are necessary to achieve the uses
6 contemplated in the express grant. Additionally, the implied limitation is not
7 exceeded if the use would have been permitted by law in the absence of the
8 **implied** limitation. Thus, a consumer (personal) use of a commercial license might
9 be permitted if it would be a fair use (if it does not adversely impact the market for
10 the work) and was not expressly precluded by the contract. However, if a grant is
11 for use of a motion picture in one location but did not use the magic word "only"
12 and the licensee uses the motion picture copy to make and distribute multiple
13 copies for sale to home uses, that activity would violate the copyright (as a non-fair
14 use) and breach the contract. The position that no implied limits are present creates
15 a trap for the unwary licensor in that it contradicts normal contract interpretation
16 ideals of viewing a contract in light of its commercial purpose. A grant to use
17 software or a motion picture in Peoria implies the lack of a contract right to do so
18 in Detroit.

19
20 **Illustration 1:** Disney licenses to Acme Theater the right "to show the movie
21 Snow White during a six month period in Kansas." Acme, enamored with the
22 musical score of the movie, digitally separates the music into a separate copy
23 and uses it during that six month period in the Acme lobby. This infringes the
24 copyright. Whether it breaches the contract depends on whether the grant
25 creates an implied limitation that precludes other uses of the work and
26 derivative copies. Under subsection (b), the implied limitation exists unless the
27 use was a fair use without that limitation or was necessary to the primary grant.
28 Neither condition is met here. The fact that Disney forgot to add the word
29 "only" to its grant language does not create a different result than would be
30 explicit in the presence of that language.

31
32 **Illustration 2:** Licensor grants the "right to use its software in motion
33 pictures." The licensee uses the software to develop and distribute an animated
34 movie. Later, it uses the software to develop and distribute a television series.
35 Assume that a television program is not within the idea of a motion picture.
36 When sued for breach, if the rule is that uses outside the grant are not breaches
37 of contract, the grant terms are inadequate to give the licensor rights in this
38 case. If there is an implied limitation as proposed here, the issue is whether
39 television use "exceeds" the grant. It should, under an appropriate test.

40
41 **Illustration 3:** Same as illustration 2, except that the license grant states that it
42 grants "the right to use its software solely in motion pictures." Under this
43 framework, use in television violates an express condition of the license and is

1 a breach. Whether such difference in result should flow from the addition or
2 omission of the word "solely" is at issue. Requiring that word may be a trap
3 for less well-counseled parties.

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

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

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

33
34 5. The first clause of subsection (c) comes from prior Section 2B-311(d)
35 which the Committee approved. The second clause comes from prior Section
36 2B-316 which was also approved. The basic principle is that no right to subsequent
37 modifications made by the other party is presumed., nor is access to typically
38 confidential material. Arrangements for improvements and source code or designs
39 constitute a separate valuable part of the relationship handled by express contract
40 terms, rather than presumed away from their owner by the simple fact of creating a
41 contract.

42
43 **Illustration 6:** Word Company licenses B to use Word's robotics software.

1 The license is a four-year contract. Three months after the license is granted,
2 Word develops an improved version of the software. Party B has no right to
3 receive rights in this improved version unless the agreement expressly so
4 provides.

5
6 **Illustration 7:** In the Word license, two years after the license is established,
7 Party B's software engineers discover several modifications that greatly
8 enhance its performance. Word is not entitled to rights in these modifications
9 unless the license expressly so provides. However, the modifications may
10 create a derivative work under copyright law and a question also exists about
11 whether the license granted the right to make such a derivative work.

12
13 The second sentence of subsection (c) is from former Section 2B-613 and provides
14 a standard interpretation of an update agreement.

15
16 6. Subsection (d)(1) provides guidance for whether (when) a license grants
17 rights only in existing media or methods of use of an intangible or whether it
18 extends to future uses. The Draft adopts the majority approach in a number of
19 recent cases. Ultimately, interpretation of a grant in reference to whether it covers
20 future technologies is a fact sensitive interpretation issue. But the intent of the
21 parties may not be ascertainable. In such cases, use of language that implies a
22 broad scope for the grant without qualification should be sufficient to cover any
23 and all future uses. This is subject to the other default rules in this chapter,
24 including for example, the premise that the licensee does not receive any rights in
25 enhancements made by the licensor unless the contract expressly so provides.

26
27 7. Subsection (d)(2) deals with how, in a commercial context, parties can
28 transfer information without giving assurances about rights. The concept of a
29 quitclaim of rights is most common in entertainment contexts, but like the idea of a
30 quitclaim in real estate, it is essentially a grant only of whatever rights the grantor
31 holds.

32
33 8. Subsection (d)(3) deals with the effect of language of exclusivity in a
34 grant. The case law and treatises on this issue are in conflict. The issue focuses on
35 two distinct elements: **a looking forward and looking backward issue about**
36 **exclusivity as to other persons, and the issue of whether the exclusivity also**
37 **applies to actions of the licensor. The Committee has not yet discussed this**
38 **provision.**

39
40
41 **SECTION 2B-311. DURATION OF CONTRACT.** If an agreement is

42 indefinite in duration, the following rules apply:

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

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

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

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

13 **Committee Votes:**

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

Reporter's Note

17 *Changes Since Past Meeting:*

- 18 1. This section was substantially redrafted and presented at the May, 1997
19 meeting in light of extensive discussion during the April Meeting and the revisions
20 have not yet been discussed by the Drafting Committee.

2. The redrafting returns the section toward current law under Article 2 and the common law, except with respect to the perpetual duration assumed where a tangible copy is delivered and there is no performance (e.g., payment) to be delivered in the future to the other party. Overall, this returns to the general approach approved at a prior meeting. It abandons the attempt to accommodate various special rules on duration present in different fields of intellectual property law. The reference in subsection (1) to “other law” incorporates that law; some of the major non-UCC themes will be discussed in Comments.

31 *General Notes:*

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

6
7 In applying this and the remainder of the section, it must be understood
8 what type of contract comes within the section. The reference is to an agreement
9 that does not specify its duration. This requires that there be an agreement. In
10 some cases, a failure to agree on duration will, like failure to agree on any other
11 scope provision in a license, indicate that no contract exists. This principle is
12 implicit in the provisions of this Article on offer and acceptance, formation.

13
14 In addition, the precondition for this section is not met simply because the
15 record that documents the agreement is silent. An agreement refers to the entire
16 bargain of the parties. This includes oral agreements, trade use considerations, and
17 the entire commercial setting. This section applies only if the total of all of the
18 circumstances defining the bargain yield no understanding about duration of the
19 contract. Thus, for example, a license reached in an industry setting where, for the
20 particular information, licenses are typically for hourly, daily, weekly, or monthly
21 terms, would typically not fall within this section because the ordinary term for
22 licenses of the type would supply the unstated duration.

23
24 The section does not deal with contracts that contain provisions defining
25 their term. Thus, for example, a contract providing that a license continues for "the
26 life of the edition" or "for so long as the work remains in print" defines the term of
27 the license in the same manner as does a contract term of, for example, ten years.
28 These contract provisions control.

29
30 On the other hand, decisions interpreting the analogous Article 2 rule for
31 cases where there are commitments to "lifetime" service or "perpetual"
32 maintenance, would provide guidance on whether language of that sort provides a
33 definite term that takes the contract out of this section. The basic policy in such
34 cases is that the person making an open-ended commitment should be held to
35 performance over a time that is reasonable in light of the payment and the type of
36 commercial setting, but would typically not be placed in a position of perpetual
37 servitude without a very clear indication that should be the case.

38
39 2. Paragraph (1) refers to other law as providing other terms for a contract.
40 In this field, there are various federal policy considerations that impinge on the
41 duration of licenses and which may have an impact here. An effort in the prior
42 Draft to capture some or all of these in the black letter of Article 2B revealed the
43 complexity of the enterprise and counsels against continuing that effort. Instead,

1 these other law principles are allowed to govern. This can occur either through
2 direct application of the other law or by its influence on determining what is a
3 reasonable time. Thus, for example, a patent license that does not state its term can
4 reasonably be presumed (at least in many cases) as extending for the life and
5 validity of the patent. A similar premise exists with reference to an indefinite
6 copyright license term. This interpretation would also allow a court to take into
7 account the patent law premise that invalidity of a patent invalidates royalty
8 obligations as to that patent.

9
10 3. Paragraph (2) differs from existing Article 2 and general common law in
11 presuming a perpetual term for a license associated with the sale or delivery of a
12 tangible copy. This rule corresponds to licensing practice in general. It applies, as
13 redrafted, to cases where neither party has an obligation to deliver on-going
14 affirmative performances to the other party. This language is intended to clarify
15 what, under current Article 2 is a reference to a contract that does (does not) entail
16 successive performances.

17
18 A rule analogous to that in paragraph (2) is applied to intellectual property
19 releases, but is stated in Section 2B-207 on releases.

20
21 4. Paragraph (3) restates and limits the rule in Article 2 and common law on
22 termination of indefinite contracts. See *Zimco Restaurants, Inc. v. Bartenders &*
23 *Culinary Workers' Union, Local 340*, 165 Cal. App. 2d 235, 331 P.2d 789 (1958);
24 *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92 C 0911, 1993 WESTLAW
25 214164 (ND Ill. June 17, 1993); *Soderholm v. Chicago Nat'l League Ball Club*,
26 587 N.E.2d 517 (Ill. Ct. App. 1992). This assumes a contract of indefinite duration.

27
28 This rule is limited to cases where a party has on-going, affirmative
29 performance obligations to be rendered to the other party. These obligations may
30 include payment obligations (e.g., royalties) or affirmative conduct (e.g., repair or
31 maintenance). The premise here is identical to current Article 2.
32
33

1 **SECTION 2B-312. RIGHTS TO INFORMATION IN ORIGINATING**
2 **PARTY.**

3 (a) Except as otherwise provided in subsection (a), if an agreement requires
4 one party to deliver commercial, technical, or scientific information to the other for
5 its use in performing its obligations under the contract or obligates one party to
6 handle or process proprietary commercial data, including customer accounts and
7 lists, and the receiving party has reason to know that the information is confidential
8 and not intended for republication, the following rules apply:

9 (1) As between the parties, the information and any summaries or
10 tabulations based on the information remain the property of the party delivering the
11 information, or in the case of commercial data the party to whose commercial
12 activities the information relates, and may be used by the other party only in a
13 manner and for the purposes authorized by the agreement.

14 (2) The party receiving, processing, or handling the information and its
15 agents shall use reasonable care to hold the information in confidence and make it
16 available to be destroyed or returned to the delivering party according to the
17 agreement or the instructions of the delivering party.

18 (b) Except as otherwise provided in subsection (c), if technical or scientific
19 information is developed during the performance of the agreement, as between the
20 parties, the following rules apply:

21 (1) If information is developed jointly by the parties, rights in the
22 information are held jointly by both parties subject to the obligation of each to

1 handle the information in a manner consistent with protection of the reasonable
2 expectations of the other respecting confidentiality.

3 (2) If the information is developed by one party, the information is the
4 property of that party.

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

7 **Uniform Law Source:** None.

8

9 **Committee Votes:**

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

11

12

Reporter's Note

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

23

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

31

32 See *Hospital Computer Sys., Inc. v. Staten Island Hosp.*, 788 F. Supp. 1351 (D.N.J.
33 1992) (respecting a contract dispute over a data processing contract in which Staten
34 had a right to return of its information at the end of the contract; case assumed to be
35 controlled by Article 2).

36

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

4
5
6
7 [E. ELECTRONICS]
8

9
10 **SECTION 2B-313. ELECTRONIC VIRUSES.**

11 (a) In this section, "virus" means computer instructions intended by the
12 person including the instructions in information to operate in manner likely to
13 disrupt, damage, destroy, or interfere with use of a computer or communications
14 facility without the consent or permission of the owner and not authorized under
15 Section 2B-314 or 2B-716.

16 (b) Unless the circumstances clearly indicate that a duty of care could not
17 be expected, a party shall exercise reasonable care to ensure that its performance or
18 message when completed by it does not contain an undisclosed virus.

19 (c) The duty described in subsection (b) is owed solely to the other party to
20 the contract and, except with respect to a mass-market license involving delivery of
21 a copy of information on a physical medium by a merchant dealing in information
22 of the kind, is satisfied if language in a contract states that no action was taken to
23 ensure exclusion of a virus or that a risk exists that viruses have not been excluded.

24 (d) A party is not liable if the virus was introduced by a third party after the
25 party completed its performance or if the party injured by the virus failed to
26 exercise reasonable care to prevent or avoid loss.

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

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

13 **Uniform Law Source:** None.

14 **Committee Votes:**

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

28
29

Reporter's Notes:

1 1. This section describes a default rule that apportions contractual
2 obligations for excluding electronic viruses. Under current law, the contractual
3 basis for liability pertaining to viruses, if any, is unclear. In cases of delivered
4 diskettes or computers, virus claims against a vendor would fall within the implied
5 warranty of merchantability. The warranty of merchantability requires that a court
6 ask two questions. The first deals with whether the "extraneous code" falls within
7 normal expectations regarding the particular type of software or performance. If its
8 does not, there may be a breach of warranty. Perhaps, courts faced with the issue
9 would refer by analogy to cases dealing with food products for standards. The
10 second issue would ask whether the implied warranty was disclaimed. In most
11 transactions, merchantability is disclaimed. Disclaimers are effective in both the
12 mass market and the commercial marketplace. While a disclaimer would be
13 required to mention merchantability, it need not refer specifically to a virus risk.

14
15 In cases outside Article 2 (e.g., on-line systems), the basic standards would
16 be under common law. In some (but not all) States, that obligation engages a duty
17 to exercise reasonable and workmanlike care in performance. That standard has
18 never been litigated with respect to a virus.

19
20 **This Article does not deal with criminal law risks. In most States,**
21 **criminal law proscribes "knowing" introduction of viruses that damage the**
22 **computer system of another person. Article 2B does not alter the criminal and**
23 **related civil liability issues there, but merely sets out contract risk allocation.**
24

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

35
36 3. Reasonable care does not create absolute liability. It creates a flexible
37 standard that gauges the party's conduct against a variety of contextual
38 considerations. No requirement exists that a party take extraordinary steps to
39 preclude viruses in all cases. Thus, for example, in a situation where the rate of
40 new virus discovered is large and exceeds any reasonable testing or preventative
41 developments, compliance with reasonable activities suffices even if it fails to
42 discover all viruses. What the section requires is reasonable care, not superhuman
43 effort. Similarly, the standard varies depending on the party to whom it applies. A

1 producer that makes no effort to screen a virus from its packaged products would
2 not be acting in a reasonable manner. A retailer that receives pre-packaged
3 software for distribution cannot be expected to examine the diskettes in the boxes
4 and, while it has a duty of care, that duty does not require the impossible. It may
5 simply require warnings if the retailer becomes aware that viruses are contained in
6 products it is providing. On the other hand, a private individual with no expertise
7 may be acting reasonably even though it takes protective steps that are far below
8 what would be reasonable for a publisher.

9
10 4. Under subsection (c), in the mass market the reasonable care obligation
11 cannot be satisfied by a merchant in the particular type of information merely by
12 inclusion of language in a contract or in packaging. That language may have an
13 effect on determining the nature of the obligation in context, but cannot be a
14 complete disclaimer. This covers all mass market transactions and many other
15 commercial deals. It does not, however, apply to transactions on the Internet or in
16 other on-line media (access contracts) where it was thought that the need to satisfy
17 the obligation by conspicuous warnings was important to allow for multi-layered
18 development of this new distribution methodology. A party who is not a merchant
19 can satisfy the obligation by conspicuous warnings as can an Internet provider.

20
21 **Illustration 1:** Jane is a licensee in an access contract with AL. Jane posts
22 data to an AL bulletin board, but the data contains a virus. A DuPont employee
23 downloads the data and the virus. Damage is caused to the AL system and
24 DuPont system. Jane is liable to AL if she failed to exercise reasonable care to
25 exclude the virus. AL might be liable on the same basis to DuPont. The degree
26 of care required varies based on the nature of the parties and the like.

27
28 **Illustration 2:** The University of Houston creates a website at which parties
29 can for a fee download digital copies of faculty articles and books. Because it
30 lacks staff, Houston cannot make assurances about virus protection. It must
31 conspicuously indicate that no precautions are taken. If it does not, the duty of
32 care to which it is required to conform relates to the nature of the
33 circumstances, including general standard on the web.

34
35 **Illustration 3:** James, a college student, sets up a web site to distribute
36 information for a fee about policies at Union. He does not concern himself
37 about viruses. When the national political party downloads data from the site
38 and pays its fee, the data includes a virus placed there by a user of the system.
39 Whether James is liable for the resulting damages depends on the standard of
40 care for a person such as James. James could avoid liability by providing on
41 his initial screens that he has made no effort to exclude viruses.

42
43 **Illustration 4:** Vendor distributes an art database in a retail market through the

1 licensing diskettes to the general public. Arthur obtains a copy of the database
2 which has a virus. Vendor's license disclaimed any duty of care and any
3 liability for viruses. The disclaimer is ineffective; Vendor's liability hinges on
4 whether the virus came from or before its performance and whether it exercised
5 what would be a relatively high standard of care for the retail market. For the
6 retailer, the fact that the product was packaged and inaccessible indicates that
7 the duty of care that it may have could not include actively searching for
8 viruses in the software and that, therefore, it has no liability unless the facts
9 indicate awareness of the risk and a failure to warn the purchaser.

10
11 5. Subsection (d) limits the obligation to reasonable care in the party's
12 performance and not to control of subsequent activities. The following illustration
13 captures the issue:

14
15 **Illustration 5:** Novell transfers software to Distributor who is licensed to
16 integrate the software into a system with other software and hardware and then
17 distribute the system on the retail market. During the integration, a virus is
18 introduced by an employee of Distributor. The system is acquired by Thomas
19 Inc. and the virus causes damage to Thomas. Novell is not liable under this
20 section since the virus was not a result of its performance and came after it
21 completed its role. Distributor is liable if it failed to exercise reasonable care.

22
23 Subsection (d) also states a concept of fault based on exercise of care to avoid loss.
24 As with the primary obligation, the nature of the reasonable care duty varies with
25 the party and the type of transaction. IBM may have a high duty to screen viruses
26 in major software licenses it acquires, while a consumer may have no obligation in
27 acquiring software in a retail package over the counter.

28
29 6. Subsection (e) has two functions. The first clarifies that the duty of care
30 must be assessed against various background variables relating to the parties and
31 the context. The last sentence of the subsection attempts to provide a more
32 specific, safe harbor guidance for both parties. It indicates that commercially
33 reasonable software employed by a party or its agent satisfies the obligation if
34 applied on or before a particular point in time. The timing variable benefits both
35 parties by giving guidance in when actions are to be taken. In the world of virus
36 protection, new viruses are discovered continuously and this should not be taken as
37 creating a continuous, never capable of being satisfied obligation for either party.

38
39 7. Subsection (f) clarifies that liability for a virus is to be determined by
40 this section and the express contract terms, indicating that the issue does not come
41 within implied warranty theory. The rationale is that this is the more specific
42 section and sets out the balanced deemed appropriate in contrast to the absolute
43 liability risk that exists in an implied warranty.

1
2
3 **SECTION 2B-314. ELECTRONIC REGULATION OF**

4 **PERFORMANCE.**

5 (a) In this section, a "restraint" means a program, code, device or other
6 limitation that restricts use of information.

7 (b) A party entitled to enforce a limitation or restriction that does not
8 depend on the existence or non-existence of a breach may include in the
9 information and utilize a restraint that restricts use in a manner consistent with the
10 agreement if:

11 (1) a term in the contract authorizes use of the restraint;

12 (2) the restraint does not destroy or alter the information, but merely
13 prevents uses of the information inconsistent with the agreement, or with a
14 licensor's rights under intellectual property law and that were not granted to the
15 licensee.

16 (3) the information is obtained for a stated period of time not more than
17 30 [90] days or a stated number of uses and the restraint merely enforces that
18 limitation; or

19 (4) the restraint prevents use at the expiration of the term of the license
20 and the licensor gives reasonable notice to the licensee before further use is
21 prevented.

22 (c) Operation of a restraint authorized under subsection (a) is not a breach
23 of contract, and the party that included the restraint is not liable for any loss created

1 by its operation. Operation of a restraint which prevents use permitted by the
2 agreement is a breach of contract. Nothing in subsection (a)(2), (3), or (4)
3 authorizes a restraint that affirmatively prevents a licensee's access to its own
4 information accomplished without use of the licensor's information.

5 (d) This section does not preclude electronic replacement or disabling of an
6 earlier version of information by the licensor with a new version of the information
7 under an agreement with the licensee.

8 (e) A restraint included in information in accordance with this section or as
9 authorized under other law is not a virus for purposes of Section 2B-313.

10 **Uniform Law Source:** None

11

12 **Reporter's Notes**

13 *Changes Since the June, 1997 Meeting:*

14 This section was edited for clarity and several substantive changes were
15 made based on the discussion at the June, 1997 Drafting Committee meeting.
16 Included in the editing was the introduction of the defined term "restraint" to
17 simplify the reference to electronic limiting devices. The second sentence of
18 subsection (c) is new and in corresponds to a concern raised by a licensee
19 representative. It clarifies the focus of the section. With or without that language,
20 however, the concept would still be inherent. The time period in subsection (a)(3)
21 contains a bracketed alternative extending the 30 day period to 90 days to
22 correspond to practices in shareware and other industries.

23

24 *General Notes:*

25 1. This section deals with electronic limitations on use that involve
26 enforcement of contract terms by preventing breach. It does not involve electronic
27 devices used to make a repossession or force discontinuation of use in the event of
28 breach. Those are covered in Section 2B-716. The electronic restrictions discussed
29 here all derive from and enforce contract terms; they limit use consistent with
30 contract terms or terminate a license at its natural end. Of course, the electronic
31 regulation discussed here assumes that the licensor is enforcing a restriction that is,
32 itself, enforceable under applicable intellectual property and contract law that may
33 limit license terms in some cases. The few reported cases that deal with electronic

1 devices support use of electronic devices even in the case of breach if disclosed to
2 the licensee; the cases have not considered the less controversial use of restrictive
3 devices not associated with enforcing claims of breach of contract.

4
5 2. The basic principle is that a contract can be enforced. Where the
6 contract places time or other limits on a party's use of licensed information,
7 electronic devices that merely enforce those limitations are appropriate. This
8 reflects an important new capability created by digital information systems. The
9 section does not state exclusive rules. Federal or other law (including other sources
10 of contract law) may also allow limiting devices designed to enforce copyright and
11 copyright management information. In effect, this section contains an affirmative
12 statement of when such limiting devices are enforceable under contract law,
13 without limiting the enforceability of other methods.

14
15 3. Subsection (b) distinguishes between active and passive electronic
16 devices. An active device terminates the ability to make any further use of the
17 information. These are dealt with in subsection (b)(1), (3), and (4). Passive
18 devices merely prevent unauthorized use, but leave the subject matter otherwise
19 unaltered. These are dealt with in subsection (b)(2). The concept of an active
20 device.

21
22 4. Under subsection (b)(2) provides that for passive devices, special notice
23 is not required if the electronics merely restrict use without otherwise disabling the
24 information. This authorizes use of passive devices to enforce use limitations.
25 This is especially important for smaller suppliers whose ability to enforce contracts
26 against often larger licensees is limited by costs of monitoring and judicial
27 enforcement. The limitations, for example, might entail a counter which can be
28 used to monitor the number of simultaneous uses or restrict use to a pre-agreed
29 system. Although no notice is required, the agreement must support the electronic
30 limitation. The licensee is protected by the fact that a limitation inconsistent with
31 the agreement constitutes a breach of contract and that it has contracted for the
32 substantive limitation itself, while the device merely prevents breach.

33
34 **Illustration 1:** The license provides that no more than five users may employ
35 the word processing software at any one time. An electronic counter is
36 embedded in the software and, if a sixth user attempt to sign on for
37 simultaneous use, that sixth user is denied access until another user
38 discontinues use. This limiting device is effective without prior notice or
39 contractual authorization.

40
41 **Illustration 2:** The same situation as in Illustration 1, except that the limiting
42 device permanently disables the software if a sixth user attempts access. This
43 device is not authorized by subsection (b)(2). It involves a form of cancellation

1 for breach. Section 2B-716 applies.

2
3 **Illustration 3:** ABC Publishing includes an anti-copying device in a CD-ROM
4 version of its novel, "Gone with the Sea" which it licenses subject to express
5 terms precluding making additional copies of the work. The device allows
6 normal loading into memory and use relating to a computer system, but
7 prevents making an additional copy. No separate contract term is required to
8 authorize the device since it merely enforces a limitation in the contract and
9 does not otherwise disable the data.

10
11 5. Subsection (b)(2) allows use of passive devices that merely preclude
12 infringing intellectual property rights reserved to the licensor. Merely preventing
13 the act does not require contract or other notice. Thus, for example, a contract that
14 grants a right to make a back-up copy and to use a digital image, does not deal with
15 the right of the licensee to transmit additional copies electronically. A device that
16 precludes communication of the file electronically, but does not alter or erase the
17 image in the event of an attempt to do so is authorized under (b)(2).

18
19 6. The devices described in subsection (b)(3) and (4) may be passive or
20 active. Since this section deals only with cases where no breach of contract occurs,
21 the contractual right to do this arises only in the event of termination pursuant to
22 contractual terms. Subsection (b)(3) and (4) state the basic principle in such cases.
23 Creation and use of the electronic means to terminate a contract (end it other than
24 for breach) requires either a contractual term that permits the action subsection
25 (b)(1), a short term contract subsection (b)(3), or reasonable notice before
26 termination. If notice is required, of course, it can come directly from the licensor
27 (a letter, e-mail, or telephone call) or through operation of the electronic restraint.

28
29 The exception to the notice rule focuses on short term agreements, such as
30 shareware or trial copies, or the new Java-based software modules whose use is
31 limited to a brief period of time or to a stated number of uses. The argument for
32 requiring consent or notice in longer term agreements deals with avoiding problems
33 due to stale information. In the brief contracts, that is not an issue. The subsection
34 dealing with this issue employs thirty days as the cut-off based on the fact that this
35 is a common period in so-called shareware or limited use demonstration systems.
36 This provision would also apply to various pay per view and similar systems, since
37 it reflects the ability to enforce short term limitations on service or use through
38 electronic devices without specific or special notice other than that inherent in the
39 contract itself.

40
41 Some argue that enforcing a contractual right not associated with breach
42 should not require notice in any case. Ending the ability to use after the term
43 merely enforces the agreement. Although that position has strength, the choice

1 here establishes additional licensee protection and limits the right to enforce
2 contract termination on the argument that a licensee might be disadvantaged by
3 being forced to strictly stay within contract limits in the absence of a contract term
4 indicating the enforcement tool was present. Notice may occur either in the terms
5 of the contract itself or in actions of the licensor or the electronic system giving
6 notice to the licensee before precluding further use. Code that precludes further use
7 of a program after one year would be effective under this section if either the
8 contract provides for electronic enforcement of the one year term or the code itself
9 displays notice of the impending termination a reasonable time before
10 implementing it (e.g., five days before the end of the term).

11
12 **Illustration 4:** A software license requires monthly payments of \$1,000 due on
13 the first of the month and covers a one year term with a right to renew based on
14 written notice before the expiration of the term. Licensee makes a payment five
15 days late because of accounting problems. Licensor uses an electronic device
16 to turn off the software. That action is not authorized under this section since it
17 enforces a breach of contract. The section on self-help applies and the action
18 may be appropriate if the breach was material.

19
20 **Illustration 5:** In Illustration 4, there was no late payment, but the licensee
21 fails to give notice of renewal within the contractual time period. Licensor
22 turns off the software. This action is covered by this section. The termination
23 electronically is valid if either the contract contained a term authorizing that
24 action, or the licensor or the device gave prior, reasonable notice of termination
25 to the licensee.

26
27 6. Subsection (c) states the obvious premise that actions consistent with a
28 contract are not a breach and do not give rise to liability under this Article or the
29 contract. What this section permits is enforcement of contract terms with respect to
30 the subject matter of the contract. It does not deal with rights to exclude, block out,
31 or otherwise impact other information owned by or licensed to the licensee.

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PART 4
WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING
AUTHORITY AND NONINFRINGEMENT.

(a) A licensor warrants that:

(1) the licensor has authority to make the transfer and that the licensor and any person holding a claim or interest created by an act of the licensor or to which the licensor is subject will not interfere with the licensee's enjoyment of its rights under the contract, except that this warranty does not relate to third party claims by way of infringement;

(2) in an exclusive license, the intellectual property rights that are the subject of the license are valid and exclusive to the licensor within the scope of the license for the information delivered as a whole; and

(3) if the licensor is a merchant regularly dealing in information of the kind, the licensor at the time of the transfer has no reason to know that the transfer, any copies transferred by the licensor, or the information, when used in any authorized use, infringes an existing intellectual property right of a third party except as disclosed to or known by the licensee.

(b) The warranties in this section are subject to the following:

(1) The warranty under subsection (a)(3) does not apply to a license of a patent accomplished without any agreement by the licensor to provide to the licensee property or services to enable the licensee to use the patented rights.

1 (2) If intellectual property rights are subject to a right of public use,
2 collective administration, or compulsory licensing, the warranty is subject to those
3 rights.

4 (3) Unless the contract expressly applies to uses or rights outside the
5 United States, the warranties under subsection (a)(2) and (3) apply solely to rights
6 arising under the intellectual property laws of the United States or a State thereof.
7 If the license of an intellectual property right expressly includes territories outside
8 the country of its origin, the warranties under subsection (a)(2) and (3) extend only
9 to countries specifically named in the license and countries included in the license
10 but not named that, at the time of the license, had entered into a treaty or other
11 binding international obligation granting the foreign intellectual property right
12 protection under the applicable intellectual property law.

13 (c) A licensee that furnishes technical specifications to a licensor or
14 financier holds the licensor and financier harmless against any claim of
15 infringement which the licensee had reason to know would arise out of compliance
16 with the specifications.

17 (d) A warranty under this section may be disclaimed or modified only by
18 express language or by circumstances giving the licensee reason to know that the
19 licensor does not warrant that competing claims do not exist or that the licensor
20 purports to transfer only the rights that it has. In an electronic transaction that does
21 not involve review of the record by an individual, language is sufficient if it is
22 conspicuous as to that term. Otherwise, language in a record is sufficient if it states

There is no warranty against third party claims that may interfere with the licensee's enjoyment of the [information] [computer program] or against infringement, or words of similar import.

Uniform Law Source: Section 2A-211; Section 2-312. Revised.

Committee Votes:

1. Voted to adopt a "reason to know" standard in lieu of "knowledge."
2. Rejected a motion to bar disclaimer in "mass market" contracts.

Selected Issues:

1. Should subsection (a)(1) be modified to conform to the language of current or revised Article 2A?

Reporter's Notes

Changes since the June Meeting:

1. Article 2B uses a reason to know standard for the warranty of infringement for both licensors and licensees, **but** expands the scope of the licensor warranty by including use of the information. In its initial review of the warranty, the Committee supported the proposed trade-off as a proper balance for a default rule. Concerns, however, have been expressed about both the standard and the expansion. The Reporter is developing a proposal for an alternative to the Draft which: (1) returns to the Article 2 warranty for copyright infringements with the absolute liability rule but narrower scope; (2) makes special accommodation for patent licenses and public use rights; and (3) accommodation for the situation of a provider that is merely a conduit for information provided by third parties.

The ultimate issue here, as in other default warranties does not lie solely in determining an appropriate risk allocation in the abstract, but also incorporates a decision about whether the default rules should construct a fair and manageable system that may eliminate the need for disclaimers supplanted by express and differently defined warranty obligations.

2. The language of the safe harbor disclaimer was modified as a result of the harmonization meeting to correspond to the language adopted in Article 2A. A further question arises about whether the subsection (a)(1) language should be modified to follow Article 2A or whether a separate policy supports the different phrasing and apparently different substance of this warranty.

1 3. The first sentence of subsection (b)(3) was added to clarify the scope of
2 the warranty in the ordinary case in which a licensor does not undertake worldwide
3 or similar obligations. A Texas licensor making a license for use in the State of
4 Oklahoma should not undertake to have made a worldwide patent and copyright
5 search.

6
7 4. A former proposed alternative B providing for an indemnity obligation
8 was deleted. As discussed in the June Meeting, the indemnity language in the
9 remedy section may be modified to deal with the issue as a remedy.

10
11 *General Notes:*

12 1. This section creates a warranty of quiet enjoyment and right to continue
13 in possession of property over the term of a contract; this extends the warranty
14 rights creates under Article 2 in current law, which center solely on the initial
15 delivery of the property.

16
17 2. Subsection (a) contains the affirmative warranties. Subsection (a)(1)
18 deals with issues other than intellectual property infringement. First, the licensor
19 represents it has authority to make the transfer. Authority here would refer to
20 possible defects in the chain of title or authorization. For example, if a licensee
21 holds information under a non-transferable license, a transfer to another licensee
22 occurs without authority and, thus, breaches this warranty. Second, the licensor
23 warrants that it will not interfere with the licensee's exercise of rights under the
24 contract. The combination of these two subsections takes language from Article 2
25 (authority) and Article 2A (interference and enjoyment), making the resulting
26 warranty broader than either of the other two articles. Authority and non-
27 interference represent the essence of the contract. See *General Talking Pictures*
28 *Corp. v. Western Electric Co.*, 304 U.S. 175, 181 (1938); *Spindelfabrik*
29 *Suessen-Schurr v. Schubert & Salzer*, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert.
30 den. 484 U.S. 1063 (1988).

31
32 3. **Subsection (a)(2) and (3) deal with intellectual property risks. In**
33 **current law, the idea of title has several different connotations. The issues can**
34 **be broken down into three parts:**

35
36 **Public Domain Risk: Whether enforceable rights exist in the technology**
37 **that is transferred. In essence, this asks whether the information is in the**
38 **public domain and thus useable by anyone with access to it.**

39
40 **Exclusivity Risk: Whether the transferor has the sole right to transfer the**
41 **technology or whether that right is also held by third parties by way of**
42 **prior assignment, joint invention or coauthorship.**

1 **Infringement Risk: Whether the transferor can convey the rights defined**
2 **in the contract in a way that enables the transferee to exercise those rights**
3 **without infringing third party rights in the technology.**
4

5 4. Subsection (a)(2) deals with the first two of these. Subsection (a)(2)
6 refers to validity and exclusivity and limits those warranties to situations in which
7 the transfer purports to convey exclusive rights in the information. If the transferee
8 relies on the rights transferred to create a product for third parties, affirmations
9 about validity define an important aspect of the deal since the converse of validity
10 is that the information is in the public domain. M. Nimmer & D. Nimmer, *The Law*
11 *of Copyright* ¶ 10.13[A]. See *M&A Assoc. v. VCX*, 657 F.Supp. 454 (E.D. Mich.
12 1987), *aff'd*, 856 F.2d 195 (licensor's failure to place appropriate copyright notices
13 on motion picture violated warranty of title). Validity (including public domain) is
14 typically not relevant to the ordinary end user license. The subsection also deals
15 with exclusivity. The title risk includes that a **portion** of the rights may be vested
16 in another person. Coequal rights exist where co-authors or co-inventors were
17 involved. Alternatively, the transferor may have executed a prior license to a third
18 party. In either case, while a transfer may convey rights, it may be no more than
19 equal to rights vested in and available for conveyance by the third party co-author.
20 Depending on the underlying deal, the existence of coequal rights in other parties
21 may have no relevance to the transferee or it may be a critical limit on the
22 licensee's ability to recoup investment. Subsection (a)(2) reflects practice in
23 motion picture and publishing industries and is an appropriate warranty for those
24 settings. Exclusivity is an important issue where a licensee undertakes significant
25 investment on the assumption that its rights are exclusive as to other competitors.
26 As to **end users and non-exclusive licenses**, the question of whether intellectual
27 property rights are **exclusive** in the licensor is seldom significant. The presence or
28 absence of exclusivity in the provider of the information does not alter the end
29 user's ability to continue to use the licensed rights without challenge from third
30 parties. A license from one co-owner adequately grants rights to the licensee and
31 the dispute would then shift to one between the two co-owners to determine
32 accounting for and distribution of the proceeds of the license.
33

34 5. The subsection (a)(3) warranty relating to infringement risk goes beyond
35 current Articles 2 and 2A in terms of what is warranted, but uses a reason to know
36 standard of liability, rather than an absolute liability standard. Current UCC
37 § 2-312 provides that every sale contains an implied warranty that the seller has
38 "good title" to the property conveyed. This does not establish a warranty that **use**
39 will not violate a patent held by a third party. *Motorola, Inc. v. Varo, Inc.*, 656 F.
40 Supp. 716 (N.D. Tex. 1986). The warranty applies to the condition of the **goods**
41 when delivered, not the use of the product. Section 2A-211 speaks not in terms of
42 good title, but of an implied warranty that for lessors who are merchants in the
43 particular type of property, "the goods are delivered free of the rightful claim of

1 any person by way of infringement or the like. In Article 2B, the warranty of
2 noninfringement covers not only the information as delivered, but the information
3 as used. The expansion gives the licensee greater protection against process
4 patents and against the fact that "copies" made during ordinary use of software in a
5 machine may infringe a copyright. Neither of these assurances exists in current
6 law.

7
8 Balancing against this, the warranty establishes a "no reason to know"
9 standard. This does not impose a duty of inquiry, but relates only to facts actually
10 known to the party. The choice between a "reason to know" and an absolute
11 liability warranty requires a balancing of the interests of the licensor and licensee in
12 an ordinary case where infringement claims may arise without fault of either party.

13 Both in copyright and patent infringement claims, the complexity of the
14 technology, the diverse sources from which it arises and character of modern
15 infringement claims that do not admit of good faith purchase and do not require
16 knowledge of infringement all create significant risk in the modern commercial
17 environment. The choice made here places knowing misconduct risk on the
18 licensor, but in cases where neither party had knowledge that an infringement
19 would ensue, to allows loss to stay with the licensee if it is the party sued unless the
20 contract reverses that allocation. No knowledge warranties are common in modern
21 licensing. Note that this does not alter current intellectual property law which
22 recognizes neither a concept of bona fide purchaser defense to infringement, nor a
23 lack of knowledge defense. Thus, in the case of a merchant who does not know
24 about the infringement, either the licensee or the licensor may have infringement
25 liability and this warranty will not redistribute the loss. Redistribution if it occurs,
26 requires an express warranty.

