DISCUSSION MEMORANDUM

FEBRUARY 1998 DRAFT
ARTICLE 2B: LICENSES

Raymond T. Nimmer
Reporter

This Draft contains style and substantive changes based on input from a wide variety of sources. Included are reactions to comments received from the ALI Council, from several organizations and individuals who reviewed the Draft with the objective of reaching final status in terms of both substantive and drafting issues, and from the decisions and discussion of the Drafting Committee.

The Draft: Wonders of Cyberspace Revisited.

This Draft reflects a policy choice (made by ALI and NCCUSL) that Article 2B (and Article 2 revisions) correspond to existing Article 2 when it covers identical subject matter and when that correspondence is reasonable in light of policy choices and differences in the subject matter of Article 2B as compared to Article 2.

The Draft does not contain black-line changes. This is because of a computer problem encountered near completion. At the time of the problem, revisions of the Draft were perhaps ninety percent complete. A computer malfunction caused a loss of the then existing copies (working and back-up) of the Draft. The prior undamaged version was two weeks old. This lost many important changes.

After an extensive effort to recover the damaged draft, a recovered version was created. That version contained, as text, all word processing codes from an extended term in development of the Draft. The choice was between cleaning codes from the recovered copy, or using the prior Draft and recreating revisions from that time. I decided to clean the recovered draft. Black lining was lost.

In the February 1998 Draft, given that choice, I attempted to underline or "strike-out" major changes. Most are identified either that way or in "Notes to this Draft."

In addition, the February 1998 Draft and the prior Draft will be posted on Internet sites. Persons with the capability to do so should run a comparison to identify changes.

I apologize for the inconvenience.

I propose, in response, a non-disclaimable warranty for information and goods (remember Intel), that nothing in the (information) (product) will interfere with a NCCUSL project.]

DRAFT

FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

February, 1998

UNIFORM COMMERCIAL CODE
ARTICLE 2B - LICENSES

With Comments

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws, the American Law Institute, or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners, the Institute and its Members, and the Drafting Committee and its Members and Reporters. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated statutory proposal.

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ARTICLE 2B - LICENSES

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PREFACE
INFORMATION AGE IN CONTRACTS

The UCC has given parties in traditional sales of goods a well-understood legal framework to establish contract formation, terms, and enforcement rights. It is timely now to adapt this framework to the digital era and to the new information products and services that will increasingly drive Global Electronic Commerce.... Article 2B can be a strong first step toward a common legal framework for digital information and software licenses. *Letter from CSPP, November 19, 1997 (a coalition of eleven major manufacturing companies)*

In the United States, every state government has adopted the [UCC]. ... [Article 2B is] working to adapt the UCC to cyberspace. ... The administration supports the prompt consideration of these proposals, and the adoption of uniform legislation by all states. *White House Report, Framework for Global Electronic Commerce, (July 1, 1997).*

INTRODUCTION

Article 2B deals with transactions in information; it focuses on transactions relating to the "copyright industries."[1] It thus deals with transactions and subject matter that largely have never been directly covered by the U.C.C. Of the transactions covered, **only** software contracts have been considered within the U.C.C. Even for computer software, coverage under the U.C.C. today is limited. But *Article 2B is not just a software contract statute.* The other subject matter for which licensing contracts are used are today governed not by the U.C.C. but by common law, federal property law, and some regulation. Part of the project involves accommodating the various legal traditions.

Yet, in the modern digital economy, these industries and subject matter are rapidly converging around the digital technology that dominates the information industry and much of the goods sector. The lines of demarcation are less and less significant while businesses converge into a multi-faceted industry with common concerns.[2] That converged industry exceeds in importance the goods manufacturing sector in our economy. The information industry is growing rapidly and commands large portions of the national economic product. The copyright industries and information transactions affected by Article 2B involve subject matter entirely unlike the traditional transactional framework which focuses on transactions in goods. In Article 2B transactions, the value of the subject matter lies in the intangibles, the information and associated rights to use that information.

When completed, Article 2B will provide a framework for contractual relationships among industries at the forefront of the information era. The test of the project lies in its ability to accommodate the practices that drive this vital part of the economy. Evaluating the balance achieved hinges on one's perspective, yet, as the following indicates, Article 2B distributes benefits among the various parties.

BENEFITS AND POSITIONS IN DRAFT ARTICLE 2B BY PARTY

GENERAL BENEFITS

+ creates balanced structure for electronic contracting
+ reduces uncertainty and non-uniformity of contract law
+ provides contract law roadmap for converging industries with differing traditions
+ confirms contract freedom in commercial transactions
+ innovates concept of mass market transaction that extends U.C.C. consumer protections to businesses
+ establishes strong protection encouraging dissemination of published informational content
+ recognizes layered contract formation occurring over time
+ clarifies enforceability of standard forms in commercial deals

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[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, 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.

- proposes solution for battle of forms
- applies “material breach” concept corresponding to common law
- sets standards relating to access and Internet contracts
- establishes contract rules for idea and content submission
- adjusts statute of frauds to information transactions
- provides ownership rules for outsourcing and development contracts
- creates understandable implied warranty for commercial deals
- outlines relationship between retailer, publisher and end user
- refines standards for enforcement of liquidated damages rule
- allows parties to contract for specific performance
- provides standard interpretations for often litigated grant terms

LICENSOR BENEFITS

+ establishes licensing framework consistent across converging industries
+ workable choice of law rules for Internet
+ enforceable choice of forum clause in commercial contracts
+ establishes guidance for attribution procedure in electronic contracts
+ settles enforceability of mass market licenses
+ creates method for contracting in Internet and similar contexts
+ excludes consequential damages for published informational content
+ establishes guidance on the meaning of license grants
+ establishes control and protections on transferability of a license
+ deals with effect on warranty of modification of code in a copy of a program
+ codifies contract treatment of electronic limiting or management devices
+ reconciles inspection with presence of vulnerable confidential material
+ establishes guidance on procedures to modify on-going contracts
+ confirms that exceeding a license as a breach of contract
+ establishes standard on connection of remedy and consequential damages limits

LICENSEE BENEFITS

+ creates refund right
+ creates procedural protections for the mass market
+ gives non-infringement warranty
+ creates right of quiet enjoyment
+ codifies that advertising can create an express warranty
+ provides that warranties by retailer are not disclaimed by publisher license
+ creates a warranty for accuracy
+ creates system integration warranty
+ requires disclaimers in a record (e.g., writing)
+ recognizes implied license grant rights
+ makes mass market licenses transferable
+ enables financing without licensor consent
+ confirms perfect tender rule for mass market transactions
+ creates right to demand a cure in commercial contracts
+ requires affirmative assent to a record and invalidates mere passive retention
+ increases persons to whom warranty runs for all types of damage
+ enforces releases without consideration
+ enforces term providing that a license can never be canceled
+ limits electronic self-help by licensor
+ presumes perpetual term in some software licenses
+ prohibits choice of forum that unfairly disadvantages a party

PART 1
CONTEXT: LAW REFORM AND THE UCC

Modern Economy and Law Reform

> The distinction that used to be drawn between "goods" and "services" is meaningless, because so much of the value provided by the successful enterprise ... entails services [and information].[3]

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

Contracts involving information are not equivalent to transactions in goods.[5] The contracts emphasize different issues and call into play a much different social policy structure concerning when and to what extent liability risk ought to be created and imposed against the provider of the subject matter of the contract.

