TO: **UCITA DRAFTING COMMITTEE**

FROM: **CONNIE RING; RAY NIMMER**

RE: **POSSIBLE REVISIONS OF UCITA DRAFT**

In correspondence and communications, there have been suggestions of changes to the Draft. We have not attempted to list them all or to respond to each. However, this memorandum does list some we believe should be on the Agenda of the Committee for discussion. If you have others, let us know.

We recommend the following suggestions:

A.1 - change Section 103(c) - see attached memo from Bugge, Ring, et. al.
A.2 - edits Section 103(d)
A.3 - either alternative 1 or 2 regarding opt in rights
B.1 - revise the definition of "authenticate"
B.2 - edit Section 216
E.1 and 2 - miscellaneous revisions

A. Revisions Pertaining to Scope of the Act.

The following four issues relate to the scope of the Act. They are refinements or adjustments, rather than substantial changes in scope.

1. Revision of Section 103(c)(1) ("embedded" programs).

Over the past several weeks, we have continued to work with the Reporters and Chair of the Article 2 Drafting Committee to clarify treatment of computer programs contained in goods. As indicated on an attached memorandum, this discussion lead to agreement on language revising the embedded software subsection of the Draft. The earlier version as an exclusion from Article 2 was supported by a vote at the ALI Annual Meeting. The new language is merely a clarification of that earlier language.

The proposed revision is as follows:

(c) The following rules apply between this [Act] and [articles of the Uniform Commercial Code]:

(1) If a transaction involves computer information and goods, this [Act] applies to the computer information. However, if a copy of a computer program is contained in and sold or leased as part of goods, this [Act] applies to the copy only if:

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

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

~~(1) If a transaction involves computer information and goods, as between this [Act] and [Article 2 and Article 2A of the Uniform Commercial Code], this [Act] applies to the computer information and [Article 2 or 2A] do not apply to the computer information. However, if a copy is contained in and sold or leased as part of primary~~

~~goods, or sold as a replacement for a copy contained in primary goods, this [Act] applies to the copy only if:~~

~~(A) the primary goods in which the copy is contained are a computer or computer peripheral; or~~

~~(B) giving the buyer or lessee of the primary goods access to or use of the computer information itself is a material purpose of ordinary transactions of the type.~~

As indicated in the attached memorandum, mirror image language is proposed for Article 2.

During our discussions, there was substantial support for a "bright line" rule under which UCITA would apply to computer information, but not goods (other than the copy), and Article 2 to goods, but not computer information. The Committee may wish to discuss that alternative.

2. Revision of Section 103(d) (exclusions).

We propose minor changes in the exclusions as indicated below. These clarify the status of transactions in print media and the relationship between UCITA and the Copyright Act relating to scope. No significant change in substance is intended.

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

(1) a financial services transaction;

(2) a contract to distribute or transfer, or to create for purposes of distribution, information in paper form;

(3~~2~~) a contract to create, perform or perform in, include information in, acquire, use, distribute, display, modify, reproduce, license, have access to, adapt, make available, transmit, license, or display:

(A) audio or visual programming that is provided by broadcast, satellite, or cable as defined in the Federal Communications Act as that Act existed on ~~January~~ July 1, 1999, or by similar methods of delivering the programming; or

(B) a motion picture, sound recording, musical work, digital musical recording, or phonorecord as defined or used in the federal Copyright Act as of ~~Jaunuary~~ July 1, 1999, or a digital motion picture recording;

(4~~3~~) a compulsory license; or

(5) a contract of employment of an individual other than as an independent contractor.

3. Revision of Section 103(e) (opt in and opt out)

After having considered comments from various sources, it was clear that modifications in UCITA rules relating to opting in or opting out should be clarified. The intent of the provisions is to make clear that the parties can, within limitations, control the application of variable contract law rules to their transaction and can use their agreement to avoid the complications created by the application of various bodies of contract laws to their transaction, or by uncertainty as to what law governs.