27
28 Part of the difficulty involves the fact that patents are not knowable or
29 readily checked by the myriad of small producers in this market place and that,
30 therefore, an absolute warranty would place liability exposure on them without an
31 effective means of protection.

32
33 **Illustration 1:** Sunspot Software develops a multi-terminal operating system
34 for Citibank. After installation of the system, a patent issues to Lansing which
35 patent reads on the process created by the Sunspot program. If the warranty
36 refers to "reason to know", Citibank bears the loss since an unissued patent
37 could not be known. If the warranty applies without knowledge, Sunspot bears
38 the loss so long as the warranty extends to uses of the software.

39
40 7. The issue is especially important in on-line systems where the licensor
41 may be providing a service that includes allowing the posting and subsequent
42 downloading of material from third parties. Case law under copyright indicate that,
43 in some cases, the vendor may be liable for infringement, but that this liability does

1 not exist in all cases. The issue here is whether a reason to know standard best
2 serves in our context.

3

4 **Illustration 2:** Adam opens an Internet website providing access for a fee to
5 photographs of football players for three cents a piece, not restricting the use of
6 the photographs by its licensees. The photographs are supplied by third parties
7 in digital form to Adam. Alumni Magazine acquires a photograph of Jones and
8 uses it in its May issue, distributed to 10,000 subscribers. Jones and the
9 photographer, who never consented to Adam's use, sue Magazine which in
10 return sues Adam for \$100,000. Should Adam be liable for breach of contract
11 and consequential damages in addition to any liability for copyright
12 infringement?

13

14 8. Subsection (b)(3) deals with application of the warranty rules in light of
15 international intellectual property law. It extends a "worldwide license"
16 infringement and exclusivity warranty to countries named in the license and
17 countries that are party of the copyright or other mutual recognition conventions or
18 treaties.

19

20

21 **SECTION 2B-402. EXPRESS WARRANTIES.**

22 (a) Subject to subsection (c), a licensor creates an express warranty as
23 follows:

24 (1) An affirmation of fact, promise, or description of information made
25 by the licensor to its licensee in any manner, including in a medium for
26 communication to the public such as advertising, which relates to the information
27 and becomes part of the basis of the bargain creates an express warranty that the
28 information and any services required under the agreement will conform to the
29 affirmation, promise, or description.

30 (2) A sample, model, or demonstration of a final product which is made
31 part of the basis of the bargain creates an express warranty that the performance of
32 the information will reasonably conform to the performance illustrated by the

1 model, sample, or demonstration, taking into account such differences between the
2 sample, model, or demonstration and the information as it would be used as would
3 be apparent to a reasonable person in the position of the licensee.

4 (b) The licensor need not use formal words, such as "warranty" or
5 "guarantee", or state a specific intention to make a warranty. However, a mere
6 affirmation or prediction of the value of the information, a display of a portion of
7 the information to illustrate the aesthetics or market appeal of informational
8 content, or a statement purporting to be the licensor's opinion or commendation of
9 the information does not create a warranty.

10 (c) This section does not create any express warranty for published
11 informational content, but does not preclude the creation of an express warranty for
12 published informational content under other law.

13 **Uniform Law Source:** Section 2A-210; Section 2-313.

14

15 **Committee Votes:**

16 1. Deleted former subsection (b) that warranties are limited to the time of
17 transfer based on the argument that this merely restates current law and that the
18 issue can be made clear in the Comments.

19 2. Motion to limit this section to the immediate parties, allow other parties to
20 be included if courts decide to do so. Rejected: 4-5

21 3. Motion to amend by adding "except for published informational content"
22 with the Comments or the section to make it clear that it's neutral on the law
23 development here. Adopted: 7-3.

24 4. Motion to change the presentation of the except clause for published
25 informational content, making an affirmative statement in subsection (c) that leaves
26 the development of obligations for informational content to common law under
27 standards evolved therein. Adopted: 6-2 (June, 1997)

28

29 Reporter's Note:

30 *Changes Since the June, 1997 Meeting:*

1 1. New subsection (c) implements the Committee vote clarifying that the
2 Article is neutral on the basis for the creation of express obligations for published
3 content, leaving that issue to other law.

4
5 *General Notes*

6 1. This section adopts existing law. It follows current Article 2 regarding
7 express warranties in general and preserves current law relating to express warranty
8 obligations in reference to published information content.

9
10 2. The section retains the “basis of the bargain” standard from current law
11 relating to transactions in goods. This allows courts and parties to draw on an
12 extensive body of case law for distinguishing express warranties from puffing and
13 other, non-enforceable statements. While the cases involve many difficult factual
14 determinations, they provide better guidance than would an entirely new standard.
15 See, e.g., *Fargo Machine & Tool Co. v. Kearney & Trecker Corp.*, 428 F. Supp.
16 364 (E.D. Mich. 1977); *Computerized Radiological Service v. Syntex*, 595 F.Supp.
17 1495 (E.D.N.Y. 1984), rev’d on other grounds, 786 F.2d 72 (2d Cir. 1986);
18 *Management Sys. Assocs. v. McDonnell Douglas Corp.*, 762 F.2d 1161 (4th Cir.
19 1985); *Consolidated Data Terminal v. Applied Digital Systems Inc.*, 708 F.2d 385
20 (9th Cir. 1983) (“the express statements warranting that the Regent 100’s would
21 perform at a 19,200 baud rate prevail over the general disclaimer.”); *Cricket Alley*
22 *Corp. v. Data Terminal Systems, Inc.*, 240 Kan. 661, 732 P.2d 719 (Kan. 1987)
23 (express warranty that cash registers would communicate with a remote computer;
24 “capability to communicate with plaintiff’s Wang computer was the prime
25 consideration in selecting new cash registers.”). By retaining current Article 2,
26 Article 2B allows courts to use the full panoply of doctrines that they have evolved.

27
28 In proposed revisions of Article 2, an extended debate and new structure has
29 developed for warranties through advertising. That debate was triggered in part by
30 the adoption of an entirely new approach to warranties in in that proposal.
31 Subsection (a)(1) makes clear that advertising can create an express warranty if the
32 basis of the bargain test is met. Article 2B clarifies appropriate law on this point.
33 No conceptual barrier exists to a published statement becoming part of the bargain
34 sufficient to constitute a warranty.

35
36 3. Subsection (a)(2) deals with samples and the use of beta models. These
37 are employed in testing not yet completed products. A beta model may include
38 elements that are not carried into the final product and may include defects that are
39 not cured in the final product. In either event, the parties both expect that the
40 product being demonstrated or used is not representative of what will eventually be
41 the product and the exclusion here is designed to protect against harm to either
42 party as a result (e.g., licensee believes a defect will be cured, but it is not cured;
43 licensor elects to delete an element in the test model when it produces the eventual

1 product).

2

3 4. The section also preserves current law for published informational

4 content. While there are many reported cases dealing with express warranties in

5 the context of goods and using the standards outlined here, no such case law exists

6 for published information. This subject matter entails significant First Amendment

7 interests and courts that deal with liability risk pertaining to that subject matter

8 must balance contract themes with more general social policies. As stated in

9 subsection (c), the intent is to leave undisturbed any existing law dealing with

10 under what obligations can be created and how they are established with reference

11 to published information. Courts may, if inclined to find liability for published

12 information, do so under any general contract law theory. Merely adopting Article

13 2 concepts from sales of goods to this much different context would risk a large and

14 largely unknown change or over-reaching of liability in a sensitive area.

15

16 5. The term, "published information content" focuses on information

17 **content** not customized to particular end users (see Section 2B-102). The

18 exclusion follows current law, requiring more than just general, undifferentiated

19 statement for expanding liability in the public market of ideas and content. The

20 basic assumption in current law is that liability for information content does not

21 exist unless there is a special or direct relationship creating it. There are no cases

22 using warranty theory for generally distributed information based on contract

23 concepts and only a small number of cases under other contract theory.

24

25

26 **SECTION 2B-403. IMPLIED WARRANTY: MERCHANTABILITY AND**

27 **QUALITY OF COMPUTER PROGRAM.**

28 (a) Subject to Sections 2B-406, 2B-407, and 2B-408, in a mass-market

29 transaction a licensor that is a merchant with respect to information of the kind that

30 provides a computer program to a licensee makes an implied warranty that the

31 computer program and media are merchantable. To be merchantable, the computer

32 program and any physical medium containing the program at minimum must:

33 (1) pass without objection in the trade under the contract description;

34 (2) be fit for the ordinary purposes for which it is distributed;

1 (3) conform to the promise or affirmations of fact made on the container
2 or label, if any;

3 (4) in the case of multiple copies, consist of copies that are, within the
4 variations permitted by the agreement, of even kind, quality, and quantity, within
5 each unit and among all units involved; and

6 (5) be adequately packaged and labeled as the agreement or
7 circumstances may require.

8 (b) In cases not governed by subsection (a), a licensor that is a merchant
9 with respect to computer programs of that kind and delivers a program to a licensee
10 warrants that any physical medium on which the program is transferred is
11 merchantable and that the computer program will perform in substantial
12 conformance with any promises or affirmations of fact contained in the
13 documentation provided by the licensor at or before the delivery of the program.
14 However, a mere affirmation or prediction of the value of the information, a display
15 of a portion of the information to illustrate the aesthetics or market appeal of
16 informational content, or a statement purporting to be the licensor's opinion or
17 commendation of the information does not create a warranty.

18 (c) A warranty under this section pertains to the functionality of a computer
19 program, but does not pertain to informational content in software, or to the quality,
20 aesthetic appeal, marketability, accuracy, or other characteristics of the
21 informational content.

22 **Uniform Law Source:** Section 2-314. Revised.

1
2 **Committee Votes:**

3 1. Rejected a motion to add language warranting that the program will not
4 damage ordinary configured systems because no "ordinary system" exists in
5 modern licensing and the general premise is covered under the language of existing
6 Article 2 as brought forward here.

7 2. Voted 10-2 to use "mass market" in this section, rather than "consumer."
8 (Feb. 1997)

9
10 Reporter's Notes

11 *Changes since the June Meeting:*

12 1. Edited based on the harmonization meeting to conform to existing
13 Article 2 and to proposed revisions of Article 2. Subsection (c) was edited to
14 clarify the distinction between the warranty for programs and the treatment of
15 informational content.

16
17 2. During the June Meeting in a memorandum signed by a leading
18 consumer advocate and an attorney from a major publisher, the following
19 alternative formulation of subsections (a) and (b) was suggested:

20
21 (a) A merchant licensor of a computer program warrants to the end user
22 that the computer program is reasonably fit for the ordinary purpose for which
23 it is distributed.

24
25 (b) A merchant licensor of a computer program warrants to a retailer that

26
27 (1) the program is adequately packaged and labeled as the agreement or
28 circumstances may require; and

29
30 (2) in the case of multiple copies, that the copies are, within the
31 variations permitted by the agreement, of even kind, quality, and quantity,
32 within each unit and among all the units involved.

33
34 This proposal should be considered by the Committee and reflects earlier proposals
35 in the Draft to consider a restructuring of the merchantability warranty in a manner
36 that would provide acceptable and tailored protections for both sides, thereby
37 reducing the desirability of disclaimers except in exceptional cases. The proposal
38 follows part of the tradition under which the original Article 2 warranty was
39 developed. As explained in the Comments to the current Section 2-314, some of
40 the various elements of the warranty were developed for specific types of products
41 (e.g., "fair average" developed with reference primarily for agricultural bulk
42 products, "adequately packaged" refers to cases where agreement requires a certain

1 type of container).

2

3 *General Notes:*

4 1. Article 2B warranties blend three different legal traditions. **One**
5 tradition stems from the UCC and focuses on the quality of the product. This
6 tradition centers on the **result** delivered: a product that conforms to ordinary
7 standards of performance. The **second** tradition stems from common law, including
8 cases on licenses, services contracts and information contracts. This tradition
9 focuses on how a contract is performed, the **process** rather than the result. The
10 obligations of the transferor are to perform in a reasonably careful and
11 workmanlike manner. The **third** tradition comes from the area of contracts dealing
12 with informational content and essentially disallows implied obligations of
13 accuracy or otherwise in reference to information transferred outside of a special
14 relationship of reliance. Current law selects the applicable tradition in part based
15 on characterizations about whether a transaction involves **goods** or not. That
16 distinction is not reliable in information contracting, especially in light of the
17 ability to transfer intangibles electronically without the use of any tangible property
18 to carry the intangibles.

19

20 2. This section and the next following section define the basis on which the
21 different traditions apply, focusing on a distinction between "computer programs"
22 and services or informational content. This expands the scope of the quality
23 warranty here by including at least some cases where a court would otherwise
24 conclude that the transaction is actually a services contract. See, e.g., *Micro-*
25 *Managers, Inc. v. Gregory*, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988);
26 *Data Processing Services, Inc. v. LH Smith Oil Corp.*, 492 N.E.2d 314 (Ind. Ct.
27 App. 1986); *Snyder v. ISC Alloys, Ltd*, 772 F.Supp. 244 (W. D. Pa. 1991) (license of
28 manufacturing process described as "services"). Compare *Hospital Computer*
29 *Systems, Inc. v. Staten Island Hospital*, 788 F. Supp. 1351 (D.N.J. 1992); *The*
30 *Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp.*, 817 F. Supp.
31 235 (D. N.H. 1993)

32

33 3. The two implied warranties are not mutually exclusive and, in many
34 cases, both will apply to the same transaction and the same digital product (e.g., an
35 encyclopedia). In the final Comments to the statute, notes will be developed
36 containing illustrations indicating the manner in which the warranties work
37 together.

38

39 **Illustration 1:** Party A contracts to transfer software to Party B that will allow
40 B to process its accounts receivable. Whether the transfer is by diskette or by
41 electronic conveyance into B's computer, the implied warranty in this section
42 applies. **Under current law, this would be a transaction in goods with an**
43 **implied warranty attached to the performance of the product.**

1
2 **Illustration 2:** Party A licenses Party B to use a copy of the Marvel
3 Encyclopedia. This warranty applies to the computer program and diskette,
4 while Section 2B-404 applies to the content of the encyclopedia. **Under**
5 **current law, this would be an information contract most likely involving no**
6 **warranty about the accuracy of the information.**
7

8 **Illustration 3:** Party A reaches a license with Party B. Party A will transfer its
9 data to B's computer for processing there. B agrees to return various reports
10 and summaries to A. The Section 2B-403 warranty does not apply since the
11 contract did not deliver a computer program to A, but use of B's facility.
12 **Under current law, most cases hold that this is a services contract**
13 **containing at most a warranty of workmanlike conduct; it is governed here**
14 **under general standards of contract and by the implied warranty in**
15 **Section 2B-404.**
16

17 4. Merchantability sets the standard for computer programs in the mass
18 market, where the idea of comparing a particular program to other mass market
19 programs of similar type. This Draft uses a substantial conformance to
20 documentation standard for non-mass market software. That warranty is common
21 in commercial licenses. The prevalence in commercial cases of disclaiming
22 merchantability is such that virtually no software cases dealing with that warranty.
23 The reliance on conformance to documentation reflects the wide range of variations
24 involved in the non-mass market. The two standards both give assurances of
25 quality, but focus on different reference points. Merchantability asks what are
26 normal characteristics of ordinary products of this type, while the documentation
27 warranty focuses on the manuals and contours of the particular product. Beside
28 conforming to ordinary commercial practice (e.g., disclaim merchantability and
29 give substantial conformance warranty), the substantive question here deals with
30 whether merchantability is a relevant standard and at all protective in cases where
31 software is often relatively unique. For example, assume a commercial computer
32 program that provides data compression functions on an ABC computer with an
33 XYZ operating system. Merchantability would ask whether that product passes
34 without objection among all data compression products of all types (e.g., mass
35 market, Windows-based, Apple systems, etc.) even though the particular
36 environment, approach and capabilities of this product may be unique. How that
37 standard protects the licensee is not clear and in fact it may set out standards well
38 below what the documentation provides.
39

40 5. Most agreements disclaim merchantability; there are few reported
41 commercial cases involving merchantability in any industry. Most licenses
42 substitute a warranty of conformance to documentation. The section treats this as
43 the presumed warranty, conforming to a commercial norm. This warranty measures

performance by reference to what is said about the particular product. The argument in favor of retaining a merchantability warranty for transactions is that it would maintain a congruence between this article and Article 2 and 2A. This may be ephemeral and could be reversed: those articles should adapt to commercial practice. Merchantability measures performance obligations by reference to other like products, while the documentation warranty measures performance by what the licensor says about its product.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Subject to Sections 2B-406, 2B-407, and 2B-408, and to subsections (b) and (c), a merchant that provides informational content in a special relationship of reliance or services in collecting, compiling, transcribing, processing, or transmitting informational content, warrants to its licensee that there is no inaccuracy in the informational content caused by its failure to exercise reasonable care and workmanlike effort in its performance.

(b) A warranty does not arise under subsection (a) for:

(1) the aesthetic value, commercial success, or market appeal of the content;

(2) published informational content;

(3) informational content in manuals, documentation, or the like, which is merely incidental to a activation of rights and does not constitute a material portion of the value in the transaction; or

(4) informational content prepared or created by a third party, if the party distributing the information, acting as a conduit, provided only editorial

1 services with respect to the content and made the informational content available in
2 a form that identified it as being the work of the third party, except to the extent
3 that the lack of care or workmanlike effort that caused the loss occurred in the
4 party's performance in providing the content.

5 (c) The liability of a third party that provides the informational content is
6 not avoided by the use of a conduit described in subsection (b)(4) or by the fact that
7 the conduit is not liable for errors under that subsection.

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

9

10 Reporter's Notes

11 *Changes Since the June Meeting:*

12 1. The former second sentence of subsection (a) was deleted and the
13 concept will be covered in the Comments to the effect that the warranty is not
14 breached merely because the performance does not yield a result consistent with
15 the objectives of the licensee or because the informational content is not accurate or
16 is incomplete.

17

18 *General Notes:*

19 1. This section creates a warranty applicable to consulting, data processing,
20 information content, and similar contracts involving an information provider or
21 processor dealing directly with a client and, with respect to content, where the
22 provider tailors or customizes its information for the client's purposes or being in a
23 special relationship of reliance with that client. The warranty reflects case law on
24 information contracts. In *Milau Associates v. North Avenue Development Corp.*, 42
25 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (NY 1977), for example, the New
26 York Court of Appeals rejected a UCC warranty of fitness for a purpose in a
27 contract for the design and installation of a sprinkler system. "[Those] who hire
28 experts for the predominant purpose of rendering services, relying on their special
29 skills, cannot expect infallibility. Reasonable expectations, not perfect results in
30 the face of any and all contingencies, will be ensured under a traditional negligence
31 standard of conduct . . . unless the parties have contractually bound themselves to a
32 higher standard of performance . . ."

33

34 2. *Restatement (Second) of Torts* § 552 regarding negligent
35 misrepresentation provides a framework. It states that: "One who, in the cause of

1 his business, profession or employment, or in any other transaction in which he has
2 a pecuniary interest, supplies false information for the guidance of others in their
3 business transactions, is subject to liability for pecuniary loss caused to them by
4 their justifiable reliance on the information, if he fails to exercise reasonable care
5 or competence in obtaining or communicating the information.¶

6
7 In most States, this liability does not exist in the absence of a ¶special
8 relationship¶ between the parties justifying a duty of reasonable care. See *Daniel*
9 *v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news
10 service not liable to customer; distribution was more like a newspaper than
11 consulting relationship); *A.T. Kearney v. IBM*, ¶ F.3d ¶ (9th Cir. 1997). The
12 obligation consists of a commitment that the content provided will not be wrong
13 due to a failure by the provider to exercise reasonable care. *Rosenstein v. Standard*
14 *and Poor's Corp.*, 1993 WL 176532 (Ill. App. May 26, 1993) (license of index;
15 liability for inaccurate number tested under *Restatement* concepts in light of
16 contractual disclaimer; information, although handled in commercial deals is not a
17 product taking it outside this *Restatement* approach). Under *Restatement* case law,
18 the obligation is limited to cases involving a special or fiduciary relationship.
19 Under subsection (a) the obligation does not center on delivering a correct result,
20 but on care and effort in performing. A contracting party that provides inaccurate
21 information does not breach unless the inaccuracy is attributable to fault on its part.
22 See *Milau Associates v. North Avenue Development Corp.*, 42 N.Y.2d 482, 398
23 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); *Micro-Managers, Inc. v. Gregory*, 147
24 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Liability under the *Restatement* for
25 inaccurate information exists only if the information was intended or designed to
26 guide the business decisions of the other party. This section is not limited to cases
27 involving business guidance.

28
29 3. The cases largely exclude liability for information distributed to the
30 public. This concept is captured by the term ¶published informational content¶ in
31 subsection (b)(2). ¶Published informational content¶ refers to information made
32 available without being customized for a particular business situation of a
33 particular licensee and where no ¶special relationship¶ of reliance exists between
34 the parties. It is material made available in a standardized form to a public defined
35 by the nature of the material involved. The information is not tailored to the
36 client's needs. This definition and the liability exclusion reflects the vast majority
37 of case law under the *Restatement* and modern values of not inhibiting the flow of
38 content. The policy values supporting this stem in part from First Amendment
39 considerations, but also from ingrained social norms about the value of information
40 and of encouraging its distribution.

41
42 **Illustration 1:** Sam opens a website making available information on
43 restaurants for a small monthly fee for subscribers. One item of information

1 concerning Restaurant A is incorrect and a subscriber has a bad experience
2 because of the error. Sam's website contains published informational content
3 and creates no warranty or resulting liability. The same would be true of a
4 restaurant review in the New York Times.

5
6 **Illustration 2:** Sam, an expert on restaurants, contracts with Able to provide
7 advice about which restaurants should be included in Able's book on the "most
8 profitable" Chicago restaurants. Sam makes a negligent error in providing a
9 list of restaurants. Sam has liability under this warranty as to Able since the
10 information is not "published informational content" but was tailored to the
11 specific purposes of the specific client. When the book is published, however,
12 no warranty exists for either provider since the book is published informational
13 content.

14
15 4. Subsection (b) lists situations in which the warranty does not arise under
16 current law. Subsection (b)(1) clarifies that this is not a warranty of aesthetic
17 quality, but accuracy, an element present in current U.S. law and important in the
18 publishing and entertainment industries affected by this Article. This point,
19 although it could be inferred from the affirmative terms of the warranty, has
20 substantial importance and language was added to this subsection based on
21 suggestions from a licensee representative involved with entertainment issues.

22
23 5. Subsection (b)(4) states as a contract law principle case law that holds
24 the publisher harmless from claims based on inaccuracies in third party materials
25 that are merely distributed by it. In part, this case law stems from concerns about
26 free speech and leaving commerce in information free from the encumbrance of
27 liability where third parties develop the information. In cases of egregious conduct,
28 ordinary principles of negligence apply. As a contractual matter, however, merely
29 providing a conduit for third party data should not create an obligation to ensure
30 the care exercised in reference to that data by the third party. See *Winter v. G.P.*
31 *Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Walter v. Bauer*, 109 Misc 2d 189,
32 439 N.Y.S.2d 821 (S. Ct. 1981). Compare *Brockelsby v. United States*, 767 F.2d
33 1288 (9th Cir. 1985) (liability for technical air charts where publisher designed
34 product) (query whether this is a publicly distributed product).

35
36 6. The issue is important for information systems analogous to newspapers
37 and are treated as such here for purposes of contract law. See *Daniel v. Dow Jones*
38 *& Co., Inc.*, 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not
39 liable to customer; distribution was more like a newspaper than consulting
40 relationship). The District Court in *Cubby, Inc. v. CompuServ, Inc.*, 3 CCH
41 Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "Technology is rapidly
42 transforming the information industry. A computerized database is the functional
43 equivalent of a more traditional news vendor, and the inconsistent application of a

1 lower standard [enabling] liability [for] an electronic news distributor . . . than that
2 which is applied to a public library, book store, or newsstand would impose and
3 undue burden on the free flow of information.[]
4

5

6

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE;

SYSTEM INTEGRATION.

8 (a) Subject to Sections 2B-406, 2B-407, and 2B-408, except with respect to
9 the aesthetic value, commercial success, or market appeal of informational content,
10 if a licensor at the time of contracting has reason to know any particular purpose
11 for which the information is required and that the particular licensee is relying on
12 the licensor's skill or judgment to select, develop, or furnish a suitable information:

13 (1) if, from all the circumstances, it appears that the contract is for a
14 price for performance which will not be fully paid if the end product is not suitable
15 for the particular purpose, there is an implied warranty that the information will be
16 fit for that purpose; but

17 (2) if, from all the circumstances, it appears that the licensor was to be
18 paid for the amount of its time or effort regardless of the suitability of the end
19 product, there is an implied warranty that there is no failure to achieve the
20 licensee's particular purpose caused by the licensor's failure to exercise
21 workmanlike effort to achieve the licensee's purpose in its performance.

22 (b) If an agreement requires a licensor to provide or select a single or
23 integrated system consisting of computer programs, hardware or similar
24 components and the licensor has reason to know that the licensee is relying on the

1 skill or judgment of the licensor to select the components, there is an implied
2 warranty that the components selected will function together as a system.

3 (c) Subsection (a) does not apply to published informational content, but if
4 the conditions of the subsection are met, may apply to the selection among different
5 items of existing published informational content for the purposes of the particular
6 licensee.

7 **Uniform Law Source:** Section 2-315; Section 2A-213. Substantially revised.

8

9 **Committee Action:**

10 1. A consensus to expand this section to cover all forms of information with the
11 possibility of an exception or special treatment for published informational content
12 and manufacturer/publishers.

13

14 **Selected Issues:**

15 1. Should subsection (a)(2) be amended to include reasonable care along with
16 "workmanlike effort" and, if not, should that term be deleted from Section
17 2B-404(a)?

18

19 Reporter's Note

20 *Changes Since the June Meeting:*

21 1. The coverage of the section has been expanded to cover all forms of
22 information, rather than solely to apply to computer programs. Subsection (c) was
23 added to clarify that the concept of an implied fitness obligation does not apply to
24 informational content that is or is to be published. The language of subsection (c),
25 however, allows the implied warranty to apply when the application of expertise
26 that is involved applies to the section among existing item. For example, a retailer
27 asked to select a digital encyclopedia suitable for a ten year old child may have an
28 implied obligation under this section and breach it if the retailer selects a product
29 that is suitable only for doctoral level persons.

30

31 2. Section 2B-405(a)(2) was edited based on Committee discussion to
32 make the standard correspond to the treatment of a similar issue in Section 2B-404.
33 The obligations focus on the licensee's purpose, but the difference between
34 subsection (a)(2) and subsection (a)(1) is that subsection (a)(1) implements a
35 goods-related absolute result obligation, while subsection (a)(2) derives from

1 services contract law and is breached only if the failure of purpose is caused by a
2 flaw in the process of performance ¶ that is, a failure to make a workmanlike effort
3 toward the applicable result.

4
5 *General Notes:*

6 1. This section builds on existing Section 2-315, but substantially alters the
7 concepts contained in that section to fit the diverse traditions that exist in the
8 various information industries that are covered by Article 2B. In computer
9 software contracts, the issues raised here are most often encountered in
10 development and design contracts. There, the basic issue is whether (if not
11 disclaimed) the appropriate implied obligation involves an obligation to produce a
12 satisfactory result (present in sales of goods contract) or an obligation to make
13 workmanlike efforts (present in services contracts). The software cases choose
14 between a warranty of result and a warranty of effort based on whether the court
15 views the transaction as involving goods (result) or services (effort). The reported
16 cases split on this issue, often turning on the subjective impressions of the court,
17 rather than on any differences in the actual transactions. Compare *USM Corp. v.*
18 *Arthur Little Systems, Inc.*, 28 Mass. App. 108, 546 N.E.2d 888 (1989) (goods);
19 *Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D.*, 524 A.2d 1172
20 (Del. 1987) (goods) with *Micro-Managers, Inc. v. Gregory*, 147 Wis.2d 500, 434
21 N.W.2d 97 (Wisc. App. 1988) (services); *Wharton Management Group v. Sigma*
22 *Consultants, Inc.*, 1990 WESTLAW 18360, aff'd 582 A.2d 936 (Del. 1990)
23 (services contract); *Data Processing Services, Inc. v. LH Smith Oil Corp.*, 492
24 N.E.2d 314 (Ind. Ct. App. 1986) (services).

25
26 2. Software development contracts are covered under Article 2B without
27 regard to classification of the contract as involving services or goods. Given that
28 coverage, subsection (a) presents a different approach to determining which type of
29 implied obligation is appropriate. That approach in effect attempts to directly
30 identify a consistent factor that will indicate which type of implied obligation is
31 appropriate in the circumstances. The factor centers on whether the agreement
32 hinges payment on the time and effort spent (services like) or only on the
33 completion of an adequate product (goods like). While the section refers to all of
34 the circumstances as providing the basis for this determination, it is clear that the
35 express contract terms on the relevant point control.

36
37 3. During the June Meeting, the Committee expanded the section to cover
38 more than computer program cases. Given that expansion, a third body of case law
39 becomes important as to warranties. This is the body of case law that holds that, in
40 some situations, as a matter of law, the implied obligation of either type stated in
41 subsection (a) can never arise. See *Milau Associates v. North Avenue Development*
42 *Corp.*, 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977) (An
43 **implied** warranty is inconsistent with the nature of the contract. Fitness of

outcome can be contracted for only as an express warranty.). That approach is, of course, common in publishing and entertainment industries. In new subsection (c), it is made clear that the implied warranty does not arise for published content as to creation or distribution in general. It may arise, however, if an expert selects among existing products to suit the other party's needs.

4. Subsection (b) provides an implied warranty of system integration. This differs from the fitness concept, but is closely related to that concept. The obligation is that the selected components will actually function as a system. That is an additional step beyond the obvious fact that the components themselves must be separately functional in a manner consistent with the contract.

SECTION 2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Language or conduct relevant to the creation of an express warranty and language or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, language or conduct disclaiming or modifying an express warranty is ineffective to the extent that such construction is unreasonable.

(b) Subject to subsections (c) and (d), to disclaim or to modify an implied warranty other than the warranty in Section 2B-401, the following rules apply:

(1) Except as otherwise provided in paragraph (5), language of disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty under Section 2B-403 or 2B-404, language that mentions "quality" or "merchantability" is sufficient as to Section 2B-403 and language that mentions "accuracy", or words of similar import,

1 is sufficient. Language sufficient to disclaim the warranty of merchantability in a
2 transaction governed by Article 2 is sufficient to disclaim the warranties under
3 Sections 2B-403 and 2B-404.

4 (3) To disclaim or modify an implied warranty arising under Section
5 2B-405, it is sufficient to state "There is no warranty that this information or my
6 efforts will fulfill any of your particular purposes or needs", or words of similar
7 import. Language sufficient to disclaim a warranty of fitness under Article 2 is
8 sufficient to disclaim the warranty under Section 2B-405.

9 (4) Unless the circumstances indicate otherwise, all implied warranties
10 are disclaimed by language stating that the information is provided "as is" or
11 "with all faults", or other language that in common understanding calls the
12 licensee's attention to the exclusion of all warranties and makes plain that there is
13 no implied warranty.

14 (5) An implied warranty may be disclaimed or modified by course of
15 performance or course of dealing.

16 (c) There is no implied warranty with respect to a defect that before
17 entering the contract was known by, discovered by, or disclosed to the licensee, or
18 which would have been revealed to the licensee if it had not refused to make use of
19 a reasonable opportunity provided to it prior to entering into the contract to
20 examine, inspect, or test the information or a sample thereof, unless the licensee
21 was not aware of the defect after examination and the licensor knew that it existed
22 at that time.

1 (d) In a mass-market license, language that disclaims or modifies an
2 implied warranty must comply with subsection (b) and be conspicuous. To
3 disclaim all implied warranties in a mass-market license, other than the warranty
4 under Section 2B-401, language in a record is sufficient if it states: "[Except for
5 express warranties stated in this contract, if any, this [information] [computer
6 program] is being provided with all faults, and the entire risk as to satisfactory
7 quality, performance, accuracy, and effort is with the user,]" or words of similar
8 import.

9 (e) If a contract requires ongoing performance or a series of performances
10 by the licensor, language of disclaimer that complies with this section is effective
11 with respect to all performance that occurs after the contract is formed.

12 (f) A contractual term disclaiming implied warranties which complies with
13 this section is not subject to invalidation under Section 2B-308(b)(1).

14 (g) Remedies for breach of warranty may be limited in accordance with the
15 provisions of this article on liquidation or limitation of damages and contractual
16 modification of remedy.

17 **Uniform Law Source:** Section 2A-214. Revised.

18
19 **Selected Issue:**

20 1. Should subsection (c) be modified to conform to current law and revised
21 Article 2 which provides: "[If a buyer before entering into a contract has examined
22 the goods, sample, or model as fully as desired or has declined to examine them,
23 there is no implied warranty with regard to conditions that an examination in the
24 circumstances would have revealed to it.]"

25 2. Should the section be modified to allow disclaimers that are not in a record
26 as under current Article 2 and proposed revisions of Article 2 and 2A and in light of
27 the recognition of oral contracts and exclusion of express warranties by conduct?

3. Should the section on disclaimer by course of dealing and course of performance reinstate disclaimer through "trade use" as under current Article 2 and revisions of Article 2 and 2A?

4. Should the disclaimer of merchantability etc. in subsection (b)(2) provide that the indicated words "must" be used as in current Article 2, or should the "is sufficient" language be retained as in revisions of Article 2?

Committee Votes:

1. Voted to delete requirement of conspicuousness for non-mass market disclaimers.

2. Rejected a motion to delete conspicuousness for mass market contracts.

3. Rejected a motion to delete subsection (b)(5) by a vote of 3-6.

4. Accepted a motion to delete subsection (b)(6) by a vote of 6-4 with the ability to rewrite to focus and clarify effects, perhaps in reference to known defects.

5. Adopted a motion to delete the reference to use of trade in subsection (b)(5) by a vote of 8-2.

6. Adopted a motion to restrict the impact of the "as is" language to exclude coverage of Section 2B-405 because at that time that warranty created a services-like obligation. Vote was 6-3.

7. Motion to adopt the idea of mass market, rather than the idea of consumer on disclaimers. Adopted 8-2 (Dec. 1996)

8. Motion to adopt language from Article 2 precluding disclaimer of consequential damages relating to personal injury, rejected by a vote of 2-8.

9. Motion to delete subsection (e) and replace that section with provision indicating that a term that is conspicuous is not a refusal term under Section 2B-308. Accepted 9-1

10. Voted 7-6 to use mass market, rather than consumer in this section. (Feb. 1997).

Reporter's Note

Changes Since the June Meeting:

1. The language in subsection (b)(2) was changed to clarify that the language referred to in that section applies separately to each of the warranties discussed there.

2. The "as is" section in subsection (a)(4) was amended to conform to the language of current law on the effect of this type of disclaimer and to thereby avoid any inadvertent changes in the applicable rules. The exclusion of Section 2B-405 warranties was not carried forward because based on Committee discussion, that warranty has been rewritten and thereby does not present the services obligation issue considered by the Committee in an earlier meeting.

1 *General Notes:*

2 1. Subsection (a) restates current law.

3

4 2. Subsection (b) brings together provisions dealing with commercial
5 disclaimers. Subsection (b)(1) requires that the disclaimer be in a record, thus not
6 following the possibility in Drafts of Article 2 that an oral disclaimer suffices
7 Subsection (b)(2) sets out a safe harbor for the merchantability warranties and also
8 allows an Article 2 disclaimer to be effective in reference to the two
9 merchantability like warranties in Article 2B. The purpose of this latter rule is to
10 avoid requiring that the guess about coverage of the two articles. Importantly, as in
11 existing and revised Article 2, the specified language is not mandatory, but merely
12 sets out a safe harbor. This language works, but other language may also work.
13 Subsection (b)(3) provides a more common language disclaimer treatment than in
14 current law.

15

16 3. Subsection (c) deals with concerns expressed during the November
17 meeting which deleted prior language taken directly from existing Article 2. The
18 revised language emphasizes knowledge or opportunity to know of the defect and
19 also expressly disallows a licensor's failure to disclose defects that it knows to be
20 present. Equally important, by focusing on reasonable use and resulting disclosure,
21 the redraft avoids the potential problem in which might disallow any implied
22 warranty where inspection was as fully as the licensee "desired". In complex
23 systems often provided through retail outlets, that standard is not workable.

24

25 3. Subsection (d) deals with mass-market disclaimers. The subsection adds
26 two requirements applicable to mass market transactions that do not apply for other
27 transactions. First, the disclaimer must be conspicuous. That requirement does not
28 apply to commercial transactions in Article 2B. Second, if the intent is to disclaim
29 all warranties in a single sentence, the subsection sets out a common language
30 disclaimer based on proposals by the software industry as a means of giving more
31 disclosure to the consumer of what is disclaimed. That language is a safe harbor,
32 rather than a required statement.

33

34 5. Subsection (f) exempts disclaimers that qualify under this section from
35 further consideration under the "refusal terms" concepts outlined in Section
36 2B-308.

37

38 6. Subsection (g) was added to conform to current law and revised Article
39 2.

40

41

42 **SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM.**

1 Modification of a computer program by a licensee invalidates any warranties,
2 express or implied, regarding the performance of the modified copy of the program,
3 but not the unmodified copy, unless the licensor agreed that the modification would
4 not invalidate the warranty or the modification was made using capabilities of the
5 program intended for that purpose in the ordinary course of operation of the
6 program. A modification occurs if a licensee alters code, deletes code from, or adds
7 code to the computer program.

8 **Uniform Law Source:** None.

9

10

Reporter's Notes

11 1. This method of losing warranty protection applies only to warranties
12 related to the performance or results of the software. It does not apply to title and
13 non-infringement warranties. More importantly, the voiding of performance
14 warranties extends only to the modified copy. If the defect existed in an
15 unmodified copy, the modifications have no effect.

16

17 2. The basis for the provision lies in the fact that because of the complexity
18 of software systems changes may cause unanticipated and uncertain results. This
19 language follows common practice. It voids the warranties whether the
20 modification is authorized or not unless the contract, or an agreement, indicates that
21 modification does not alter performance warranties. The section covers cases
22 where the licensee makes changes in the program that are not part of the program
23 structure or options itself. Thus, if a user employs the built-in capacity of a word
24 processing program to tailor a menu of options suited to the end user's use of the
25 program, this section does not apply. If, on the other hand, the end user modifies
26 code in a way not made available in the program options, that modification voids
27 all performance warranties as to the altered copy.