Project History

Although it today involves participation by motion picture, recording, music, publishing, banking, and online industries, Article 2B began with a focus on the contract issues associated with software licensing as many of those transactions were brought within the scope of Article 2, a statute dealing with **sales of goods**. The project focused from the outset on the entire range of contracts in this industry, including mass market and commercial transaction frameworks.

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

This underlying difference coupled with the ease of copying involved in modern digital products

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

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

5 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 acquisition 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 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).

causes sharp differences in contracting practices. The differences are only enhanced with the development of the Internet and online services as an important feature of contemporary commerce since these systems allow for transfer of information without the intermediation of tangible objects. Indeed, in the modern marketplace for information, a major conflict looms between systems in which the end user has in its own machine the software and other information assets needs for its business as compared to systems that use rapid communications and Internet capabilities to enable that end user to seamlessly employ software and other information assets located hundreds or thousands of miles away in "cyberspace."

Over several years, committees of NCCUSL, the ABA and other groups examined the consequences of a mismatch in concept between contract law aimed at defining relationships relating to the sale of goods (article 2) and contract relationships in which information (or more generally, intangibles) were the centerpiece of the transaction and the contractual format most often involves a license, rather than a sale. The conclusion of these committees and by representatives of the information industries entails two basic observations:

1. **Distinct From Sales.** Information transactions and, especially, transactions involving licensing of digital information, differ substantively from transactions involving the sale or lease of **goods**. The differences are manifested in both the conditional nature of the transaction and that the value obtained or conveyed lies not in the tangible property, but in the information and rights that are severable from the tangibles. Indeed, it will continue to be increasingly the case that no tangible items are needed to convey information on-line or in electronic transactions. Because of the differences, a body of law tailored to transactions whose purpose is to pass title to tangible property can not be simply applied to transactions whose purpose was to convey rights in intangible property and information. A separate treatment of this commercially important class of transactions was needed.
2. **Commercial Significance.** The commercial importance, both currently and in the future, of the information industry is obvious. Software and related information technologies currently account for in excess of 6% of the gross national product and the size of the industry continues to grow. Adding in the other industries (publishing, motion pictures, on-line systems) swells the figure to a huge share of the economy The treatment of digital information, both in intellectual property law and in contract law, has become a major focus of contemporary debate. These industries and the transactions they engage in are major factors in the commercial landscape more than sufficient to justify coverage in a **commercial** code.

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 of input and commentary possible. To a greater extent than in any other recent UCC project, this has led to an active engagement of the views of many different groups and individuals. During the period of from March, 1994 through today, the Reporter and various members of the Committee have met with representatives or members of a wide range of groups to review provisions of various interim drafts. More than sixty organizations have been represented at Drafting Committee meetings. In addition, Drafting Committee meetings are routinely attended by a large number of practicing lawyers not affiliated with associations and by representatives of various companies. Drafts of Article 2B have been discussed at over 200 seminars and public meetings; a large number of individual attorneys have provided written commentary on draft provisions.

PART 2: BASC THEMES

LICENSING LAW AND PRACTICE

A paradigmatic transaction involves a **license**, rather than a sale.[6] The transaction is characterized by 1) the **conditional** nature of the rights or privileges conveyed, and 2) the **focus** on information, rather than tangible property with reference to both the value conveyed and the restrictions imposed.

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

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

Many licenses regulate rights in intellectual property. There are many situations, however, in which a license occurs in the absence of intellectual property. For example, a license also exists in situations in which one party receives permission to enter the physical premises or computer of another or where property owned by the licensor is made available to the licensee.[9] That model exists in the digital world in transactions in which parties are licensed to access computer or other information resources of a licensor. In Article 2B, that is described as an "access contract" which, as to rights to access a facility. Section 2B-102 defines such contracts as a contract "for electronic access to a resource containing information, resource for processing information, data system, or other similar facility of a licensor, licensee, or third party." These are contracts for online access and services. The focus centers on licensed access to a resource or facility. This relationship creates a variety of ongoing obligations of the parties (e.g., the obligation to pay for access, the obligation to maintain accessibility) not present in other licenses.

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

Licensing is a dominant means of commerce in digital information and in commercial information transactions. Typically, as a simple matter of contract law, license restrictions are enforceable even though their terms do not mirror the "exclusive rights" in copyright or patent law. Indeed, while many courts use Article 2 to resolve contract disputes relating to themes covered by that article, Article 2 has never been applied to determine the effectiveness of use restrictions. Courts consistently apply licensing law paradigms to issues involving software and online contracts where the issues involve enforcing restrictions on use of information.

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[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).

[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).

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

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

COMMERCIAL PRACTICE

As in transactions in goods, licensing spans a wide range of commercial practices. Article 2B focuses on many of the most commercially important transactions in modern commerce.[10] For purposes of illustration, it is useful to distinguish various types of licensing.

One factor differentiates between licenses that relate to information physically transferred to a licensee, as contrasted to licenses that enable a licensee to access a location (i.e. a computer) in which information resides. The latter contracts are used widely in Internet and online transactions.

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

In areas covered by Article 2B, copyright law is a dominant (but not sole) source of intellectual property rights. It gives the copyright owner the exclusive right to make copies of its work, to distribute copies, to make derivative works, to publicly display or perform the work, and other rights. A basic commercial choice made by a copyright owner is whether to license or to sell a copy of its work. In book publishing and most records, in current practice in the mass market, copies are sold. In the motion picture industry, licensing is the common approach in reference to theaters who publicly perform the movies, while in the consumer market, copies are either sold or leased (with a license that precludes public performance) for a brief time. Software is typically licensed, although computer game distribution frequently involves sales of copies.

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

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

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

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

As in other areas, commercial licensing also occurs in context of broader distribution and utilizes distribution chains. These are not analogous to distribution chains employed in the sale of goods marketplace because of the intangible subject matter and the overlay of intellectual property rights which include the exclusive right to **distribute** copies. While it greatly over-simplifies the matter, it is useful to discuss two distinct frameworks.

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

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

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

If, however, the copyright owner elected a licensing framework, given the structure of the transactions, the end user's right to "use" (e.g., copy) the software depends on the end user license. Typically, this is characterized as a license from the producer to the end user. It creates a direct contractual relationship that would not otherwise exist and which, in light of concepts of privity, might not be implied as between **these** parties. The contract, then, at this point, jumps past the chain of distribution and creates a direct link to the producer by the end user. It is also, in this sequence, the only contract that enables the end user to make copies of the software in its own machine.