The following alternatives implement that policy, but narrows the statutory opt in or opt out. Comments will indicate that the subsection does not prevent opting in outside the terms of the subsection, but that the availability of that option is governed by other law.

Both of the alternatives stated below limit the ability to opt in to cases where the transaction includes subject matter within this Act or excluded by subsection (d)(1-4). These are information transactions to which the provisions of this Act reasonably apply and transactions in

which the need for a clear option right is paramount. Alternative 1 further limits the grant of an opt in right to an option to include the informational subject matter, but does not indicate any position with respect to other subject matter, such as goods, real estate or the like.

Alternative 1:

(e) Except as otherwise provided in subsection (c)(2), if ~~the subject matter of~~ a transaction includes subject matter within this [Act] or excluded under subsection (d)(1-4) ~~information~~, the parties may agree that this [Act], including contract formation rules, governs that subject matter, ~~the transaction~~ in whole or in part, or that other law governs the transaction and this [Act] does not apply. The agreement is subject to the following rules: [remainder is unchanged]

Alternative 2:

(e) Except as otherwise provided in subsection (c)(2), if ~~the subject matter of~~ a transaction includes subject matter within this [Act] or excluded under subsection (d)(1-4), the parties may agree that this [Act], including contract formation rules, governs, the transaction in whole or in part, or that other law governs the transaction and this [Act] does not apply. The agreement is subject to the following rules: [remainder is unchanged]

4. Revise subsection (d)(3) and definitions as follows:

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

… (3~~2~~) a contract to create, perform or perform in, include information in, acquire, use, distribute, display, modify, reproduce, license, have access to, adapt, make available, transmit, license, or display:

……

(B) a motion picture, sound recording, musical work, ~~digital musical recording,~~ or phonorecord as defined or used in the title 17 of federal Copyright Act as of ~~Jaunuary~~ July 1, 1999, or a digital musical recording or digital motion picture recording;

add:

"Digital musical recording" means a material object where the computer information fixed therein consists primarily [only] of sounds, and material, statements, or instructions incidental to those fixed sounds, if any, and from which the sounds and incidental material can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. However, the term does not include a material object in which (i) the fixed sounds consist entirely of spoken word recordings and musical or other sounds incidental to the spoke words, or (ii) are fixed primarily [one or more] computer programs, except statements or instructions constituting fixed sounds and incidental material and statements or instructions to be used directly or indirectly to bring about the perception, reproduction or communication of the fixed sounds and incidental materials.

Notes:

These changes were proposed by Recording Industry of America (RIAA) as a result of on-going discussion and in response to a recent decision of the Ninth Circuit Court of Appeals. The

current draft defines "digital musical recording" in terms used by federal law. The underlined and bracketed language in proposed revision indicate where the primary substantive differences appear to lie (underlined indicates the RIAA language, while bracket indicates existing federal law). The Ninth Circuit decision in Diamond Multimedia v. RIAA, -- F.3d -- (9th Cir. 1999) in essence held that a computer hard disk was not a digital musical recording for purposes of that Act.

At this time, we are still discussing this issue with RIAA and persons from the affected groups. The impact of the change will be to move the definition of this concept into state law, although it is likely that federal legislative history would be used as important interpretive material. To the extent that this broadens the exclusion, it might have the effect of placing more of this material within Article 2.

In addition to the foregoing, it may be important to adopt a definition of the term "digital motion picture recording", which does not have a federal law equivalent.

> "Digital motion picture recording" means a material object where the computer information fixed therein consists primarily [only] of a motion picture, and material, statements, or instructions incidental to the motion picture, if any, and from which the motion picture and incidental material can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. However, the term does not include a material object in which (i) the fixed motion picture consists entirely of spoken words and musical or other sounds incidental to the spoken words, or (ii) are fixed primarily [one or more] computer programs, except statements or instructions constituting the fixed motion picture and incidental material and statements or instructions to be used directly or indirectly to bring about the perception, reproduction or communication of the motion picture and incidental material.