28

29

30

SECTION 2B-408. CUMULATION AND CONFLICT OF

31 **WARRANTIES.** Warranties, whether express or implied, must be construed as
32 consistent with each other and as cumulative. However, if that construction is
33 unreasonable, the intention of the parties determines which warranty prevails. In

1 ascertaining that intention, the following rules apply:

2 (1) Exact or technical specifications prevail over an inconsistent sample,
3 model, demonstration, or general language of description.

4 (2) A sample, model, or demonstration prevails over inconsistent general
5 language of description.

6 (3) An express warranty prevails over an inconsistent implied warranty
7 other than the implied warranty of effort to achieve a purpose.

8 **Uniform Law Source:** Section 2-317.

9

10 **Committee Action:**

11 Approved in principle.

12

13

Reporter's Note

14 This section follows existing Article 2. A substantive difference exists
15 between this Draft and the proposed revisions to Article 2 which indicate that an
16 express warranty does not prevail over inconsistent implied warranties in a
17 consumer contract. The apparent intent of this is to eliminate the ability to replace
18 implied merchantability warranties with express warranty concepts.

19

20

21 **SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.**

22 (a) Except for information made available as published informational
23 content, a warranty made to a licensee extends to persons for whose benefit the
24 licensor intends to supply the information, directly or indirectly, and which use the
25 information in a transaction or application in which the licensor intends the
26 information to be used.

27 (b) For purposes of this section, a licensor that provides the information to
28 a consumer as a licensee is deemed to have intended to supply the information to

1 any other individual who is in the immediate family or household of the licensee if
2 it was reasonable to expect that such individual would rightfully use the copy of the
3 information delivered to the licensee.

4 (c) A disclaimer or modification of a warranty, or of rights or remedies,
5 which is effective against the licensee is also effective against a beneficiary under
6 this section. An expressed intent that limits or excludes third-party beneficiaries
7 excludes any obligation or liability under the contract with respect to third parties
8 excluded by the contract other than persons described in subsection (b).

9 **Uniform Law Source:** Section 2-318.

10

11 **Committee Action:**

12 1. Motion to adopt language precluding disclaimer of consequential damages
13 relating to personal injury, rejected; vote of 2-8.

14

15

Reporter's Notes

16 1. This section defines third party beneficiary concepts. It neither expands
17 nor restricts tort concepts that might apply with reference to third party risks in
18 reference to information. The field of products liability remains outside this
19 Article; governed by tort law in each jurisdiction. In the absence of prior law
20 creating product or other tort liability for the subject matter covered by this Article,
21 Article 2B allows the development of that theme to common law courts.

22

23 2. The section deals with when a beneficiary status exists. For a discussion
24 of beneficiary issues see *Artwear, Inc. v. Hughes*, 615 N.Y.S.2d 689 (1994). For a
25 discussion of information liability to third parties, see *Bily v. Arthur Young & Co.*, 3
26 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts *Restatement* test;
27 [By confining what might otherwise be unlimited liability to those persons whom
28 the engagement is designed to benefit, the *Restatement* rule requires that the
29 supplier of information receive notice of potential third party claims, thereby
30 allowing it to ascertain the potential scope of its liability and make rational
31 decisions regarding the undertaking.]).

32

33 3. Subsection (a) derives from and should be interpreted in light of both the
34 contract law concept of [intended beneficiary] and the concept in the *Restatement*

(*Second*) of Torts § 552. In both instances, for information, contract-based liability is restricted to intended third parties and those in a special relationship with the information provider. The scope of liability extends to transactions that the provider of information intended to influence. This section incorporates those concepts. The section also must be considered in light of the scope of warranties under this Article which create no implied warranty of accuracy pertaining to published informational content.

Illustration 1: Clancey contracts for publication of his text on chemical interactions. Publisher obtains an express warranty that Clancey exercised reasonable care in researching the material. Publisher distribute the text to the general public. Some data is incorrect. Neither Publisher (which make to warranty on published information content), nor Clancey (excluded under (a) makes a warranty to a general buyer of the book.

4. Unlike in goods, the willingness of courts and legislatures to avoid privity and impose third party liability under tort or contract theory has been limited in information products. The *Restatement (Third)* on products liability recognizes this; it notes that informational content is not a product for purposes of that law. The only reported cases imposing products liability on information products all involve air craft charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided one of the air chart cases, but later commented that public policy accepts the idea that information content once placed in public moves freely and that the originator of the data does not own obligations to those remote parties who obtain it. See *Winter v. G. P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991). See also *Fairbanks, Morse & Co. v. Consolidated Fisheries Co.*, 190 F.2d 817, 824 (3rd Cir. 1951); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990) ([The] imposition of liability against a trademark licensor under [tort law] is appropriate only when the licensor is significantly involved in the manufacturing, marketing or distribution of the defective product); *Porter v. LSB Industries, Inc.*, 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993) (product liability cannot be imposed on a party that is outside the manufacturing, selling, or distribution chain); *E.H. Harmon v. National Automotive Parts*, 720 F. Supp. 79 (N. D. Miss. 1989) (strict liability cannot be imposed on one who neither manufactures nor sells the product); *Snyder v. ISC Alloys, Ltd*, 772 F Supp. 244 (W. D. Pa. 1991) (16 UCC Rep. Serv.2d 38); *Jones v. Clark*, 36 N. C. App. 327, 24 UCC Rep. Serv. 605, 244 S.E.2d 183 (N. C. App. 1978) (implied warranty cannot be imputed to one who simply allows its seal of inspection to be placed on a product manufactured by another; if some type of implied warranty were arguably applicable such a warranty could not meet privity requirements since sellers purchased unit from manufacturer and it was only the

1 manufacturer which dealt directly with the laboratory).

2
3 While there may be a different policy dealing with software embedded in
4 products, this Article does not deal with embedded products. Tort issues regarding,
5 for example, the software that operates the brakes in an automobile falls within
6 Article 2. No reported cases place products liability on software products that are
7 not embedded in hardware products.

8
9 5. *Restatement (Second) of Torts* § 552 establishes a limited third party
10 liability structure for persons who provide information to guide others in business
11 decisions. This section is consistent with that *Restatement* which limits liability to
12 pecuniary loss suffered by the person or one of a limited group of persons for
13 whose benefit and guidance he **intends** to supply the information or knows that the
14 recipient intends to supply it; and through reliance upon it in a transaction that he
15 **intends** the information to influence or knows that the recipient so intends or in a
16 substantially similar transaction. In most States, no liability arises under this
17 theory of action unless there is a "special relationship" between the information
18 provider and the injured party. Modern case law is increasingly oriented toward the
19 terms of the *Restatement*. See *Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 11 Cal.
20 Rptr. 2d 51, 834 P2d 745 (1992). This is a contract law statute. To the extent that
21 greater liability is desired, that should come from tort law development, rather than
22 from an expanding notion of **contract** liability.

23
24 6. If the subject matter involves informational content, constitutional
25 considerations and general considerations of policy often limit liability at least in
26 respect of the liability of the publisher. See, e.g., *Winter v. G. P. Putnam's Sons*,
27 938 F.2d 1033 (9th Cir. 1991) (publisher of encyclopedia of mushrooms has no
28 duty of care respecting accuracy); *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d
29 334 (NY City Ct. 1987) (electronic news service not liable to customer). Compare
30 *Brockelsby v. United States*, 767 F.2d 1288 (9th Cir 1985); *Saloomey v. Jeppeson*
31 *& Co.*, 707 F.2d 671 (2d Cir 1983); *Aetna Casualty & Surety Co. v. Jeppeson &*
32 *Co.*, 642 F.2d 339 (9th Cir. 1981). Both of the latter cases deal with highly
33 technical and highly specialized information products and impose liability on the
34 author-publisher running to persons with no privity. They have not been followed
35 with respect to any other information liability case.

36
37 7. Subsection (b) modifies beneficiary concepts to include the family of a
38 licensee. This goes beyond the relevant alternative in current Section 2-318 which
39 limits that extension to personal injury claims. The extension here covers both
40 personal injury and economic losses.

41
42 8. Subsection (c) recognizes and flows from the fact that the basis of this
43 section lies in beneficiary status, rather than product liability concepts. A

1 disclaimer or a statement excluding intent to effect third parties excludes liability
2 under this section. Thus, in *Rosenstein v. Standard and Poor's Corp.*, 1993 WL
3 176532 (Ill. App. May 26, 1993), for example, the court treated a license agreement
4 involving Standard and Poors (SP), which provided data and index figures for daily
5 closing of options based on the SP index, as an information contract. When SP
6 provided an inaccurate number because of an error in the price of one stock, the
7 court applied concepts of negligence and effort, rather than UCC warranty rules to
8 gauge potential liability. The court held that concepts of negligent
9 misrepresentation applied to this form of information service. The third parties
10 were barred from recovery, however, based on a disclaimer in the original license
11 agreement.
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PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If an agreement transfers ownership of intellectual property rights and does not specify when ownership is to pass, ownership passes to the transferee:

(1) if the information is in existence at that time, when the contract becomes enforceable between the parties; and

(2) if the information is not in existence when the contract becomes enforceable, when the information has been so far identified to the contract as to be distinguishable in fact from similar property even if it has not been fully completed and any required delivery has not yet occurred.

(b) Transfer of title to or possession of a copy of information does not transfer ownership of intellectual property rights in the information.

(c) In a license, the following rules apply to copies of information:

(1) Title to a copy is determined by the contract.

(2) A licensee's right to possession or control of a copy is governed by the contract and does not depend on title to the copy.

(3) Reservation of title to a copy reserves title in that copy and any copies made by the licensee unless the license contemplates that the licensee will make and transfer copies of the information to other purchasers, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

1 (d) If the parties intend to transfer title to a copy and the contract does not
2 specify when title transfers:

3 (1) physical delivery of a tangible copy transfers title to the copy on
4 delivery to and acceptance by the licensee; and

5 (2) electronic delivery of a copy to the licensee transfers title of the
6 copy when a first sale occurs under federal copyright law.

7 **Uniform Law Source:** Section 2-401; Section 2A-302. Revised.

8

9 **Committee Vote:**

10 1. Voted 11-0 to delete a sentence restricting exercise of rights until it pays
11 according to the terms of the contract. That concept can be transferred to
12 Comments in a form that also accommodates in kind and other value.

13

14 **Reporter's Notes**

15 1. This section distinguishes title to the copy from ownership of the
16 intellectual property rights, a point that is made explicit in subsection (b). This
17 distinction flows from the Copyright Act and other law. It means that, while
18 ownership of a copy may carry with it some rights with respect to that copy, it does
19 not convey ownership of the underlying rights to the work of authorship or the
20 patented technology. This represents a basic theme in differentiating intangibles
21 and tangible objects. The media here is not the message, but the conduit.

22

23 2. Subsection (a) deals with intellectual property rights and when
24 ownership of the rights transfers as a matter of state law. This deals with cases
25 where there is an intent to transfer title to intellectual property rights (as compared
26 to title to a copy). If federal law requires a writing to make this ownership transfer;
27 state law is subject to that limit. The subsection solves the problem in *In re Amica*,
28 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article 2 theories of title
29 transfer to goods to hold that title to an intangible (a computer program) being
30 developed for a client could not pass until the program was fully completed and
31 delivered.) The transfer of title hinges on completion to a sufficient level that
32 separates the transferred property from other property of the transferor. See *In re*
33 *Bedford Computer*, 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallows transfer of title
34 in software where "new" code could not be separately identified from old or pre-
35 existing code.).

36

1 3. **Under subsection (c)**, in a license, the right to the copy of information
2 depends on the terms of the contract and not on the label one applies to handling
3 underlying media. This is a default rule that applies regardless of the terms of the
4 license contract. As in Article 2A, this Draft does not spell out title transfer rules
5 with reference to licenses. The question of whether title to a copy in fact transfers
6 in a license may depend on the terms of the license and the marketplace in which
7 the license transaction occurs. Especially in many commercial licenses, it is
8 inappropriate to presume that title does pass to the licensee in the absence of
9 contractual reservation. The typical presumption is that the transfer there is
10 conditional as reflected in the license terms. See *United States v. Wise*, 550 F.2d
11 1180 (9th Cir. 1977) (licenses transferred rights for exhibition or distribution and
12 did not constitute first sales); *Data Products Inc. v. Reppart*, 18 U.S.P.Q.2d 1058
13 (D. Kan. 1990) (license not a sale).

14
15 The circumstances may be different in the mass market even where
16 purchasers are aware that a license will be involved. As drafted, the section takes
17 no position on that issue or how one distinguishes these cases. The mass market
18 licensee receives protections under applicable default rules that are not based on
19 title issues. If the issue were to become important in litigation and were not dealt
20 with by contract, a court would presumably inquire about the intent of the parties as
21 to title to the copy.

22
23 In subsection (c)(3), the primary rule is that a reservation of title in a
24 delivered copy extends that reservation to all copies made by the licensee. That
25 presumption is altered in cases where the license intends the making of copies for
26 sale. Thus, for example, a license of a manuscript to a book publisher
27 contemplating production of books and sale of the copies, does not reserve in the
28 author title to all the books. This concept does not apply where the expectation is
29 that the licensee will transfer copies by a further license.

30
31 4. Subsection (d) deals with cases involving an intent to sell a copy and
32 states various presumptions relating to when title passes to copies. The basic theme
33 is that the contract controls. Absent contract terms, the Draft distinguishes between
34 tangible and electronic transfers. The rule for tangible transfers of a copy parallels
35 Article 2 in current law. The electronic transfer approach defers to federal law on a
36 potentially controversial issue. The White Paper on copyright in the Internet
37 suggests and legislation is being considered to implement that the electronic
38 delivery of a copy of a copyrighted work is not a first sale because it does not
39 involve transfer of a copy **from** the licensor to the licensee. While state law could
40 control questions of title to personal property, this Draft suggests that the issue be
41 left to federal policy.

1 **SECTION 2B-502. TRANSFER OF PARTY’S INTEREST.**

2 (a) Except as otherwise provided in subsection (b), a party’s rights under a
3 contract may be transferred, including by an assignment or through a financier’s
4 interest, unless the transfer would materially change the duty of the other party,
5 materially increase the burden or risk imposed on the other party, cause a
6 delegation of material performance, disclose or threaten to disclose trade secrets or
7 confidential information of the other party, or materially impair the other party’s
8 likelihood or expectation of obtaining return performance.

9 (b) A transfer of a licensee’s contractual rights under a nonexclusive
10 license is ineffective unless the licensor consents to the transfer or the transfer is
11 subject to the terms of the license and:

12 (1) the contract is a mass-market license and the licensee received
13 delivery of a copy of the information, and transfers or destroys the original copy
14 and all other copies made by it; or

15 (2) the licensee received title to the copy of the information by a transfer
16 authorized by the party that holds intellectual property rights in the information, the
17 license did not preclude transfer of the licensee’s rights, and the transfer of the
18 licensee’s rights complies with applicable provisions of federal law for the owner
19 of a copy to make the transfer.

20 (c) Subject to subsection (a), either party may transfer the right to receive
21 payment from the other party.

22 (d) A transfer made in violation of this section is ineffective.

1 **Uniform Law Source:** Section 2A-303. Substantially revised.

2

3 **Committee Vote:**

4 1. Voted 7-1 to add a provision to allow transfer when the licensee owns the
5 copy of the information.

6 2. Voted unanimously to use mass market, rather than consumer in this section.

7

8

Reporter's Notes

9 1. [Transfer] is used in the sense of a conveyance of rights and duties
10 under a contract and contrasts to the idea of merely delegating or sub-licensing
11 performance where the delegator remains primarily responsible and in control of
12 the contract performance. It contrasts to the idea of delegation or sublicense which
13 involve a shift of the performance to a third party without transferring the
14 contractual rights. Section 2B-506 deals with delegation of performance or
15 sublicensing.

16

17 2. The provisions of this section apply in the absence of contractual
18 restrictions. The effect of contract restrictions on alienation are treated elsewhere
19 as is the enforceability of a security interest. Subsection (a) states a general
20 principle of transferability subject to that being disallowed in cases where the
21 transfer jeopardizes significant interests of the other party to the license contract.
22 This is consistent with general UCC themes, except that the subsections spell out
23 additional protected interests that block transfer and that are important here, but not
24 in reference to sales of goods. Included among those interests are transfers that
25 create and actual disclosure or threaten a disclosure of confidential material.
26 Whether this occurs must be viewed in context of the original transaction. The
27 application of this concept would be limited to cases where actual trade secret or
28 confidentiality relationships had been established with respect to some of the
29 information that forms the subject matter of the contract.

30

31 3. Subsection (a) expressly refers to transfers that disclose or threaten to
32 disclose trade secret or confidential material of the other party. Whether particular
33 information is confidential or not will ordinarily be determined by other law,
34 including common law contract and trade secret law. Application of this limitation
35 on transfer hinges on the existence of such an interest. The restriction on transfer
36 that results occurs only if the transfer increases the risk of confidentiality disclosure
37 juxtaposed to the original transaction itself. Thus, for example, if arguable trade
38 secrets are embedded in object code of a computer program, but the contract does
39 not place confidentiality restrictions on the licensee, merely transferring the copy to
40 another party, if that is otherwise permitted, does not jeopardize the secrets for
41 purposes of subsection (b). With reference to both the transferor and transferee, in
42 the absence of enforceable confidentiality restrictions in the contract or otherwise

1 in law, discovery of the secret information may be appropriate and the degree of
2 risk does not change for the secret owner. On the other hand, where confidential
3 material is subject to restrictions or is directly disclosed as a result of the transfer,
4 the limitation in subsection (a) applies. Of course, even if the limitation grounded
5 in confidentiality concepts does not apply, a non-exclusive license may be
6 otherwise non-transferable under the other provisions of this section.

7
8 4. Subsection (b) follows current law which holds that a licensee cannot
9 assign its rights in a nonexclusive license. For patents and copyrights, this
10 represents federal policy. The fact that this federal policy overrides state law was
11 restated and accepted by the Ninth Circuit in 1996. See *Everex Systems, Inc. v.*
12 *Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996); *Unarco Indus., Inc. v. Kelley Co., Inc.*,
13 465 F.2d 1303 (7th Cir. 1972). The non-transferability premise flows from the fact
14 that a nonexclusive license is a personal, non-assignable contractual privilege,
15 representing less than a property interest. See *Harris v. Emus Records Corp.*, 734
16 F.2d 1329 (9th Cir. 1984) (copyright); *In re Alltech Plastics, Inc.*, 71 B.R. 686
17 (Bankr. W. D. Tenn. 1987).

18
19 5. The Ninth Circuit explained the policy basis for this federal law rule in
20 reference to patent licenses in the following terms:

21
22 Allowing free assignability □ or, more accurately, allowing states to allow free
23 assignability □ of nonexclusive patent licenses would undermine the reward that
24 encourages invention because a party seeking to use the patented invention
25 could either seek a license from the patent holder or seek an assignment of an
26 existing patent license from a licensee. In essence, every licensee would
27 become a potential competitor with the licensor-patent holder in the market for
28 licenses under the patents. And while the patent holder could presumably
29 control the absolute number of licenses in existence under a free-assignability
30 regime, it would lose the very important ability to control the identity of its
31 licensees. Thus, any license a patent holder granted □ even to the smallest firm
32 in the product market most remote from its own □ would be fraught with the
33 danger that the licensee would assign it to the patent holder's most serious
34 competitor, a party whom the patent holder itself might be absolutely unwilling
35 to license. As a practical matter, free assignability of patent licenses might spell
36 the end to paid-up licenses such as the one involved in this case. Few patent
37 holders would be willing to grant a license in return for a one-time lump-sum
38 payment, rather than for per-use royalties, if the license could be assigned to a
39 completely different company which might make far greater use of the patented
40 invention than could the original licensee. Thus federal law governs the
41 assignability of patent licenses because of the conflict between federal patent
42 policy and state laws, such as California's, that would allow assignability.

1 *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996). The approach
2 to non-exclusive copyright licenses in federal law is the same. See *Harris v. Emus*
3 *Records Corp.*, 734 F.2d 1329 (9th Cir. 1984).

4
5 6. The three exceptions in subsection (b) situations in which the basis of
6 this policy are not present. The first deals with the case of actual consent. The
7 second, mass market licenses, indicates the fact that in a mass market environment
8 the licensor has essentially chosen not to be concerned about the identity of the
9 particular licensee, but rather places the information out to the general public. In
10 the third exception, federal law rules relating to first sales apply and allow the
11 owner of a copy to distribute that copy, presumably along with the right to use/copy
12 that work in the case of computer software. See 17 U.S.C. § 117.

13
14 7. Subsection (d) states a rule on the effectiveness or ineffectiveness of
15 transfers of non-exclusive license rights by a licensee that makes the transfer
16 ineffective unless authorized by this section. Given the carve outs for mass market
17 and owned-copy transactions in subsection (b), this rule carries forward the federal
18 policy and the underlying personal nature of the non-exclusive licensee's rights.
19 Cases such as *Everex* indicate not only that the attempted assignment violates
20 contract provisions, but that it is invalid without the licensor's consent. The Ninth
21 Circuit in *Everex* indicated that federal law sets out a bright line test invalidating
22 the transfer without consent and entirely independent of whether there was (or was
23 not) actual impact on the licensor's interests. The predominant interest here
24 focuses on the licensor's intellectual property rights and control of to whom the
25 intellectual property is given. Article 2A, dealing with tangible property, makes
26 the contrary assumption in Section 2A-303(5), but would generally enable a lessor
27 to cancel the lease because of the transfer. Under the intellectual property regime
28 that governs here, that additional step is not warranted and may be barred by
29 existing case law. It is important to recognize, however, that the net effect of this
30 section and the parallel rule in Section 2B-503 is to increase significantly the
31 transferability of licensee rights.

32
33
34 **SECTION 2B-503. CONTRACTUAL RESTRICTIONS ON TRANSFER.**

35 (a) Except as otherwise provided in subsection (b), a contractual restriction
36 or prohibition on transfer of an interest of a party to a contract or of a licensor's
37 ownership of intellectual property rights in information that is the subject of a
38 license is enforceable. A transfer made in breach of an enforceable contractual

1 term that prohibits transfer is ineffective.

2 (b) With respect to a financier's interest, the following contractual
3 restrictions are not effective to prevent creation of the interest, but a transfer or
4 creation of an interest made in violation of the restriction constitutes a breach:

5 (1) a term that prohibits a party's transfer of its interest or creation or
6 enforcement of a security interest in an account or in a general intangible for
7 money due or to become due or which requires the other party's consent to such
8 transfer; and

9 (2) a term that prohibits a party's transfer of its interest or creation of a
10 financier's interest except to the extent that creation of the financier's interest
11 would be precluded under Section 2B-502.

12 **Uniform Law Source:** Section 2A-303(2), (3), (4), (6), (8).

13
14 **Committee Vote:**

15 1. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a
16 mass market license.

17
18 **Reporter's Note**

19 This section generally validates contractual restrictions on the transfer of a
20 contractual interest. The primary exceptions to this policy relate to financing
21 arrangements, the transfer of interests in a cash flow from a license and the
22 creation of a financier's interest under this Article.

23
24
25 **SECTION 2B-504. FINANCIER'S INTEREST IN A LICENSE.**

26 (a) The creation of a financier's interest in a party's rights under a license
27 without the consent of the other party to the license is effective if the creation of the
28 interest would be effective under Sections 2B-502 and 2B-503. However,

1 enforcement of a financier's interest thus created is effective only if enforcement
2 would also be effective under Sections 2B-502 and 2B-503.

3 (b) If the creation or enforcement of a financier's interest in a licensee's
4 rights under a nonexclusive license is not effective under subsection (a), the
5 following rules apply:

6 (1) Subject to paragraph (2), the creation or enforcement is effective
7 only to the extent that it does not result in an actual transfer or change of the use or
8 possession of, or access to, the information, or a result not consistent with the
9 limitations of Section 2B-502(a) other than as to the obligation to make payments
10 to the licensor.

11 (2) In the event of a breach of contract by the licensee, as between the
12 financier and the licensee, the financier has a right under Section 2B-715 to
13 prohibit the licensee from using the information covered by the financier's interest
14 and may take possession of copies of the information or related materials covered
15 by its interest only if the licensor consents or the conditions of Section 2B-502(a)
16 are met.

17 (c) A financier that creates or enforces an interest and any transferee of the
18 financier is subject to the terms and limitations of the license and to the licensor's
19 intellectual property rights. The financier may not use, sell, or otherwise transfer
20 rights in the license or copies of the information or access to the information unless
21 the conditions of subsection (a) are met as to enforcement of the interest.

22 (d) The creation or enforcement of a financier's interest imposes no

1 obligations or duties on the licensor with respect to the financier.

2 **Committee Action:**

3 1. Consensus that Article 2B should allow creation of limited rights in licensee
4 side of non-exclusive licenses, but not permit sale and the like without consent of
5 the licensor.

6

7

Reporter's Notes

8 1. This section reflects the general approach of Article 2B of combined
9 treatment of security interests and financing leases in an integrated treatment. The
10 definition of "financier" covers both secured parties and lessors. See Section
11 2B-102.

12

13 2. As redrafted, subsection (a) makes clear that, in general, a financier's
14 interest can be created in any contractual right that can be transferred and that, in
15 all other cases, consent by the other party to the contract makes transfer possible,
16 but that the act of creating a security interest and the act of enforcing that interest
17 are separable events. Unlike in sales of goods, licenses create a situation where
18 three parties have an interest in what happens to the property and the contractual
19 rights associated with it: the lender, the debtor and the licensor. In many cases, the
20 licensor's rights are dominant. Thus, a critical limit on enforcement and, except
21 for non-possessory interests, creation of a financier's interest lies in Section
22 2B-502(a) which disallows transfers that impinge on licensor interests of the type
23 described therein.

24

25 3. For non-exclusive licenses, the transferability of a licensee's rights is
26 even further constrained in law by federal policy limitations that presume non-
27 transferability without licensor consent. See Section 2B-502(b). This Article
28 pushes the scope of secured lending in the absence of licensor consent as far as
29 possible in light of that strong contrary and preemptive federal policy. It assumes
30 that the license is non-assignable and personal for reasons noted in the cases cited
31 in Section 2B-502 notes, but tailors a right to **create** a security interest without the
32 licensor's consent in a manner that avoids preemption by satisfying the policy
33 interests that underlie the basic non-assignability principle. Thus, while an interest
34 can be created, it cannot, without the licensor's consent, result in an actual change
35 of control, access or use or any sale. This preserves the licensor's protected
36 interest under federal law in controlling the resale market and the identity of the
37 licensee to whom it transfers rights in its intellectual property. See *Everex Systems,*
38 *Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996).

39

40 4. The approach is modeled after Section 2A-303(3) which limits the
41 enforceability of lease provisions restricting security interests in the lessee's

1 interests. It applies here to both a contract clause and to a non-exclusive license
2 that contains no such clause because, unlike in leases, the underlying law does not
3 routinely allow assignment of the licensee's interest. The Comments to Section
4 2A-303 state: "[The] lessor is entitled to protect its residual interest in the goods by
5 prohibiting anyone other than the lessee from possessing or using them." Section
6 2A-303, Comment 3. As in Article 2A, the licensor (lessor) has a right to control
7 who is in effective possession (including use and access) of the subject matter of
8 the license. In many cases, this will preclude repossession or sale without the
9 licensor's consent. It does not prevent repossession and sale if the licensed rights
10 would be transferable under Sections 2B-502 and 2B-503.

11
12 5. The provisions here allow creation of a security interest in many cases
13 because mere creation does not make an actual change of possession, use, or
14 access, nor does it delegate obligations. The argument against preemption is that
15 "creating" a security interest does not "transfer" or assign the interest under the
16 license. The *Everex* case indicated that one aspect of the federal policy was that
17 the intellectual property rights holder has a protected interest in restricting the use
18 of its intellectual property by persons other than those it specifically authorizes.
19 The approach in this Draft draws a balance that allows full pursuit of that federal
20 policy, but gives substantial scope to the state law policy of allowing creation of
21 security interests. The same would not be true, for example, with a rule that allows
22 all assignment of rights under the other section of transferability, a rule that would
23 be specifically subject to preemption.

24
25 6. The Draft also parallels Article 2A in providing that the secured lender
26 and any transferee take subject to the terms of the original license. The license is
27 the dominant document in that it defines the licensee's rights. A lender does not
28 have the ability to abrogate those rights and the limitations that are attached to the
29 rights.

30
31 7. The result of the financing provisions allow creation of a security
32 interest in any case where creation, in itself, alters none of the actual interests of the
33 parties. When it comes to enforcement of the interest, however, the lender's rights
34 are subordinate to actual interests of either party and to federal policies about
35 transferability. The effect of the provisions is illustrated in the following examples.

36
37 **Illustration 1. Financing a Licensor's Interest.**
38 Creditor desires to finance the licensor's interest in a commercial license. To
39 determine whether it can do this, the creditor must make the following
40 determinations: (a) under Section 2B-502(a) would creation of the interest
41 make a change that impinges one or more of the interests listed there; (b) if not,
42 under Section 2B-503 is there an enforceable no transfer provision that
43 precludes creation of the interest without consent; (c) if not, then the interest

1 can be created under Section 2B-504(a). However, if the transfer is precluded
2 by either of the above, no security interest can be created.

3
4 If an interest can be created, the lender would make the same analysis in
5 reference to enforcement (e.g., repossession or sale). The issues are different,
6 of course, since repossession or sale precludes some further uses and changes
7 the party in control in a way that may adversely impact the licensee. The result
8 of the analysis would depend on the licensor's personal role in the on-going
9 license. In cases of fully paid up, [perpetual licenses, enforcement would not
10 be barred unless, for example, it threatens trade secret rights of the licensee.

11 12 **Illustration 2. Financing the Licensee in a Commercial License.**

13 Assume creditor desires to finance the licensee's interest in a commercial, non-
14 exclusive license. It would ask the following questions: (a) is the creation of
15 the interest blocked by Section 2B-502(a) in that it would cause an
16 inappropriate delegation, deny the return expected by the licensor, or otherwise
17 adversely impact the interests listed there; (b) if the interest is **permitted** under
18 Section 2B-502(a), it is still prohibited under Section 2B-502(b) unless it falls
19 into one of the exceptions there (mass market, or title without contract
20 restriction); (c) if it is not within an exception, the Creditor would not need to
21 consult Section 2B-503, if it did so, however, and there was a contractual
22 limitation on creation of an interest or on transfer, that contract terms is
23 effective since creation of an interest is barred under Section 2B-502; (d) if
24 creation is barred under either Section 2B-502 or 2B-503, Section 2B-504(b)(1)
25 still permits creation of an interest if this does not violate Section 2B-502(a) or
26 change possession, use or control of the information.

27
28 In most cases, the net of these provisions allows **creation** of an interest in a
29 non-exclusive license, but this does not permit the full panoply of enforcement.
30 The analysis must be repeated for any effort to enforce the interest.

31 Enforcement will involve different issues because it changes possession or use.

32 The first stages of analysis are the same. If repossession or sale is barred under
33 Section 2B-502 or 2B-503, which it will ordinarily be, Section 2B-504(b) may
34 not alter that result *as to enforcement*. Under subsection (b)(1) enforcement is
35 not permitted if it changes possession or use. Subsection (b)(2) is an over-ride
36 that allows taking possession (but not sale) and barring use, **but only if these**
37 **acts do not violate the rules of Section 2B-502(a)**. In effect, enforcement
38 without licensor consent cannot occur if it adversely affects the licensor's
39 interest, including an adverse effect by making the licensor's return less likely
40 to be received. In end user software, this will often allow a court order to
41 prevent use under subsection (b)(1), but may will not allow repossession.
42 Subsection (b)(2) does not authorize enforcement by sale in a licensee situation
43 in any case without the licensor's consent.

1
2 **Illustration 3. Financing an Entertainment Licensee Interest.**

3 Assume that the commercial license in Illustration 2 involves a distribution
4 license for a motion picture. Under Section 2B-502(a), while creation of an
5 interest in the licensee rights may not be barred, any enforcement of those
6 rights without consent would typically be barred because it would change
7 (increase) the risk of the licensor not receiving a return expected from the
8 contract. This is true regardless of the presence or absence of contract
9 provision. Under Section 2B-504, creation of the interest may be permitted
10 under subsection (b)(1), but typically, no enforcement would be permitted
11 because enforcement (barring use, taking possession) would adversely effect
12 the return and other interests of the licensor.
13

14 **Illustration 4. Financing a Mass Market Licensee Interest.**

15 The treatment of a mass market license parallels other non-exclusive licenses,
16 except that the exception stated in Section 2B-502(b) shifts the presumptions
17 and, at least if the definition of mass market focuses on anonymous, true retail
18 transactions where the licensee identity is not relevant, the nature of the product
19 will often eliminate a major limitation on transfer. Section 2B-504(a) requires
20 analysis under 502 and 503. Under Sections 2B-502 and 2B-503, a lender can
21 create an interest in a mass market license if the creation of the interest does not
22 result in a 502(a) injury to the licensor. Under these same sections, a lender can
23 enforce the interest if (a) enforcement does not violate Section 2B-502(a) and
24 (b) enforcement is not barred by a contract provision against enforcement or
25 transfer. If either of these conditions preclude enforcement, the focus shifts to
26 Section 2B-504(b). This section does not allow sale, but does allow creating an
27 interest and enforcement that does not violate 502(a). In effect, in the **true**
28 mass market the lender can create and enforce its interest unless the licensor
29 contractually bars transfer, in which case, creation is still allowed. This
30 solution works so long as the idea of mass market does not encroach too
31 strongly into commercial transactions.
32
33

34 **SECTION 2B-505. EFFECT OF TRANSFER OF CONTRACTUAL**

35 **RIGHTS.**

36 (a) A transfer of a party's rights under a contract is a transfer of contractual
37 rights subject to the restrictions on use of the information contained in the
38 agreement and, unless the language or the circumstances indicate to the contrary,

1 such as in a transfer limited to creating an financier's interest, the transfer is a
2 delegation of duties by the transferor. Acceptance of the transfer constitutes a
3 promise by the transferee to perform the duties of the transferor. The promise is
4 enforceable by the transferor or any other party to the contract.

5 (b) A transfer of contractual rights does not relieve the transferor of a duty
6 under the contract to pay or perform, or of liability for breach of contract, except to
7 the extent the other party to the original contract agrees.

8 **Uniform Law Source:** Section 2-210; Section 2A-303.

9
10 **Committee Action:**

11 Discussed in November, 1996, without substantial comment.

12
13 **Reporter's Note**

14 1. This section implements a policy in current Article 2 and Article 2A.
15 The recipient of a transfer is bound to the terms of the original contract and that
16 obligation can be enforced either by the transferor or the other party to the original
17 contract.

18
19 2. This section clarifies that an effective transfer (assignment or otherwise)
20 of rights under a contract constitutes a transfer of those contract rights and, a
21 delegation of duties if accepted by the transferee. This language follows Article 2
22 (which uses the word assignment) and Article 2A (which refers to transfers).

23
24 3. Subsection (b) also follows current law and provides that the transfer
25 does not alter the transferor's obligations to the original contracting party in the
26 absence of a consent to the novation.

27
28
29 **SECTION 2B-506. DELEGATION OF PERFORMANCE;**

30 **SUBCONTRACT.**

31 (a) A party may delegate or subcontract performance of its contractual
32 obligations unless:

- 1 (1) the contract prohibits delegation or subcontracting
2 (2) transfer would be prohibited under Section 2B-503, or
3 (3) the other party otherwise has a substantial interest in having the
4 original promisor perform or directly supervise or control the performance.

5 (b) Delegation or subcontracting does not relieve the delegator or
6 subcontractor of any duty under the contract to pay or perform, or of liability for
7 breach of contract, except to the extent the other party to original contract agrees.

8 **Uniform Law Source:** Section 2-210; Section 2A-303.

9
10 **Committee Action:**

11 Reviewed in November, 1996, without substantial comment except that
12 adjustments should be made to clarify that the section is subject to restrictions on
13 transfer.

14
15 **Reporter's Notes**

16 1. Delegation or subcontracting of performance refers to a party's ability to
17 use a third party in making an affirmative performance under an information
18 contract. It does not refer to authorization or other allowance of third party
19 exercise of rights in licensed information pursuant to in a contract is generally
20 allowed. In both cases, while the performance may be made by the delegee, the
21 original; party remains bound by the contract and responsible for any breach
22 thereof. The ability to delegate performance must be read in contrast to the general
23 limitations on transferability of non-exclusive licenses under in Section 2B-502. A
24 delegation or subcontract works a transfer equivalent in substance to a transfer or
25 assignment of

26
27 2. The ability to delegate is subject to contrary agreement. Thus, a contract
28 that permits use of licensed information only by a named person or entity controls
29 and precludes delegation. The result in such cases is determined by both the
30 general principle that contract terms control and the more specific principle that the
31 other party has, by the contract, expressed an interest limiting performance to the
32 designated party.

33
34 3. In the absence of a contractual limitation, delegation can occur unless
35 the circumstances come within one of three conditions are met. The first condition

1 that prevents delegation arises if the transfer of an interest would be precluded
2 under Section 2B-503. That section disallows transfers in cases where the contract
3 prohibits such action. The second condition, arises if the contract is silent but the
4 other party has a substantial interest in having performance rendered by the person
5 with whom it contracted. Obviously, a party has a substantial interest in having the
6 original party perform if the delegation triggers the restrictions outlined in Section
7 2B-502(a). On the other hand, neither of these provisions would deny a right to
8 delegate or subcontract performance in a mass market transaction where, under
9 Section 502, can be freely transferred by the licensee.

10
11
12 **SECTION 2B-507. PRIORITY OF TRANSFER BY LICENSOR.**

13 (a) A licensor's transfer of ownership of intellectual property rights is
14 subject to a previous nonexclusive license if that license was in a record
15 authenticated by the licensor before the transfer of ownership.