NATURE OF A COMMERCIAL STATUTE

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

Informational Content

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

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

A White Report on global commerce in information strongly indoresed the non-regulatory and contract freedom approach taken in modern U.S. law and in Article 2B as the primary methodology for allocating rights and risks in the information economy.

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

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

How one decides what rules will best facilitate contracting practice is a matter of dispute in literature. In this context, the best source of substantive default rules lies not in a theoretical model, but in reference to commercial and trade practice. This is not simple faith in empirical sources for commercial law. It stems from the reality that, even though we may not know how law interacts with contract practice,

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[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).

[13] Grant Gilmore, On the Difficulties of Codifying Commercial Law, 57 YALE L. J. 1341 (1957).

decisions about contract law will continue to be made. In those decisions, we should refer for guidance to the accumulation of practical choices made in actual transactions. The goal is a congruence between legal premise and commercial practice so that transactions adopted by commercial parties achieve commercially intended results.[14] Background rules tied to the ordinary, but actual commercial context tend both to provide a legal base that falls within the tacit expectations of the parties and to ameliorate problems from lack of knowledge by supplying common sense outcomes.

Yet, in Article 2, Article 2A, and Article 2B, a wide range of transactions exist and a variety of diverse industries are affected. The transactions range from a casual deal between two individuals at a garage sale to transactions between sophisticated businesses employing multiple lawyers and affecting billions of dollars of business. The approach needed is not to draft rules that an individual party would draft tailored to each case, but to select an intermediate or ordinary framework whose contours are appropriate, but whose terms will be altered in the more sophisticated environments. A UCC Article designs default rules that are acceptable in ordinary transactions where they can be frequently used without disruption or costly negotiation.

Intellectual Property Overlay

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

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

Important issues exist here. Federal intellectual property law, as well as other federal law and regulation, place some specific, existing, and recognized limits on contract. These include restrictions on transferability, recording requirements in some cases, a statute of frauds concept, and enforceability of property rights against good faith purchasers. A state law developed in context of these **specific** and existing rules *cannot* ignore them. While state commercial law themes might prefer a rule that a secured creditor can create and enforce a creditor's interest in a licensee's rights, federal law precludes any transfer of a licensee's rights in a non-exclusive license without the licensor's consent. A default rule that ignores this preemptive provision creates true traps for the unwary. In this draft, they are avoided insofar as possible, although in several situations, there are provisions that push against explicit federal rules insofar as reasonably possible.

This interaction of state law and specific federal yields default rules that, in some cases, do not

[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.").

[15] 17 U.S.C. § 301.

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

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

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

This occurs primarily in respect to federal policies managing competition under antitrust and similar theories of intellectual property misuse and to the application of federal policy about the availability of publicly distributed information for fair use and public domain applications. Typically, in determining whether or when such policies apply, courts accept that contract law generally prevails, but ask whether a particular contract clause in a particular setting conflicts with federal policies when balanced against the general role of contracts in the economy and legal system. How far the federal policies reach remains in dispute. Not surprisingly, in light of the transformations and economic shifts yielded by digital information technology, defining the proper scope of rights as a matter of federal property law has been controversial; it remains unresolved despite extensive periods of negotiation and political discussion. Two disputed issues deal with reverse engineering of copyrighted, but unpatented technology and with the scope of educational or scientific fair use of digital works. The issues are questions of federal law and policy. They must be resolved by courts and Congress, rather than through state legislation. Article 2B takes no position on these policy questions, but merely provides a generic contract law framework to augment and bring to modern form the existing complex network of common law, code and general industry practice.

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[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).

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PART 1

GENERAL PROVISIONS

SECTION 2B-101. SHORT TITLE. This article may be cited as Uniform Commercial Code - Licenses.

Uniform Law Source: UCC 2-102.

Reporter's Note:

The scope of Article 2B is defined in section 2B-103. While the scope covers more than licenses, the transaction that provides the base for this article involves licensing of information. The title follows Article 2 which is designated "sales" because that was the primary transaction format used to develop provisions for that Article, but actually scope covers all "transactions" in goods.

SECTION 2B-102. DEFINITIONS.

(1) “Access contract” means a contract for electronic access to, or electronic information from, a separate electronic resource or facility containing information. The term does not include a contract for access to a physical location, such as a theater or the like.

(2) “Attribution procedure” means a commercially reasonable procedure established by law, regulation or agreement, or adopted by the parties for the purpose of verifying that an electronic authentication, record, message, or performance is that of the respective party, or for detecting changes or errors in content.

(3) (A) “Authenticate” means to sign, or to execute or adopt a symbol or sound, or encrypt or process a record in whole or in part, with intent by the authenticating party

(i) identify that party;

(ii) adopt or accept a record or term; or

(iii) assert the genuineness of a record or term that contains the authentication or to which a record containing the authentication refers.

(B) Unless the circumstances indicate otherwise, authentication establishes the party’s identity, its adoption and acceptance of the record or term, and the accuracy or source of the record or term as of the time of the authentication.

(4) “Automated transaction” means a contract formed by electronic messages in which the messages of one or both parties will not be reviewed by an individual as an ordinary

step in forming the contract.

(5) "Cancellation" means an act that ends a contract because of breach by the other party. "Cancel" has a corresponding meaning.

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

(7) "Consequential damages"

(A) means compensation for any provable loss resulting <u>in the ordinary course from the breach or </u>from a party's general or particular <u>circumstances,</u> requirements and needs of which the other party at the time of contracting had reason to know and which could not reasonably be prevented by the aggrieved party by mitigation or otherwise, and from injury to person or property proximately resulting from any breach of warranty, but

(B) the term does not include direct or incidental damages.

(8) "Conspicuous", with reference to a term or clause, means so written, displayed or presented that a reasonable person against whom it is to operate ought to have noticed it or, in the case of an electronic record intended to evoke a response by an electronic agent, in a form that would enable a reasonably configured electronic agent to take it into account or react without review of the record by an individual.

(A) A term or clause is conspicuous with respect to a person if it is:

(i) a heading in capitals (as: Non-Negotiable Bill of Lading) equal or greater in size to the surrounding text;

(ii) language in a record or display in larger or other contrasting type or color than other language <u>or set off from other language by symbols or other marks that call attention to the language (as: ** Disclaimer **)</u>;

(iii) prominently referenced in the body or text of an electronic record or display and can be readily accessed and reviewed from the record or display;

(B) A term or a clause is conspicuous with respect to a person or an electronic agent if it is:

(i) so positioned in a record or display that the person or electronic agent cannot proceed without some additional action taken with respect to it; or

(ii) language that in any other manner is conspicuous.

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

(10) "Contract fee" means the price, fee, rent or royalty payable under a contract under this article.

(11) "Contractual use restrictions" means limitations on use of information, including obligations of nondisclosure and confidentiality and limitations on scope, manner, method, or location of use, that are created by the contract.