5. Consider revising the definition of computer:

Several have requested that the definition of "computer" be reviewed. The alternatives below are edited from the indicated statutory sources.

Current UCITA version:

(10) "Computer" means an electronic device that can perform substantial computations, including numerous arithmetic operations or logic operations, without human intervention during the computation or operation.

Edited Versions from Other Statutory Sources:

(-) "Computer" means an electronic ~~magnetic, optical, electrochemical, or other high speed data processing~~ device performing, logical, arithmetic, or storage [memory] functions~~, and includes any data storage facility or communications facility directly related to or operating within such a device, but such term does not include an automated typewriter or typesetter, a portable hand held calculator, or other similar device~~. (modified from 18 USC 1030)

(-) "Computer" means a device or group of devices which, by manipulation of electronic, magnetic, optical, or electrochemical impulses, pursuant to a computer program, can

automatically perform arithmetic, logical, storage [memory] or retrieval operations with or on ~~computer data~~ [electronic information]. (Modified from NY Penal Code 156(1))

(-) "Computer means an electronic device that performs, logical, arithmetic and memory functions by the manipulation of electronic or magnetic impulses. (Ohio Stat. 2913.01)

B. Revisions Relating to UETA

At a harmonization meeting in May, drafts of UCITA and UETA were brought into substantial harmony. Since then, several decisions by the UETA committee moved away on some points of contact between UETA and UCITA. In the spirit of seeking optimal correspondence and harmonization drafts, the following changes in UCITA are recommended.

1. "Authenticate":

We recommend revising this definition as follows:

(6) "Authenticate" means ~~(A)~~ to sign, or ~~(B) otherwise~~ to execute or adopt an electronic symbol, ~~or~~ sound, or ~~to use encryption or another~~ process attached to, ~~with respect to a record, with intent of the authenticating person to: (I) identify that person; or (ii) adopt or accept the terms or a particular term of a record that~~ included in, or ~~is~~ logically associated ~~with,~~ or linked with, a record or term, with the intent to sign the ~~to, the authentication, or to which a~~ record or a record to which it ~~containing the authentication~~ refers.

NOTE: The drafts of UCITA made an effort to identify the various component elements of the intended effect of a signature. That has proven difficult, but has the beneficial effect of focusing a court or party's attention on the meaning of a signature in electronic contexts. That approach is adopted in Article 2 and in Article 9.

A different, simplified approach has been adopted in proposed UETA (as to electronic signatures) and in proposed federal legislation. The changes suggested above correspond this draft to UETA, leaving interpretation of the meaning of "sign" or intent to "sign" in individual cases to the courts and common sense. If this change is adopted by the committee, subsection 108(c) will be deleted. That subsection currently reads:

> (c) Unless the circumstances indicate otherwise, authentication is considered to have been done with the intent to:
>
> (1) establish a person's identity; and
>
> (2) establish that person's adoption or acceptance of the authenticated record, term, or contract.

2. Attribution rules (detect errors): UETA § 109/ UCITA § 216

UCITA sets out presumptions that apply if the parties use a commercially reasonable procedure to detect changes or errors in an electronic record. It also sets out a liability allocation rule for cases where one party follows the procedure, but the other does not. UETA deleted the presumptions. UETA also modified the rule regarding a failure to follow a procedure to one that allows the conforming party to "avoid" the effect of the change if following the procedure would have discovered the change. The current UCITA language is:

> (4) If the sender has conformed to the procedure but the other party has not and the nonconforming party would have detected the change or error had that party also conformed. the sender is not bound by the change or error.