16 (b) A financier's interest created by a licensor or a transfer of ownership of
17 intellectual property rights under a financier's interest in information or in copies
18 of the information is subordinate to a nonexclusive license that was:

19 (1) authorized by the secured party;

20 (2) documented in a record authenticated by the licensor before the
21 security interest was perfected; or

22 (3) transferred in the ordinary course of the licensor's business to a
23 licensee that acquired the license in good faith and without knowledge that it was
24 in violation of the security interest.

25 (c) For purposes of this section, a transfer of ownership or of a financier's
26 interest occurs when the transfer is effective between the parties. However, if
27 applicable intellectual property law requires filing or a similar act to obtain priority

1 against other transfers, the transfer does not occur until the date on which priority
2 begins under that law after the filing or similar act occurs.

3 **Uniform Law Source:** Section 2A-304. Revised.

4

5 **Selected Issues:**

6 1. Should the Article provide a rule about transfer of intellectual property
7 ownership that is subject to contrary federal intellectual property law when
8 applicable as has been suggested?

9

10

Reporter's Note

11 1. This is an area heavily influenced by federal copyright law as to
12 copyright interests and the provisions here attempt to trace that influence while
13 providing maximum state law recognition for traditional UCC priorities. As to
14 transfers of ownership and, arguably, security interests, federal law may preempt
15 state law in reference to federal intellectual property rights. There is no such
16 preemption in reference to data, trade secrets and other non-federal rights. For
17 security interests and their relationship in terms of priority to the rights created
18 under an intangibles contract, the priority questions might be dealt with in this
19 article as was done in Article 2A or they may be dealt with in Article 9. Subsection
20 (a) deals with general priorities. Subsection (b) deals with the priority of a security
21 interest in conflict with a non-exclusive license.

22

23 2. Under the Copyright Act, a prior non-exclusive license is subordinate to
24 a later transfer of copyright ownership unless the license is in a signed writing.
25 This rule, while awkward and somewhat inconsistent with modern trends, was
26 made part of the Copyright Act in 1976; there are no indications of probable repeal.
27 The restatement of that rule here alerts persons who engage in commercial
28 transactions about a priority rule that may not otherwise be expected. This avoids
29 traps for unwary licensees. Note, however, that by using the new terms "record"
30 and "authentication" this section are not yet explicitly adopted in federal law.

31

32 **Illustration 1:** Computer Associates sells the copyright in its data compression
33 program to Major Holdings Corp. Five days before that sale, Computer
34 Associates entered a non-exclusive license with Boeing Corp. for a 100 user
35 site license, which license was in an unsigned form. Three days after the sale,
36 Computer Associates entered a non-exclusive site license with Standard Corp.
37 Under subsection (b) **and** under federal law, the licensees' rights to copy (e.g.,
38 use) the software are subordinate to the copyright ownership of Major.

39

40 **Illustration 2:** Lotus enters into a non-exclusive distribution license with

1 Distributor, allowing Distributor to make and distribute copies of 1-2-3
2 Spreadsheet in the mass market subject to a standard form license for end users.
3 Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale, Distributor
4 provides a copy of 1-2-3 to Smith, who assents to the license. If the
5 distribution license was a signed writing, the distribution was authorized by the
6 license which has seniority over Taylor. Smith has priority over Taylor because
7 it took through the valid license. If the distribution license was not a signed
8 writing, Taylor's purchase is senior to that license and Smith is not an
9 authorized user.

10
11 3. Subsection (b) also presents a preemption problem under federal
12 copyright law, but the case for preemption is less clear since the UCC generally
13 controls priorities and other aspects of law relating to security interests and the
14 federal concerns in the priority statute are more focused on title transfers. This
15 section does not take a position on whether a security interest should be filed in
16 federal or state records systems; it simply refers to perfection of the interest. It
17 adopts priority rules for a security interest in conflict with a nonexclusive license
18 that parallel priority positions in current Article 9. The goal is to facilitate use of
19 secured lending related to intangibles by creating provisions that enable the
20 licensor whose intangibles are encumbered to continue to do business in ordinary
21 ways.

22
23 4. Article 2A deals with the priority conflicts that arise when the licensor or
24 owner transfers to a third party an interest in the property that is subject to a lease.
25 The focus in such cases is on relating the rights of the transferee to the rights of the
26 lessee in the **particular item**. That situation does not arise in intangibles involving
27 two nonexclusive licenses since intangibles can be licensed an infinite number of
28 times and each licensee receives the same rights. In contrast, if there is a transfer
29 of ownership **of the information** there may be a conflict between the transferee
30 and the licensee. There are two types of priority conflicts in such cases and modern
31 law lacks clear guidance or commercially viable solutions. One conflict is between
32 two transferees of ownership. The other is dealt with in this section: conflicting
33 claims of a nonexclusive licensee as against a transferee of ownership rights,
34 including a secured party.

35
36 5. For rights not created by federal law, the priority issue raised is a
37 question of state law. The same is apparently true for rights that arise under federal
38 patent law. The Patent Act contains provisions that deal with the respective priority
39 of transfers of patent ownership. A nonexclusive license is not a transfer of
40 ownership and the relationship between the nonexclusive licensee and a transferee
41 of a patent is not dealt with in current federal law. The situation is different in
42 copyright law. Section 205(f) of the Copyright Act provides:

1 A nonexclusive license, whether recorded or not, prevails over a conflicting
2 transfer of copyright ownership if the license is evidenced by a written
3 instrument signed by the owner of the rights licensed or such owner's duly
4 authorized agent, and if:

5
6 (1) the license was taken before execution of the transfer; or

7
8 (2) the license was taken in good faith before recordation of the transfer and
9 without notice of it.

10
11 17 U.S.C. § 205(f). There is no case law under this provision. Significantly,
12 however, the provision does not allow a license made after recordation of the
13 ownership transfer to attain priority under any conditions. Also, an unwritten
14 license will lose even to a subsequent transfer of ownership if this section is
15 regarded as a comprehensive priority rule.

16
17 6. Copyright Act § 205(f) can be viewed as a comprehensive rule of
18 priority (e.g., an unwritten license never superior to a transfer of ownership and the
19 priority status of a written license entirely controlled by Section 205(f)).
20 Alternatively, one might view it as a minimum condition for a particular result
21 (e.g., that a written nonexclusive license has priority under specified circumstances,
22 but not suggesting that these are the only conditions under which this is true). This
23 Draft adopts the view that the priority rule states a minimum and does not establish
24 a comprehensive rule. Thus, as a matter of enacted federal policy, a nonexclusive
25 license prevails in the listed situations, but a nonexclusive license in cases not
26 covered by Section 205 is not controlled by federal law. A contrary interpretation
27 would mean that all mass market licenses currently are subject to being overridden
28 by any subsequent transfer of the underlying copyright since many of these
29 transactions may not qualify as involving a writing signed by the owner of the
30 copyright. Clearly, an assignee of the copyright to Word Perfect software should
31 not be able to sue pre-existing Word Perfect licensees for continued use of the
32 program without a license from the current owner. Even if this position is not
33 correct, the priority rules here would apply to all intangibles other than copyrights,
34 leaving a wide variety of important situations to be addressed here.

35
36
37 **SECTION 2B-508. PRIORITY OF TRANSFERS BY LICENSEE.**

38 (a) In a license, a creditor or other transferee of a licensee acquires no
39 interest in information, copies, or rights held by the licensee unless the conditions
40 for an effective transfer under this article and the license are satisfied. If the

1 transfer is effective, the creditor or other transferee takes subject to the terms of the
2 license.

3 (b) Except for rights under trade secret law, a person that acquires
4 information that is subject to the intellectual property rights of another person
5 acquires only the rights that its transferor was authorized to transfer by the owner
6 of the intellectual property rights or its agent as such rights were limited under the
7 license.

8 **Uniform Law Source:** Section 2A-305.

9

10 **Committee Action:**

11 This section was considered in November, 1996, without substantial comment.

12

13

Reporter's Notes

14 1. A license, previously created, governs rights in the information and in
15 copies thereof. A transferee acquires only the rights that the license allows. As a
16 general principle, a license does not create vested rights and is not generally
17 susceptible to free transfer in the stream of commerce. Subsection (a) is generally
18 consistent with Article 2A.

19

20 2. Subsection (b) states an important principle, mandated under current
21 intellectual property law. The idea of entrustment, which plays a major role in
22 dealing with goods, has less role in intangibles covered by patent or copyright law,
23 since the value involved resides in the intangibles and the concept of possession
24 being entrusted in a manner that creates the appearance of being able to reconvey
25 the valuable property is not ordinarily a relevant concern. Intellectual property law
26 does not recognize a buyer in the ordinary course (or other good faith purchaser) as
27 taking greater rights than the information or copy than were authorized to be
28 transferred. While copyright law allows for a concept of "first sale" which gives
29 the owner of a copy various rights to use that copy, the first sale must be by a party
30 authorized to make the sale under the terms provided to the buyer.

31

32 **Illustration 1:** Correll transfers copies of its software to DAC a distributor.
33 DAC is licensed to transfer the software for educational uses only. DAC
34 transfers a copy to Mobil Oil for use in a business application. Mobil has no
35 knowledge of the Correll license restriction. DAC breached its contract and its

1 distribution also constitutes copyright infringement. Mobil's copying (use) of
2 the software is not authorized under copyright law since it did not receive an
3 authorized distribution. The remaining question is whether Mobil should be
4 subject to a contract action for violating the license in the DAC contract. This
5 section takes no position on the issue.
6

7 3. Transfers in a chain of distribution that exceed a license or that otherwise
8 are unlicensed and unauthorized by a patent or copyright owner create no rights of
9 use in the transferee. A transferee that takes outside the chain of authorized
10 distribution does not benefit from ideas of good faith purchase, but its use is likely
11 to constitute infringement. As to software, this established principle was enforced
12 by the court in *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F.
13 Supp. 208 (ED NY 1994). A retailer that obtained copies of software from third
14 parties argued that the distribution was not a violation of copyright because it in
15 good faith believed that it obtained the copies of the software through a first sale
16 from an authorized party. The court held that there is no concept of good faith
17 purchaser under copyright law and that the buyer cannot obtain any greater rights
18 than the seller had. In the case where the seller is neither an owner of a copy or a
19 person acting with authorization to sell copies to third parties, no first sale occurs
20 and the "buyer" is subject to the license restrictions created under any license to
21 the third party seller. In one instance, the defendant had purchased from a licensee
22 who was authorized to transfer the Microsoft product in sales of its machines. In
23 fact, however, it purported to sell the product as a stand alone. This clearly
24 exceeded the license to it and the mere fact that the alleged buyer acted in good
25 faith did not insulate it from copyright liability. "Entering a license agreement is
26 not a "sale" for purposes of the first sale doctrine. Moreover, the only chain of
27 distribution that Microsoft authorizes is one in which all possessors of Microsoft
28 Products have only a license to use, rather than actual ownership of the Products."
29 See also *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D.
30 N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995);
31 *Marshall v. New Kids on the Block*, 780 F. Supp. 1005 (S.D.N.Y. 1991).
32

33 4. This section does, however, allow for a bona fide purchaser in reference
34 to trade secret claims. The essential feature of a trade secret resides in enforcing
35 confidentiality obligations. Where a party takes without notice of such restrictions,
36 it is not bound by them and, in effect, is a good faith purchaser, free of any
37 obligations regarding infringement except as such exist under copyright, patent and
38 similar law.
39

40 5. Article 2A provides that a buyer from a lessee generally acquires only
41 the "leasehold interest in the goods that the lessee had or had power to transfer, and
42 . . . takes subject to the existing lease." Section 2A-305(1). The exception to these
43 principles in Article 2A occurs in the case of a buyer (or sublessee) from who

1 acquires in the "ordinary course" of the lessor-seller's business. The buyer here
2 takes free of the lease under theories of entrustment. For a buyer to acquire these
3 rights, however, it must purchase from a "person in the business of **selling goods of**
4 **the kind.**" In effect, the goods were entrusted to a sales business. Also, the buyer
5 must be in good faith and without knowledge that the sale violates the lease or
6 ownership rights of the lessor.
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PART 6
PERFORMANCE
[A. GENERAL]

SECTION 2B-601. PERFORMANCE OF CONTRACT.

(a) A party shall perform in a manner that conforms to the contract.

(b) A party’s duty to perform, other than with respect to contractual use restrictions, is contingent on the absence of an uncured material breach by the other party of obligations or duties that precede in time the party’s performance.

(c) In a mass-market transaction, if the performance consists of delivery of a copy which constitutes the initial activation of rights, the licensee may refuse the performance if the performance does not conform to the contract.

(d) If a party is subject to contractual use restrictions or required to render future or on-going performance, the party’s rights under the contract are contingent on the absence of an uncured material breach of the obligations or duties of that party.

Uniform Law Source: *Restatement (Second) of Contracts* § 237. Substantially revised.

Committee Vote:

1. Motion to make an exception to the material breach rule for mass market contracts on the issue covered by Article 2 (the right to reject a transfer of rights). Adopted 12-0

2. Voted 10-3 to use mass market license, rather than consumer in this section.

3. Voted 1-7 to reject a motion to use the idea of perfect tender as the standard for the right to reject and cancel for breach in any performance of any type of contract term.

Reporter's Notes

Changes Since the June Meeting:

1. The second sentence of subsection (a) was deleted as redundant with the same material covered in Section 2B-305 based on discussion at the harmonization meeting.

2. Former subsection (e) dealing with suspending performance and cancellation was deleted because it is a remedies concepts and redundant of the more specific and fully developed coverage of remedies in other sections..

3. Former subsection (f) defining "contractual use restrictions" was moved to the definition section since it is used in this section and in Section 2B-621.

General Notes:

1. Subsection (a) states a generalized default rule which basically requires a court to look to reasonable commercial standards in any case not otherwise governed by the contract or by provisions of this Article as to default terms.

2. Subsection (b) adopts the theme of material breach (or substantial performance) as the measure of the right to cancel or refuse a performance except in reference to certain mass market transactions. As is described in the *Restatement*, that rule holds that a duty to perform is contingent on the prior performance by the other party without a material failure of performance. *Restatement (Second) of Contracts* § 237 states: "[It] is a condition of each party's remaining duties to render performances . . . under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time." This is also the common law rule. In subsection (b), it is made clear that the contingent relationship does not refer to situations involving contractual use restrictions. A breach of a license by the licensor does not give the licensee unfettered rights to act in derogation of the licensor's ownership rights in the intellectual property and the use restrictions that these support.

This section sets out basic default rules. The model treats the performance of the parties as being mutually conditional on the substantial performance of the other party. Other sections dealing with specific types of contract supplement these with more specific provisions that enhance and amplify the general rules, but displace them only if there is a conflict.

3. The decision to adopt a material breach concept places Article 2B parallel with common law and the modern international law of sales (except in the mass market which is kept in line with current Article 2 rules). The Convention on

1 the International Sale of Goods (CISG) refers to "fundamental breach," which it
2 defines as: "A breach . . . is fundamental if it results in such detriment to the other
3 party as substantially to deprive him of what he is entitled to expect under the
4 contract, unless the party in breach did not foresee and a reasonable person . . .
5 would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles
6 of International Commercial Law state: "A party may terminate the contract where
7 the failure of the other party to perform an obligation under the contract amounts to
8 a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article
9 2A stand essentially alone in modern transactional law in requiring so-called
10 "perfect tender." Even then, these statutes do so in reference to a single fact
11 situation only: a single delivery of goods not part of an installment contract.
12 Outside that single context, the use of materiality as a performance standard for
13 when the reciprocal performance is not required is virtually unanimous.

14
15 **Illustration 1:** Tom Jones has agreed to develop systems software for DNY.
16 DNY promises to pay the purchase price of \$300,000 in three installments once
17 every three months. Jones fails to complete stage 1 in month 2 and this failure
18 is material. When the first payment is due, if the failure remains uncured, DNY
19 is not required to pay. It can cancel the contract or seek assurances of
20 performance. To alter this result would require an express agreement severing
21 the obligation to pay from the performance of the deliveries.

22
23 5. The concept is simple: A minor defect in the transfer does not warrant
24 rejection of performance or cancellation of a contract. Minor problems constitutes
25 a breach of contract, but the remedy is compensation for the value lost. The
26 objective is to avoid forfeiture based on small errors and to recognize that,
27 especially if performance involves ongoing activity, fully perfect performance
28 cannot be the expected norm. This is especially true in information contracts.
29 Software often contains "bugs" or imperfections. Information services often entail
30 small errors and incompleteness. The policy choice here adopts general law and
31 allows a party whose performance has minor errors to expect performance by the
32 other party; subject, in appropriate cases, to offsets and compensation for the
33 problems.

34
35 6. The substantial performance rule does **not** hold that substantial (but
36 imperfect) performance of a contract is not a breach. Substantial (but imperfect)
37 performance is a breach of contract. The significance of substantial performance
38 lies in the remedy for the injured party. Substantial performance is sufficient to
39 trigger the injured party's obligations to perform. Unless a breach is material, it
40 cannot be used as an excuse to void or avoid the contract obligations. A licensee
41 who receives substantial (but imperfect) performance from the licensor, cannot
42 reject the initial tender or cancel the contract on that account, but it can obtain
43 financial satisfaction for the less than complete performance.

1
2 7. This section creates a carve out of perfect tender in mass market
3 transactions with respect to tender of deliver of a copy other than in an installment
4 contract setting. This tender rule does not mean that the tendered information is in
5 fact perfect, but that it meet the general contract description in light of ordinary
6 expectations and trade use. As in Article 2, this rule applies only to tender of a
7 copy and the resulting duty to accept or right to refuse the tender that is the single
8 performance in the transaction (e.g., delivery of a television set, delivery of the
9 diskette containing the software). As under current law, however, substantial
10 performance rules apply in reference to on-going performance for both parties,
11 services such as continuous access, and deliveries of a series of copies in an
12 installment contract.

13
14 8. Article 2 applies a "perfect tender" rule to only one setting: the initial
15 tender (transfer) of goods in a contract that does not involve installment sales.
16 Article 2 does not allow the buyer to assert a failure of perfect tender in an
17 installment contract (that is, a contract characterized by an ongoing relationship).
18 Even in a single delivery context, the theory of perfect tender is hemmed in by a
19 myriad of countervailing considerations. As a matter of practice, a commercial
20 buyer cannot safely reject a tendered delivery for a minor defect without
21 considering the rights of the vendor to cure the defect under the statute or under
22 commercial trade use. White and Summers state: "[we found no case that] actually
23 grants rejection on what could fairly be called an insubstantial non-conformity . . ."
24 Indeed, in one case involving software, a court applied a substantial performance
25 test to a UCC sales transaction. See *D.P. Technology Corp. v. Sherwood Tool, Inc.*,
26 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled
27 with no proven economic loss).

28
29 9. Definitions in Section 2B-102 make "substantial performance" and
30 "material breach" mirror image concepts. Material breach is defined in Section
31 2B-108 and is discussed in the Reporter's Notes to that section. The definition
32 largely adopts the definition in the *Restatement (Second) of Contracts* § 241,
33 adding some specificity related to this commercial context. This article rejects the
34 less fully explored language used in Article 2A (and some parts of Article 2) which
35 refers to breaches that "substantially impair" the value of a contract to the injured
36 party. A material breach is a breach that significantly damages the injured party's
37 receipt of the value it expected from the contract, but reliance on language that is
38 common in general law and legal tradition enables this article to fall back on
39 themes that courts are familiar with, rather than on language in other UCC articles
40 that has not been well explored in case law.

41
42
43 **SECTION 2B-602. SUBMISSIONS OF INFORMATIONAL CONTENT.**

1 (a) If a party submits informational content to a licensee under an
2 agreement that requires that the information be to the subjective satisfaction of the
3 licensee, the following rules apply:

4 (1) Sections 2B-607 through 2B-613 and Section 2B-619 do not apply.

5 (2) If the informational content is not satisfactory to the licensee, the
6 parties may engage in efforts to correct the deficiencies over a period of time and in
7 a manner consistent with the ordinary standards of the trade or industry.

8 (3) Neither refusal nor acceptance occurs unless the licensee makes an
9 express, affirmative indication of refusal or acceptance of the submission to the
10 licensor.

11 (4) Refusal terminates the agreement and does not constitute a breach
12 of contract.

13 (b) If a person submits informational content or an idea other than under an
14 agreement, the following rules apply:

15 (1) A contract or obligation does not arise and is not implied from the
16 mere receipt of an unsolicited disclosure of an idea for the creation, development,
17 or enhancement of information. Engaging in a trade or industry that by custom or
18 conduct regularly acquires ideas for the creation, development, or enhancement of
19 information does not in itself constitute an express or implied solicitation of such
20 information.

21 (2) If the recipient notifies the person making the submission that it
22 maintains a procedure to receive and review such submissions, no contract is

1 created unless the information or idea is submitted and accepted pursuant to that
2 procedure or the recipient expressly agrees to contractual terms concerning the
3 submission.

4 (c) Unless a term in the agreement expressly provides otherwise, an
5 agreement to disclose an idea for the creation, development, or enhancement of
6 information does not create an enforceable contract if the idea is not confidential,
7 concrete, or novel to the trade or industry.

8 **Prior Uniform Law:** None.

9

10 **Committee Action:**

11 1. Reviewed without substantive changes in May, 1997.

12

13

Reporter's Notes

14 1. This section deals with a problem that was raised recurrently during the
15 discussion of the Committee concerning the carrying forward of Article 2 rules
16 concerning tender, acceptance and rejection into situations involving the
17 informational content industries where practices are much different than in
18 traditional sales of goods. The section solves that conflict by carving out content
19 submissions from the circumstances involved in reference to tender of a required
20 performance in other respects.

21

22 2. For transactions involving traditional book and publishing upstream
23 agreements, the solution lies simply in recognizing that the submission of a
24 manuscript, even pursuant to an agreement, does not represent a tender of
25 performance analogous to that involving a delivery of goods that requires
26 immediate acceptance or rejection. Rather, the delivery of informational content in
27 this context triggers a process that typically centers around the fact that the licensee
28 has the right to refuse if the content does not satisfy its expectations. Once that fact
29 is recognized, the inapplicability of the various rules on acceptance and the like
30 becomes apparent. The provisions of subsection (a) attempt to capture basic
31 principles of content submission in such case, but need to be reviewed by members
32 of the industry for relevance and desirability.

33

34 3. An important aspect of the difference in the two circumstances lies in
35 subsection (a)(3) where it is made clear that only an explicit refusal or acceptance

1 satisfies the standard of acceptance in this setting since, by presumption, the
2 circumstances are keyed to the subjective satisfaction of the receiving party.

3

4 4. Subsection (b) deals in a limited way with a problem that exists in all of
5 the industries to which this Article applies: submission of informational content not
6 pursuant to an agreement. It provides that, if a procedure exists for receipt and
7 review of such submissions to which the submitting party is referred, no contract
8 exists unless the submission was pursuant to that procedure or compliance with the
9 procedure was waived by the licensee. This leaves undisturbed a vast array of
10 doctrines dealing with adequacy of consideration, equitable remedies, and the like,
11 but clarifies the legal effect of the submission in contractual doctrine.

12

13

14 **SECTION 2B-603. ACTIVATION OF RIGHTS; LICENSOR'S**

15 **OBLIGATIONS.**

16 (a) Subject to Section 2B-601, a licensor shall complete the initial
17 activation of rights. The licensor completes its obligations with respect to the initial
18 activation of rights when it completes the activation of rights and gives its direct
19 licensee any notice reasonably necessary to make it aware of that occurrence in a
20 commercially reasonable manner.

21 (b) If applicable intellectual property law requires or allows the filing of a
22 record to establish the priority of a transfer of ownership of intellectual property
23 rights and a transfer of ownership is contemplated by the agreement, on request by
24 the licensee, the licensor shall deliver a record sufficient for such purpose.

25 (c) If no act is required to make information available, the activation of
26 rights occurs when the contract becomes enforceable between the parties.

27 (d) If information is made available by delivery of a copy, the following
28 rules apply:

1 (1) If the contract is silent as to delivery:

2 (A) except as otherwise provided in paragraphs (2) and (3), in a

3 physical delivery of a tangible copy, the licensor shall make the copy available to

4 the licensee at the licensor's place of business or, if it has none, its residence, but,

5 if the copy is identified at the time of contracting and located elsewhere, the

6 licensor shall make the copy available at that place; and

7 (B) in a delivery of a copy by electronic means, the licensor shall

8 make the information available in an information processing system designated by

9 the licensor and shall provide the licensee with authorization codes, addresses,

10 acknowledgments, and any other materials necessary to obtain the information.

11 (2) If the contract requires or authorizes delivery of a copy held by a

12 third party to be delivered without being moved, the licensor shall deliver any

13 documents, authorizations, addresses, access codes, and other materials necessary

14 for the licensee to obtain the copies.

15 (3) If the contract requires or authorizes the licensor to send a copy of

16 the information to the licensee or a third party but does not expressly require the

17 licensor to deliver it to a destination:

18 (A) in a physical delivery of a tangible copy on a physical medium,

19 the licensor shall put the copy in the possession of a carrier, make such

20 arrangements as are reasonable for transportation to the licensee or the third party

21 with the expenses of the shipment to be borne by the licensee, and deliver any

22 documents necessary to obtain the copies from the carrier; and

1 (B) in a delivery of a copy by electronic means, the licensor shall
2 initiate an appropriate transmission of the information to the licensee or a third
3 party.

4 (e) If an activation of rights is to occur by making access available to a
5 licensee or providing the licensee with access to a facility containing the
6 information, the licensor shall complete any acts necessary to make access
7 available, including providing the licensee with any documents, authorizations,
8 addresses, access codes, acknowledgments, and other materials necessary for the
9 licensee to obtain access.

10 (f) In an electronic transmission or delivery, information provided in a
11 manner consistent with the technological capabilities of the receiving party known
12 to the licensor or the ordinary methods in the business, trade, or industry for
13 transfers of the particular kind.

14 **Uniform Law Source:** Sections 2-401, 2-509(a), 2-308.

15
16

Reporter's Notes

17 1. This section brings together various rules defining the obligations of the
18 licensor relating to completion of its obligation to activate the rights provided for
19 under the contract. The section corresponds to Section 2B-606 which deals with
20 tender of performance

21

22 2. The section corresponds to the treatment of title and delivery in Article
23 2. While title itself is not a key concept in article 2, the seller's obligations for
24 delivery correlate to obligations relating to title transfer and risk of loss. In Article
25 2B, title and delivery are less significant. The keys are transfers of rights which
26 involve making information available to the transferee. The default rules here
27 correspond to standards in Article 2 relating to delivery and title transfer, but they
28 account for transactions involving access and electronic transfers.

29

30 3. These are default rules and are thus subject to contrary terms of

1 agreement.

2

3 4. Subsection (d)(1) distinguishes between physical delivery and electronic
4 delivery of a copy. In both cases, consistent with current law in Article 2, the
5 obligation consists of making the copy or access to making a copy available to the
6 transferee. In development or similar contexts, contrary agreement often occurs
7 (e.g., by requiring installation or testing on site). Under Article 2, despite similar
8 fact settings, current law chose an approach that effectively corresponds to so-
9 called shipment contracts. Absent contrary agreement, the assumption is that the
10 licensor (or seller in Article 2) is not obligated to transport without charge the
11 material to the licensee's location.

12

13

14 **SECTION 2B-604. PERFORMANCE AT SINGLE TIME.** If it is

15 commercially reasonable to render all of one party's performance at one time, the

16 performance is due at one time and the other party's reciprocal performance is due

17 only on tender of full performance.

18 **Uniform Law Source:** Section 2-307.

19

20 **Committee Action:**

21 This section was reviewed in November without substantive comment.

22

23

Reporter's Note

24 The section adopts an approach found in both Section 2-307 and common
25 law as described in the *Restatement (Second)* with reference to the relationship
26 between performance and payment in cases where performance can be rendered at
27 a single time. It adds the qualification that the ability to so perform must be gauged
28 against standards of commercial reasonableness. The section does not affect the
29 treatment of contracts calling for delivery of systems in modular form or for
30 contracts that extend performance out over time, such as in data processing
31 arrangements. In each of these cases, the performance of the one party cannot be
32 completed at one time.

33

34

35 **SECTION 2B-605. WHEN PAYMENT DUE.**

36 (a) If the circumstances or the agreement give a party the right to make or

1 demand performance in part or over a period of time, payment, if it can be
2 apportioned, may be demanded for each part performance.

3 (b) If payment cannot be apportioned or the agreement or circumstances
4 indicate that payment may not be demanded for part performance, payment is due
5 only on tender of completion of the entire performance.

6 **Uniform Law Source:** *Restatement (Second) Contracts*; Section 2-310.

7

8 **Committee Action:**

9 Considered in November, 1996, without substantive comment.

10

11

Reporter's Note

12 This section follows current law in Article 2 and in the *Restatement*.

13

14

15

16

[B. TENDER OF PERFORMANCE; ACCEPTANCE]

17

18

19

SECTION 2B-606. ACCEPTANCE: EFFECT.

20 (a) A party shall pay or render other performance required according to the
21 contractual terms for any performance it accepts.

22 (b) The burden is on the party that accepted the performance to establish
23 any breach of contract with respect to the performance accepted.

24 **Uniform Law Source:** Section 2-507.

25

26 **Committee Action:**

27 Considered in November, 1996, without substantive comment.

28

29

Reporter's Notes

30 1. This section should be read in context of the right to revoke, the
31 licensor's obligation to cure immaterial breaches, and the licensee's right to

1 recoup from future payments even in the case of an immaterial breach where the
2 amounts to be recouped are liquidated amounts. The additional language in new
3 (b) is taken from current Section 2-607(4).

4
5 2. In the CISG, the remedies of the buyer do not depend on whether the
6 buyer accepted the goods or not or whether revocation occurred. In cases of
7 information content, the Committee should consider whether a similar model would
8 be more appropriate. In cases of material breach, the licensee's right to recover
9 what it paid or to avoid paying further should not hinge on questions of whether it
10 has a right to revoke, but on a calibration of loss sustained compared to benefit
11 received. Buyer remedies arise when the seller "fails to perform any of his
12 obligations," Art. 45(1), and are preserved if proper notice is given. Art. 39(1).
13 There is no rejection remedy in general and the buyer is obligated to pay the
14 purchase price unless the contract can be avoided for "fundamental breach." Art.
15 25. This model more closely resembles the *Restatement*. The Article 2 Drafting
16 Committee has considered and rejected use of this in lieu of the acceptance-
17 rejection model on several occasions.

18
19 3. In cases of rejection, proposed Article 2 reflects this model in part by
20 providing that "If the use of the goods is reasonable . . . and is not an acceptance,
21 the buyer on returning or disposing of the goods, shall pay the seller the reasonable
22 value of the use to the buyer. This value must be deducted from the sum of the
23 price paid to the seller . . . and any damages . . ." Section 2-605(b)(2).

24
25
26 **SECTION 2B-607. TENDER OF PERFORMANCE; RIGHT TO**
27 **ACCEPTANCE.**

28 (a) A tender of performance occurs when a party, with manifest present
29 ability to do so, offers to complete the performance. If a performance by the other
30 party is due before the tendered performance, the other party's performance is a
31 condition to the first party's duty to complete the tendered performance.

32 (b) Tender of performance that substantially conforms to the contract
33 entitles the party to acceptance of that performance. However, in a mass-market
34 transaction, if the performance consists of the delivery of a copy which constitutes

1 the initial activation, the licensee may refuse the performance if it does not conform
2 to the contract.

3 (c) If performance entails delivery of a copy, a licensor shall tender first
4 but need not complete the performance until the licensee pays and tenders other
5 performance required at that time. Tender must be at a reasonable hour and
6 requires that the licensor:

7 (1) notify the licensee that the information or copies are available or
8 have been shipped;

9 (2) tender any documents, authorizations, addresses, access codes,
10 acknowledgments, or other materials necessary for the licensee to obtain access to,
11 control over, or possession of the information; and

12 (3) hold the information, copies, and materials at the licensee's disposal
13 for a period reasonably necessary to enable the licensee to obtain access, control, or
14 possession.

15 (d) Tender of payment is sufficient if made by any means or in any manner
16 current in the ordinary course of business unless the other party demands payment
17 in money and gives any extension of time reasonably necessary to procure it.

18 **Uniform Law Source:** Sections 2-510, 2-511(a)(b). *Restatement (Second) of*
19 *Contracts* § 238.

20

21 **Committee Action:**

22 1. Approved substantial performance rule in (b). (September, 1996)

23

24 **Selected Issues:**

25 1. Should full conformance to express performance standards or conditions by

1 both parties be an exception to the substantial performance standard in (b)?

2

3

Reporter's Notes

4 1. This section brings together various rules from existing Article 2.

5

6 2. Subsection (a) states a general principle of what constitutes tender. It is
7 drawn from the *Restatement*. Unlike in Article 2, the performances here are not
8 always actions relating to an offer to delivery goods and to pay for them. As a
9 result, general language in subsection (a) provides an important baseline.

10

11 3. Subsection (b) states the substantial performance rule and the mass-
12 market exception. In contracts where the information must be to the satisfaction of
13 the licensee, performance that is not satisfactory does not satisfy the condition
14 stated in subsection (b) and creates no obligation to accept.

15

16 4. Subsection (c) chooses who goes first. Current law (Section 2-511(1))
17 states that tender of payment is a precondition for the duty to tender or complete
18 delivery. In this Draft, the licensor, must tender first. The basic model is that
19 tender of a performance means to offer to perform, and typically precedes actual
20 performance. In reference to transfers of rights, Article 2B follows Article 2 by
21 requiring tender, then payment, then completion. For tender, the circumstances
22 must clearly indicate that performance is immediately forthcoming. This is the
23 function of the references to shipment, tender of materials and the like.

24

25 5. As in the case of Article 2, the licensee's duty to accept typically hinges
26 on its right to inspect the tendered copy as outlined in Section 2B-609 and
27 elsewhere. In the case of development contracts, the common practice typically
28 expands on the inspection right, creating a period of testing before acceptance at
29 the end of the contract. In such cases, the tender itself implies an opportunity to
30 test and inspect the copy. The duty to accept conforming property comes
31 afterwards.

32

33 **Illustration 1:** Jones contracts for the development of a system by Smith.
34 Smith completes what it anticipates to be the full system and tenders a disk
35 containing the software to Jones. Jones has a right to inspect the information
36 before paying pursuant to an interaction of this section and the section on
37 inspection. If the parties agreed to acceptance tests, those tests define the scope
38 of the inspection right. If not, a reasonable inspection is required. Payment
39 follows satisfactory inspection.

40

41 6. Subsection (d) is drawn from Article 2.

42

43

1 **SECTION 2B-608. COMPLETED PERFORMANCES.**

2 (a) If performance involves delivery of informational content,
3 entertainment, or related artistic, personal or professional services that because of
4 their nature provide the licensee substantially with the value of the information and
5 that value cannot be returned once delivery or performance is received by the
6 licensee, Sections 2B-609 through 2B-613 and Section 2B-619 do not apply and
7 the rights of the parties are determined under Section 2B-601 and the ordinary
8 practices of the applicable business, trade, or industry.

9 (b) In a contract governed by subsection (a), before payment, a party may
10 inspect the media and label or packaging of a performance but may not view or
11 receive the performance unless the agreement provides otherwise.

12 **Committee Action:**

13 1. Reviewed without substantive changes in June, 1997

14
15

Reporter's Notes

16 This section deals with a problem arising from the nature of the subject
17 matter covered in this article. Some subject matter is, in effect, fully delivered
18 when made available to or read by the transferee; theories of inspection, rejection
19 and return as in Article 2 are not applicable. This is true, for example, in a pay per
20 view arrangement for an entertainment event or other information. It is also the
21 case where the subject matter of the contract involves informational content that,
22 once seen, has in effect communicated its entire value. The parties should be left to
23 general, common law remedies as described in Section 2B-601. If the delivered
24 performance constitutes a material breach, the receiving party can obtain its money
25 back or sue for damages, but it cannot demand full performance prior to payment as
26 would be the case with anything other than the limited inspection right described in
27 subsection (b).

28
29

30 **SECTION 2B-609. LICENSEE'S RIGHT TO INSPECT; PAYMENT**

1 **BEFORE INSPECTION.**

2 (a) If performance requires delivery of a copy, the following rules apply:

3 (1) Except as otherwise provided in this section, a licensee, before
4 payment or acceptance, has a right to inspect the physical medium and the
5 information and to obtain any related documentation at a reasonable place and time
6 and in a reasonable manner in order to determine conformance to the contract.

7 (2) Expenses of inspection must be borne by the licensee.

8 (3) A place or method of inspection or an acceptance standard fixed by
9 the parties is presumed to be exclusive. However, unless otherwise expressly
10 agreed, the fixing of a place, method or standard does not postpone identification or
11 shift the place for delivery or for passing the risk of loss. If compliance with the
12 place or method becomes impossible, inspection must be made as provided in this
13 section unless the place or method fixed by the parties was clearly intended as an
14 indispensable condition whose failure avoids the contract.

15 (4) A licensee's right to inspect is subject to the confidentiality of the
16 information. Unless the licensor otherwise agrees, the licensee may not inspect
17 before payment in a manner that would disclose or jeopardize trade secret or
18 confidential information if that information is so designated by the licensor.

19 [(5) If inspection would provide the licensee substantially with the
20 value of the information, access, or performance before payment, the licensee does
21 not have a right to inspect before payment.]

22 (b) If a right to inspect exists under subsection (a) and the agreement are

1 inconsistent with an opportunity to inspect before making payment, the licensee
2 does not have a right to inspect before payment. Nonconformity in the tender does
3 not excuse the licensee from making payment unless:

4 (1) the nonconformity appears without inspection and would justify
5 refusal under Section 2B-610; or

6 (2) in a documentary transaction, despite tender of the required
7 documents, the circumstances would justify injunction against honor under Article
8 5.

9 (c) Payment in accordance with subsection (b) is not an acceptance of
10 performance and does not impair a licensee's right to inspect or preclude other
11 remedies of the licensee.

12 **Uniform Law Source:** Section 2-513; CISG Art. 58(3); Section 2-508.
13 Substantially revised. [The phrase "standard of inspection" perhaps should be
14 altered to refer to "acceptance criteria".]
15

16 Reporter's Note

17 *Changes Since the June Meeting:*

18 Subsection (a)(2) was edited at the Harmonization meeting based on the
19 treatment of "incidental damages" which cover expenses of inspection in the event
20 of breach.
21

22 1. This section combines former Sections 2B-607 and 2B-608 with new
23 material relevant to the information industries.
24

25 2. Subsection (a)(4) deals with the relationship between confidentiality and
26 the right to inspect. Absent contrary agreement, inspection prior to payment is not
27 appropriate if the type of inspection involved would reveal designated trade secrets
28 or confidential information. This does not bar any inspection, but merely indicates
29 that a right to see trade secret information cannot be presumed. Also, the balance
30 here is limited to situations where the licensor designates information as
31 confidential or a trade secret.