(12) "Copy" means information that is fixed on a temporary or permanent basis in a medium from which the information can be perceived, reproduced, used, or communicated, either directly or with the aid of a machine. The term includes phonorecords.

(13) "Court" includes an arbitrator or other dispute-resolution tribunal.

(14) "Delivery", as to a contractual performance, means the voluntary physical or electronic transfer of possession or control of a copy to a recipient, a facility, or a bailee if the recipient has a right of access to the copy in the bailee's possession.

(15) "[Direct] [general] damages" means compensation for losses consisting of the difference between the value of the required performance as measured by the contract and the

value of the performance actually received, or in an appropriate case, compensation for losses in the nature of reliance or restitution. The term does not include consequential or incidental damages.

(16) "Electronic" means electrical, digital, magnetic, optical, electromagnetic, or any other form of technology that entails similar capabilities.

(17) "Electronic agent" means a computer program or other electronic or automated means used, selected, or programmed by a person to initiate or respond to electronic messages or performances without review by an individual.

(18) "Electronic message" means an electronic record or display that is stored, generated, or transmitted by electronic means for purposes of communication to another person or an electronic agent.

(19) "Enable use" means a grant of a contractual right or permission to take action with respect to information coupled with any acts of the transferor initially necessary to enable the transferee to exercise the right or permission

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

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

(22) (A) "Incidental damages" means compensation for any commercially reasonable charge, expense, or commission incurred after breach by the other party in :

(i) inspection, receipt, transportation, care, or custody of rightfully refused;

(ii) stopping delivery, shipment, or transmission;

(iii) effecting cover, return or retransfer of copies or information; or

(iv) otherwise incident to the breach.

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

(23) "Information" means data, text, images, sounds, and works of authorship, along with any related informational property rights in such information.

(24) "Informational content" means information that in its ordinary use is intended to be communicated to or perceived by a person in the ordinary use of the information.

(25) <u>"Information processing system" means a system or facility for generating, sending, receiving, storing, displaying, or processing electronic information.</u>

(26) "Informational property rights" include all rights in information created under laws [governing patents, copyrights, trade secrets, trademarks, publicity rights, or any other law] which permits a party independently of contract to control or preclude another party's use or disclosure of information on the basis of the owner's interest in the information.

(27) "License" means a contract that authorizes, prohibits, or controls access to or use of information but expressly limits the scope of the rights or permissions granted, or that affirmatively grants less than all rights in the information, whether the information exists or is to be developed, created or compiled pursuant to the contract and whether or not the contract transfers title to a copy of the information. The term includes an access contract and a consignment of copies of information. The term does not include a contract to the extent that contract is:

(A) an unconditional transfer of ownership of informational property rights,

(B) a reservation or creation of a financier's interest, or

(C) a transfer by will or operation of law.

(28) "Licensee" means a person authorized to exercise rights or permissions in a contract under this article, whether or not the contract constitutes a license.

(29) “Licensor” means a transferor in a contract under this article whether or not the contract constitutes a license. The term includes a provider of services. In an access contract, as between a provider of access and a customer, the provider is the licensor, and as between the provider of access and a provider of the content to be accessed the provider of content is the licensor. If performance consists of an exchange of information, each party is a licensor with respect to the information or access it provides.

(30) “Mass-market license” means a standard form that is prepared for and used in a mass-market transaction.

(31) “Mass-market transaction” means a consumer transaction and any other transaction in information directed to the general public as a whole under substantially the same terms for the same information with an end-user licensee. To qualify as a mass-market transaction if the licensee is not a consumer, the licensee must acquire the information in a retail transaction under terms and in a quantity consistent with an ordinary transaction in that marketplace. The term does not include:

(A) a contract for redistribution;

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

(C) a transaction in which the information is or becomes customized or otherwise specially prepared for the licensee;

(D) a site license, or

(E) an access contract not involving a consumer.

(32) “Merchant” means a person that deals in information of the kind or otherwise by the person’s occupation holds itself out as having knowledge or skill peculiar to the practices or information involved in the transaction [whether or not the person previously engaged in such transactions] or to which such knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that by its occupation holds

itself out as having such knowledge or skill.

(33) “Nonexclusive license” means a license under which the same rights or permissions may be offered by the licensor to other licensees. The term includes a consignment of copies.

(34) “Present value” means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties in their agreement unless that rate was manifestly unreasonable when the transaction was entered into. Otherwise, the discount is determined by a commercially reasonable rate that takes into account the circumstances of each case at the time the transaction was entered into.

(35) “Published informational content” means informational content prepared for or made available to recipients generally or a class of recipients in substantially the same form and not customized for a particular recipient by an individual or group of individuals acting on behalf of the licensor and using judgment and expertise. The term does not include informational content provided in a special relationship of reliance between the provider and the recipient.

(36) “Receive,” as to a copy or a performance, means to take delivery. “Receive,” as to a notice or notification, means that the notice or notification:

(A) comes to the person’s attention; or

(B) is delivered to a location designated by agreement for that purpose or, in the absence of an agreed location:

(i) is delivered at the individual’s residence or the person’ place of business through which the contract was made, or at any other place held out by the person as a place for receipt of such communications, or

(ii) in the case of an electronic notification, comes into existence in an information processing in a form capable of being processed by or perceived from a system of that type, and the recipient uses, or otherwise has designated or holds out that system as a place for the receipt of such notices or notifications.

(37) “Record” means information inscribed on a tangible medium or stored in an electronic or other medium and retrievable in perceivable form.

(38) “Refund”, with respect to a refused record or term, means:

(A) reimbursement of any contract fee paid and a right to stop any payment already initiated but not yet completed, on return of the product and all copies to which the record applies; and

(B) with respect to multiple products integrated into a bundled whole and transferred for one bundled price

(i) reimbursement of the entire bundled price on return of the entire bundled product and all copies within a reasonable time after delivery, if the record is material to the bundled product and is refused before or during the initial use of the bundled product and the bundled product is returned without further use, or

(ii) in all other cases, reimbursement of the fee paid for the rejected record or, if no fee is separately stated, an allocation of the fee attributable to the rejected record that is reasonable with respect to the licensor and the rejecting party in light of the circumstances on return of all copies to which the refused record applies.

(39) “Release” means an agreement not to object to, or exercise legal or equitable remedies against, the use of information, if the agreement requires no affirmative acts by the party giving the release to enable or support the other party’s use of the information. The term includes a waiver of informational property rights.

(40) “Sale” means the passing of title to a copy for consideration.

(41) “Scope,” with respect to a license, means the terms of the license that define the:

(A) licensed copies or subject matter and informational property rights involved;

(B) uses authorized, prohibited, or controlled;

(C) geographic area, market, or location in which the license applies; and

(D) duration of the license.