We recommend 1) deletion of the presumption language since it serves a limited purpose in light of the rebuttable nature of the presumption and 2) adoption of the following language replacing former Section 216(4):

> If there is a commercially reasonable attribution procedure used between the parties to detect errors or changes in an electronic event and one party conformed to the procedure but the other party has not, and the nonconforming party would have detected the change or error had that party also conformed, the conforming party may avoid the effect of the change or error.

C. Issues Raised by the Article 2 Consumer Task Force.

At a harmonization meeting in May, 1999, there was a memorandum stating a group of points that had been agreed between a task force of the Article 2 committee and representatives of consumer groups. The points on that memorandum had not been at that time, and subsequently have not been, agreed to by any industry representatives involved in the Article 2 discussions. During the meeting, the chair and reporter of UCITA agreed to present several of the issues for review by this committee.

1. Unconscionability. One group of issues dealt with substantive revisions and expansions of the concept of unconscionability. The harmonization group agreed that these revisions would be reviewed by the UCITA committee, but no position was expressed on whether the new rules are appropriate for UCITA. They were viewed as acceptable for Article 2 and 2A if they became a part of an overall compromise in reference to that draft. As contained in revised Article 2-105, the new concepts state:

> …..
>
> (b) In a consumer contract, a nonnegotiated term in a standard form record is unconscionable and is not enforceable if it:
>
> (1) vitiates the essential purpose of the contract;
>
> (2) subject to Section 2-202, conflicts with other material terms to which the parties have expressly agreed; or
>
> (3) imposes a manifestly unreasonable risk or cost on the consumer in the circumstances.
>
> (c) If a court as a matter of law finds that a consumer contract or any term thereof has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a consumer contract, the court may grant appropriate relief.

Subsection (b)(2) corresponds to the treatment of agreed terms stated in UCITA Section 211, but in the UCITA formulation, it is treated as an issue of interpretation, rather than an issue of unconscionability. The difference has significance for liability issues outside of the UCC (or UCITA). Subsection (c) comes from current Article 2A. Subsections (b)(1) and (b)(3) adopt a concept of substantive unconscionability that does not depend on the existence of procedural problems in the presentation or assent to the terms.

UCITA, of course, has several protections against abuse in standard form contracting that are not present in revised Article 2. These include standards of assent and opportunity to review, as well as the fundamental public policy rule. UCITA states the rule against unconscionable terms in language identical to that found in existing Article 2.

2. Limits when Remedy Fails.

Revised Article 2 provides that, if a limited remedy fails of its essential purpose, this causes any limitation on consequential damages in a consumer case to also fail, regardless of the language in the contract. After the harmonization meeting, Article 2A was to conform to the revised treatment in Article 2. There was no recommendation to harmonize UCITA on this point. UCITA already extends protection beyond that in existing Article 2 in that it provides that the consequential damage term fails unless it was expressly made independent of the limited remedy.

3. Parol Evidence.

a. Merger Clauses: Not Conclusive. The Article 2 Task Force proposed that it be made clear that merger clauses in consumer contracts are not effective. The harmonization committee recommended that consideration be given to placing this treatment of merger clauses in consumer contracts in the comments, rather than text. The harmonization group recommended that UCITA consider corresponding to Article 2 on this issue. Article 2, however, currently has a textual invalidation of merger clauses in consumer cases stating: "In a consumer contract, a term purporting to make the record a final expression of the agreement is not conclusive evidence of an intent that a record be a complete and exclusive statement of the terms of the agreement." Proposed comments to Article 2 describe this as merely an application of the "general rule" that merger clauses are not conclusive of the intent to exclude parol evidence.

Current UCITA language duplicates existing Article 2 which does not contain this language. The current notes refer the strong effect of merger clauses in negotiated commercial contracts, but also note that circumstances may indicate that, notwithstanding the merger clause, the parties did not intend that the record be the exclusive statement of the deal.

b. Explanatory language. Article 2 added language allowing a court to "explain" an agreement "from other sources as determined by the court under applicable law." UCITA follows existing Article 2 language; it was asked to consider this language.