1
2 3. Subsection (a)(5) concerns situations in which the nature of the
3 information is such that inspection would effectively convey substantially all of the
4 value to the licensee before payment. Thus, for example, in a transaction where the
5 essence of the deal is to reveal discrete information known to one party (e.g., the
6 profit record of a company for the past year), inspection would communicate the
7 subject matter of the deal and that communication cannot effectively be taken back
8 if payment does not follow. The parties can agree to this result if they so choose,
9 but it is not appropriate for law to presume it. This rule would not apply, however,
10 where merely inspecting information conveys it. Thus, an author's submission of a
11 manuscript to a publisher would not trigger this rule since the publisher's does not
12 obtain the value by merely examining the manuscript.

13
14 4. Subsection (b) follows the rules stated in current UCC § 2-512.
15
16

17 **SECTION 2B-610. REFUSAL OF DEFECTIVE TENDER.**

18 (a) Subject to subsection (b), if a tender of performance or the tendering
19 party's previous performance constitutes a material breach of contract, as to the
20 particular tendered performance, the party to which it is tendered may:

21 (1) refuse the performance;

22 (2) accept the performance;

23 (3) accept any commercially reasonable units and refuse the rest; or

24 (4) permit an opportunity to cure the nonconformity.

25 (b) In a mass-market license, a licensee may refuse a performance
26 consisting of the delivery of a copy which constitutes the initial activation of rights
27 if the performance does not conform to the contract.

28 (c) Refusal under subsection (a) or (b) is ineffective unless made within a
29 reasonable time after the tender and the completion of any permitted effort to cure
30 and before acceptance and the party whose performance is refused is notified

1 within a reasonable time after the breach of contract was or should have been
2 discovered.

3 **Uniform Law Source:** Combines Sections 2-601, 2-602, Section 2A-509.
4 Substantially revised.

5
6 **Votes:**

7 1. The Committee adopted a "perfect tender" carve out for cases involving the
8 tender of delivery of a copy in circumstances equivalent to those where the perfect
9 tender rule applies in Article 2.

10

11

Reporter's Note

12 1. This section deals with refusal of tendered performance. The word
13 "refuse" is used in lieu of the Article 2 term "reject" because the intent is to cover
14 more broadly the circumstances under which a party can decline to accept a
15 performance of any type, rather than merely to concentrate on cases of a refused
16 (rejected) tender of delivery as the phrase is used in Article 2. Thus, for example, a
17 party might refuse proffered services under a maintenance contract because of prior
18 breach or of their failure to substantially conform to the contract. The right to
19 refuse tendered performance hinges either on the substantial nonconformity of the
20 particular performance or on the existence of an uncured, prior material breach by
21 the tendering party.

22

23 2. This section and the section on cure give control of the situation to the
24 licensee to whom improper performance is provided. In this Article, other than in
25 the mass market, refusal or cancellation can occur only in the event of a material
26 breach. This is unlike in Article 2 where even minor defects may allow rejection of
27 a tender. Given the greater impact of the breach, the equities shift more clearly to
28 the injured party and it is given a right to close out the transaction without waiting
29 for cure. Cure cannot come after cancellation.

30

31 3. Subsection (b) implements the carve out for mass market transactions
32 which are governed in this Article under standards that are consistent with Article 2
33 in the sale of goods.

34

35

36 **SECTION 2B-611. DUTIES FOLLOWING RIGHTFUL REFUSAL.** After

37 a rightful refusal or revocation of acceptance, the following rules apply:

38 (1) Any use of the information or copies, or any disclosure of a trade secret

1 or confidential information inconsistent with the agreement, constitutes a breach of
2 contract. However, use for a limited time solely to avoid or mitigate loss is not
3 prohibited if the use is not inconsistent with the licensee's refusal of the
4 performance or the terms of the agreement.

5 (2) A licensee in possession of copies or documentation or additional
6 copies, shall return all copies and documentation to the licensor or hold them for
7 disposal at the licensor's instructions for a reasonable time. If the licensee holds
8 the materials, the following additional rules apply:

9 (A) The licensee shall follow any reasonable instructions received from
10 the licensor. However, instructions are not reasonable if the licensor does not
11 arrange for payment of or reimbursement for the reasonable expenses of complying
12 with the instructions.

13 (B) If the licensor does not give instructions within a reasonable time
14 after being notified of refusal, the licensee may in a reasonable manner to avoid or
15 mitigate loss store the documentation and copies for the licensor's account or ship
16 them to the licensor with a right of reimbursement for reasonable costs of storage,
17 shipment, and handling.

18 (3) A licensee has no further obligations with respect to information or
19 copies and documentation. However, both parties remain bound by any obligations
20 of nondisclosure or confidentiality and any scope or other contractual use
21 restrictions which would have been enforceable had the performance not been
22 refused.

1 (4) In complying with this section, a licensee is held only to good faith and
2 a standard of care that is reasonable in the circumstances. Conduct in good faith
3 under this section does not constitute acceptance or conversion and is not the basis
4 for an action for damages or equitable relief.

5 **Uniform Law Source:** Sections 2-602(2), 2-603, 2-604.

6

7

Reporter's Note

8 1. This section does not give the licensee a right to sell goods,
9 documentation or copies related to the intangibles under any circumstance. The
10 materials may be confidential and may be subject to the overriding influence of the
11 proprietary rights held and retained by the licensor in the intangibles. As Comment
12 2 to current Section 2-603 states: "The buyer's duty to resell under [that] section
13 arises from commercial necessity" That necessity is not present in respect of
14 information. The licensor's interests are focused on protection of confidentiality or
15 control, not on optimal disposition of the goods that may contain a copy of the
16 information.

17

18 2. Subsection (1) limits the revoking person's right to use the information
19 in its possession. Uses inconsistent with the terms of this section or the contract
20 constitute a breach by the party engaging in the misuse. The section does permit,
21 however, limited uses for purposes of minimizing loss. That use does not extend to
22 disclosure of confidential information or sale of the copies. It cannot be
23 inconsistent with the refusal. This section asks courts to reach the balance
24 discussed in *Can-Key Industries v. Industrial Leasing Corp.*, 593 P.2d 1125 (Or.
25 1979) and *Harrington v. Holiday Rambler Corp.*, 575 P.2d 578 (Mont. 1978) with
26 respect to goods, but with an understanding of the nature of any intellectual
27 property rights that may be involved here.

28

29 3. Subsection (3) makes clear that, following refusal or revocation, both
30 parties remain bound by confidentiality obligations with respect to the information.
31 Unlike in reference to sales of goods, it is not uncommon that each party have
32 some such information of the other and a mutual, continuing restriction is
33 appropriate.

34

35 4. The eventual Comments to the section will make clear that a wrongful
36 refusal is not a refusal for purposes of this and other sections, but simply a breach
37 of contract. That breach may or may not be material, but in either event, it triggers
38 the sequence of remedies contained in the contract and this article, rather than the
39 duties stated here.

1
2
3 **SECTION 2B-612. WHAT CONSTITUTES ACCEPTANCE OF**
4 **PERFORMANCE.**

5 (a) Acceptance of a performance occurs when the party receiving the
6 performance:

7 (1) substantially obtains the value or access expected from the
8 performance and, without objecting, retains the value or utilizes the access beyond
9 a reasonable time to refuse the performance;

10 (2) signifies or acts with respect to the information in a manner that
11 signifies to the other party that the performance was conforming or that the party
12 will take or retain the performance in spite of the nonconformity;

13 (3) fails effectively to refuse performance under the terms of the
14 agreement or Section 2B-610;

15 (4) acts in a manner that makes compliance with the licensee's duties
16 on refusal impossible because of commingling[; or

17 [(5) receives a substantial benefit or knowledge of valuable
18 informational content from the performance and the benefit or knowledge cannot
19 be returned].

20 (b) Except in cases governed by subsection (a)(4) and (5), if a right to
21 inspect exists under Section 2B-609 or the agreement, acceptance of performance
22 that involves delivery of a copy occurs only when the party has a reasonable
23 opportunity to inspect the copy and any document.

1 (c) If an agreement requires performance in stages to deliver the complete
2 information product, this section applies separately to each stage. If the agreement
3 contemplates delivery of a product in stages, rather than repeated separate
4 performances under an overall agreement, acceptance of any stage is conditional
5 until acceptance of the activation of rights in the completed information.

6 **Uniform Law Source:** Section 2A-515. Revised.

7

8

Reporter's Note

9 1. Acceptance is the opposite of refusal. As to its effect on remedies, see
10 sections on waiver and general remedies sections.

11

12 2. Subsection (a)(2) and (3) conform to the language of Article 2A,
13 clarifying as in Article 2A, that actions as well as communications can signify
14 acceptance. This section does not adopt existing Article 2 provisions relating to
15 actions inconsistent with the party's ownership since, as in Article 2A, there is a
16 split between performance and retention of ownership in many cases. That split
17 indicates that, as in 2A, the ownership standard is not relevant to use of information
18 assets and other performance relevant here.

19

20 3. Subsection (a)(4) and (5) focus on two circumstances significant in
21 reference to information and that raises issues different from cases involving goods.
22 In subsection (a)(4), the key fact is that it would be inequitable or impossible to
23 reject the data or information having received and commingled the material. The
24 receiving party can exercise rights in the event of breach, but rejection is simply
25 not a helpful paradigm. Recall that a rejecting licensee must return or to keep the
26 digital information available for return to the licensor. Commingling does not refer
27 only to placing the information into a common mass from which they are
28 indistinguishable; it also includes cases in which software is integrated into a
29 complex system in a way that renders removal and return impossible or where they
30 are integrated into a database or knowledge base that they cannot be separated
31 from. Commingling is significant because it precludes return of the rejected
32 property.

33

34 4. The second situation (a)(5) involves use or exploitation of the value of
35 the material by the licensee. In information transactions, it is the case that in many
36 instances merely being exposed to the factual or other material transfers the
37 significant value. Also, often, use of the information does the same. Again,
38 rejection is not a useful paradigm. The recipient of the information can sue for

1 damages for breach and, when breach is material, either collect back its paid up
2 price or avoid paying a price that would otherwise be due.

3
4 **Illustration 1:** Licensee receives a right to use a mailing list of names of
5 customers of Macey's store. It notices that the list contains no names from a
6 particular zip code, but goes ahead with an initial mailing. It then seeks to
7 reject the performance. While this would not fit within subsection (a)(5), the
8 section provides that the acceptance already occurred if substantial value was
9 received. Licensee can collect damages for the error and, if the breach was
10 material, avoid obligation for the price. But it cannot reject because of (a)(1).

11
12 **Illustration 2:** A contracts with B to obtain the formula to Coca Cola and
13 information from B about how to mix the formula. B delivers the formula, but
14 the mixing information is entirely inadequate. If the mixing information is not
15 significant to the entire deal, A cannot reject because it received substantial
16 performance. If the mixing information is significant, a right to reject may arise
17 because of a material breach. However, subsection (a)(5) bars rejection if A
18 received substantial value by obtaining knowledge of the formula and cannot
19 return that knowledge. Even though it can return copies of the formula,
20 knowledge would remain. A can sue for damages, but cannot reject after the
21 formula is made known to it.

22
23 **Illustration 3:** Intel contracts with John for a right to use John's list of the ten
24 largest users of Motorola chips in the Southwest. The price is \$1 million. John
25 supplies the list, but there are two names that, through negligence, are not
26 correct. After reading the list, Intel desires to reject the performance and cancel
27 the contract. Subsection (a)(5) would ask whether Intel received substantial
28 valuable knowledge and, thus, cannot reject. If so, its remedies are for breach
29 under applicable sections involving a recovery for the difference in promised
30 and received value. If it can reject, it can recover the part of the price already
31 paid, plus any relevant and provable loss under the methods described in this
32 Article.

33
34 Subsection (a)(5) may be deleted if the Drafting Committee adopts the proposed
35 Section 2B-608 on performances complete when delivered.

36
37 5. This section must be read in relationship to the reduced importance of
38 acceptance. Refusal and revocation both require material breach in order to avoid
39 the obligation to pay according to the contract. This is unlike Article 2 which
40 follows a perfect tender rule for rejection, but conditions revocation on substantial
41 impairment. Acceptance does not waive a right to recover for deficiencies in the
42 performance.

1
2 **SECTION 2B-613. REVOCATION OF ACCEPTANCE.**

3 (a) A licensee may revoke acceptance of a commercial unit that is part of a
4 performance by the licensor if the nonconformity of the commercial unit is a
5 material breach of the contract and the party accepted the performance:

6 (1) on the reasonable assumption that the breach would be cured, and it
7 has not been seasonably cured;

8 (2) during a period of continuing efforts at adjustment and cure, and the
9 breach has not been seasonably cured; or

10 (3) without discovery of the breach, and the acceptance was reasonably
11 induced by the other party's assurances or by the difficulty of discovery before
12 acceptance.

13 (b) Revocation is not effective until the revoking party sends notice of it to
14 the other party and is barred if:

15 (1) the revocation does not occur within a reasonable time after the
16 licensee discovers or should have discovered the ground for it;

17 (2) the revocation does not occur before any substantial change in
18 condition or identifiability of the information not caused by the breach of contract;
19 or

20 (3) the party attempting to revoke acceptance received a substantial
21 benefit or knowledge of valuable informational content from the performance or
22 access, and the benefit or knowledge cannot be returned.

- 1 (c) A party that justifiably revokes acceptance:
- 2 (1) has the same duties and is under the same restrictions with regard to
- 3 the information and any documentation or copies as if the party had refused the
- 4 performance; and
- 5 (2) is not obligated to pay the contract price for the performance as to
- 6 which revocation occurred.

7 **Uniform Law Source:** Section 2A-516; Section 2-608.

8
9

Reporter's Note

10 1. Acceptance obligates the licensee to the terms of the contract, including

11 the payment of any purchase price. Often, of course, other performance will have

12 already occurred. This section deals with revocation of acceptance as to any type

13 of performance, not limited to the revoked acceptance of a tender of delivery that

14 occupies the attention of article 2.

15

16 2. Subsection (a)(2) adds provisions to deal with an issue often encountered

17 in litigation in software. It reduces the importance of when or whether acceptance

18 occurs. In cases of continuing efforts to modify and adjust the intangibles to fit the

19 licensee's needs, asking when an acceptance occurred raises unnecessary factual

20 disputes. Both parties know that problems exist. The question is whether or not

21 the licensee is obligated for the contract price, less a right to damages for breach by

22 the licensor.

23

24 There has been substantial litigation in Article 2 on questions of whether or

25 not an acceptance occurred (or can be revoked) in a situation in which the licensee

26 participates with the licensor in an effort to modify, correct and make functional the

27 software that is being provided. The issue has importance because acceptance

28 obligates the licensee to the purchase price unless that acceptance can be revoked

29 due to a substantial defect, while prior to acceptance the licensee can reject for a

30 failure to provide "perfect" quality. *National Cash Register Co. v. Adell Indus.,*

31 *Inc.*, 225 N.W.2d 785, 787 (Mich. App. 1975) ("Here, the malfunctioning was

32 continuous. Whether the plaintiffs could have made it functional is not the issue.

33 The machine's malfunctions continued after the plaintiff was given a reasonable

34 opportunity to correct its defects. [The] warranty was breached."); *Integrated Title*

35 *Data Systems v. Dulaney*, 800 S.W.2d 336 (Tex. App. 1990); *Eaton Corp. v.*

36 *Magnovox Co.*, 581 F. Supp. 1514 (E.D. Mich. 1984) (failure to object or give

37 notice of a problem may constitute a waiver); *St. Louis Home Insulators v.*

1 *Burroughs Corp.*, 793 F.2d 954 (8th Cir. 1986) (limitations bar); *The Drier Co. v.*
2 *Unitronix Corp.*, 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ.
3 1987); *Computerized Radiological Service v. Syntex*, 595 F. Supp. 1495, rev'd on
4 other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use precludes rejection); *Iten*
5 *Leasing Co. v. Burroughs Corp.*, 684 F.2d 573 (8th Cir. 1982); *Aubrey's R.V.*
6 *Center, Inc. v. Tandy Corp.*, 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App.
7 1987) (nine month delay did not foreclose revocation); *Triad Systems Corp. v.*
8 *Alsip*, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years
9 after the initial delivery of software and hardware system); *Money Mortgage & Inv.*
10 *Corp. v. CPT of South Fla.*, 537 So.2d 1015 (Fla. Dist. Ct. App. 1988) (18 month
11 delay permitted); *Softa Group v. Scarsdale Development*, No. 1-91-1723, 1993 WL
12 94672 (Ill. App. March 31, 1993); *David Cooper, Inc. v. Contemporary Computer*
13 *Systems, Inc.*, 846 S.W.2d 777 (Mo App 1993); *Hospital Computer Systems, Inc. v.*
14 *Staten Island Hospital*, 788 F. Supp. 1351 (D.N.J. 1992).

15
16 3. Revocation is a remedy for the licensee, but its role in the remedies
17 scheme must be carefully understood. In effect, revocation reverses the effect of
18 acceptance and places the licensee in a position like that of a party who rejected the
19 transfer initially. The effects of acceptance that are most important here include: (i)
20 the licensee must pay the licensee fee for the transfer and is obligated as to other
21 contract duties respecting that transfer and (ii) the licensee essentially keeps the
22 copies or other materials associated with the transfer but subject to contract terms.
23 Revocation does not, however, serve as a precondition to suing for damages. In the
24 context of information transactions, revocation is not appropriate where the value
25 of the information cannot be returned and is significant. That principle is stated in
26 subsection (b)(3).

27
28 4. In the CISG, the remedies of the buyer do not depend on whether the
29 buyer accepted the goods or not or whether revocation occurred. In cases of
30 information content, the Committee should consider whether a similar model would
31 be more appropriate. In cases of material breach, the licensee's right to recover
32 what it paid or to avoid paying further should not hinge on questions of whether it
33 has a right to revoke, but on a calibration of loss sustained compared to benefit
34 received.

35 36 37 38 [C. SPECIAL TYPES OF CONTRACTS]

39 40 41 **SECTION 2B-614. ACCESS CONTRACT.**

42 (a) An access contract grants rights of access to the information as

1 modified from time to time and made generally available by the licensor over the
2 duration of the period of under the license. Changes in the content of the
3 information to which access is provided do not constitute a breach of contract
4 unless they conflict with an express term of the agreement.

5 (b) Unless subject to a license or other use restrictions relating to the
6 information contained in the access contract or a record to which the licensee
7 agreed, including by manifesting assent to the record, information obtained by a
8 licensee in an access contract is free of any restriction by the licensor except
9 restrictions resulting from the intellectual property rights of a licensor or other
10 applicable law. The licensee may make a transitory copy for purposes of viewing
11 or other agreed use only but may make a permanent copy of the information
12 accessed only if authorized by the agreement.

13 (c) In an access contract, access must be available at times and in a manner
14 consistent with:

15 (1) express terms of the agreement; and

16 (2) to the extent not dealt with by the terms of the agreement, in a
17 manner and with a quality that is reasonable consistent with ordinary standards of
18 the business, trade or industry for the particular type of agreement.

19 (d) In an access contract which, during agreed periods of time, affords the
20 licensee a right of access at times substantially of its own choosing, intermittent
21 and occasional failures to have access available do not constitute a breach of
22 contract if they are consistent with:

- 1 (1) the express terms of the agreement;
- 2 (2) standards of the business, trade or industry for the particular type of
- 3 agreement; or
- 4 (3) scheduled downtime, reasonable needs for maintenance, reasonable
- 5 periods of equipment, software or communications failure, or events reasonably
- 6 beyond the licensor's control.

7 **Uniform Law Source:** None

8

9

Reporter's Note

10 1. This section applies to a "access" transactions. In concept, access

11 contracts are of two types. In one, the access and the contract creation or

12 performance occur essentially at the same time and there is no on-going

13 relationship between the parties. In the other, which some describe as a continuous

14 access contract, the license contemplates that the licensee has a right to intermittent

15 access at times of its own choosing within the time period of agreed availability.

16 This latter type of relationship is characterized by on-line services such as Westlaw

17 and Lexis. Access contracts of this latter type constitute an important application

18 of an ongoing relationship rules involving information services. The transaction is

19 not only that the transferee receives the functionality or the information made

20 available, but that the subject matter be accessible to the transferee on a consistent

21 or predictable basis. The transferee contracts for continuing availability of

22 processing capacity or information and compliance with that contract expectation

23 hinges not on any specific (installment), but on continuing rights and ability to

24 access the system. The continuous access contract is unlike installment contracts

25 under Article 2 which have more regimented tender-acceptance sequences. Often,

26 the licensor here merely keeps the processing system on-line and available for the

27 transferee to access when it chooses.

28

29 As outlined in the definition of "licensor", the model followed in three

30 party access transactions, such as where the content provider makes content

31 available through a third party access provider, entails two separate agreement and,

32 in some cases, three separate contracts. The first is between the content provider

33 and the on-line provider. This license may be an ordinary license to use the

34 information or an access contract in itself. The second is between the on-line

35 provider and the end user or other client. This is an access contract. The content

36 provider is not necessarily party to or beneficiary of the contract. The third

37 possible contract occurs when the content provider additionally contracts directly

1 with or establishes terms with the end user or client.
2

3 2. Subsection (b) outlines two important default rules with respect to the
4 treatment of information obtained through an access contract. The first is that,
5 unless there are license terms dealing with the information obtained through access,
6 information obtained by access is received on an unrestricted basis, subject only to
7 whatever intellectual property rights apply. Thus, for example, if an access contract
8 merely enables access to news articles, but does not further limit their use by the
9 licensee, no limitation exists other than as applied under copyright law. In contrast,
10 if the agreement contains license restrictions on use of the articles obtained by the
11 access, those license terms would be governed under Article 2B and other law.
12

13 3. The second issue considered in subsection (b) concerns the making of
14 copies. The default position here recognizes that access contracts will involve a
15 wide variety of contexts, many of which do not contemplate that the license make
16 and retain a copy of the information accessed (e.g., video on demand). The default
17 rule assumes that transitory copies to enable viewing of the information are
18 implicitly authorized.
19

20 4. Access contracts are a form of license in the pure common law sense that
21 they entail a grant of a right to have use of a facility or resource owned or
22 controlled by the licensor. This involves less of a traditional intellectual property
23 license and more of a modern application of traditional concepts of licensed use of
24 physical resources. See *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No.
25 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993); *Soderholm v.*
26 *Chicago Nat'l League Ball Club*, 587 NE2d 517 (Ill. App. Ct. 1992) (license
27 revocable at will). For a discussion of how one potential vendor handles these
28 problems, see Proposed Rule Regarding Postal Electronic Commerce Service (39
29 C.F.R. § 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed
30 regulations and terms of use for Postal Service electronic commerce systems).
31

32 5. Under current law, these contracts are services or information contracts.
33 The fault based warranties noted in the warranty sections apply insofar as one deals
34 with the accuracy of content or processing. The contract obligation deals with an
35 obligation to make and keep the system available. Obviously, availability
36 standards are subject to contractual specification, but in the absence of contract
37 terms, the appropriate reference is to general standards of the industry involving the
38 particular type of transaction. Thus, a database contract involving access to a news
39 and information service would have different accessibility expectations than would
40 a contract to provide remote access to systems for processing air traffic control
41 data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v.*
42 *Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).
43

1 6. In continuous access contracts, the transferee may receive substantial
2 value before or despite problems in the overall transaction. The remedies provide
3 for a concept of partial performance. For example, the fact that a company
4 continues to use a remote access database processing system for several years while
5 encountering problems and seeking a replacement system, may allow it to reject the
6 future terms of the contract, but leaves the transferee responsible for the past value
7 received. *Hospital Computer Systems, Inc. v. Staten Island Hospital*, 788 F. Supp.
8 1351 (D.N.J. 1992).

9
10
11 **SECTION 2B-615. CORRECTION AND SUPPORT CONTRACTS.**

12 (a) If a party agrees to correct errors or provide similar services, the
13 following rules apply:

14 (1) If the services cover a limited time and are part of a limited remedy
15 in a contract between the parties, the party undertakes that its performance will
16 provide the licensee with information of a quality that conforms to that contract.

17 (2) In cases not covered by paragraph (1), the party shall perform at a
18 time and place and with a quality consistent with the express terms of the
19 agreement and, to the extent not dealt with by the express terms, in a workmanlike
20 manner and with a quality that is reasonably consistent with ordinary standards of
21 the business, trade, or industry for similar contracts. The party providing the
22 services does not warrant that its services will correct all defects or errors unless
23 the agreement expressly so provides.

24 (b) A licensor is not required to provide support or instruction for the
25 licensee's use of information or licensed access after the activation of rights. If a
26 person agrees to provide support for the licensee's use of information, the person
27 shall make the support available in a manner and with a quality consistent with the

1 express terms of the support agreement and, to the extent not dealt with by the
2 agreement, in a workmanlike manner and with a quality that is reasonably
3 consistent with ordinary standards of the business, trade, or industry for the
4 particular type of agreement.

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

6

7

Reporter's Notes

8 1. The section deals with obligations to correct errors and obligations to
9 provide support.

10

11 2. Obligations to correct errors are different from an obligation to provide
12 updates or enhanced versions. In modern practice, contracts to provide updates,
13 generally described as maintenance contracts, are a valuable source of revenue for
14 software providers. Under Section 2B-310, no implied obligation exists to provide
15 updates or new versions. A licensor may have an obligation to make an effort to
16 correct errors in some cases even independent of a separate contract to do so.

17

18 The reference to error corrections covers contracts where, for example, a
19 vendor agrees to be available to come on site and correct or attempt to correct bugs
20 in the software for a separate fee. This type of agreement is a services contract.
21 The other type of agreement occurs when, for example, a vendor contracts to make
22 available to the licensee new versions of the software developed for general
23 distribution. Often, the new versions cure problems that earlier versions
24 encountered and the two categories of contract overlap. Yet, here we are dealing
25 with new products.

26

27 3. Contracts to provide corrections are services contracts. As in any other
28 services contract, the services provider must provide a reasonable and workmanlike
29 effort to correct identified problems. Subsection (a) sets out this basic principle,
30 but subsection (a)(1) recognizes an important, alternative obligation that is
31 presumed when the obligation to correct errors arises in lieu of a remedy under a
32 contract.

33

34 4. Subsection (a)(1) deals with situations in which the circumstances
35 indicate that promisor agrees to a particular outcome, as contrasted to the ordinary
36 case where the contract entails a services contract requiring effort. The obligation
37 stated in subsection (a)(1) arises in any case where the repair/correction obligation
38 is set out as a form of remedy for any breach of the contract. The focus is on the
39 classic "replace or repair" warranty. When the obligation to correct errors arises in

1 that context, the promissor's obligation is to complete a product that conforms to
2 the contract.

3
4 5. Subsection (a)(2) deals with the broader case of the general repair
5 obligation outside of the limited remedy. The obligation here is simply the
6 obligation that any other services provider would undertake: a duty to exercise
7 reasonable care and effort to complete the task. A services provider does not
8 typically guaranty that its services yield a perfect result.

9
10 6. Subsection (b) provides a default rule regarding the time, place and
11 quality of the services in a support agreement in the absence of contrary agreement.
12 The standard reflects a theme of "ordinariness" that provides default performance
13 rule throughout the chapter. It measures a party's performance commitment by
14 reference to standards of the relevant trade or industry.

15
16 **Example:** Software Vendor agrees to provide a help line available for
17 telephone calls from its mass market customers. If this agreement constitutes a
18 contractual obligation, the availability and performance of that help line is
19 measured by reference to similar services or by express terms of a contract.

20
21
22 **SECTION 2B-616. PUBLISHERS, DISTRIBUTORS AND RETAILERS.**

23 (a) In this section:

24 (1) "End user" means a licensee that acquires a tangible copy of the
25 information for its own use and not for the purpose of distributing to third parties
26 by sale, license, or other means.

27 (2) "Publisher" means a licensor other than a retailer that enters into an
28 agreement with an end user with respect to the information.

29 (3) "Retailer" means a merchant licensee that receives information
30 from a licensor for sale or license in tangible copies to end users.

31 (b) In a contract between a retailer and an end user, if the parties
32 understand that the end user's right to use the information is to be subject to a

1 license from the publisher for which there was no opportunity to review before
2 payment to the retailer, the following rules apply:

3 (1) The contract between the end user and the retailer is conditional on
4 the end user's assent to the publisher's license.

5 (2) If the end user refuses the terms of the license with the publisher,
6 the end user may return the information to the retailer and receive from it a refund
7 of any contract fee already paid in an amount consistent with Section 2B-113(b)
8 and avoid any obligation for future payments to the retailer for the information.
9 Refund under this paragraph constitutes a refund under Section 2B-113.

10 (3) The retailer is not bound by the terms of, and does not receive the
11 benefits of, an agreement between the publisher and the end user unless the retailer
12 and end user adopt those terms as part of their agreement.

13 (c) If a refund is made in good faith pursuant to this section or Section
14 2B-113:

15 (1) a retailer that makes the refund to its end user because the end user
16 refused the publisher's license is entitled to reimbursement from the authorized
17 party from which it obtained the copy of the amount paid for the copy by the
18 retailer on return of the copy and documentation to that person; and

19 (2) a publisher that makes the refund to the end user is entitled to
20 reimbursement from the retailer of the difference between the amount refunded and
21 the price paid by the retailer to the publisher for the product.

22 (d) If an agreement contemplates physical distribution of tangible copies

1 provided by the publisher, a retailer or other distributor shall distribute such copies
2 and documentation as received from the publisher and subject to any contractual
3 terms provided for end users.

4 (e) A retailer that enters into an agreement with an end user is a licensor of
5 the end user under this article.

6 **Uniform Law Source:** None.

7

8

Reporter's Note

9 1. This section deals with the three party relationship common in modern
10 information transactions, especially in reference to digital products. The three
11 party transaction involves a publisher, retailer, and end user. While the end user
12 acquires the copy of information from a retailer, the retailer often lacks authority to
13 convey a right to use a copyrighted work to the end user or, even, the right to
14 transfer title to the copy. The right to "use" (e.g., copy) arises by agreement
15 between the end user and the producer (party with ownership or control of the
16 copyright). Often, in retail markets, this latter agreement is a screen license or a
17 shrink wrap license. The enforceability of the terms of that license with respect to
18 the licensee and publisher are dealt with elsewhere.

19

20 2. While there are three parties involved in separate relationships, it is clear
21 that the relationships are linked. Subsection (b) deals with the relationship from
22 the perspective of the **retailer's** contract with the **end user**. The basic principle in
23 subsection (b)(3) is that a retailer is not bound by nor does it benefit from any
24 contract created by the producer with the end user. This mirrors modern law and
25 limited case law dealing with sales of goods where manufacturer warranties and
26 warranty limitations do not bind the retailer, but also do not benefit that retailer. A
27 prior Draft of this section stated the opposite position, but that met strong dissent.
28 This means, of course, that the retailer does not have the benefit of warranty
29 disclaimers made in a mass market publisher's license. That result can be changed
30 by contract, of course. However, it gives the end user two different points of
31 recourse — retailer and publisher.

32

33 Subsection (e) confirms that warranties exist on the part of the retailer by
34 stating that the retailer is a licensor with respect to its licensee.

35

36 3. Subsection (b)(1) and (2) deal with the reality that performance of the
37 retailer's relationship with the end user hinges on the end user's ability to make
38 actual use of the information supplied by the retailer and that this depends on the

1 license between the producer and the end user. The net effect is to give the end
2 user who declines a license a right to refund and to not being forced to pay the
3 purchase price to the retailer. This refund concept creates a refund *right*, rather
4 than an option on the part of the retailer. It reflects the conditional nature of the
5 transaction with the end user. It differs from the publisher's option to provide a
6 refund opportunity as a means of enabling the effective assent to the publisher's
7 license terms. While they are distinct, however, a refund made by the retailer under
8 the conditions of subsection (b) satisfies the refund opportunity required under
9 Section 2B-113 for creating an opportunity to review.

10
11 4. There are several ways to view the retailer-end user relationship in
12 reference to the publisher's license. One is to treat the publisher's license in full
13 as an element of the retailer contract, understood as present by both the retailer and
14 the end user from the outset, even if the precise terms are not yet known. See
15 *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). An alternative treats the
16 retailer's commitment as being to deliver the copy and to convey the right to use
17 (e.g., copy into a machine). It cannot do the latter unless or until the end user
18 assents to the publisher's license since, in most cases, the retailer's contract with
19 the publisher authorizes only distributions subject to end user licenses and
20 distributions that go outside this restriction constitute copyright infringement in
21 cases where the information consists of copyrightable material. The end user's
22 assent to the producer's license is then, as to its situation with the retailer, either a
23 condition precedent (there being no final agreement until the end user can review
24 and assent to or reject the license) or a condition subsequent (the agreement being
25 subject to rescission if the terms of the license are unacceptable). In either case, if
26 the end user declines the license, it can return the product to the retailer and obtain
27 a refund or, if it has not already paid, avoid being forced to pay the contract fee.
28 Subsection (b)(1) and (2) create this result. The contract between the retailer and
29 end user is a license in that the end user's use rights are subject to assent to and the
30 terms of the publisher's license. When the end user assents to the license, the
31 publisher's license in effect replaces the retailer-end user license except as to
32 obligations expressly created and earmarked as continuing on the part of the
33 retailer (such as a services or support obligation). Of course, in addition, if the
34 information breaches a warranty, the right to recover from the retailer remains
35 present unless it was disclaimed by the retailer's contract.

36
37 5. In a recent European case, *Beta Computer (Europe) Ltd. v. Adobe*
38 *Systems (Europe) Ltd.*, the court gave the end user a right to return the software and
39 not pay the purchase price as to the retailer when the contract terms were
40 unacceptable. The analysis was that the retailer's contract with the end user must
41 have contemplated that the end user would have a right to copy/use the software,
42 but that right could be obtained only through license or other agreement from the
43 copyright owner. When the end user declined the license, in effect the conditions

1 of the retailer's obligation were not met. The court did not treat this as a breach of
2 contract, but as a failure to conclude the contract between the parties. No final
3 agreement was present until the end user could review and accept or reject the
4 license terms. In effect, the contract was concluded (or to be concluded) over a
5 period of time, as opposed to at a single point in time over the counter.
6

7 **Illustration 1:** User acquires three different software programs from Retailer
8 for a price of \$1,000 each to be used in its commercial design studio. User is
9 aware that each software comes subject to a publisher license. When it reviews
10 one license, however, it notices that the license restricts use to non-commercial
11 purposes. User refuses that license. It has a right to refund since the retailer
12 did not provide a useable package and the end user did not pay simply for a
13 diskette. Because the failed sale occurred due to the license terms, the refund
14 under this section is from the retailer. An alternative refund option would be
15 from the publisher who cannot obtain consent to its license unless it offers a
16 refund for those who decline the terms. In most cases, of course, the publisher
17 will establish this alternative refund process as at least initially coming through
18 the retailer.
19

20 6. In most cases where an end user license is contemplated, the publisher's
21 arrangements with distributors are licenses that retain ownership of all copies in the
22 publisher and permit distribution only subject to a license. The legislative history
23 of the Copyright Act indicates that, whether there was a sale of the copy or not,
24 contractual restrictions on use are appropriate under contract law. "[The] outright
25 sale of an authorized copy of a book frees it from any *copyright* control over . . . its
26 future disposition. . . . This does not mean that conditions . . . imposed by contract
27 between the buyer and seller would be unenforceable between the parties as a
28 breach of contract, but it does mean that they could not be enforced by an action for
29 infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).
30

31 7. To the extent that the retailer performs the producer's warranty
32 obligations, the presumption is that it has a right of reimbursement from the
33 producer. The provisions regarding refunds coordinate this section with the
34 obligations incurred in creating an opportunity to review the terms of a license,
35 which opportunity requires that there be a refund if the terms of the contract are
36 refused. The consumer is entitled to refund of the retail price of the refused
37 product and may obtain that either from the retailer or the producer. However, as
38 between the producer and the retailer, the retailer can only receive reimbursement
39 for what it paid to the producer. Thus, for example:
40

41 **Illustration 2:** Consumer refuses a program because it dislikes the license. It
42 obtains a refund of the price paid to retailer (\$100). Retailer is entitled to
43 reimbursement from Producer of the \$75 price that Retailer paid Producer for

1 the product (if it returns the product). On the other hand, if Consumer obtains
2 the \$100 from Producer, Producer is reimbursed \$25 from Retailer.

3
4 8. Subsection (d) sets out a basic default rule that corresponds with current
5 law. The distributor is bound in its distribution by the terms of the contract with
6 the producer and, as a default assumption, must redistribute in a form and subject to
7 the conditions contained in the materials as received by it from the producer.

8
9
10 **SECTION 2B-617. DEVELOPMENT CONTRACT.**

11 (a) In this section, "developer" means a person hired or commissioned to
12 create, modify, or develop a computer program, and "client" means a person that
13 hires a developer.

14 (b) If an agreement requires the development of a computer program, as
15 between the developer and the client, the following rules apply.

16 (1) Unless an authenticated record provides for a different result:

17 (A) the developer retains ownership of the intellectual property
18 rights except to the extent that the program includes intellectual property of the
19 client or the client would be considered a co-owner under other law; and

20 (B) the client receives a nonexclusive but irrevocable license to use
21 the information in any manner consistent with the agreement.

22 (2) If the client requests response in a record, the developer shall notify
23 the client if it used independent contractors or information provided by other third
24 parties and shall provide the client with a statement that either confirms that all
25 applicable intellectual property rights have been obtained or will be obtained, or
26 that it makes no representation about those rights beyond any stated in the

1 agreement. The response must be made within 30 days after the request is received
2 unless the time for performance is less than 30 days, in which case the response
3 must be before the activation of rights.

4 (3) If an authenticated record or applicable intellectual property law
5 provides that ownership of the intellectual property rights in the program passes to
6 the client, but does not otherwise deal with the following issues, the following rules
7 apply:

8 (A) Ownership of the program passes under Section 2B-501.