(42) “Send” ~~as to a notice or notification,~~ means to deposit in the mail or with an other commercially reasonable carrier or to otherwise deliver for or take steps that initiate transmission to or creation within another location or system by any usual means of communication with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed. With respect to an electronic message, the term means to initiate operations that in the ordinary course will cause the record to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, and the recipient uses or by agreement or otherwise has designated or held out that system as a place for the receipt of such communications. Actual receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(43) “Software” means a computer program and any informational content included in the program and any supporting material provided by a licensor as part of the transaction.

(44) “Software contract” means a sale of a copy of software, a license of software, or a transfer of ownership of software, whether the software exists or is to be developed or created pursuant to the contract. The term includes a contract to develop software as a work for hire.

(45) “Standard form” means a record, or a group of linked records, containing contractual terms that were prepared for general and repeated use in transactions without negotiation of or changes in most of the terms. Negotiation or customization of price, quantity, method of payment, standard performance options, or time or method of delivery does not preclude a record from being a standard form.

(46) "Substantial performance" means performance that does not constitute a material breach of contract under Section 2B-109.

(47) "Termination" means an act by either party other than for its breach which puts an end to a contract under a power created by agreement or law. "Terminate" has a corresponding meaning.

(b) Article 1 contains general definitions and principles of construction that apply throughout this article. In addition, the following definitions in other articles of this Act apply to this article:

(1) "financial asset," Section 8-102(a)(9);

(2) "funds transfer," Section 4A-104 (credit orders only);

(3) "identification" to the contract, Section 2-501.

(4) "item," Section 4-104;

(5) "letter of credit," Section 5-102;

(6) "negotiable instrument," Section 3-104;

(7) "payment order," Section 4A-103 (credit orders only); and

(8) "investment property," Section 9-115(f) (conforming amendments to Art. 8, UCC Appendix 12)

(c) Other definitions applying to this article or to specified parts thereof and the sections in which they appear are:

(1) "material breach," Section 2B-109.

(2) "location of a party," Section 2B-107.

(3) "manifest assent," Section 2B-111.

(4) "opportunity to review," Section 2B-112.

COMMITTEE VOTES:

1. Authenticate:

a. Adopted the term "authentication" to replace "signed" by a consensus without a formal vote.

b. Voted to retain the use of "authentication." Vote: 5 – 3 (November, 1997)

2. Mass Market:

a. Voted to retain the concept of "mass market" licenses, subject to revision and consideration of its use in specific sections as contrasted to use of the term "consumer." Vote: 13-0 (September, 1996)

b. Voted that definition of "mass market license" should refer to a market involving the general public and small retail transactions and excluding special business transactions. (December, 1996)

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

d. Voted to delete language that gave explicit coverage of all consumer transactions. Vote: 8-4 (Feb. 1997)

e. Voted to use a dollar limitation to cap the risk created under the definition of mass market, Vote: 10-3. (Feb. 1997)

f. Rejected a motion to delete any reference to "consumer" in the act. Vote: 4 – 8

g. Deleted one reference to "retail market" but retained the other reference. Vote: 7 – 5

h. Decided to retain the current approach and not an adhesion contract or a product-based definition. Vote: 11 – 0

i. Rejected a motion to rely solely on a dollar limitation. Vote: 3 – 10

j. Rejected a motion to delete the reference to "the general public as a whole." Vote: 2- 10.

k. Rejected a motion to delete the language of "as a whole". Vote: 5 – 5.

l. Deleted the dollar cap on the understanding that applications of the concept would be reviewed in light of this change. Vote: 6 – 3.

m. Rejected a motion to delete the concept. Vote: 1 – 8.

3. Consequential damages.

a. Voted to move references to particular types of damages from definition of consequential damages to the comments except for personal injury. Vote: 8-5 (Feb. 1997)

b. In Article 2, NCCUSL Annual Meeting defeated a motion to delete the disproportionate loss test.

4. Information.

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

5. Conspicuous.

a. NCCUSL voted as a sense of the house that the terminology regarding conspicuous should be the same in all three articles and that the definition should retain safe harbor language. (Annual Meeting 1997)

b. Sense of the house that conspicuousness should be a matter of law for decision by court. (Annual Meeting 1997)

c. Committee reviewed without a motion on safe harbor use. (Nov. 1997)

6. Good Faith.

a. NCCUSL voted to expand concept to cover consumer obligations of fair dealing. (July, 1997)

Notes to this Draft: The Draft contains a number of editorial and structural revisions for clarity. In addition:

1. "Access contract" was edited to clarify that it is electronic in nature)see definition of electronic) and includes electronic information acquired by access to a facility.

2. "Authentication" brings in material on presumed effects of an authentication; "attribution procedure" has been moved here from a substantive section with no change.

3. "Automated transaction" replaces "electronic transaction" without substantive change.

4. The "disproportionate" to risk language was moved from the definition of consequential damages to Section 2B-701 on general damages rules.

5. "Conspicuous" deletes a reference in current law to telegraphs and adds new language earmarked to electronic commerce discussed at the Committee's last meeting.

6. "Information" is simplified.

7. "Mass Market" has been adapted to Committee votes.

Reporter's Notes:

1. "Access contract." Access contracts are contracts that authorize electronic access to a facility or that allow obtaining information from the facility, controlled by the licensor or another party along with access to the information contained therein. The contract does not depend on intellectual property rights, but on control of a resource. A party's right to preclude unauthorized access to computer or other resources is recognized in most states and by federal law. The facility may be an Internet web site, a computer containing a database, or any other electronic facility.

Access contracts represent a major method. of information distribution. Digital technology enables this shift from distribution in physical copies to merely making information available at a remote location. Access contracts thus often entail what some describe a "pull technology" whereby a licensee reaches into the resource to obtain or use relevant information or processing power.

The term also includes contracts for the use of remote data processing, including third party E-mail systems and EDI services, as well as situations where a database in the licensee's information processing system is automatically updated either by an aspect of the program in the licensee's system automatically accessing the remote system, or the remote system automatically accessing the local database and adding updated material to it. These latter transaction involve, for example, a contract in which Lexis provides an integrated environment where the software first queries an on-site copy of a CD-ROM then checks a local network update and obtains the latest information in a seamless Internet or dial-up updating.

An access contract requires electronic access. The term does not cover grants of a right to enter, for example, a building in which information is displayed or made available in books.

In many access contracts, the provider of access also provides contractual rights in the information systems that are accessed by the licensee. In some cases, the information is that of the access licensor, while in others, the transaction involve a three party framework. In the three-party relationship, one person provides access, while another party (the information provider) licenses information to the customer. This three party transaction involves two and, in some cases, three separate contracts. The first is between the content provider and the access provider. This may be an ordinary license to the information or an access contract itself. The second is between the access provider and the end user. This is an access contract. The third occurs if the content provider contracts directly with the end user or client. The contracts are independent unless linked by their own terms.

The definition does not refer to chips or systems enabling access within product such as a smart card or programs resident in the same computer, but to arrangements that grant permission to access remote data, processing or similar resources. This is made explicit in the reference to "separate" facilities.