4. Conspicuous.

Article 2 was to adopt the UCITA concept of conspicuous, including the stated safe harbors. The black letter has been amended. Comments in Article 2, however, expressly indicate that the text does not create "safe harbors". No changes are required in UCITA.

D. Other Changes Recommended for Harmonization.

1. Modification.

(a) The harmonization committee recommended that UCITA follow revised Article 2 in its revision of the treatment of modifications of contracts that occur and become enforceable without consideration. This would entail revising Section 303(a) as follows:

> (a) An agreement <u>in good faith</u> modifying a contract subject to this [Act] needs no consideration to be binding.

Comments to existing Article 2 suggest that a good faith standard is implicit in that statute, although not contained in the black letter of the statute. The concern addressed in elevating this

to the black letter lies in the fact that the UCC standard of "good faith" is implied in the performance of obligations, but it is not clear whether this extends to modifications.

(b) It was agreed that UCITA should consider using existing Article 2 language regarding when a "no oral modification" clause must be separately agreed. The UCITA language was intended primarily to clarify the scope of coverage of this subsection which comes from original Article 2 and to provide for electronic applications of the concept that a non-merchant must specifically assent to the no modification clause. Concerns have been expressed about the possible change of scope caused by the language. The following revision is recommended:

> (b) An authenticated record containing a term that precludes modification or rescission except by an authenticated record may not otherwise be modified or rescinded. If the term is in a standard form supplied by a merchant to a non-merchant ~~consumer~~, it must be separately authenticated. ~~a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.~~

2. Scope of Article 2 and UCITA.

The committee agreed that the Article 2 scope should exclude information covered by UCITA, not contingent on passage of UCITA because of the differences in subject matter. The relevant provisions on embedded programs have been harmonized as indicated earlier in this memo.

3. Liquidated Damages (Section 804)

The harmonization committee recommended that UCITA harmonize to revised Article 2 by making the following change in Section 804(a) which we recommend that the Committee adopt:

> (a) Damages for breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of the loss anticipated at the time of contracting, the actual loss, or the actual or anticipated difficulties of proving loss in the event of breach. ~~A term fixing unreasonably large liquidated damages is void.~~ If a term liquidating damages is unenforceable under this subsection, the aggrieved party may pursue the remedies provided in this article.

4. Statute of Limitations (Section 805)

The harmonization committee recommended that Article 2 conform to UCITA on rules of extending the statute and that UCITA adopt the revised Article 2 rule which precludes reducing the statute of limitations in a consumer case. The change recommended here would read as follows:

> (b) By the original agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues but may not extend it. However, in a consumer contract, the period of limitations may not be reduced.

E. Miscellaneous Changes.

1. Make the following editorial changes:

(a) Section 105(d)(2).

Change "writing" to "record or writing".

Reason: Clarify scope and meaning of the subsection.

(b)**. Definition and generally.**

Replace the term "electronic event" with the term "electronic act", retaining the substantive definition.

Reason: Preferable language for this composite concept. No change in substance occurs.

(c). Section 401 (title).

Delete the word "quiet".

Reason: Conform to text of the section.

(d). Section 508(b)(2).

Edit as follows: "(2) The financier makes no warranties to the accommodated licensee other than the warranty ~~of quiet enjoyment~~ under Section 401(b)(1) and any express warranties in the financial accommodation contract."

(e). Section 105(c).

Delete "in effect on the effective date of this [Act]"

Reason: This limitation is implicit in ordinary statutory construction and will be described in comments. Statutes enacted after UCITA carry their own treatment of conflicts.

(f). Section 709(d).

Change the reference from Section 711 to Section 710.

(g). Section 401

In subsection (c)(2): change "the scope or the warranty" to "the scope <u>of</u> the warranty"

Reason: Correct typographical error.

(h). Section 503 and 504.