9 (B) The client receives the program free of restrictions on use and
10 its rights in the program may not be canceled by the developer after ownership
11 vests in the client.

12 (C) The developer retains ownership of components or code
13 developed before or independent of the contract, but the client has an irrevocable
14 license to use the components or code delivered to the client consistent with the
15 agreement.

16 (D) The client receives ownership of generally applicable
17 components or code, including development tools or the like, developed in
18 performance of the contract, but the developer has an irrevocable, nonexclusive
19 license to use in other contracts generally applicable components or code that do
20 not include confidential or otherwise proprietary information of the client.

21 (4) Language in an authenticated record is sufficient to provide that
22 ownership of all intellectual property rights will pass to the client or be retained by

1 the developer if it states "All rights, title, and interest in the completed program
2 will be owned by [named party]", or words of similar import.

3 **Uniform Law Source:** None

4

5 **Committee Action:**

6 1. Motion to delete the clause in (b)(2)(D) following the word "but", rejected
7 2-5 (June, 1997).

8

9 **Selected Issues:**

10 1. Should the section be expanded with modifications to cover all information
11 contracts?

12 2. Should subsection (b)(3)(D) be deleted?

13

14

Reporter's Notes

15 1. This section deals with an important area of software contracting. It is
16 an area affected by federal intellectual property law rules and also characterized by
17 both, extensively negotiated contracts as well as very informal relationships. In
18 many cases, the licensor-developer is a smaller firm dealing with larger companies.
19 The section is specifically limited to development contracts relating to computer
20 programs. The section has been controversial in that it attempts to develop contract
21 themes that reflect what would be the most likely expectation of the parties in
22 development contract and rules that provide a sound basis for allocating rights
23 between the developer and client in the absence of addressing two important issues.
24 The section creates an implied license for the client who does not have
25 documentation capable of obtaining ownership rights under copyright law and
26 creates an implied license in development tools for the developer who needs those
27 tools to continue in business.

28

29 2. Federal copyright law provides that, unless there is an express transfer of
30 the copyright in a writing, copyright ownership remains in the developer, rather
31 than the client for whom the developer worked. The copyright rule was adopted
32 after substantial deliberation and placed in the 1976 Copyright Act. It sets the
33 background for default rules in this section. In addition, the default rules seek to
34 balance the interests of the developer in continuing in business with the interests of
35 the client in obtaining a right to use the information developed for it. In many
36 cases, retention of rights in elements of a developed program is critical for the
37 developer who will reuse program components and routines in subsequent projects.

38

39 3. Subsection (b)(1)(A) states a default rule that corresponds to copyright
40 law rules about ownership. In the absence of an employment relationship,

1 ownership remains in the creative individual or company unless the contract
2 expressly provides for a transfer of that ownership to the client (licensee). This
3 rule states an important premise relating to the rights of the individual or other
4 small developer to retain the primary rights in its intellectual work product unless it
5 specifically and clearly transfers those rights. This policy reflect federal
6 intellectual property law and protects small developers. Subsection (b)(1)(B),
7 however, ameliorates the possibility of an adverse impact due to a
8 misunderstanding by providing what amounts to an implied license for the client.
9 The license is non-exclusive. A critical issue needs to be resolved about the scope
10 of the license, with the two alternatives being to make the rights unrestricted or to
11 limit the implied license to uses consistent with the developmental purposes.

12
13 The implied license approach is consistent with case law dealing with this
14 type of case. In the reported cases, the implied license tends to be limited to uses
15 consistent with the purposes of development.

16
17 4. Subsection (b)(2) provides important protection for a licensee not found
18 in current law. The section stems from a problem created under federal intellectual
19 property law, especially as to copyright ownership. Copyright law allows
20 independent contractors to retain copyright control of their work unless they
21 expressly transfer it. The licensee, even if unaware of the contractor's rights, is
22 subject to them since intellectual property law does not contemplate good faith
23 buyer protection. The section places an obligation on the developer of software to
24 respond to a request of the licensee. This does not supplant warranties against
25 infringement or warranties of title, but sets out a method to potentially avoid those
26 problems.

27
28 5. Subsection (b)(3) deals with cases where the contract gives ownership of
29 the intellectual property in the program to the client. The default rule is intended to
30 provide protection for small developers and small licensees who may not address
31 the basic questions presented. The theme is that ownership transfers in all code
32 **developed for and included in** the program and that no conditions limit the
33 licensee's use. However, two interests are balanced in the event that the contract
34 does not deal with them: (1) the developer's right to continue to use general
35 applicability code and tools and (2) the licensee's rights in code developed outside
36 the project which are not clearly transferred to it. In each case, a split between
37 ownership and a non-revocable license is used to give each party rights in the
38 materials as a default rule. The developer retains ownership of previously
39 developed materials, but the licensee has an irrevocable license to use them. In
40 reference to included general tools, on the other, the licensee has ownership, but the
41 developer has a license to continue to use.

42
43 6. Subsection (4) provides safe harbor transfer language for effectuating a

1 transfer. The terminology is designed to clearly indicate that more than a transfer
2 of a copy was contemplated.

3
4
5 **SECTION 2B-618. FINANCIAL ACCOMMODATION CONTRACTS.**

6 (a) A financier is subject to the terms and limitations of the license and to
7 the intellectual property rights of the licensor. Except as otherwise provided under
8 subsection (c)(1), the creation and enforcement of a financier's interest in a license
9 is subject to Section 2B-504.

10 (b) If a financier is not a licensee that transfers rights under the license to a
11 licensee receiving financial accommodation, the following rules apply:

12 (1) The financier is not required to perform the obligations owed to the
13 licensee under the license and does not receive the benefits of the license.

14 (2) The licensee's rights and obligations with respect to the
15 information are governed by the license and any rights of the licensor under other
16 law and, to the extent not inconsistent with the license or other law, the terms of the
17 financial accommodation agreement.

18 (c) If a financier is a licensee that transfers the license to a licensee
19 receiving the financial accommodation, the following rules apply:

20 (1) The transfer to the licensee is not effective unless:

21 (A) the transfer meets the conditions for transfer under Sections
22 2B-502 and 2B-503; or

23 (B) the accommodated party agrees to the license and the financier
24 becomes a licensee solely to make the financial accommodation and before the

1 licensor provides the information, the financier delivered notice to the licensor
2 giving the name and location of the accommodated party and indicating that the
3 accommodated party will be the only end user of the information, but the financier
4 may make only the single transfer contemplated by the notice financial
5 accommodation unless the licensor consents to a subsequent transfer or the
6 subsequent transfer is effective under Section 2B-504.

7 (2) After transfer to the licensee, the licensee becomes a party to the
8 license and the licensee's rights and obligations with respect to the information are
9 governed by the license and any rights of the licensor under other law and, to the
10 extent not inconsistent with the license or other law, the terms of the financial
11 accommodation agreement.

12 (3) With respect to the licensee, on completion of an effective transfer to
13 the licensee, the financier is no longer a licensor and, except for the warranty under
14 Section 2B-401 concerning authority and quiet enjoyment, makes no warranties to
15 the licensee other than any express warranties in the agreement.

16 (d) Unless the licensee is a consumer, if the financial accommodation
17 agreement so provides, as between the financier and the licensee and any transferee
18 of either party, the licensee's promises under the financial accommodation and any
19 related agreements become irrevocable and independent of the license on:

20 (1) the licensee's acceptance of the license and [commitment to pay]
21 [payment] by the financier unless the information was selected, created, or supplied
22 by the financier, the financier provides support, modifications, or maintenance for

1 the information, or the financier holds intellectual property rights in the
2 information; or

3 (2) transfer of the contract by the financier to a third party.

4 (e) As between the financier and the licensee, if the financial
5 accommodation agreement so provides, the financier is entitled to possession of
6 any copies, upgrades, new versions, or other modifications of the information
7 provided by the licensor under the license, but the financier's rights with respect to
8 the licensor are determined under Section 2B-504.

9 (f) On breach of a financial accommodation agreement by the licensee, the
10 financier may cancel that agreement but may not cancel the license. The rights of
11 the financier to further enforce the agreement are subject to Section 2B-504.

12 (g) The licensor's rights and obligations with respect to the licensee are
13 governed by the terms of the license and any rights of the licensor under this article
14 or other law.

15 **Committee Action:**

16 1. In December, 1996, the Committee concluded, by a consensus, that
17 treatment of financing arrangements was appropriate, but that it should be limited
18 and generic. The over-riding concept would allow creation of an interest, but not
19 sale and reflect important differences in the license arrangement as contrasted to
20 lease and security interests in goods.

21 2. The Committee did not adopt a motion that the "hell and high water" rules
22 in subsection (d) should be applicable even though the contract does not so
23 provide. Vote: 5-5 (April, 1997).

24
25

Reporter's Notes

26 1. This section is one of two sections that implement the integrated
27 treatment of security interests and finance leases. This section deals with the
28 relative rights among the parties, while Section 2B-504 on financier's rights deals

1 with the creation of the interest. The term "financier" includes both a secured
2 creditor and a lessor. The critical distinction, implemented here and in the
3 definition of the term, is between a traditional loan arrangement where the financier
4 does not become a party to the license and the relationship that exists more in
5 reference to traditional tree party leasing where the lessor (financier) acquires the
6 property (license) and transfers this down to the licensee.

7
8 2. An important licensee protection makes the financial accommodation
9 conditional on the licensee's assent to the license. In the absence of such assent,
10 the licensee may have no rights to use the information and, thus, the transaction is
11 illusory from its standpoint. The definition of "financier" incorporates this
12 concept, requiring that the licensee's assent be a condition to the creation of the
13 lease. This transaction is different from the ordinary equipment lease because of
14 the central importance of this license agreement and the provisions here recognize
15 that importance (see also the treatment of when promises become irrevocable).

16
17 3. Subsections (b) and (c) outline some attributes of the two scenarios.
18 Subsection (b) involves a situation where the licensor contracts directly with the
19 licensee as to the information, even though the lessor may also have a contract
20 relationship with the licensee. The key factor here is that the lessor is not bound by
21 the obligations of the license, but is bound by the limitations of the license. The
22 licensee's rights are governed first by the license and secondly by the financial
23 accommodation agreement. In subsection (c) we deal with the less common
24 situation where the license is actually provided to the lessor and then passed down
25 through to the licensee. Here, when the licensee takes on the license, the lessor is
26 taken out of the transaction as between the licensee and financier for purposes of
27 qualitative and other issues except for quiet enjoyment and authority to transfer
28 consideration. The licensee becomes a direct party to the license.

29
30 4. Subsection (d) provides rules pertaining to hell and high water clauses.
31 Promises become irrevocable if the agreement so provides and the financier was
32 not an active, substantive party to the license. The rule is not needed where the
33 financier never acquires a position as licensor/licensee, but is helpful in the three
34 party context. Additionally, the provisions have been modified to reflect a problem
35 not present in ordinary equipment leasing. Section 2A-407 provides that the
36 promises become irrevocable on the lessee's acceptance of the goods. In the
37 stereotypical transaction under that article, the goods are sold to the lessor and sent
38 to the lessee. If there is non-payment by the lessor, the seller's remedies are
39 against the lessor (not the lessee). In a license transaction, however, there are two
40 different factors. First, in many cases, the licensee contracts directly with the
41 licensor. Non-payment then may give a contractual right of action for the price
42 against the licensee even though its lease called for payment by the lessor. Second,
43 in a license, payment is typically a condition on the licensee's rights to continue to

1 use the information. Thus, although the lessor was to pay, the licensee may be
2 placed in a position of paying twice if the lessor fails to do so. To avoid this type
3 of problem, the irrevocability concept is limited here not only to acceptance of the
4 transfer, but also payment to the licensor. Comments to subsection (d)(1) will
5 indicate that selecting involves actual choices, rather than merely following orders.

6
7 5. Subsection (e) deals with a common area of litigation in the leasing
8 industry, focusing on the relationship between the three parties in reference to
9 update and the like made available during the license term. As between the
10 financier and its debtor, possession and rights of control can be apportioned by the
11 financing agreement. As between the licensor, however, the general provisions of
12 Section 2B-504 control.

13
14 6. Subsection (f) states a primary right of the financier in the event of
15 breach. Since the financier is not a party to the license, it cannot cancel that
16 contract.

17
18
19
20 [D. PERFORMANCE PROBLEMS; CURE]

21
22
23 **SECTION 2B-619. CURE.**

24 (a) A party in breach of a contract, at its own expense, may cure the breach
25 if the party:

26 (1) without undue delay notifies the other party of its intent to cure; and

27 (2) effects cure promptly before cancellation or refusal of a performance
28 by the other party.

29 (b) If a licensor, other than in a mass-market license, receives timely notice
30 of a specified nonconformity and a demand for cure from a licensee that was
31 required to accept a performance consisting of an initial activation of rights because
32 a nonconformity was not material, the licensor promptly and in good faith shall
33 make an effort to cure unless the cost of the effort would be disproportionate to the

1 adverse effect of the nonconformity on the licensee.

2 (c) A breach of contract which has been cured may not be used to cancel a
3 contract or refuse a performance, but mere notice of intent to cure does not
4 preclude cancellation or refusal.

5 **Uniform Law Source:** Section 2-508; Section 2A-513.

6

7

Reporter's Note:

8 1. In Article 2B, unlike in Article 2, the idea of cure applies in important
9 respects in both directions. This, coupled with the fact that this Article uses a
10 material breach concept like common law, makes the idea of cure as substantially
11 different theme in Article 2B than in Article 2. Unlike in Article 2 transactions, it
12 affects performance obligations of both the licensee and the licensor. In Article 2
13 the sole emphasis is on the seller's right to cure. For licensees' cure often relates
14 to missed payments, failures to give required accounting or other reports, and
15 misuse of information. For licensors, depending on the context, the issues often
16 focus on timeliness of performance, adequacy of delivered product, breach of
17 warranty and the like.

18

19 2. In this Article, unlike in Article 2, except in mass market licenses,
20 breaches that trigger cure typically do not occur unless there was a material breach
21 of the relevant performance obligation. This shifts the equities in reference to the
22 extent to which a right to cure exists. This section does not create a "right" to cure.
23 The basic policy is that, when there exists a material breach, the aggrieved party's
24 interests prevail over the vendor's interests.

25

26 3. The idea that a breaching party may, if it acts promptly and effectively,
27 alleviate the adverse effects of its breach and preserve the contractual relationship
28 is embedded in modern law. *Restatement (Second) of Contracts* § 237 provides
29 that a condition to one party's performance duty in a contract is that there be no
30 **uncured** material breach by the other party.

31

32 4. Although the idea of cure is embedded in modern law, there is significant
33 disagreement in pertinent statutes and statements of contract law as to the scope
34 and balance applied to the operation of a cure.

35

36 a. The UNIDROIT Principles go the furthest in establishing a **right** to
37 cure indicating that a cure is not precluded even by notice of termination for breach
38 and by not limiting the opportunity to cure in any manner related to the timing of
39 the performance. That is, cure is neither more nor less possible as a right if it

1 occurs during the agreed time for performance than if it occurs afterwards. The
2 UNIDROIT Principles, of course are not enacted law in any State. They condition
3 cure on "prompt" action and allow it if "appropriate in the circumstances" and if
4 the other party has no "legitimate interest" in refusing the cure. UNIDROIT art.
5 7.1.4

6
7 b. Article 2, in contrast, distinguishes between cure made within the
8 original time for performance (essentially allowing a right to cure) and cure
9 occurring afterwards (which it restricts to cases where the vendor expected the
10 tender to be acceptable). Draft revisions of Article 2 are in flux, apparently
11 attempting to blend the existing Article 2 concept with the Unidroit concept.

12
13 c. The UN *Sales Convention* does not distinguish between cures
14 occurring within or after the original agreed date for performance. It allows the
15 seller to cure if it can do so without unreasonable delay and without causing the
16 buyer unreasonable inconvenience or uncertainty. *Sales Convention* art. 48.
17 However, the cure right is subject to the party's right to declare the contract
18 "avoided" (e.g., canceled) if the breach was a fundamental breach of contract.

19
20 5. This section is consistent with the *Sales Convention*. That approach is
21 used because this Article employs the standard of materiality of breach as a
22 precondition for cancellation or refusal of a performance. This section allows cure
23 if it is prompt, but does not create a right to cure. The cure is subject to prior
24 cancellation or refusal by the other party. This places control in the aggrieved party
25 who has suffered a material breach by the other person. In a mass market setting, it
26 enables a clearly delineated right to end the transaction which many from the
27 consumer context have viewed as significant.

28
29 6. Subsection (b) applies to cases where the licensee accepts a performance
30 because the material breach standard is not met even though some defect exists. It
31 creates an obligation to attempt a cure. Failure to undertake the effort is a breach,
32 but consistent with Comments to other sections, this will be pointed out in
33 Comments, rather than in the statute. One might ask whether this obligation should
34 be mutual and apply to situations where the licensor has been required to accept
35 nonmaterial breaches.

36
37 7. The final Comments will discuss aspects of the substantive elements of
38 cure. The elements that would be discussed include: fully perform the obligation
39 that was breached, compensate for loss, timely perform on all assurances of cure,
40 and provide assurance of future performance.

41
42
43 **SECTION 2B-620. WAIVER.**

1 (a) A claim or right arising out of an alleged breach of contract may be
2 discharged in whole or in part without consideration by a waiver contained in a
3 record authenticated by the party making the waiver or [to which it manifests
4 assent] [authenticated by the party making the waiver].

5 (b) A party that accepts a performance, knowing or with reason to know
6 that the performance constitutes a breach of contract:

7 (1) waives its right to revoke acceptance or cancel because of the breach
8 unless the acceptance of the performance was on the reasonable assumption that the
9 breach would be seasonably cured, but acceptance does not in itself preclude any
10 other remedy provided by this article; and

11 (2) waives any remedy for the breach if the party fails within a
12 reasonable time to object to the breach.

13 (c) Except with respect to a failure to meet a contractual requirement that
14 performance be to the subjective satisfaction of a party, a party that refuses a
15 performance and fails to state in connection with its refusal a particular defect that
16 is ascertainable by reasonable inspection waives the right to rely on the unstated
17 defect to justify refusal or to establish breach only if:

18 (1) the other party was not aware of the defect and could have cured the
19 defect if stated seasonably; or

20 (2) between merchants, the other party after refusal has made a request
21 in a record for a full and final statement in a record of all defects on which the
22 refusing party proposes to rely.

1 (d) Waiver of breach of contract in one performance does not waive the
2 same or similar breach in future performances of like kind unless the party making
3 the waiver expressly so states.

4 (e) A waiver may not be retracted as to the performance to which the
5 waiver applies. However, except for a waiver in accordance with subsection (a) or
6 a waiver supported by consideration, a waiver affecting an executory portion of a
7 contract may be retracted by seasonable notice received by the other party that
8 strict performance is required in the future of any term waived, unless the retraction
9 would be unjust in view of a material change of position in reliance on the waiver
10 by the other party.

11 **Committee Action:**

12 This section was considered in December, 1996 and June, 1997 without
13 substantive changes.

14
15 **Selected Issues:**

16 1. Should subsection (a) require an authenticated record?
17

18 **Reporter's Notes**

19 1. A "waiver" is "the voluntary relinquishment" of a right. As with respect
20 to cure, ideas of waiver in this Article must be considered in both directions.
21 Conduct and words may constitute a waiver by either the licensor or the licensee.
22 This section brings together rules from various portions of existing Article 2
23 dealing with waiver issues and recasts those rules to fit the broader number and
24 variety of types of performance that are involved in Article 2B transactions. The
25 section also applies principles from the *Restatement*.
26

27 2. Subsection (a) stems from Section 2A-107. Waivers contained in a
28 record are contractual modifications which, under current law and this Article, are
29 enforceable without consideration. The *Restatement* is consistent with this view.
30 See *Restatement (Second) 277* ("a written renunciation signed and delivered by the
31 obligee discharges without consideration a duty arising out of a breach of
32 contract."). Subsection (a) does not preclude other ways of making an effective

1 waiver, but that it merely confirms that waivers that meet its provisions are
2 effective. For example, an oral waiver, if effective under common law of a State,
3 remains effective.

4
5 A similar concept exists under current Article 1, but requires both a
6 signature and delivery of the record signifying waiver. The requirement of delivery
7 seems unimportant and is not required for cases involving modifications under
8 UCC rules. Developing Article 1 proposed revisions also eliminate that
9 requirement. Depending on reconciliation between Article 2B and Article 1
10 revisions, this concept of waiver may be relocated into Article 1.

11
12 3. The language in subsection (a) was modified as a result of discussions at
13 the harmonization meeting dealing with Articles 1, 2, 2A, and 2B. In some cases,
14 authentication will be needed to establish the written waiver, while in others, assent
15 manifested to the waiver will be adequate.

16
17 4. Subsection (b) brings together rules from current Section 2-607(2) and
18 (3)(a) and generalizes the language. In Article 2, the rules apply **only** to a tender
19 by the seller and acceptance of delivery by the buyer. Here, the effect also applies
20 to acceptance of tendered performance by the licensee (e.g., a payment of
21 royalties). The rule does not apply to cases where the party merely knows that
22 performance under the license is not consistent with the contract unless that
23 defective performance is tendered and accepted. This section on waiver is from
24 current law in Article 2 and follows that rule. It is also consistent with the
25 *Restatement (Second)* § 246 which provides that retention of a performance with
26 reason to know it was defective creates a promise to perform despite the breach.
27 The following illustrates the rule here:

28
29 **Illustration:** Licensee has an obligation to pay royalties to the Licensor based
30 on 2% of the sale price of products licensed for its manufacture and
31 distribution. The royalty payments must be received on the first of each month.
32 A 5% late fee is imposed for delays of more than five days and the license
33 provides that delay of more than five days is a material breach. In one month,
34 the licensee does not tender payment until the 25th day of the month and its
35 tender does not include the late charge. Licensor may refuse the tender and
36 cancel the contract. If it accepts the tender it knows of the breach and cannot
37 thereafter cancel the contract **for that breach**. If it fails to object in a
38 reasonable time to the late tender and the nonpayment of the late fee, it is also
39 barred from recovering that amount.

40
41 4. Subsection (d) states a presumption consistent with common law that,
42 unless the intent is express or the circumstances clearly indicate to the contrary, a
43 waiver applies only to the specific performance defect waived. This principle does

not, of course, alter estoppel concepts; a waiver by performance may create justifiable reliance as to future conduct in an appropriate case. Such common law principles continue to apply.

5. Subsection (e) comes from current UCC Article 2 setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* § 84, comment f.

SECTION 2B-621. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes on a party an obligation not to impair another party's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the other party may demand in a record adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance other than with respect to contractual use restrictions for which the agreed return performance has not already been received.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of the assurance offered is determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand, failure to provide assurance of due performance that is adequate under the circumstances of the particular case within a reasonable time, not exceeding 30 days, is a repudiation of the contract.

1 **Uniform Law Source:** Section 2-609.

2

3 **Committee Action:**

4 This section was considered in December without substantial substantive
5 comment.

6

7

Reporter's Note

8 This section corresponds to existing law in Article 2.

9

10

11 **SECTION 2B-622. ANTICIPATORY REPUDIATION.**

12 (a) If either party to a contract repudiates a performance not yet due and the
13 loss of performance will substantially impair the value of the contract to the other,
14 the aggrieved party may:

15 (1) await performance by the repudiating party for a commercially
16 reasonable time or pursue any remedy for breach of contract even if it has urged
17 the repudiating party to retract the repudiation or has notified the repudiating party
18 that it would await the agreed performance; and

19 (2) in either case, suspend its own performance.

20 (b) Repudiation includes but is not limited to language that one party will
21 not or cannot make a performance still due under the contract or voluntary
22 affirmative conduct that reasonably appears to the other party to make a future
23 performance impossible.

24 **Uniform Law Source:** Section 2-609.

25

26 **Committee Action:**

27 This section was considered in December without substantial substantive
28 comment.

29

Reporter's Note

This section corresponds to current law in Article 2.

SECTION 2B-623. RETRACTION OF ANTICIPATORY

REPUDIATION.

(a) A repudiating party may retract a repudiation until its next performance is due unless an aggrieved party after the repudiation has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction under subsection (a) may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 2B-621.

(c) Retraction under subsection (a) reinstates a repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay caused by the repudiation.

Uniform Law Source: Section 2-610.

Committee Action:

This section was considered in December without substantial substantive comment.

Reporter's Note

This section corresponds to existing law in Article 2.

[E. LOSS AND IMPOSSIBILITY]

1
2
3 **SECTION 2B-624. RISK OF LOSS.**

4 (a) Except as otherwise provided in this section, the risk of loss as to a
5 copy passes to the licensee on receipt of the copy. In an access contract, risk of
6 loss as to the information to be accessed remains with the licensor if the resource is
7 in the possession or control of the licensor, but risk of loss as to a copy of
8 information made by the licensee passes to the licensee when it receives the copy.

9 (b) If a contract requires or authorizes a licensor to send a tangible copy by
10 carrier, the following rules apply:

11 (1) If the contract does not require delivery at a particular destination,
12 the risk of loss passes to the licensee when the copy is delivered to the carrier even
13 if the shipment is under reservation.

14 (2) If the contract requires delivery at a particular destination and the
15 copy arrives there in the possession of the carrier, the risk of loss passes to the
16 licensee when the copy is tendered in a manner that enables the licensee to take
17 delivery.

18 (3) If a tender of delivery of a copy or a shipping document fails to
19 conform to the contract, the risk of loss remains on the licensor until cure or
20 acceptance.

21 (c) If a copy is held by a third party to be delivered or reproduced without
22 being moved, or if a copy is to be delivered by making access available to a
23 resource that contains the copy of the information, the risk of loss passes to the

1 licensee upon:

2 (1) the licensee's receipt of a negotiable document of title covering the

3 copy;

4 (2) acknowledgment by the third party to the licensee of the licensee's

5 right to possession of or access to the copy; or

6 (3) the licensee's receipt of a record directing delivery or access or of

7 access codes enabling delivery or access.

8 **Uniform Law Source:** Section 2-509

9

10 **Reporter's Notes**

11 1. In an information contract, in most cases, risk of loss issues relate to
12 copies of the information and eventually deal with the obligation to pay for or
13 provide additional copies or additional access to obtain new copies of the
14 information. For example, a licensee's data may be transferred to the licensor for
15 processing and destruction of the processing facility may destroy the data.
16 Alternatively, a purchaser of software transferred in the form of a tangible copy
17 may (or may not) suffer a loss when or if the original copy is destroyed (depending
18 of course on whether additional copies were made before that time). This section
19 uses a concept of transfer of possession **or control** as a standard for when risk of
20 loss is transferred to the other party. Unlike in the sale of goods, buyer-seller
21 environment, however, the issue may go in either or both directions as, in modern
22 commerce, there are frequent transactions in which licensees provide copies of
23 information to licensors. Basically, the premise of this section is that risk passes to
24 the party who has access to, taken possession of copies, or received control of the
25 information.

26

27 2. Subsection applies that basic principle to Internet or similar transactions.
28 The risk remains with the licensor as to the basic information that it controls and
29 retains, but as to copies made by the licensee passes on the making of the copy.

30

31

32 **SECTION 2B-625. EXCUSE BY FAILURE OF PRESUPPOSED**

33 **CONDITIONS.**

34 (a) Delay in performance or nonperformance by a party is not a breach of

1 contract if performance as agreed has been made impracticable by:

2 (1) the occurrence of a contingency whose nonoccurrence was a basic

3 assumption on which the contract was made; or

4 (2) compliance in good faith with any applicable foreign or domestic

5 governmental regulation, statute, or order, whether or not it later proves to be

6 invalid, if the parties assumed that the delay or nonperformance would not occur.

7 (b) A party claiming excuse under subsection (a) shall seasonably notify the

8 other party that there will be delay or nonperformance. If the claimed excuse

9 affects only a part of the party's capacity to perform, the party claiming excuse

10 shall also allocate performance among its customers in a manner that is fair and

11 reasonable and notify the other party of the estimated quota made available.

12 However, the party may include regular customers not then under contract as well

13 as its own requirements for further manufacture.

14 (c) A party that receives notice in a record of a material or indefinite delay,

15 or of an allocation which would be a material breach of the whole contract, may:

16 (1) terminate and thereby discharge any unexecuted portion of the

17 contract; or

18 (2) modify the contract by agreeing to take the available allocation in

19 substitution.

20 (d) If, after receipt of notification under subsection (b), a party fails to

21 terminate or modify the contract within a reasonable time not exceeding 30 days,

22 the contract lapses with respect to any performance affected.

1 **Uniform Law Source:** Sections 2A-405, 2A-406; Sections 2-615, 2-616.

2

3 **Committee Votes:**

4 1. Voted unanimously to delete former Section 2B-624, with reporter free to
5 replace some of the concepts in another section.

6 2. Voted 12-1 to delete section on invalidity of intellectual property.

7

8

9

10 [F. TERMINATION]

11

12

13 **SECTION 2B-626. TERMINATION; SURVIVAL OF OBLIGATIONS.**

14 (a) Except as otherwise provided in subsection (b), on termination of a

15 contract, all obligations that are still executory on both sides are discharged.

16 (b) The following survive termination of a contract:

17 (1) a right or remedy based on breach of contract or performance;

18 (2) a limitation on the use, manner, method, or location of the exercise

19 of rights in the information;

20 (3) an obligation of confidentiality or nondisclosure;

21 (4) an obligation to return or dispose of information, materials,

22 documentation, copies, records, or the like to the other party or to obtain

23 information from an escrow agent;

24 (5) a choice of law or forum;

25 (6) an obligation to arbitrate or otherwise resolve contractual disputes

26 by means of alternative dispute resolution procedures;

27 (7) a term limiting the time for commencing an action or for providing

28 notice;

- 1 (8) an indemnity term pertaining to future claims;
- 2 (9) a limitation of remedy or disclaimer of warranty and a warranty that
- 3 expressly extends to future claims;
- 4 (10) an obligation to provide an accounting;
- 5 (11) any right, remedy, or obligation stated in the agreement as
- 6 surviving; and
- 7 (12) other rights, remedies, or limitations if in the circumstances such
- 8 survival is necessary to achieve the purposes of the parties.

9 **Uniform Law Source:** Section 2A-505(2); Section 2-106(3).

10 **Committee Action:**

11 1. This section was reviewed by the Committee in December with no

12 substantial substantive concerns.

13 2. The section was discussed again in June, 1997, with no substantive

14 objections, but comments that are reflected in the changes made in this Draft.

15

16 **Reporter's Note**

17 1. Subsection (a) states the primary effect of termination, which refers to

18 the discharge of executory obligations. This corresponds to current law.

19

20 2. Subsection (b) provides a list of provisions and rights that presumptively

21 survive termination. In most of the cases, the list presumes that the obligation was

22 created in the contract. The exceptions deal with remedies. The list indicates terms

23 that would ordinary be treated as surviving in a commercial contract and the intent

24 is to provide background support, reducing the need for specification in the

25 contract with resulting risk of error. Of course, under the basic theme of contract

26 flexibility, additional surviving terms can be added and the terms provided here can

27 be made to be non-surviving.

28

29 3. Subsection (b) is a default rule. The contract terms can clearly add

30 additional surviving obligations. The contract can also negate the survival of the

31 listed rights. To do so, however, the contract would require specific reference and

32 negation. Mere failure to list an element of subsection (b) does not mean that it

33 does not survive.

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1 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket
2 services through licensor owned facilities). In fact, in many cases, unless the
3 contract otherwise provides, a license to use resources or property of the licensor is
4 subject to termination at will. Of course, the concept of termination refers to events
5 not associated with breach. Where the reason to end the access relates to the
6 existence of a breach, the section on discontinuing access controls.

7
8 4. The language in the last part of subsection (c) sets out a standard for
9 measuring the validity of contract provisions relating to time, place and method of
10 termination notice. Current Article 2 allows the dispensing with notice if the term
11 is not unconscionable. Subsection (c) retains that concept. In addition, however,
12 Article 2B refers to concepts set out in Article 9-501 allowing standards to be set
13 for notification. As in Article 9, that standard creates substantial room for effective
14 exercise of contract freedom. The subsection invalidates waivers that are
15 unconscionable, but allows specification of standards for notice subject to a
16 standard of manifest unreasonableness.

17
18
19 **SECTION 2B-628. TERMINATION: ENFORCEMENT AND**
20 **ELECTRONICS.**

21 (a) On termination of a license, a party in possession or control of
22 information, materials, or copies which are the property of the other party or are
23 subject to a contractual obligation to be returned, shall return all materials and
24 copies or hold them for disposal on instructions of the party to whom the materials
25 are to be returned. If information, materials, or copies are jointly owned, the party
26 in possession or control shall make the information, materials, or copies available
27 to the other joint owner.

28 (b) If the information, materials, or copies were subject to restrictions on
29 use or disclosure, the party in possession or control following termination shall
30 cease continued exercise of the terminated rights. Termination discontinues all
31 rights of use under the license. Continued exercise of the terminated rights or other

1 use is a breach of contract unless it is authorized by a contractual term that survives
2 cancellation or which was designated in the contract as irrevocable.

3 (c) Each party is entitled to enforce its rights under subsections (a) and (b)
4 by judicial process. To the extent necessary to enforce those rights, a court may
5 order the party or an officer of the court to:

6 (1) take possession of copies or any other materials to be returned;

7 (2) render unusable or eliminate the capability to exercise rights in the
8 licensed information and any other materials to be returned without removal;

9 (3) destroy or prevent access to any record, data, or files containing the
10 licensed information and any other materials to be returned under the control or in
11 the possession of the other party; and

12 (4) require that the party in possession or control of the licensed
13 information and any other materials to be returned assemble and make them
14 available to the other party at a place designated by that other party or destroy
15 records containing the materials.

16 (d) In an appropriate case, the court may grant injunctive relief to enforce
17 the rights under this section.

18 (e) A party may utilize electronic means to enforce termination under
19 Section 2B-314. If termination is for reasons other than expiration of the license
20 period or the happening of an agreed event, the party terminating the contract by
21 electronic means shall notify the other party before using the electronic means
22 either directly or through the electronic means.

1 **Uniform Law Source:** None.

2

3

Reporter's Notes

4 *Changes Since the June Meeting:*

5 Restructured for clarity.

6

7 *General Notes:*

8 1. This section only deals with licenses. Subsection (a) states the
9 unexceptional principle that the expiration of the contract term justifies immediate
10 termination of contract rights and performance.

11

12 2. Termination differs from cancellation in that cancellation applies only in
13 cases of ending a contract for breach. Subsection (e) deals with electronic means to
14 enforce contract rights, a phenomenon present in digital information products, but
15 not generally available in more traditional types of commercial products. The
16 provisions here involve use of electronics to enforce contract rights that are not
17 characterized by enforcing a breach of the agreement. Enforcement in the event of
18 breach is dealt with in Sections 2B-715 and 2B-716.

19

20 3. The ability to use electronic means to effectuate a termination does **not**
21 allow use of those means to destroy or recapture records, but merely enables the
22 licensor to preclude further use of the information. Section 2B-314 requires notice
23 in the contract, except in stated cases. The electronic means to enforce termination
24 would include, for example, a calendar or a counter that monitors and then ends the
25 ability to use a program after a given number of days, hours, or uses, whichever
26 constitutes the applicable contract term.

27

28 **Illustration 1:** Sun licenses Crocker to use a word processing system for one
29 use; the system operates through the Internet and the use of mini-program
30 modules that are downloaded into the system as needed and remain in the
31 system for brief periods. The license as to each applet terminates at the end of
32 its brief use period. This section allows the use of electronic means to
33 effectuate that termination.

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PART 7
REMEDIES

[A. IN GENERAL]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury.

(b) Unless the contract contains a term liquidating damages, a court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) If a party is in breach of contract, whether or not material, the other party has the rights and remedies provided in the agreement and this article, but the agreed party must continue to comply with contractual use restrictions. Unless the contract so provides, the party also has the rights and remedies available to it under other law.

Uniform Law Source: Section 2A-523.

Reporter’s Note

Changes Since the June Draft:

1. The new language in current subsection (c) was moved here from Section 2B-601(e)(2) in the June Draft with no substantive change.
2. Former subsection (a) was deleted because it repeats language and concepts already in Article 1.
3. Former subsection (d) was deleted since the concept is handled in the specific remedies and damages sections.

General Notes:

1 1. The basic theme of contract remedies is set out in Article 1. The goal is
2 to place an aggrieved party in the position that would occur if performance had
3 occurred as agreed. This is stated in UCC § 1-106(1) which provides that
4 "remedies . . . shall be administered to the end that the aggrieved party may be put
5 in as good a position as if the other party had fully performed." This Draft has
6 been amended to not restate that basic principle here, relying instead on the
7 principle that Article 1 rules apply unless expressly displaced.
8

9 2. Subsection (a) affirms that the remedies in this article are cumulative and
10 there is no concept of election of remedies such as would bar seeking multiple
11 forms of remedy. This is a fundamental approach in the UCC and expressed in
12 Section 2A-501(4) as to leases.
13

14 3. Subsection (b) gives a court a limited right to deny a remedy if it would
15 place the injured party in a **substantially better position** that performance would
16 have. This is a general review power given to the court. It does not justify close
17 scrutiny by a court of the remedies chosen by an injured party, but only a broad
18 review to prevent **substantial** injustice. The basic remedies model adopted here
19 gives the primary right of choice to the injured party, not the court, and uses the
20 substantial over-compensation idea as a safeguard. The limiting reference to
21 "substantially" better position has been extensively debated in the Article 2
22 Drafting Committee and, in the current Draft, remains used as a reference point
23 consistent with the idea of allows the parties, rather than the court, to elect among
24 the remedies provided.
25

26 **SECTION 2B-702. CANCELLATION.** 27

28 (a) A party may cancel a contract if the other party's conduct constitutes a
29 material breach of contract which has not been cured or if the agreement so
30 provides.

31 (b) Cancellation is not effective until the canceling party notifies the other
32 party of cancellation.

33 (c) On cancellation the following rules apply:

34 (1) A party in possession or control of information, materials, or copies
35 shall comply with Section 2B-628.

1 (2) All obligations that are executory at the time of cancellation are
2 discharged.

3 (3) The rights, duties, and remedies described in Section 2B-626(b)
4 survive.

(d) A contractual term providing that a party's rights may not be canceled is enforceable and precludes cancellation as to those rights. However, a party whose right to cancel is limited retains all other rights and remedies under the agreement or this article.