3. "Authenticate." Authenticate replaces "signature" or "signed." in this article. It expands on the concept of signature. The adoption or execution of any symbol with the intent to sign or authenticate that would have been a signature under prior law is an authentication under Article 2B. This would include, for example, the use of identifiers such as a PIN number, if use is accompanied by the requisite intent. In addition, the definition expand prior law and expressly includes actions and sounds. Both of these are potentially important in electronic commerce and can be used to achieve the purposes historically associated with a signature. encryption and other technologically enabled activities can and will be used to achieve the effects that a traditional, written signature would achieve. The critical factor in meeting the concept of authentication lies in the intent with which the party acts. the idea of authentication encompasses not only the adoption of symbol intended to authenticate a record, but other processing of the record intended to achieve the same effect.

The definition is technologically neutral. Statutes in some states give special recognition to "digital signatures" that conform to a particular encryption technology and a certification system. The procedures establish under that type of legislation qualify as an authentication for purposes of Article 2B. The Article 2B concept is broader, however, and recognizes that technology and commercial practice are constantly changing and provide many different ways of achieving an authentication. This technology neutral approach is endorsed by federal government reports and major companies involved in electronic commerce.

Authentication can be intended to have various effects. The definition clarifies that which effect is intended relates to a party's intent. This is consistent with existing law, although the rule is more often implicit in how parties treat a signature than explicit in reported decisions. Absent circumstances or express indication that a different intent exists, an authentication is presumed to contemplate all three of the effects listed. The contrary circumstances, of course, would include the use of a procedure for authentication that focuses on only one of these effects.

4. "Automated transaction" refers to transactions formed and effective as a contract even though one of the parties (or both) are represented by automated devices, such as electronic agents or other computer programmed and used for the purpose of engaging in an contractual relationship. This situation, which became common with the advent of automated ordering devices using voice systems to interact with persons placing an order, is increasingly utilized in modern electronic commerce as sophisticated computer systems seek out resources and transaction with other systems making those resources available, all acting without the direct guidance of an individual reviewing the choice made by the automated entities. While law could adopt a fiction that attributes to these automated activities the intent of the person selecting and using them, this Article more directly recognizes that these interactions involve operations of automated systems and that they can create binding legal obligations for those who utilize them.

5. "Cancellation" corresponds to existing law in Article 2-106.

6. "Computer program" parallels the U.S. Copyright Act (17 U.S.C. § 101) and adds language

necessary to implement the distinction in this Article between programs as operating instructions and controls on the one hand, and "informational content" as information communicated to people on the other hand.

7. “Consequential damages” generally corresponds to the existing Article 2 definition but makes clear that consequential damages may be recovered by either party. This follows common law and recognizes the mutuality of risk characteristic of many transactions involving information assets. Unlike in a sale of goods, current Article 2 awards consequential damages only to the buyer, the parties’ risks here are not defined solely by the sale or license price. A similar rule is proposed in pending Article 2 revisions. with one substantive change.

Because of the subject matter and the coverage of losses suffered by either party, current Article 2 language has been amended to cover losses suffered as a ordinary (predictable) result of the breach. See Restatement (Second) of Contracts 351(2). The basic principle requires that losses be foreseeable or, in the case of personal injury or property damage, that they proximately result from the breach. If losses result from particular needs or circumstances of the aggrieved party, those particular needs and circumstances must generally be made known to the other party at the time of contracting. Ordinary course results and “general” requirements or circumstances often can be presumed to be within the contemplation of the other party.

The burden of proving the extent of loss is on the party claiming a right to damages. The Article does not require proof with absolute certainty or mathematical precision. Consistent with the underlying principle of Article 1 that there be a liberal administration of the remedies of this Act, the remedies must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See Restatement (Second) of Contracts 352 (“Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty.”). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see Freund v. Washington Square Press, Inc., 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) (“[Plaintiff’s] expectancy interest in the royalties ... was speculative. [He] provided no stable foundation for a reasonable estimate of royalties he would have earned had defendant not breached his promise to publish. [The] claim for royalties fails for uncertainty.”).

Consequential damages do not include “direct” or “incidental” damages. While the boundaries among these terms are not susceptible to precise delineation, the terms are used both by courts and by parties drafting agreements and this Article seeks to provide guidance on what type of damages fall within the various categories. The realm of consequential loss lies in those damages that go beyond the difference in value of the performance received and the performance promised as measured by contract terms, and deal with either losses of the benefits were anticipated as a result of the performance or detriments or costs incurred as a result of non-performance and not incident to the breach itself.. Thus, consequential damages include damages in the form of lost profit or opportunity, damages to reputation, lost value in confidential information because of wrongful disclosure or misuse, damages for loss of privacy interests associated with the contract, loss of data as a result of the operational defect, and like damages.

Recovery of consequential damages, of course, is limited by other principles stated elsewhere in this Article and by the terms of the contract. Section 2B-701 provides that consequential damages that are disproportionate to the risk assumed should not be awarded.

8. “Conspicuous” follows existing law, but adds several new concepts related to electronic commerce, while deleting a reference in existing law to terms in a telegram. The basic test is whether a term in a record is so positioned or presented that attention can reasonably be expected to be called to it. Whether a term of a contract is conspicuous is a matter of law to be determined by the court. See Section 2B-114.

Current UCC § 1-201(10) contains four provisions defining specifically illustrative means of making a term conspicuous. These play a critical role in commercial practice in drafting contracts. The purpose of requiring that a term be conspicuous and defining that concept blends a notice function (it ought to be noticed by a party) and a planning function (giving certainty to the party relying on the term). The illustrative methods create “safe harbors” that, over the years, have provided a tool to avoid uncertainty and litigation. Absent exceptional circumstances, a term that conforms to a safe harbor provision is conspicuous.

While some participants in the revision process early on argued for deletion of the safe harbors, a NCCUSL sense of the house motion in July 1997 affirmed the decision to retain safe harbor concepts. Proposed revisions of Article 2 as well as this provision of Article 2B do so.

In modern commerce, many transactions are fully or partially automated. The use of “electronic agents” requires a different concept of what is conspicuous since programs and devices do not “notice” in-puts, but merely respond operationally to them. In this automated environment, presentation of a term in a form calculated to allow that reaction to occur suffices as conspicuous. The electronic message suffices if it is designed to invoke such a response from a "reasonably configured" electronic agent, a concept that contemplates an analogous construct to the reasonable person standard of the general concept.

The illustrative forms of conspicuousness in subsection (A) incorporate existing law, except that Article 2B does not provide that all terms in a "telegram" are conspicuous. A "telegram" includes "any mechanical method of transmission, or the like" and could be construed to include ordinary E-Mail, facsimile, and similar communications. No per se rule is justified. Terms in a telegram are judged no differently than other records and terms. The illustrative terms in (A) also include references oriented to electronic commerce. Subsection (A)(iii) deals with hyperlink and related technologies that are a central feature of Internet commerce.. It contemplates a situation in which a computer screen displays a term or image and the party using the display, by taking an action with reference to that term or image, is transferred to a different file or location wherein the relevant contract term is available. In this context, to be conspicuous, the image and must be prominent and its use must readily enable review of the contract term itself. The access must be <u>from</u> the screen or display itself and not through other actions such as a telephone call or physically going to another location. When the term is accessed, it must be in a form that can be readily reviewed.