Edit as follows:

503(2): "<u>Except as provided in Section 503(a)(1)(B), a</u> ~~A~~ term prohibiting transfer of a party's interest is enforceable, and a transfer made in ……."

504(a): "….Whether the transfer is effective is determined under Section 503 <u>and Section 503(a)(1)(B)</u>.

2. Section 213: Internet Disclosure: Safe harbor

Edit subsection (2) as follows:

(2) does not take affirmative steps to prevent <u>printing,</u> downloading or copying of the standard terms for archival or review purposes by the licensee."

……..

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

Reason: To clarify that downloading includes printing. The current formulation parallels Magnuson-Moss disclosures. Adding the word "promptly" moves away from that statute, but clarifies that there timing is important in this context.

3. Section 406 Disclaimer of Warranty

Edit subsection (b)(5) as follows:

(5) ~~In a mass-market transaction, l~~ Language in a record that disclaims or modifies an implied warranty under Section 403 and 405 must be conspicuous.

Reason: This brings the disclaimer rules into consistency with existing Article 2. The Drafting Committee earlier determined that, in commercial contexts, the requirement of conspicuousness in disclaimers between commercial parties is a potential trap beyond its usefulness. However, in light of the existing law for goods and the fact that revisions of Article 2 did not adopt this view, adopting a different perspective might create confusion that could be especially problematic in mixed transactions. Also, requiring use of the conspicuousness standard for mass market transactions weakened the practical benefit that would have resulted from a different rule outside the mass market.

The change applies the requirement of conspicuous disclaimers to merchantability and fitness warranties, but does not require this for the data accuracy warranty because no such warranty exists under current law and adding this standard might truly create unexpected results in cases involving that warranty.

4. Section 304 (modification of continuing contract).

Add to subsection (c): "However, in a [mass-market] [consumer] contract, the provision of subsection (b)(2) may not be varied by agreement unless the agreement was for a fixed term at a fixed price or rate."

Reason:

The ability to make changes in on-line continuous access contracts in an expeditious manner is important, but the right of withdrawal for a consumer may be an important safeguard. The change would establish a fixed minimum rule in such cases.

5. Section 104(c)(3) (non-variable provisions)

Add new subsections to make Section 304(b)(2) and Section 704(b) non-variable.

Reason:

See item 9 regarding Section 304. Also, Section 704 requires a "tender that conforms to the contract" in certain mass-market transactions. This is the Article 2 rule. In Article 2, it is not described as variable by agreement or not.

6. Section 816 (electronic self-help)

Edit the section as follows:

(c) A licensee must separately manifest assent to a conspicuous term authorizing use of electronic self-help. The term must: …

(2) state the name of the person designated by the licensee to which notice of exercise must be given and the place to which notice must be sent to that person; and …

(d) ….

(e) A licensee may recover direct and incidental damages caused by wrongful use of electronic self-help. The licensee may also recover consequential damages for wrongful use of electronic self-help even if such damages are excluded by the terms of the license if:

(1) …. ~~or~~

(2) …. or

(3) the licensor fails to provide the notice required in subsection (d).

(f) ….

(g) A court of competent jurisdiction of this State shall give prompt consideration to an application for injunctive relief and may temporarily or permanently enjoin … if the court finds:

(1) risk of grave harm of the kinds stated in subsection (f), whether or not the licensor has reason to know of those circumstances;

(2) threat of irreparable harm or threat of irreparable harm to the licensee or licensor, as the case may be; ….

(7**). Section 510(b)(3) (financier remedies)**

Edit as follows:

(3) The financier's remedies under the financial accommodation contract are subject to the licensor's rights and the terms of the license. The remedies against the license or the licensed subject matter may not be exercised in a manner that interferes with the licensor's rights ~~pursuit of its remedies for breach or otherwise~~ under the license.

Reason: Clarify that this is not intended to create a general subordination, such as if the two parties have money judgments, each judgment can be enforced generally without the one being subordinate to the other.