9 (e) Unless a contrary intention clearly appears, language of cancellation,
10 rescission, or avoidance or similar language is not a renunciation or discharge of
11 any claim in damages for an antecedent breach of contract.

12 **Uniform Law Source:** Section 2A-505; Sections 2-106(3)(4), 2-720, 2-721.
13 Revised.

15 **Selected Issue:**

- 16 1. Should rights granted by a licensee under authorized licenses to third parties
17 survive cancellation?
- 18 2. Should the Draft alter current Article 2 and require notice before
19 cancellation since cancellation requires material breach or an event defined in the
20 contract as sufficient to allow cancellation?

22 Reporter's Note

1. Cancellation means putting an end to the contract **for breach** and is distinct from termination (this terminology is not necessarily common in licensing practice, which tends to treat ending the contract for breach as a termination of the contract). In this article, the right to cancel exists **only** if the breaching party's conduct constitutes a **material breach** of the entire contract **or** if the contract creates the right to cancel under the circumstances. There is substantial case law in licensing and other contexts on this point. The concept of a breach material as to the entire contract is also found in Article 2A (Section 2A-523) and Article 2 (installment contracts). Interestingly, Article 2A defines any failure to pay rent as

1 such a breach, while this Draft treats non-payment of fees as material only if
2 substantial. The primary issue in this section concerns whether the injured party
3 must give notice to the other party before the cancellation for material breach is
4 effective.

5
6 2. In an ongoing relationship, the remedy of cancellation is important in
7 two different ways. First, it is important to the injured party because it ends the
8 party's duty to continue to perform executory obligations under the agreement.
9 Thus, for example, cancellation in a continuous access contract would end the
10 access provider's obligation to continue to make access available. Second, in
11 licenses that involve intellectual property rights, cancellation ends the contractual
12 permission to utilize the information in ways that would otherwise infringe the
13 licensor's intellectual property rights. This creates the possibility of intellectual
14 property remedies for infringement that co-exist with contractual remedies for
15 breach. This is true because, at least in most cases, cancellation of a license
16 coupled with continued use (e.g., copying) by the licensee infringes the property
17 rights of the transferor. In practice, in licensing, contract damages are often not
18 sought because a licensor relies on the infringement claim, rather than on contract
19 law for recovery, but both types of recovery exist and the ability to cancel the
20 license may trigger the intellectual property recovery right. See *Schoenberg v.*
21 *Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992); *Costello Publishing Co. v.*
22 *Rotelle*, 670 F.2d 1035, 1045 (D.C. Cir. 1981); *Kamakazi Music Corp. v. Robbins*
23 *Music Corp.*, 684 F.2d 228 (2d Cir.1982). Damages for copyright infringement
24 include "actual damages suffered by [the copyright owner] as a result of the
25 infringement **and** any profits of the infringer that are attributable to the
26 infringement and are not taken into account in computing the actual damages
27" 17 U.S.C. § 504(b). There is also a statutory damages provision.

28
29 A license is a permit granted by the licensor to the licensee that allows the
30 licensee to use, access or take whatever other actions are contracted for with
31 respect to the intangibles without threat of infringement action by the licensor. If
32 the license terminates, that "defense" dissolves; a licensee who continues to act in
33 a manner inconsistent with any underlying intellectual property rights of the
34 licensor exposes itself to an infringement claim. Intellectual property remedies are
35 in addition to contract remedies. The infringement and the contract remedies deal
36 with a different injury (breach of contract expectation or damage to exclusive
37 rights).

38
39 3. The right to cancel **also** affects judicial jurisdiction issues if the
40 information is covered by federal intellectual rights. An infringement claim places
41 the licensor within **exclusive** federal court jurisdiction. See *Schoenberg v.*
42 *Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992). *Schoenberg* comments:
43 "If the breach would create a right of rescission, then the asserted claim arises

1 under the Copyright Act. In order to sue for infringement (in addition to or in lieu
2 of the breach of contract), the licensor must establish that the contract no longer
3 grants permission to the licensee to do what it alleges that the licensee is doing. A
4 contract claim arises under state law and comes under federal jurisdiction under
5 diversity or pendent jurisdiction concepts.
6

7 4. Of course, the fact that a material breach occurred does not **require** the
8 injured party to cancel. It may continue to perform and collect damages under
9 other remedial provisions. Under the section dealing with cure, the ability to cure a
10 material breach is subject to the injured party's right to cancel. Thus, there is no
11 obligation to wait for a possible cure. Cancellation may be immediate. However,
12 if cure precedes cancellation, cure precludes cancellation.
13

14 5. Cancellation is effective when the injured party notifies the other party.
15 In a single delivery in the mass market, refusal of delivery itself provides the
16 required notice. More generally, since the right to cancel arises in the event of a
17 **material** breach, the equities favor flexibility for the injured party.
18

19 Yet, the Draft does not allow cancellation without any effort to notify the
20 breaching party. "Notifies" is defined in Article 1 (Section 1-201(26)) as taking
21 steps reasonably required to inform the other party of the fact, but does not require
22 **receipt** of the notice. An obligation to ensure receipt would be inconsistent with
23 the balance of rights here and other law, such as in Article 9. Since cancellation
24 requires a material breach, however, the Committee should consider whether a
25 precondition of notice should be imposed at all or whether cancellation without
26 notice is appropriate. That requirement apparently does not exist in current Article
27 2.
28

29 6. Subsection (d) clarifies the enforceability of contract terms that provide
30 that a licensee's right cannot be canceled, even for material breach. This type of
31 remedy limitation is especially common in transactions where the licensee
32 contemplates distribution of the information product developed or licensed by the
33 other party and makes a significant investment in developing the information
34 product based on the license. The non-cancellation term has as much or more
35 importance in information industries as does the refund and replacement term in
36 transactions involving the sale of goods.
37

38 7. Subsection (e) is from current Article 2.
39
40

41 **SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.**

42 (a) An agreement may add to, limit, or provide a substitute for the measure

1 of damages recoverable for breach of contract or limit a party's other remedies,
2 such as by precluding the party's right to cancel or limiting the remedies to return
3 of all copies of the information and refund of the contract fee, or repair and
4 replacement of copies of the information.

5 (b) Resort to a modified or limited remedy is optional unless the remedy is
6 expressly agreed to be exclusive. An exclusive remedy precludes resort to any
7 other remedies under this article. However, if an exclusive remedy requires
8 performance by the party that breached the contract and the performance of that
9 party in providing the agreed remedy fails to give the other party the remedy, the
10 aggrieved party is entitled to specific enforcement of the agreed remedy or, to the
11 extent that the performance failed to provide the agreed remedy and subject to
12 subsection (c), to other remedies under this article.

13 (c) Failure or unconscionability of an agreed remedy does not affect the
14 enforceability of separate terms disclaiming or limiting consequential or incidental
15 damages unless those terms are expressly made subject to the performance of the
16 agreed remedy.

17 (d) Consequential damages and incidental damages may be excluded or
18 limited by agreement unless the exclusion or limitation is unconscionable. A
19 conspicuous term enforceable under this section is not subject to invalidation under
20 Section 2B-308(b).

21 **Uniform Law Source:** Section 2-719 (revised).

22

23 **Committee Actions:**

1. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2-8.

2. Considered in June 1997 with consideration of whether failure of exclusive remedy should assume failure of consequential damages limiting clause unless the clauses are expressly indicated to be independent.

Reporter's Note

Changes Since the June Meeting:

1. The section has various edits relating to harmonization.

2. Subsection (c) proposes a resolution of a heavily litigated issue about the relationship between exclusive remedy and consequential damage limiting clauses.

See Reporter's Note 4. During the June meeting of the Drafting Committee, this approach was discussed extensively with the Committee asking the Reporter to consider whether this approach should be retained or whether there should be a presumption that the two clauses are dependent unless the contract expressly provides that they are independent clauses. The alternative formulation has not been fully considered by the Reporter or the Committee. It would state something along the following lines as a substitute for current subsection (c): "Failure or unconscionability of an agreed remedy precludes enforcement of terms limiting or excluding consequential or incidental damages unless those terms are expressly described as independent of the other agreed remedy."

General Notes:

1. Subsection (a) validates the ability of parties to contractually limit remedies. It generally conforms to current law. Subsection (a) also lists an additional remedy (non-cancellation) relevant in information transactions, but not in sale of goods law. The list in subsection (a) is not an exclusive statement of appropriate options, but provides guidance on what options are clearly acceptable, if performed by the party seeking to enforce the limited remedy.

This Draft follows current Article 2 in providing that exclusion or limitation of **consequential damages** is permitted unless the clause doing so is unconscionable. In information contracts, unlike in reference to transactions involving the sale of goods, there does not exist a body of law applying contract breach principles to create liability for personal injury for the information provider.

In fact, in dealing with informational content, most cases do not provide for personal injury recovery, even under tort theories. Where the subject matter involves computer software, as compared to informational content, there is a similar lack of case law creating liability for personal injury claims. Additionally, most cases where personal injury risk is clearest in reference to computer software (e.g., embedded software operating automobile brake systems) are not within the

1 scope of Article 2B (see Section 2B-103). Under these circumstances, the Draft
2 does not adopt the sales law presumption that exclusion of loss for personal injury
3 in **consumer** cases is prima facie unconscionable. An assumption that limitation of
4 such loss is wrongful is not appropriate since the availability of such a remedy is
5 not generally established in law. On the other hand, the Draft does provide that
6 personal injury in appropriate cases does fall within the definition of consequential
7 damages. **The Draft simply takes no position on the issue of the conscionability**
8 **of excluder clauses.**

9
10 2. Subsection (b) begins with language from current article 2: a contractual
11 remedy is not the exclusive remedy unless the terms of the contract expressly so
12 provide. The second sentence of subsection (b), however, reflects modern case law
13 and clarifies the test for failure of a remedy under current Article 2. Current Article
14 2 provides that a contractual limit is eliminated if the circumstances "cause an
15 exclusive agreed remedy under subsection (a) to fail of its essential purpose". This
16 language has led to a myriad of case law rulings and does not clearly describe what
17 is at issue in failed remedy cases.

18
19 The need for clarification was suggested from the floor of the NCCUSL
20 meeting in 1995. The basic principle in this subsection is that, if a party agrees to
21 specified performance as an exclusive remedy in lieu of other remedies, its failure
22 or inability to perform its that agreement on remedies both vitiates the exclusive
23 nature of the remedy limitation or allows specific performance at the aggrieved
24 party's option.

25
26 3. This Draft follows current law under Article 2 in that it does not restrict
27 the ability of the parties to control their remedies by contract through a statutory
28 concept that there must be a so-called "minimum adequate remedy". Under current
29 law, that phrase appears only in Comments to Section 2-719. In some reported
30 cases, those Comments have been used as a basis to challenge contractual remedy
31 limitations, but the challenges have been effective in only a few cases and typically
32 only if the remedy limitation essentially denies any remedy to the party. That being
33 said, the standards for what constitutes a "minimum adequate remedy" are not
34 clearly delineated either in current Comments the Article 2 of in the reported cases.
35 See, e.g., *Cognitest* case.

36
37 The Comments to current Section 2-719 tie the idea of a minimum adequate
38 remedy to two legal analyses, both of which are present under this Draft. In one
39 respect, they seem to refer to an idea of a failure of mutuality or consideration and
40 resulting questions about the enforceability of the entire contract (e.g., "If the
41 parties intend to conclude a contract for sale . . . they must accept the legal
42 consequence that there be at least a fair quantum of remedy . . ."). Alternatively,
43 the concept is connected in the Comments to the idea of unconscionability, a

1 standard against which all contract clauses are tested in this Article (e.g., "Thus any
2 clause purporting to modify or limit the remedial provisions of this Article in an
3 unconscionable manner is subject to deletion . . .").

4
5 Since these generally applicable and more widely accepted themes remain
6 present in reference to all contract, the decision to not elevate the commentary to
7 statutory law avoids creating a new and undefined basis for invalidating important
8 contract terms without substantively altering the rights of the parties under current
9 law.

10
11 The provision regarding exclusive remedies in this context is exclusive only
12 as to contractual remedies, it does not refer to being exclusive as to all "rights" of a
13 party, such as the right to prohibit use or copying, or disclosure unless the contract
14 expressly so provides. See Section 2B-701(e)

15
16 4. **Subsection (c)** provides a basis for resolving an issue that yields
17 inconsistent results in reported decisions under Article 2. That situation involves
18 an interpretation problem where a contract contains both a limited, exclusive
19 remedy and a contractual exclusion of consequential damages. Cases split on
20 whether in such situations a failure of the exclusive remedy also invalidates the
21 consequential damages exclusion. Most states holding that the failure of one
22 remedy does not necessarily exclude enforceability of the other limitation. This is
23 essentially a contract interpretation issue in that it asks whether the one contract
24 clause is dependent (or independent) of the other clause.

25
26 The resolution proposed in this Draft is that the two clauses are considered
27 to be independent unless the contract expressly links them as dependent clauses.

28
29
30 **SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.**

31 (a) Damages for breach of contract by either party may be liquidated in an
32 amount that is reasonable in the light of either the actual loss or the then anticipated
33 loss caused by the breach and the difficulties of proof of loss in the event of breach.
34 A term fixing unreasonably large liquidated damages is unenforceable. If a term
35 liquidating damages is unenforceable, the aggrieved party has the remedies
36 provided in the agreement or this article. However, the unenforceability of that

1 term does not affect the enforceability of separate terms limiting or excluding
2 consequential damages or incidental damages unless the separate terms are
3 expressly made subject to the liquidated damages terms.

4 (b) A party in breach of contract is entitled to restitution of the amount by
5 which the payments it made for which performance was not received exceeds the
6 amount to which the other party is entitled under terms liquidating damages in
7 accordance with subsection (a).

8 (c) A party's right under subsection (b) is subject to offset to the extent that
9 the other party establishes a right to recover damages under the agreement or this
10 article other than under the terms liquidating damages in accordance with
11 subsection (a) and the amount or value of any benefits received by the licensee
12 directly or indirectly by reason of the contract.

13 **Uniform Law Source:** Section 2-718. Revised.

14

15 **Committee/Other votes:**

16 1. At the Annual Meeting, in reference to Article 2, that Drafting Committee
17 accepted a motion from the floor to clarify that no after the fact determination of
18 excessive or too minimal damages is intended.

19 2. At the June 1997 meeting, the Drafting Committee by consensus agreed to
20 delete a restitution formula contained in current Article 2, but which has had
21 limited or non-existent use.

22

23

Reporter's Note

24 This Draft continues the presumption that contractual choices should be
25 enforced unless there is a clear, contrary policy reason to prevent enforcement or
26 there is over-reaching. If the choice made by the parties was based on their
27 assessment of choices at the time of the contract, that choice should be enforced. A
28 court should not revisit the deal after the fact and disallow a contractual choice
29 because the choice later appeared to disadvantage one party. In essence, if two
30 commercial parties negotiate the clause, it is essentially per se reasonable.

1
2
3 **SECTION 2B-705. STATUTE OF LIMITATIONS.**

4 (a) An action for breach of contract under this article must be commenced
5 within the later of four years after the right of action accrues or one year after the
6 breach was or should have been discovered, but no longer than five years after the
7 right of action accrued. By agreement, the parties may reduce the period of
8 limitations to not less than one year after the right of action accrues and may extend
9 it to a term of not longer than eight years.

10 (b) A right of action accrues when the act or omission constituting the
11 breach occurs or should have occurred, even if the aggrieved party did not know of
12 the breach. Breach of warranty occurs when the activation of rights occurs.
13 However, if a warranty explicitly extends to future conduct, breach of warranty
14 occurs when the conduct that constitutes the breach of warranty occurs or should
15 have occurred, but not later than the date the warranty expires.

16 (c) A right of action for breach of warranty under Section 2B-401, an
17 express warranty covering similar subject matter as Section 2B-401, a warranty
18 against third party claims for libel, defamation or the like, or for a breach of
19 contract involving disclosure or misuse of confidential information accrues on the
20 earlier of when the act or omission constituting the breach is or should have been
21 discovered by the aggrieved party. A right of action for a failure to provide an
22 indemnity accrues on the earlier of when the act or omission that constitutes a
23 breach of the obligation to indemnify is or should have been discovered by the

1 indemnified party.

2 (d) This section does not apply to a right of action that accrued before the
3 effective date of this article.

4 **Uniform Law Source:** Section 2A-506; Section 2-725. Revised.

5

6

Reporter's Note

7 *Changes Since the June Meeting:*

8 1. Subsection (c) was amended to reflect concerns expressed about similar
9 types of warranty and other breaches that would not necessarily be covered under
10 traditional Article 2 language.

11

12 *General Notes:*

13 1. This section combines a discovery rule with a rule of repose. The
14 discovery rule extends the limitations period for one additional year if applicable.

15

16 2. The cause of action as a general rule in this Draft when the **conduct**
17 **constituting** a breach occurs. In ordinary warranties, including all implied
18 warranties, the warranty is met or breached on delivery of a product or service,
19 even if the performance problem may not appear until later. Performance, in the
20 sense of ongoing operation of a program, is not the measure of when the breach
21 occurs. Performance in the sense of completion of one's required conduct in the
22 transaction is the measure

23

24 3. This Draft follows Article 2A and Article 2 and adopts a four year limit
25 for the contract action, but allows extension by one year if the breach could not
26 have been discovered earlier. Article 2A uses a "discovery" rule. In a license, this
27 can create an extended period of exposure to suit because of the long term nature of
28 the contract and because many defects in software and similar intangibles do not
29 become manifest until particular conditions arise. Additionally, of course, breaches
30 occur during the contract performance and do not relate to circumstances present at
31 the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause
32 of action arises, except in cases where warranty extends to future performance and
33 the breach cannot be discerned until that performance occurs. In most warranty
34 cases, the breach of warranty arises on delivery. See *Intermedics, Inc. v. Ventritex,*
35 *Inc.*, No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30,
36 1993) (cause of action for contract breach related to the misappropriation would not
37 entail a continuing breach); *Computer Associates International, Inc. v. Altai, Inc.*
38 (Tex. 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute
39 of limitations in trade secret misappropriation claim). A three year statute barred a

1 cause of action for appropriation of the secrets contained in a computer program.

2

3 4. Subsection (a) applies the basic principle of contract freedom and holds
4 that parties can contract for a longer period of limitations than under the statute.
5 Modern practice routinely allows and relies on "tolling agreements" in contractual
6 disputes. The basic issue is whether a contract can **extend** as well as limit the term.
7 The Draft allows extension with a eight year maximum.

8

9 5. This section deletes the "future performance" remedy exception as
10 defined in current Article 2 and substitutes a standard that avoids the litigation that
11 the current standard generates. In current Article 2, the time of accrual standard is
12 dropped entirely if a warranty extends to future performance.

13

14

15 **SECTION 2B-706. LIABILITY OVER.**

16 (a) In this section:

17 (1) "Indemnified party" means a party that has a right of action over
18 against another party based on a claim brought by a third party.

19 (2) "Indemnifying party" means a party liable to the indemnified party
20 because of the third-party claim.

21 (b) If a indemnified party is sued by a third party other than for
22 infringement, the indemnified party must notify the indemnifying party of the
23 litigation. If the notice states that the indemnifying party may come in and defend
24 and that if it does not do so the indemnifying party will be bound in any action
25 between the indemnifying party and the indemnified party by any determination of
26 fact common in the two litigations, the indemnifying party is bound by any
27 determinations of fact in the litigation unless the indemnifying party after
28 seasonable receipt of the notice comes in and defends.

29 (c) If a indemnified party receives notice of litigation against it for

1 infringement, relating to information provided by the indemnifying party, the
2 following rules apply:

3 (1) Unless the indemnifying party has notified it of the litigation, the
4 indemnified party shall promptly notify the indemnifying party of the litigation.

5 (2) If the indemnifying party is answerable over to the indemnified
6 party for the claim or the contract is a nonexclusive license, the indemnifying party
7 has a right to take over control of the litigation, including settlement, if it demands
8 in a record that the licensee turn over control and:

9 (A) the demand states that the indemnifying party will bear all of the
10 expenses and satisfy any adverse judgment or settlement; and

11 (B) the indemnifying party provides adequate assurance of its
12 capability to do so.

13 (3) A indemnified party is barred from any remedy or recovery from or
14 against the indemnifying party for liability established by the litigation if it fails to
15 notify the indemnifying party of the litigation or refuses to turn over control of the
16 litigation to the indemnifying party when presented with a demand that complies
17 with subsection (c)(2).

18 **Uniform Law Source:** Section 2A-516; Section 2-607. Revised.

19

20 **Selected Issue:**

21 1. Should this section be deleted in light of the wide variety of situations
22 and industry practices that are involved?

23

24

Reporter's Note

25 1. This section adapts the answerable over rules of Article 2 to licenses. In

1 reference to intellectual property rights, where the issue involves a nonexclusive
2 license or a obligation over to the licensee, the licensor's interests in protecting
3 against an adverse infringement claim are often dominant. This section gives the
4 party a right to control the case if it provides adequate assurance that it is capable
5 of doing so, including satisfying a potential judgment.

6
7 2. Unlike in Article 2, this section reflects that indemnity provisions and
8 answer over obligations run in both directions in information contracts.

9
10
11
12 [B. DAMAGES]
13

14
15 **SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.**

16 (a) If there is a breach of contract, an aggrieved party may recover as
17 [direct] [general] damages, compensation the loss resulting in the ordinary course
18 from the breach as measured in any reasonable manner, together with the present
19 value of any incidental and consequential damages, less expenses avoided as a
20 result of the breach of contract.

21 (b) The remedy for breach of contract relating to disclosure or misuse of
22 information in which the aggrieved party has a right of confidentiality or which it
23 holds as a trade secret may include compensation for the benefit received by the
24 party in breach as a result of the breach. A remedy under the agreement or this
25 article for breach of confidentiality or misuse of a trade secret is not exclusive and
26 does not preclude remedies under other law, including the law of trade secrets,
27 unless the agreement expressly so states.

28 (c) Except as otherwise provided in the agreement or this article, an
29 aggrieved party may not recover compensation for that part of a loss that could

1 have been avoided by taking measures reasonable under the circumstances to avoid
2 or reduce loss, including the maintenance before breach of contract of reasonable
3 systems for backup or retrieval of information. The burden of establishing a failure
4 to take reasonable measures under the circumstances is on the party in breach.

5 (d) In a case involving published informational content, neither party is
6 entitled to consequential damages unless the agreement expressly so provides.

7 **Committee Votes:**

8 1. Voted 7-6 in March, 1996 to allow consequential damages only in cases
9 where the parties agreed to provide for that remedy.

10 2. Voted 14-0 in September, 1996, to return to consequential damages rule of
11 common law, but to consider specific types of circumstances in which
12 consequential damages should be allowed only if agreed to by the parties.

13 3. Voted 5-7 in December, 1996, to reject a motion to reverse the consequential
14 damages presumption in the case of a battle of forms.

15 4. Consensus to retain the exception for consequential damages in reference to
16 published informational content. (December, 1996)

17 5. Reviewed without substantive change or comments in June, 1997.
18 Subsection (a) subsequently edited without substantive change in response to
19 harmonization meeting in June.

20

21 Reporter's Notes

22 *Changes Since the June Draft:*

23 1. Subsection (a) was rewritten to correspond to the general damages
24 standard contained in current law and delete details that were not needed.

25

26 *General Notes:*

27 1. Subsection (a) defines a broad approach to remedies intended to cover
28 the myriad of contexts that are potentially encountered within this Article. Unlike
29 in current Article 2, reliance on formula-driven damage computation is often not
30 appropriate in Article 2B. Breach does not always or even primarily entail defects
31 in delivered products or failures to pay by a recipient (e.g., buyer). The Article
32 covers a wide range of performances and this section allows a court and a party to
33 resort to general, common sense approaches to damage computation for such
34 occurrences. Comments to the eventual Act will provide illustrations of approaches
35 to the computation of damages derived from reported license breach cases.

1
2 2. Section 2A-523(2) provides for recovery of [the loss resulting in the
3 ordinary course of events from the lessee's default as determined in any reasonable
4 manner . . . less expenses saved in consequence of the lessee's default.] The
5 *UNIDROIT Principles* provide: [An aggrieved party is entitled to full compensation
6 for harm sustained as a result of the non-performance. Such harm includes both
7 any loss which it suffered and any gain of which it was deprived, taking into
8 account any gain by the aggrieved party resulting from its avoidance of cost or
9 harm. *UNIDROIT* art. 7.4.2.

10
11 3. A party may elect to use the measure of damages in subsection (a) in the
12 case of either material or non-material breach. This is subject to general limitations
13 on double recovery and the like. However, the principle is that the aggrieved party
14 controls the choice, while the court (or jury) controls the computation. The
15 *Restatement (Second)* provides for computation of damages in the following
16 manner: [Subject to [limitations], the injured party has a right to damages based on
17 his expectation interest as measured by: (a) the loss in the value to him of the other
18 party's performance caused by its failure or deficient, **plus** (b) any other loss,
19 including incidental or consequential loss, caused by the breach, **less** (c) any cost or
20 other loss that he has avoided by not having to perform.]

21
22 4. Subsection (a) maintains the distinction between general or direct
23 damages and consequential damages. The measurement provided here is intended
24 to relate only to direct loss and the definition suggested in Section 2B-102 should
25 be considered in placing limitations on this concept. That definition provides:
26 [Direct [general] damage] means compensation for losses to a party consisting of
27 the difference between the value of the expected performance and the value of the
28 performance received.] Direct [or general] damage refers to the value of the
29 performance received, while consequential loss refers to foreseeable losses
30 resulting from the inability to use the performance.

31
32 The *Restatement (Second) of Contracts* defines recoverable damages as
33 consisting of three elements: (a) the loss in the value to him of the other party's
34 performance caused by its failure or deficiency, plus (b) any other loss, including
35 incidental or consequential loss, caused by the breach, less (c) any cost or other
36 loss that he has avoided by not having to perform. *Restatement (Second) of*
37 *Contracts* § 347.

38
39 **Illustration 1:** OnLine Corp. provides access to stock market price quotations
40 for a fee of \$1,000 per hour. It fails to have the system available during a
41 period that proves to be critical for Meri-Lynch, a client, during a ten minute
42 period. Meri-Lynch can recover as direct damages under this formula, the
43 value of the breached performance (e.g., the difference in the value of the

1 monthly performance if perfect and as delivered), but losses from not being
2 able to place profitable investments during the ten minute period are
3 consequential damages, if recoverable at all.

4
5 **Illustration 2:** Sizemore Software licensed its database software to General
6 Motors, restricting the licensed use to no more than twenty simultaneous users.
7 General Motors used the system with an average of twenty two simultaneous
8 users over a two month period. Sizemore can recover as direct damages the
9 difference in the value of a twenty-two person license for the applicable term
10 and the value of the twenty person license, or may recover the value difference
11 as measured in any reasonable manner. The excessive use is also likely to
12 constitute copyright infringement.

13
14 5. Subsection (c) requires mitigation of damages and places the burden of
15 proving a failure to mitigate on the party asserting the protection of the rule. The
16 idea that an injured party must mitigate its damages permeates contract law
17 jurisprudence, but has never previously been stated in the UCC. The basic
18 principle flows from the idea that remedies are not punitive in nature, but
19 compensatory. Especially in context of the information products considered here,
20 the need to consider whether mitigating efforts occurred are significant given the
21 potentially wide ranging losses that breach might entail.

22
23 6. This Draft excludes consequential damages for "[p]ublished
24 informational **content**." As noted elsewhere, published informational (Internet and
25 newspaper) invokes many fundamental and important values of our society.
26 Whether characterized under a First Amendment analysis or treated as a question of
27 simple social policy, our culture has a valued interest in promoting the
28 dissemination of information, this Article should take a position that strongly
29 advocates support and encouragement of broad distribution of information content
30 to the public. Indeed, a decision to do otherwise would place this Article in
31 diametric contrast to how modern law has developed. One aspect of promoting
32 publication of information is to reduce the liability risk; that principle has
33 generated a series of Supreme Court rulings that deal with defamation and libel.
34 Beyond the global concern about encouraging information flow, there are other
35 principles that suggest the same result. As indicated in the definition of published
36 informational content, the context involves one in which the content provider does
37 not deal directly with the data recipient in a setting involving special reliance
38 interests. The information is merely compiled and published. That activity should
39 be sustained. Furthermore, the information systems of this type are typically low
40 cost and high volume. They would be seriously impeded by high liability risk.
41 Finally, with few exceptions, modern law recognizes the liability limit even under
42 tort law and the exclusion would merely decline to change the law on this issue.
43 The *Restatement of Torts*, for example, limits exposure for negligent error in data to

1 cases involving an intended recipient and even then to [pecuniary loss] which
2 courts typically interpret as direct damages.

3
4 **Illustration 3:** Dow Jones distributes general stock market and financial
5 transaction information through sales of newspapers and in an on-line format
6 for a fee of \$5 per hour or \$1 per copy. Dow, the financial officer of Dupond,
7 reviews information in the online system and relied on an error to trade 1
8 million shares of Acme at a price that caused a \$10 million loss. If Dupond was
9 in a situation of special reliance on Dow Jones, the consequential loss would be
10 recoverable. If this is published content, Dupond cannot recover for the
11 consequential loss.

12
13 **Illustration 4:** Disney licenses a motion picture to Vision Theaters. Vision
14 shows the movie to audiences under a ticket contract that qualifies as an access
15 contract (e.g., on-line). One member of the audience who pays five dollars
16 hates the movie and spends a sleepless week because the movie was more
17 violent than expected. That audience member should have no recovery at all,
18 but if it can show that there was a breach, the individual could not recover
19 consequential loss because this is published content. If liability for a violent
20 movie exists, it exists only under tort law.

21
22
23 **SECTION 2B-708. LICENSOR'S DAMAGES.**

24 (a) Except as otherwise provided in subsection (b), for a material breach of
25 contract by a licensee, the licensor may recover as damages compensation for the
26 particular breach or, if appropriate, as to the entire contract, the sum of the
27 following:

28 (1) as [direct] [general] damages, the value of accrued and unpaid
29 contract fees or other consideration for any performance rendered by the licensor
30 for which the licensor has not received the contractual consideration, plus:

31 (A) the present value of the total unaccrued contract fees or other
32 consideration required for the remaining contractual term, less the present value of
33 expenses saved as a result of the licensee's breach;

1 (B) the present value of the profit and general overhead which the
2 licensor would have received on acceptance and full payment for the performance
3 that was to be delivered to the licensee under the contract and was not accepted to
4 or delivered to the licensee because of an improper refusal or a repudiation of the
5 contract; or

6 (C) damages calculated pursuant to Section 2B-707; and

7 (2) the present value of any consequential and incidental damages, as
8 permitted under the agreement or this article, determined as of the date of entry of
9 the judgment.

10 (b) If the breach of contract makes possible a substitute transaction
11 concerning the same subject matter that would not have been possible in the
12 absence of breach, the damages in subsection (a) must be reduced by due allowance
13 for the proceeds of any actual substitute transaction or the market value of the
14 substitute transaction made possible because of the breach, less the costs of the
15 substitute transaction.

16 (c) The date for determining present value of unaccrued contract fees and
17 date for determining the sum of accrued contract fees under subsection (a) is:

18 (1) if the initial activation of rights never occurred, the date of the
19 breach of contract;

20 (2) if the licensor cancels and discontinues the right to possession or
21 use, the date the licensee no longer had the actual ability to use the information; or

22 (3) if the licensee's rights were not canceled or discontinued by the

1 licensor as a result of the breach, the date of the entry of judgment.

2 (d) To the extent necessary to obtain a full recovery, a licensor may use any
3 combination of damages provided in subsection (a).

4 **Uniform Law Source:** Section 2A-528; Section 2-708.

5

6

Reporter's Note

7 *Changes Since the June Draft:*

8 Subsection (a)(1)(B) dealing with lost profits was re-inserted and restated to
9 clarify that this is not referring to lost profits in the sense of consequential
10 damages, but rather to the profit that would have been achieved from a transaction
11 that delivers a copy or other performance to the licensee, but which did not occur
12 because of refusal or repudiation. If the repudiation makes possible a replacement
13 transaction that would not be possible in the absence of breach, subsection (b)
14 requires accounting for the resulting substitute profits.

15

16 *General Notes*

17 1. This section gives the licensor a right to elect damages under three
18 measures described in (a). Each is subject to subsection (b). As is also true for
19 licensee remedies, the basic principle assumes that the aggrieved party chooses the
20 method of computation, subject to judicial review on whether the choice
21 substantially over-compensates or enables a double recovery. Thus, no order of
22 preference is stated for the three options.

23

24 2. Licensor remedies are formulated in a manner that differs from those
25 made available for lessors or sellers. The most significant difference lies in the
26 intangible character of the value with reference to which the transactions was
27 conducted. Given their ability to be recreated easily and rapidly, with little cost,
28 contracts involving digital information assets are prime candidates for damage
29 assessment focusing on net return or profit lost to the licensor. Most importantly,
30 this Draft eliminates the resale remedy standard. That approach to damages results
31 from a focus on the goods as the critical element of the contract and does not apply
32 to cases where the value of the transaction lies in the services, information, or other
33 non-goods elements. Instead of that resale or contract market focus, this Draft
34 centers damages on the contract fee and lost benefits of the licensor. This is
35 consistent with common law approaches in similar cases.

36

37 3. The measure used here reflects the subject matter. Unlike for goods,
38 information can be replicated many times over with little cost or none. Thus, the
39 remedies do not relate to resale or re-license of the particular diskette or copy.

1 Instead, the approach taken here allows a court to consider cost savings and
2 alternative transactions made possible by the breach. The reference to alternative
3 transactions is in subsection (b). This due allowance approach is appropriate in this
4 setting because of the nature of the subject matter and the variety of circumstances
5 that can be encountered. Similar language is employed in the *Restatement*. In
6 addition, of course, the injured licensor is also subject to an obligation to mitigate
7 damages.

8
9 **Illustration 1:** Chambers agrees to supply a master disk of its software to
10 Wilson Distributing and agrees to allow Wilson to distribute 10,000 copies of
11 the software in a wholesale marketplace. This is a nonexclusive license. The
12 cost of the license is \$1 million. The cost of the disk is \$5. Wilson fails to pay,
13 but instead repudiates the contract. Under subsection (a)(1)(A), Chambers
14 recovers \$1 million less the \$5. Chambers recovery is also to be reduced by
15 dues allowance for (1) any alternative transaction made possible by this breach
16 (e.g., another transaction in a market created by the lack of the 10,000 products,
17 and (2) by any failure to mitigate under Section 2B-707.

18
19 **Illustration 2:** Same as in Illustration 1, except that the contract also requires
20 Chambers to deliver manuals, boxes and other distribution materials for Wilson
21 to distribute the software. The cost of 10,000 of these materials is
22 approximately \$800,000. In computing damages, the \$800,000 cost savings is
23 deducted from the \$1 million. In considering what "due allowance" should be
24 made for any alternative transactions, a court should take into account that this
25 expense adjustment already reflects some accommodation to the alternative
26 transaction, but if a second deal had the same terms, the issue would be whether
27 the second transaction was made possible by the breach.

28
29 **Illustration 3:** Same as Illustration 1, but the license was a worldwide
30 **exclusive** license. On breach, Chambers makes an identical license with
31 Second Distributor for a fee of \$900,000. This transaction was possible
32 because the first was canceled. Chambers recovery is \$100,000 less any net
33 cost savings that are not accounted for in the second transaction.

34
35 4. This Draft retains the lost profits concept that had been developed in
36 parallel to Article 2. See *Krafsur v. UOP, (In re El Paso Refinery)*, 196 BR 58
37 (Bankr. WD Tex. 1996) (discussing of the application of the alternative transaction
38 concept in reference to a lost profits claim relating to a license breach).

39
40 **Illustration 4:** Compart licenses robotics software designed to operate aircraft
41 engine plants making a particular type of engine. There are five such plants in
42 the world. One is operated by Boeing. Boeing decides to sell the plant to
43 Douglas and, since the license is not transferable, it repudiates the license at the

1 time of sale. Douglas enters into a separate license with Compart. The second
2 transaction was made possible because of the breach by Boeing. The profit and
3 contract fees it generates off-set any profit or fees lost in the Boeing breach.
4

5 **Illustration 5:** Parkins grants an exclusive license to Telemart to distribute
6 products comprised of copies of the Parkins copyrighted digital encyclopedia.
7 This is a ten year license at \$50,000 per year. In Year 2, Telemart breaches the
8 license and Parkins cancels. It sues for damages. Its recovery is the present
9 value of the remaining contract fees with due allowance for alternative
10 transactions made available by virtue of the breach and subject to a duty to
11 mitigate. Here, since the breached license was exclusive, Parkins must reduce
12 its recovery by the returns of any alternative license for the distribution of the
13 encyclopedia.
14

15 5. The damages rules follow common law and give both the licensor and
16 the licensee a right to consequential damages. The *Restatement* uses a licensing
17 illustration in describing its general damages approach in an illustration that, under
18 this Article, deals with consequential damages, rather than the direct damages
19 measure of the formulae in subsections (a) and (b).
20

21 □A□ contracts to publish a novel that □B□ has written. □A□ repudiates the
22 contract and B is unable to get his novel published elsewhere. Subject to the
23 limitations stated [elsewhere], B□s damages include the loss of royalties that he
24 would have received had the novel been published together with the value to
25 him of the resulting enhancement of his reputation.
26

27 *Restatement (Second) of Contracts* □ 347, illustration 1. The UN Sales Convention
28 applies the same damages approach to the buyer as to the seller. *UN Convention*
29 art. 74.
30

31 Recovery of consequential (or any other damages), of course, is limited by
32 the principle that the loss must be proven with reasonable certainty. See □ 352.
33 The *Restatement* example, although apt for purposes of this Article, fails to reflect a
34 number of cases that reject claims of recovery for lost potential profits as being too
35 speculative. This Article does not disturb the basic rule requiring adequate proof of
36 loss.
37

38 The formulae in subsection (a) relate to direct (general) damages. The
39 consideration referred to in that section does not, therefore, include what gains the
40 licensor hoped to recover from full performance by the licensee which might yield
41 a broader profit for the licensor. It refers to consideration agreed to be paid and
42 independent of the market success or other unpredictable resulting gains from the
43 success.