Subsection (B)(i) provides as a safe harbor, a procedure by which, without taking action <u>with respect to the term</u>, the party cannot proceed further in reference to the file or location. Thus, for example, a screen which states: "There are no warranties of accuracy with respect to the information on this site" that is displayed in a form that precludes the user from moving further in the system without expressing assent to this condition suffices under the safe harbor concept.

9. "Consumer." This definition adapts language from existing Article 9 defining "consumer goods." The basic principle that a "consumer" transaction refers to one involving subject matter obtained for personal, household, or family use is used in various areas of U.S. law, but is not ordinarily followed in European law. Whether a party is a consumer is determined at the time of contracting. While Article 2B deals with many on-going relationships, changes in purpose or use after a contract becomes enforceable cannot retroactively alter the standards applicable to the contract.

In information transactions, many "personal" uses are not consumer uses (see, e.g., a stock broker using database software to "personally" track billion dollar investments). Distinguishing these business uses and true consumer uses has great importance in Article 2B; software and other information is frequently acquired for use "personally" in traditional business contexts. The definition distinguishes between use in profit making professional or business activities and use personal or family uses more akin to ordinary consumer activites, including ordinary asset <u>management</u> for a family. In the modern economy where individuals can and often do engage in serious commercial enterprises without a corporate structure, the personal use idea must reflect the modern practice.

This resolves an issue that has arisen in many areas of law outside of Article 9 where making a distinction between consumer and non-consumer "personal" use has proven to be difficult and subject to litigation. This is true in lending, bankruptcy and other contexts. For example, a number of reported decisions focus on whether or when a purchase of stocks or limited partnership assets for <u>investment</u> purposes would be considered a consumer purchase since it might fall within the general reference to "personal" purposes. See, e.g., <u>Thomas v. Sundance Properties,</u> 726 F.2d 1417 (9th Cir. 1984); <u>In re Manning</u>, 126 B.R. 984 (M. D. Tenn. 1991) (UCC definition "not especially helpful on its face"). Some courts emphasize the difference between acquisition for consumption (consumer) and acquisition or use "for profit-making." The Truth in Lending Act, for example, uses a definition of consumer debt much like the definition in Article 9 of consumer but contains an express exemption for business transactions. The "profit-making" test has been applied in bankruptcy cases. For example, the Fifth Circuit commented that "[The] test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family or household purposes is whether it was incurred with an eye toward profit." <u>In re Booth</u>, 858 F.2d 1051 (5th Cir. 1988). See also <u>In re Circle Five, Inc.,</u> 75 B.R. 686 (Bankr. D. Idaho 1987) ("Debt used to produce income is not consumer debt "primarily for a personal, family or household purposes.").

10. "Contract fee" recognizes the various forms and methods of monetary compensation encountered in information transactions. The term refers to essentially any money payment under a contract.

11. "Contractual use restrictions." This term encompasses any restriction on use or disclosure of information that is created by contract. It does not include limitations imposed by other law, such as copyright or patent law, without contract terms.

12. "Copy." The definition corresponds to copyright law. 17 U.S.C. 101. A copy does not require permanence in the sense of longevity, but it cannot be transitory, such as an image on a screen. See <u>MAI Systems Corp.</u>

v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993); Lewis Galoob Toys, Inc. v. Nintendo of America, 964 F.2d 965 (9th Cir. 1992).

13. "Court" includes officers of non-judicial forums such as arbitration.

14. "Delivery" recognizes that in electronic technology, transfers of possession and control can occur either through a change of possession of a tangible copy or through electronic transfer. For purposes of whether delivery of a performance has occurred, the methodology does not alter the result.

15. "Direct damages" Direct damages are losses associated with a loss of value as to the contracted for performance itself, as contrasted to losses caused by intended uses of the performance or use of the results of the performance by the recipient outside the contract. Direct damages are measured by the damages formulae in this Article. This definition rejects cases where courts treat as direct damages losses that relate to anticipated advantages that were expected to flow from the use of the product. In Article 2B, these are consequential damages. Thus, if software is purchased for $1,000 and, if perfect, would yield profits of $10,000, but the software is totally defective, the "direct" damages are $1,000.

The definition also includes reliance and restitution damages in an appropriate case. When damages of this type are appropriate is determined by general law. However, to be treated as direct damages, these recoveries must fall within the general concept of direct, as contrasted to consequential damages.

16. "Electronic." While most modern information systems entail electrical technologies, the term here is intended to be open-ended. It encompasses other forms of information processing technology as may be developed in the future.

17. "Electronic agent." This term is new. It includes a computer program used for the stated purposes, but is not limited to that particular technology. The term recognizes that many aspects of commerce are characterized by automated responses. The agency here, however, is not equivalent to common law agency concepts since the "agent" is not a human actor, but an automated system. To qualify as an electronic agent, the automated system must have been affirmatively selected, used or programmed for that purpose. This is important because, under other provisions of Article 2B, a party may be bound by the operations of its agent.

18. "Electronic Message." This term parallels a term in the UNCITRAL Model Law on Electronic Commerce. Two different types of message are included.. One, such as a fax, a telex or an E-mail, is intended for a human recipient. The other involves information communicated where the intended recipient is a computer system operating without review by a human. A message is distinguished from the broader term "record" by the fact that it is to be communicated to another. In many systems, communication to another person does not require that the message be transmitted or sent to any new location; the recipient and the person creating the message may share a common E-mail system or other resource and the message can be "stored" for purposes of communicating to another as indicated in the definition.

19. "Enable use."

20. "Financier." This term is new. It includes both security interests and leases.

21. "Good Faith." The definition follows current Article 2, but extends the duty of good faith and fair dealing to consumers. It was supported by a vote of the National Conference at the 1996 Annual Meeting.

22. "Incidental damages." This definition integrates and largely corresponds to the two definitions of incidental damages found in current Article 2.

23. "Information." This definition provides a broad construction of information that includes both individual data items, such as words and images, along with those items as integrated into a whole. The term, "work of authorship" comes from the Copyright Act and is used here as used in that statute. It includes literary works, computer programs, motion pictures, compilations, and the like. The term also covers informational property rights pertaining to these materials. Transactions covered by Article 2B often involve licensing of intellectual property rights, but also may involve transactions for access to or possession of data, images or the like without attendant intellectual property rights. In this Article, information is the broader term and in appropriate situations more specific reference is made to particular types of aspects of information, such as computer programs, informational content, and informational property rights.