1
2 **Illustration 6.** I receive a promise to be paid \$10,000 for an item that cost
3 \$1,000 and receive a further commitment of 3% royalties for any sales of
4 copies of that item. Assume that the licensee repudiates the entire contract. As
5 direct damages under subsection (a), I receive \$10,000 less any expenses saved.
6 The potential loss of royalty profits is treated as potential consequential loss. It
7 can be recovered only if proven with the degree of certainty required under
8 general contract law cases in the applicable jurisdiction.
9

10 6. If the breach relates to use or disclosure restrictions, consequential
11 damages are appropriate. This is consistent with current law. See *Universal Gym*
12 *Equipment, Inc. v. Erwa Exercise Equipment Ltd.*, 827 F.2d 1542 (Fed. Cir. 1987)
13 (On breach of license, under California law, [Universal was entitled to recover the
14 profits it lost as a result of [defendant's] breach . . . The court correctly undertook
15 to determine (1) which of the sales that [defendant] made after the agreement was
16 terminated would have been made by Universal if [defendant] had not violated that
17 provision and (2) the profit Universal would have made on those sales.]; *United*
18 *States Naval Institute v. Charter Comm.*, 936 F.2d 692 (2d Cir. 1991) (Premature
19 publication under book publishing license entitled licensor to lost profits caused by
20 the effect of early publication on the sales of hard copies).
21

22 7. The section provides that, for consequential damages, present values are
23 measured as of the date of the entry of the judgment. The section distinguishes
24 between contract fees and royalties on the one hand (as direct damages) and
25 consequential damages on the other. As to the direct damages, a distinction will
26 often be required between when a fee is accrued and when a fee is not accrued.
27 The provisions of subsection (c) provide guidance on this issue, making
28 computation of accrued and unaccrued fees occur on the same date.
29

30 **Illustration 7:** A five year license requires that the Sony pay a \$5 royalty to
31 Smith, the licensor, for each copy of the Power Rangers video game that it
32 produces for the retail market from a master copy given to it by the licensor.
33 Payments are made on a monthly basis. After non-payment for three months,
34 Smith notifies Sony that it is canceling the license. Assume that \$50,000 of
35 royalty fees would accrue each month of the ten year contract. Under
36 subsection (c)(2), the date for distinguishing accrued and unaccrued fees arises
37 when Sony no longer had possession or the ability to continue use of the
38 information. Assume that it returned the master disk at the end of month 3.
39 The sum of accrued and unpaid fees is \$150,000, while the unaccrued fees total
40 (assuming this can be proven or reliably estimated) \$50,000 times the
41 remaining 57 months of the license. The present value of that amount would be
42 determined as of the end of the third month. If Sony's performance also
43 breached quality requirements in the license, Smith may be able to recover

1 consequential loss to the value of the images as computed on the date of
2 judgment.

3
4 8. The licensor may have remedies under other law. The primary
5 alternative is intellectual property law. Default by the licensee introduces the
6 possibility of an infringement claim if (a) the breach results in cancellation
7 (rescission) of the license and the licensee's continuing conduct is inconsistent
8 with the licensor's property rights, or (b) the default consists of acting outside the
9 scope of the license and in violation of the intellectual property right. See
10 *Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992); *Costello*
11 *Publishing Co. v. Rotelle*, 670 F.2d 1035, 1045 (D.C. Cir. 1981); *Kamakazi Music*
12 *Corp. v. Robbins Music Corp.*, 684 F.2d 228, 230 (2d Cir.1982); *Rano v. Sipa Press*,
13 987 F.2d 580 (9th Cir. 1993) ([Under] federal and state law a material breach of a
14 [copyright] licensing agreement gives rise to a right of rescission which allows the
15 non-breaching party to terminate the agreement. After the agreement is terminated,
16 any further distribution would constitute copyright infringement.); *Costello*
17 *Publishing Co. v. Rotelle*, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

18
19 9. Remedies for copyright infringement include both monetary recovery
20 and a right of action against the infringing works and the infringer's future
21 conduct. The two remedies are not mutually exclusive and are simultaneously
22 available. 17 U.S.C. § 504. Loss is measured in terms of wasted advantage, lost
23 profit or the like. See *Data General Corp. v. Grumman Systems Support Corp.*,
24 Civ. A. No. 88-0033-S, 1993 WL 153739 (D. Mass. May 11, 1993); *Harris Market*
25 *Research v. Marshall Marketing & Comm., Inc.*, 948 F.2d 1518 (10th Cir. 1991)
26 (licensing fees due under sublicenses were admissible on the issue of damages
27 under theory of breach of license agreement); *Engineering Dynamics, Inc. v.*
28 *Structural Software, Inc.*, 785 F. Supp. 576 (E.D. La. 1991) (infringing user
29 manual; damage award adjusted to reflect the fact that losses suffered by copyright
30 owner stemmed from factors other than actions attributable to improper use of the
31 manual); *Deltak, Inc. v. Advanced Systems, Inc.*, 767 F.2d 357 (7th Cir. 1985)
32 (damages measure value of the infringing use; in case in which no directly
33 attributable profit could be discerned, each infringing copy [had a value of use
34 equal to the acquisition cost saved by the infringement instead of purchase which
35 [defendant] was then free to put to other uses.])

36
37 10. Infringement of a patent entitles the patent holder to damages computed
38 so as to place the patentee in the position that it would have been in had the
39 infringement not occurred. 35 U.S.C. § 284 (damages [adequate to compensate for
40 the infringement.]) The Patent Act also authorizes a court to award treble damages
41 in the event of a willful infringement. Actual damages are assessed in terms of loss
42 suffered by the patent holder with the measure of [loss] frequently gauged in terms
43 of loss of profits in reference to the patented invention. *Zegers v. Zegers, Inc.*, 458

1 F.2d 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132
2 (1972); *Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp.*,
3 270 F.2d 635 (5th Cir. 1959).

4
5 11. Trade secret law is grounded in state law relating to the enforcement of
6 confidential relationships relating to information. There are three sources of trade
7 secret law: the *Restatement (First) of Torts* § 757, the *Restatement (Third) of Unfair*
8 *Competition*, and the *Uniform Trade Secrets Act (UTSA)*. While the first
9 *Restatement* has dominated this field, the majority of all States have now adopted
10 the UTSA. *Restatement*: in addition to injunctive and other relief, the trade secret
11 owner may recover damages for past harm . . . or be granted an accounting of the
12 wrongdoer's profits and provides that the owner of the trade secret can have two
13 or more of these remedies in the same action. *Restatement (First) of Torts* § 757
14 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may
15 recover damages for the **actual loss** caused by misappropriation. A complainant
16 also may recover for the **unjust enrichment** caused by the misappropriation that is
17 not taken into account in computing damages for actual loss."

18
19 12. Licensors often opt for intellectual property remedies, rather than
20 contract remedies under current law because the recovery is often greater and the
21 standards for damages are more clearly defined. Federal intellectual property
22 remedies do not preempt or displace contract remedies provisions since they deal
23 with different issues. The two remedies may raise dual recovery issues in some
24 cases. The general principle is that all remedies are cumulative, except that double
25 recovery is not permitted. See *Harris Market Research v. Marshall Marketing &*
26 *Communications, Inc.*, 948 F.2d 1518 (10th Cir. 1991) (licensing and processing
27 fees due under sublicense admissible on the issue of damages under either the
28 theory of copyright infringement or of breach of license agreement); *Paramount*
29 *Pictures Corp. v. Metro Program Network, Inc.*, 962 F.2d 775 (8th Cir. 1992)
30 (award of damages for a breach of license contract and copyright infringement by
31 unauthorized display was not an award of double damages).

32 33 34 **SECTION 2B-709. LICENSEE'S DAMAGES.**

35 (a) Subject to subsection (b), on material breach of contract by a licensor,
36 the licensee may recover as damages compensation for the particular breach or, if
37 appropriate, as to the entire contract, the sum of the following:

38 (1) as [direct] [general] damages, the value of any payments made or

1 other consideration provided to the licensor for performance that has not been
2 rendered, plus:

3 (A) the present value, as of the date of breach, of the market value of
4 performance not provided minus the contract fee or other consideration for that
5 performance;

6 (B) damages computed pursuant to Section 2B-707; or

7 (C) if the licensee has accepted performance from the licensor and
8 not revoked acceptance, the present value, at the time and place of performance, of
9 the difference between the value of the performance accepted and the value of the
10 performance had there been no defect, not to exceed the agreed contract fee or
11 other contractual consideration required for the performance; and

12 (2) the present value of incidental and consequential damages, as
13 permitted under the agreement or this article, resulting from the breach as of the
14 date of the entry of judgment.

15 (b) The amount of damages calculated under subsection (a) must be
16 reduced:

17 (1) by expenses avoided as a result of the breach; and

18 (2) if further performance is not anticipated under the agreement, by any
19 unpaid contract fees for performance by the licensor which has been received by
20 the licensee.

21 (c) Market value is determined as of the place for performance. Due
22 weight must be given to any substitute transaction entered into by the licensee

1 based on the extent to which the substitute transaction involved contractual terms,
2 performance, and information that were similar in terms, quality, and character to
3 the information or agreed performance.

4 (d) To the extent necessary to obtain a full recovery, a licensee may use any
5 combination of the measures of damages provided in subsection (a).

6 **Uniform Law Source:** Section 2A-518; Section 2A-519(1)(2). Revised.

7

8 **Selected Issue:**

9 1. Should a formula approach be used or should a general damages approach
10 be stated without an attempt to develop formulae?

11

12

Reporter's Notes

13 1. As in licensor remedies, this section allows the licensee to choose among
14 alternatives. Given a court's general overview to prevent excessive damages, there
15 is no reason to make one option preferred over the other. Also, the type of breach
16 involved here is more varied; greater flexibility is needed. Because of the diverse
17 problems that might be involved in dealing with breach of a license, the narrow
18 structure of Article 2 remedies for a licensee (buyer) is not appropriate. This Draft
19 makes the choice of remedy broader and eliminates the hierarchy set out in current
20 Article 2. The remedial options in this section should be read in conjunction with
21 the general damages concepts of mitigation and avoiding double recovery.

22

23 2. Option 1 parallels the Article 2 concept of comparing contract price to
24 market value for performance not received. It is predicated on the initial
25 assumption that the breaching party will also return any contract fees already
26 received for that performance. Unlike in Article 2, there is no provision dealing
27 with a remedy based on contract price compared to "cover." This remedy is
28 removed because, in dealing with intangibles that are, by their nature, often distinct
29 or unique, the option of "cover" is often not viable and often uncertain of
30 application. In this Draft, alternative transactions are to be given "due weight" in
31 determining market value under subsection (c), but a failure to effect an alternative
32 transaction does not bar recovery unless it affects concepts of mitigation. This
33 approach was built on ideas from Article 2A. For purposes of subsection (a),
34 performance has not been provided by the licensor if the licensor fails to make a
35 required delivery, repudiates, the licensee rightfully rejects or justifiably revokes
36 acceptance, and with respect to any performance that was executory at the time that
37 the licensee justifiably cancels.

1
2 **Illustration 1:** Amoco Oil contracts for a 1,000 person site license for database
3 software from Meed Corp. The contract price is \$500,000 in initial payment
4 and \$10,000 for each month of use. The contract term is two years. Amoco
5 makes the first payment, but Meed fails to deliver a functioning system.
6 Amoco cancels the contract and sues, applying subsection (a)(1). It is entitled
7 to return of the \$500,000 payment plus recovery of any difference between the
8 contract price and the market price for a similar site license of similar software.
9

10 **Illustration 2:** Same facts as in Illustration 1, but Amoco goes to Oracle
11 Software and obtains a license for a 1,000 user site license for the Oracle
12 database software. The contract terms involve a \$900,000 initial payment and a
13 monthly use payment of \$12,000. The term is two years. In its lawsuit, if the
14 issue is raised, the court must consider to what extent this second transaction
15 gauges the market value applicable to the Meed contract. The issue would
16 involve the terms of the license, the nature of the software and any other
17 relevant variables.
18

19 **Illustration 3:** Same facts as in Illustration 2, but Amoco obtains a license for
20 the Meed software from an authorized distributor (Jones) for a \$600,000 initial
21 fees and under other terms identical to the Meed contract. The issue of
22 similarity is the same, but giving due weight to this alternative transaction will
23 presumably limit the Amoco recovery to its initial payment, \$100,000, and any
24 incidental or consequential damages.
25

26 3. The third alternative is limited to cases in which the breach relates to
27 performance that has been delivered and accepted. It parallels the provisions of
28 current Article 2, but caps the recovery by the contract price. This is based on a
29 differentiation between consequential and direct or general damages. For
30 "accepted" goods under Article 2 (sales), the damages formula is in Section 2-714,
31 consisting of any incidental and consequential damages resulting from the seller's
32 plus: (1) the "loss resulting in the ordinary course of events from the seller's
33 breach as determined in any manner which is reasonable" or (2) "the measure of
34 damages for breach of warranty [which is] the difference at the time and place of
35 acceptance between the value of the goods accepted and the value they would have
36 had if they had been as warranted, unless special circumstances show proximate
37 damages of a different amount." UCC § 2-714. Section 2A-519(3) provides that
38 the measure of damages for accepted goods is: "loss resulting in the ordinary
39 course of events from the lessor's default as determined in any manner which is
40 reasonable" plus incidental and consequential damages less expenses saved.
41 Article 2A provides that for breach of warranty the measure of damages is the
42 present value of the difference between the value of the goods as warranted and
43 their value as accepted.

1
2 4. As a general rule, the "value of the goods as warranted" focuses on the
3 market value of the property if it were consistent with the represented quality it was
4 to have. This should most often equal the purchase price, but it is not always so
5 limited by courts. See *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670
6 F.2d 1304 (3rd Cir. 1980) (allows value measure that encompassed the value that
7 the buyer would have obtained from a perfect computer system with specific
8 capabilities, including advantages in inventory control, profits and the like, in
9 excess of the contracted price). This Draft reverses that approach. The additional
10 value loss (e.g., lost benefits) are consequential damages and covered by treatment
11 of that type of damage in the contract and under the article. This Draft allows
12 recovery based on the cost of repairs incurred to bring the product to the
13 represented or warranted quality. *Fargo Machine & Tool Co. v. Kearney & Trecker*
14 *Corp.*, 428 F.Supp. 364 (E.D. Mich.).

15
16 5. Courts apply a flexible approach to licensee damages outside the UCC.
17 If the damages are proven with reasonable certainty, they can include lost profits in
18 this context. In *Western Geographic Co. of America v. Bolt Associates*, 584 F.2d
19 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits
20 that the licensor earned from licensing following breach. In *Cohn v. Rosenfeld*, 733
21 F.2d 625 (9th Cir. 1984) a company was entitled to recover lost profits when a
22 California distributor of motion pictures breached licensing agreement where
23 California distributor knew that the owner was attempting to obtain films for
24 redistribution in Europe and should have known that owner and company intended
25 to resell films. In *Ostano Commerzanstalt v. Telewide Sys., Inc.*, 880 F.2d 642 (2d
26 Cir. 1989) the court approved a lost profit recovery based on a failure of a licensor
27 to make available to the licensee various films for showing in European markets.
28 In *Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc.*, 874 F.2d 1107 (6th Cir. 1989) a
29 licensee brought action for breach of contract and for wrongful termination of
30 license related to trademarks and manufacturing know how. The contract breach
31 consisted in part of actions taken by the licensor in violation of the territorial
32 exclusivity provisions of the license. The court approved an award of lost profits
33 for breach of contract based on estimates of lost sales, but reversed on the basis of
34 how the profits were computed requiring computation of profits based on a
35 marginal cost approach. Compare *William B. Tanner Co., Inc. v. WIOO, Inc.*, 528
36 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

37 38 39 **SECTION 2B-710. RECOUPMENT.**

40 (a) If a party is in breach of contract, the other party, after notifying the
41 party in breach of its intention to do so, may deduct all or any part of the damages

1 resulting from breach from any part of payments still due and owing to the party in
2 breach under the same contract.

3 (b) If a nonmaterial breach of contract has not been cured, after notifying
4 the other party of its intention to do so, an aggrieved party may exercise its rights
5 under subsection (a) but may exercise those rights only if the agreement does not
6 require further affirmative performance by the other party and the amount of
7 damages deducted can be readily liquidated under the agreement.

8 **Uniform Law Source:** Section 2-717. Revised.

9

10 **Committee Action:**

11 1. Discussed in June, 1997; requirement of prior notification suggested.

12

13

Reporter's Note

14 1. Subsection (a) adopts language from Article 2 and Article 2A. It
15 recognizes that the injured party can employ self-help by diminishing the amount
16 that it pays under the contract. Unlike in the sale of goods, the obligations of the
17 parties here often run continuously and in complex ways back and forth.

18

19 2. Subsection (b) applies that principle to the case of nonmaterial breaches,
20 recognizing the different interests that are involved in ongoing performance
21 contracts and minor breaches. Article 2 does not deal with this because it generally
22 does not focus on ongoing contracts or recognize a distinction between material
23 and nonmaterial breach. Importantly, this Article creates an obligation to cure
24 nonmaterial breaches where the cost of that cure is not disproportionate to the
25 harm.

26

27

28

29

[C. PERFORMANCE REMEDIES]

30

31

32 **SECTION 2B-711. SPECIFIC PERFORMANCE.**

33 (a) A court may enter a decree of specific performance of any obligation,

1 other than the obligation to pay for information or services already received, if:

2 (1) the agreement expressly provides for that remedy and specific

3 performance is possible; or

4 (2) the contract was not for personal services, but the agreed

5 performance is unique and monetary compensation would be inadequate.

6 (b) A decree for specific performance may contain any terms and

7 conditions the court considers just but must provide adequate safeguards consistent

8 with the terms of the contract to protect the confidential information and

9 intellectual property rights of the party ordered to perform.

10 (c) An aggrieved party has a right to recover information that was to be

11 transferred to and thereafter owned by it if the information exists in a form capable

12 of being transferred and, after reasonable efforts, the aggrieved party is unable to

13 effect reasonable cover or the circumstances indicate that an effort to obtain cover

14 would be unavailing.

15 **Uniform Law Source:** Section 2A-521; Section 2-716. Revised.

16

17 **Committee Action:**

18 1. Discussed without substantive changes in June, 1997.

19

20 Reporter's Notes

21 1. This section explicitly affirms the right of parties to contract for specific

22 performance, so long as a court can administer that remedy. Literature clearly

23 supports that this contractual option promotes freedom and flexibility of contract.

24 This premise is consistent with the overall approach in this Article to favor and

25 support freedom of contract. The principle excludes the obligation to pay a fee,

26 however, since this is essentially equivalent to a monetary judgment and not

27 relevant to the principle of contract remedy choice. [Comments will discuss how

28 this works with respect to development contracts; it depends on the type of

1 commitment made in the contract.]

2

3 2. The second principle in subsection (a) outlines a common basis for

4 specific performance (the unique nature of the performance). That principle cannot

5 apply to a "personal services contract" in light of traditional concerns about not

6 imposing judicial obligations requiring work or services by an individual. Article 2

7 does not deal with this latter issue, since it is not involved in transactions that might

8 fall within this category. Excluding specific performance of the price element of a

9 contract avoids creating a surrogate form of contempt proceeding. Of course, if

10 there is a specific performance order requiring transfer of property under court

11 order, a reciprocal obligation to pay any relevant fees is an appropriate condition of

12 the specific performance decree.

13

14 3. Article 2 allows specific performance "where the goods are unique or in

15 other proper circumstances." UCC § 2-716(1). The Comments state: "without

16 intending to impair in any way the exercise of the court's sound discretion in the

17 matter, this Article seeks to further a more liberal attitude than some courts have

18 shown in connection with specific performance of contracts of sale." UCC

19 § 2-716, Comment 1. There are few cases ordering specific performance in a sale

20 of goods. In most cases, a court concludes that adequate substitutes are available

21 and that any differences in quality or cost can be compensated for by an award of

22 damages. Article 2A has a similar specific performance section. Section 2A-521.

23

24 4. In common law, despite the often unique character of intangibles, respect

25 for a licensor's property and confidentiality interests often precludes specific

26 performance in the form of allowing the licensee continued use of the property.

27 Courts often rule that a monetary award fits the circumstances, unless the need for

28 continued access is compelling. See *Lubrizol Enterprises, Inc. v. Richmond Metal*

29 *Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985); *Johnson & Johnson Orthopedics,*

30 *Inc. v. Minnesota Mining & Manufacturing Co.*, 715 F. Supp. 110 (D. Del. 1989).

31 Very few cases award specific performance in information-related contracts.

32

33 5. The *Restatement (Second) of Contracts* distinguishes between specific

34 performance awards and injunctive relief. *Restatement (Second) of Contracts*

35 § 357. Specific performance relates to ordering activity consistent with the

36 contract. The most common use concerns injunctions against acts that the

37 defendant promise to forebear or mandatory injunctions demanding performance of

38 a duty that is central to preserving the licensor's position. The *Restatement* states:

39 "The most significant is the rule that specific performance or an injunction will not

40 be granted if damages are an adequate remedy [to protect the expectation interest of

41 the injured party]." *Restatement (Second) of Contracts* § 357, Introductory note.

42 Non-uniform case law deals with under what circumstances a damage award is or

43 will be considered to be inadequate. The *Restatement* catalogues the following

1 circumstances under which damages may be inadequate:

2
3 (a) the difficulty of providing damages with reasonable certainty,

4
5 (b) the difficulty of procuring a suitable substitute performance by means of
6 money . . . ,

7
8 (c) the likelihood that an award of damages could not be collected.
9

10 *Restatement (Second) of Contracts* § 360. The most frequently discussed
11 illustrations of when these conditions are sufficiently met are cases in which the
12 subject matter of the contract is unique.

13
14 6. Subsection (b) recognizes judicial discretion, but provides an important
15 protection for confidential information that is relevant for both the licensor and the
16 licensee. The section casts the balance in favor of a party not being required to
17 specifically perform in cases where that performance would jeopardize interests in
18 confidential information of the party. Confidentiality and intellectual property
19 interests must be adequately dealt with in any specific performance award. Article
20 2A allows the court to order conditions that it deems just, but does not deal with
21 confidentiality issues.
22

23 7. Subsection (c) creates an important right for a licensee. It adapts
24 language from Article 2 and Article 2A to give the licensee a right to force
25 completion of a contractual transfer if, at the time of breach, the information is
26 capable of being identified and the contract contemplated that the licensee would
27 own the information product had the transaction been fully performed. It applies in
28 cases where the contract calls for a transfer of the intangibles, not merely rights to
29 use. This occurs, for example, in cases of software development where the
30 software is at least partially developed, but not yet delivered to the transferee. See,
31 e.g., *In re Amica*, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (uses Article 2 title rules
32 to resolve rights in incomplete software in a bankruptcy proceeding).
33

34
35 **SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE.** On breach of

36 contract by a licensee, the licensor in the exercise of reasonable commercial

37 judgment for the purposes of avoiding loss and of effective realization may either

38 complete and identify the information to the contract or cease work on the

39 information. In either case, the licensor may recover damages or pursue other

1 remedies.

2 **Uniform Law Source:** Section 2A-524(2); Section 2-704(2). Revised.

3

4

Reporter's Notes

5 1. This section adopts the premise of both Article 2 and Article 2A that the
6 licensor faced with a material breach by the licensor while a development contract
7 is in process can choose to complete the work or not. Having made the choice in
8 good faith and in a commercially reasonable manner, the licensor is entitled to
9 damages and other remedies gauged by the situation in which it finds itself
10 following the choice. If the transferor elects to complete, the fundamental principle
11 is that the transferee should not be prejudiced by the additional work that decision
12 entails. Section 2A-524(2) provides: "If the goods are unfinished, in the exercise
13 of reasonable commercial judgment . . . the [lessor] may either complete the
14 manufacture and wholly identify the goods to the lease contract or cease
15 manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage
16 value or proceed in any other reasonable manner."

17

18 2. This section does not use language in Article 2 and Article 2A that refers
19 to a seller's right to identify goods to the contract or to treat goods "demonstrably
20 intended" for the contract as a subject of resale even if they have not been finished
21 at the time of the breach. These sections follow a policy similar to that adopted
22 here, but deal with facts specifically linked to transactions in goods. The rights
23 implied in the other language, to the extent appropriate, are covered within the
24 more general theme in this section. As a general matter, identifying and completing
25 the intangibles will be inappropriate since most intangibles have infinite number of
26 transfers contained in or available with respect to one fund of information. The
27 notion of resale as a way of relieving loss is often inappropriate.

28

29 3. This Draft applies the cases in which contracts involve development or
30 compilation. In such cases, intangibles may not have a general market. The option
31 to complete often will often be commercially reasonable

32

33

34 **SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE.** On

35 breach of contract by a licensor, the licensee may continue to use the information

36 under the contract. If the licensee elects to continue to use the information, the

37 following rules apply:

38 (1) The licensee is bound by all of the terms of the agreement, including

1 restrictions as to use, disclosure, and noncompetition, and any obligations to pay
2 contract fees or royalties.

3 (2) Subject to Section 2B-620, the licensee may pursue remedies with
4 respect to accepted performances.

5 (3) The licensor's rights and remedies remain in effect as if the licensor
6 had not been in breach.

7 Reporter's Note

8 This section makes clear the consequences of a licensee's decision to
9 accept flawed performance by the licensor and pursue remedies that do not involve
10 a cancellation of the contract obligate the licensee to continued performance of the
11 intangibles contract itself. A licensee faced with breach by the licensor can elect to
12 continue the contract and claim damages for the breach. This section clarifies that,
13 if this choice is made, the licensee is bound by the contract terms. However, it
14 retains rights of action with respect to the prior, defective performance.

15

16

17 **SECTION 2B-714. RIGHT TO DISCONTINUE.** In an access contract, in
18 the event of a material breach of contract or if the agreement so provides, a party
19 may discontinue access by the party in breach or instruct any third person that is
20 assisting the performance of the contract to discontinue its performance.

21 Reporter's Notes

22 1. This section deals with the right of a party in an access contract to stop
23 performance under two significant circumstances. The ability to act quickly in an
24 access contract is potentially critical to party's ability to avoid continuing liability
25 risk, as might occur where the basis of the breach includes use of the access system
26 to distribute infringing, libelous, or otherwise damaging material. More generally,
27 it corresponds to current common law principles regarding access to facilities —
28 treating these as arrangements subject to cancellation at will by the party who
29 controls the facility unless the contract otherwise provides. The right to
30 discontinue is recognized in licenses whose basic nature entails a contractual
31 permission to access or use a resource owned or controlled by the licensor. In such
32 cases, the contract will be treated as preemptively subject to termination at will

1 (even without a breach). See *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No.
2 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of
3 access to ticket services through licensor owned facilities).
4

5 In cases where the information available for access is information of the
6 breaching party, the breaching party's rights to recover the information are
7 protected under other provisions of this Article.
8

9 2. This section does not create a right to retake transfers already made, but
10 merely to stop future performance. Article 2 and Article 2A are similar in reference
11 to the seller's (lessor) right to stop delivery of goods in transit. This subsection
12 derives in part from Section 2A-525(1). It does not create special rules for
13 insolvency. Cases of insolvency will be handled either in the definition by contract
14 of material breach or in the rules dealing with insecurity about future performance.
15 This grants lesser rights to the transferor than do either Article 2 or 2A. Both give
16 a right to stop shipment in the event of discovered insolvency.
17

18
19 **SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.**

20 (a) On a breach and cancellation of a license, if not prohibited by the
21 agreement, the [aggrieved party] [licensor] has

22 (1) a right to possession of all copies of the information transferred by it
23 to the party in breach that are in that party's possession or control whether
24 delivered to or made by the party in breach and any other materials that by contract
25 were to be returned by the licensee; and

26 (2) a right to prevent the licensee's continued exercise of rights in the
27 licensed information.

28 (b) A court may enjoin the party in breach from continued use of the
29 information and may order that the aggrieved party or an officer of the court take
30 the steps described in Section 2B-628(b). The aggrieved party may proceed by
31 judicial process under this section but may proceed without judicial process only if

1 it complies with Section 2B-716.

2 (c) If the agreement so provides, a court may require the party in breach to
3 assemble all copies of the information and information relating thereto and make
4 them available to the aggrieved party at a place designated by that party which is
5 reasonably convenient to both parties.

6 (d) The right to possession under subsections (a) and (b) is not available if
7 the information, before breach and in the ordinary course of performance under the
8 license, was altered or commingled so as to be no longer reasonably identifiable
9 and the remedy cannot be administered without undue harm to the information or
10 property of the licensee or another person.

11 **Uniform Law Source:** Section 2A-525; Section 9-503; Section 2A-525(1);
12 Section 2A-526; Section 2-705. Revised.

13

14 Reporter's Notes

15 1. This section was modified following the June Meeting of the Committee
16 to reflect that the right to obtain possession and to control use of information in the
17 hands of the other party in commercial practice may run either to the benefit of the
18 licensor or the licensee. This is true because in many commercial settings, the
19 licensee provides information important to it to the licensor for purposes of
20 processing, analysis and otherwise. While in a simple software license, the
21 information flows from licensor to licensee, that is not true in other situations and
22 the principle which gives the injured party a right to recover and control use of its
23 information should not be restricted to a licensor.

24

25 This section deals only with judicial action. The right to self help is
26 covered under the next section, as indicated in subsection (b). That right is more
27 restricted than the equivalent rights in Article 9 and Article 2A. For example,
28 Section 2A-525 states: "After default [that is material], the lessor has the right to
29 take possession of the goods. . . . Without removal, the lessor may render unusable
30 any goods employed in trade or business The lessor may proceed . . . without
31 judicial process if it can be done without breach of the peace or the lessor may
32 proceed by action." This gives the lessor a right to repossess in the event of any
33 non-payment of rentals. Article 9 repossession rights are even less limited in that

1 they do not hinge on a material breach.
2
3 2. The right under this section flows from the conditional nature of the
4 transaction. It arises only in the case of a license and applies only if there is a
5 material breach of the contract. The right stated here exists only to the extent that
6 the remedy can be administered without undue damage to the information or
7 property of the licensee due to commingling in the ordinary course of performance
8 under the license. The remedy entails a combination of an injunction and return of
9 copies of the information.
10
11 3. As redrafted prior to the June 1997 meeting, the section differentiates
12 between the right to obtain possession and the right to prevent on-going use of the
13 information. The right to possession is contingent on there being no commingling
14 in the ordinary course of the license such that the information cannot be identified
15 or reasonably separated from the property of the party in breach. This deals, for
16 example, with cases where data are thoroughly intermingled with data of the other
17 party **and** that intermingling occurs in the ordinary performance under the license.
18 In such cases, repossession is impossible and the reason it is impossible lies in the
19 expected performance of the parties under the contract.
20
21 If, however, an image, trademark, name or similar material is incorporated
22 and inseparable from other property of the party in breach, that fact does not in the
23 case of a material breach and cancellation, preclude the injured party from
24 preventing further use of the information by the party in breach. Thus, for
25 example, a limited license of the "Mickey Mouse" character which results in
26 placing that image on hats produced by the party in breach does not prevent the
27 other party from barring continued use of the image on the hats in commerce.
28
29 4. A right to prevent use is appropriate in a license because the contract
30 restricts use of the information. The right to enforce this does not depend on there
31 being a property interest in the subject matter, but merely a contractual right. In
32 effect, the right to enforce a discontinuation of use also stems from contractual
33 principles of specific performance. The restrictive license provisions carry with
34 them the implication that a material breach ends the right to use as created by
35 contract. Also, if there are intellectual property rights associated with the material,
36 the remedies most often available in those property law areas give the licensor a
37 right to retake and prevent continued use in the event of infringement. This Draft
38 limits the repossession right in two ways. First, the section only applies to licenses.
39 Second, the rights cannot be implemented to the extent they would yield undue
40 harm to property of the licensee.

41
42
43 **SECTION 2B-716. LICENSOR'S SELF-HELP.**

1 (a) A licensor may proceed under Section 2B-715 without judicial process
2 only if:

3 (1) the breach is material as to the entire contract without regard to
4 contractual terms defining material breach; and

5 (2) the licensor does not commit a breach of the peace, or create a
6 foreseeable risk of injury to person or significant damage to or destruction of
7 information or property of the licensee or a third party.

8 (b) A licensor may include in the subject matter of a license the means to
9 enforce its rights under subsection (a) only if [the licensee manifests assent to a
10 term of the license providing] [a conspicuous term of the license provides] that it
11 may do so. If a contractual term authorizes the licensor to include a means to
12 enforce its rights, the following rules apply:

13 (1) The licensor's use of electronic means to prevent further use of the
14 information is subject to the limitations in subsection (a) and Section 2B-715.

15 (2) Exercise of the means to prevent further use inconsistent with
16 subsection (b)(1) constitutes a breach of contract by the licensor.

17 (3) If the licensor's improper use of the means to prevent further use of
18 the information is improper under this section and results in loss to the licensor as
19 described in subsection (a), the licensee may recover damages from the licensee,
20 including consequential damages.

21 (c) Except as otherwise provided in this section, the licensee's remedies,
22 including its right to recover damages, and the limitations on the licensor under this

1 section may not be waived or altered by agreement prior to the breach of the
2 contract.

3 **Uniform Law Source:** Section 9-503. Revised.

4

5 **Committee Action:**

- 6 1. Considered and substantially revised in January 1996.
7 2. Considered in June, 1997.

8

9

Reporter's Notes

10 1. This section has been controversial, primarily because of the remedy of
11 [electronic self-help] dealt with in the section. During the June Meeting, the
12 Committee received the conflicting views of a number of parties and the general
13 consensus was that we should consider not only the approach described here, but
14 other alternatives for balancing the interests of the parties. The issues addressed
15 here are relevant not only to Article 2B, but also to Article 2A and Article 9,
16 although Committees involved in those revision projects have not considered the
17 implications of digital media and the ability of a vendor or lender to enforce
18 contractual restrictions on use, payment, or other conditions.

19

20 2. **The current Draft** recognizes the ability to use electronic means to
21 enforce conditions in the event of breach through self-help, but requires prior
22 notice in the form of an express contractual provision allowing this and also places
23 various substantive restrictions on the exercise of that right which restrictions are
24 not waivable. The reliance on prior notice in the contract is consistent with the
25 limited relevant case law. In *American Computer Trust Leasing v. Jack Farrell*
26 *Implement Co.*, 763 F. Supp. 1473 (D Minn. 1991) the court held that remote
27 deactivation was permitted for a breach of payment obligations on a software
28 license. The court's analysis was premised on the view that a breach of the license
29 entitled the licensor to terminate the relationship by whatever means it could so
30 long as no violence occurred. The transaction in *Farrell* involved a combined
31 hardware lease and software license. Also important was the court's assumption
32 that the licensee agreed to or authorized the remedies taken by the licensor. [ADP
33 had a legal right to deactivate the defendants' software pursuant to the contracts
34 and the extortion statutes do not apply.] Several cases disallowed use of this
35 device where no prior authorization or notice was given. See *Franks & Son, Inc. v.*
36 *Information Solutions*, Computer Industry Litigation Rep. 8927-25 (ND Okla.
37 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of
38 inclusion); *Art Stone Theatrical Corp. v. Technical Programming & Sys. Support,*
39 *Inc.*, 157 App. Div. 2d 689, 549 NYS2d 789 (1990).

40

1 3. Although not yet fully developed or presented to the Drafting
2 Committee, several other approaches to the issue are possible. These include:

3
4 a. Allowing physical repossession under standards applicable in Article 9
5 and 2A (e.g., limited by breach of the peace), allowing electronic deactivation
6 where the subject matter is informational content not involved in the operation
7 of a licensee's computer systems, providing for a right to an expedited hearing
8 and preliminary restraining order on proof of likelihood of success on showing
9 breach, and affirmatively state that rules under Article 9. Article 2A and other
10 law are undisturbed.

11
12 b. Allowing physical repossession under standards in Article 9 and 2A (e.g.,
13 limited by breach of peace), not dealing with electronic remedies, and
14 affirmatively state that rules under Article 9, 2A and other law are undisturbed.

15
16 4. Current law includes rights of self-help repossession under both Article 9
17 (security interests) and Article 2A (leases). In each area, self-help is allowed
18 except if it causes a breach of the peace. Each of these statutes recognizes the right
19 to self-help by "rendering unusable" goods used in business or trade. That, of
20 course, can be done physically or electronically in the digital world. It is already
21 being done electronically with reference to automobile rentals and other forms of
22 limited term or limited use contracts. Exercise of the right is conditioned on a
23 "material" default as defined in Article 2A. The Comments note that: "[in] an
24 appropriate case action includes injunctive relief." UCC § 2A-525, Comment 3,
25 citing *Clark Equip. Co. v. Armstrong Equip. Co.*, 431 F.2d 54 (5th Cir. 1970), cert.
26 den., 402 U.S. 909 (1971). Materiality can be determined by contract (which
27 cannot occur in this Draft) and applies in concept to any failure to pay rent (in this
28 context, the failure must be material).

29
30 5. The approach in Section 2B-716 places substantial restrictions on
31 electronic self-help that go beyond current law. These include:

32
33 a. Can only be used if contractual provision authorizes it and the licensee
34 manifests assent to that term.

35
36 b. Can only be used if there was a material breach of the license (as
37 compared to any default)

38
39 c. Can only be used if there is no foreseeable breach of peace.

40
41 d. Can only be used if there is no foreseeable risk of damage to persons or
42 property.

1 e. Can only be used if the information affected has not been commingled in
2 a way that makes it no longer identifiable.

3
4 f. The breach must be material without regard to the terms of the contract
5 defining material breach.

6
7 g. Misuse of the electronics constitutes a breach of contract.

8
9 h. Improper use that causes damages creates liability for the licensor and
10 the damage claim cannot be waived or altered prior to the breach.

11
12 6. The Draft also adopts a concept of proportionality by providing that self-
13 help (electronic or otherwise) can occur only if there is a breach that would be
14 material as to the entire contract independent of what definition of materiality
15 exists in the contract. Thus, under the definition of material breach applicable in
16 the absence of contract terms, there must be a breach by the licensee that
17 substantially threatens or reduces the value of the contract to the licensor. This
18 proportionality concept is substantially different from the provisions of Article 9
19 where self help hinges solely on default and the absence of a breach of the peace.
20 A policy consideration exists about whether this greater precondition is justified
21 and whether it will simply result in self help occurring through the creation of an
22 Article 9 interest as an adjunct of a license.