24. "Informational content." This term refers to information whose ordinary use entails communicating the information to a human being. For example, in an electronic database of images the entire information package may include the images and a program enabling display or access to the images. The functional aspects of the program constitute information, but not informational content. The images are informational content. Similarly, when a licensee accesses Westlaw and uses its search program to obtain a case, the program is not informational content, but the text is

within the definition.

25. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce.

26. "Intellectual Property Rights." This term includes, but is not limited to "intellectual property" rights. It refers to any law that gives a person a right to control another's use of information independent of contract. The rights referenced here are property rights in the sense of their being established in law with respect to a particular subject matter, but the definition does not require that the rights be comprehensive or exclusive as to all other persons. The term includes the various new areas of law in which new forms of property are being created by legislatures and courts, but does not of course create any property rights itself. The definition of intellectual property rights does not include the right to sue for defamation or similar tort claims.

27. "License." A license is a limited or conditional transfer or information or rights in information. The definition makes clear that the limitations must be express in the contract and not merely implied in law. Most transactions involving the acquisition of a copy of a copyrighted work are subject to retained property rights held by the copyright owner, but a license exists only if the limitations on use or copying of the work are express in the contract itself. In an unrestricted sale of a copy, the transferee receives ownership of the copy, but if intellectual property rights apply to the information, is subject to implicit restrictions on use of the information derived from intellectual property law.

The definition does not cover naked "implied licenses." Under current law, an implied license might arise, for example, if a court holds that, to make the transaction reasonable in light of the parties' expectations, some rights or limitations not express in the contract should be implied. Many such transactions are within this Article because the implied terms are part of an actual license, but if the implied terms are the only limitations on the use of the information, the transaction is not a license.

On the other hand, the presence or absence of a contractual license is not affected by whether or not there has been a sale of a copy of a work such as a computer program. The license pertains to use rights in reference to the information and only indirectly involves the tangible copy as the conduit, in some cases, for transfer of the information. A license deals with control of the information, while title to the goods deals simply with that - title to the goods.

28. "Licensor" and "Licensee." These terms refer to the transferee and transferor in a contract covered by this article, whether or not the contract is a license.

29. "Mass-market license" and "Mass-market transaction." These terms are new. This term implements an expansion of protections for individual consumers into a consumer marketplace standard that applies even though a particular transaction does not involve a consumer licensee. As a new conceptual framework, the definition must be applied in light of its intended function. That function is to identify those relatively small dollar value, routine or anonymous transactions that occur in a retail marketplace available to the general public. The definition includes all consumer transactions and some transactions involving businesses acquiring information. It does not apply, however, to ordinary commercial transactions that occur in a marketplace characterized primarily by transactions between business entities dealing directly with each other or through ordinary commercial methods of ordering and transferring commercial information.

The definition contemplates a retail marketplace where information is made available in pre-packaged form under generally similar terms to the general public. The definition applies to information that is aimed at the general public as a whole, including consumers. It does not cover products directed at a limited subgroup of the general public or to information products restricted to members of an organization or to persons with a separate relationship to the information provider. Where the line will be drawn in determining the size or scope of subgroup that would qualify as a distribution directed to the general public cannot be answered in the abstract, but courts making that judgment should do so in light of the purpose of the definition itself. The intent is that the products covered here do not include specialty software, information directed to specially targeted limited audiences, purely commercial software distributed in non-retail transactions, or professional use software, but to materials that are acquired by consumers or that appeal and intend to appeal to a general public audience as a whole where the identity and status of the eventual licensee is irrelevant

A mass market transaction is a transaction that occurs in retail market. The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract the general public as a whole. They are also characterized by the fact that, while the retail merchants may make sales or other transactions to other businesses, the predominant transaction involves consumers. In a retail market, the vast majority of the transactions also involve relatively small quantities of particular products, non-negotiated contractual terms, and transactions to an end user rather than a purchaser who intends to resell the acquired product. The products are available to anyone who enters the retail location and can pay the applicable price.

The definition contains several specific exceptions that do not apply to consumer licensees, but to transactions in a retail market where the person acquiring the information is a commercial entity. A transaction for redistribution or a license for public display or performance of a copyrighted work are never mass market transactions because they involve none of the attributes of the retail marketplace. Similarly, where the information product is customized for the licensee and that licensee is not a consumer, the transaction lacks the anonymous, non-negotiated character of the mass market.

The definition adopts a bifurcated treatment of on-line (Internet) transactions. Consumer transactions here fall within the definition. It is especially important however, with this new transactional environment, to not regulate transactions outside the consumer context. The definition excludes any online transaction not involving a consumer. This gives the online industry room for develop not subject to unintentional regulations, while preserving consumer protections. It is consistent with the position on non-regulation advanced in the White House paper on electronic commerce.

30. "Merchant." This term comes from existing Article 2-104.

31. "Non-exclusive license." This is the most common form of commercial license contract. It is characterized by the fact that the licensor grants very limited rights and does not foreclose itself from making additional licenses involving the same subject matter and general scope.

32. "Present value." This term comes from and corresponds to Article 2A-103.

33. "Published informational content." This definition identifies a sub-category of informational content that has great importance in the information economy. It is the type of information most closely associated with First Amendment and related public policy concerns. This is the material of newspapers, books, motions pictures and the like, which are distributed to the public and intended to communicate knowledge, sounds, or other experiences to a human being, rather than to simply operate a machine. Of course, Article 2B does not apply to this subject matter unless the transaction involves a license or a software contract. As used here, however, the term includes many modern information distribution systems and includes interactive content products since in those product, all of the information is generally available and the end user selects, perhaps interactively, from the available information. This is like the reader of a newspaper focusing on part, but not all of the newspaper.

34. "Receive." This definition, as to performances, corresponds to Article 2-103. As to notices, it updates Section 1-201(26) to reflect issues in electronic commerce and the use of electronic systems to give and receive notice.

35. "Record." This definition broadens the traditional term, "writing", and incorporates electronic records. It does not require permanent storage or anything beyond temporary recordation. The analogy is to the idea of a copy under copyright law and, as there, perception can be either directly or indirectly with the aid of a machine.

36. "Refund." For purposes of this Article, a refund consists of a reimbursement of fees paid in return for return of all copies of the information. Whether or when a refund right exists depends on the contract and the substantive provisions of this Article.

The definition also deals with the difficult problem of administering a refund right in the context of so-called "bundled" products, that is products which include numerous separate information of other products transferred as a unitary whole for a single fee. Where the products are subject to separate licenses, the difficulty arises in administering a refund right where one license is refused. The definition provides that a refund in such situations consists of the entire bundled product in return for the entire price if the refund is sought early. Otherwise, a refund consists of an allocated portion of the overall price as is fairly or contractually attributable to the particular, returned product.

37. "Release."

38. "Sale." This definition conforms to Article 2-106.

39. "Scope." This defines an integral part of a license. Scope provisions in a license are equivalent to the product descriptions in sales or leases of goods. In many situations, the license (its scope) is the product. That is, the same information has entirely different characteristics as a commercial subject matter depending on what scope of rights are granted with reference to that information.

40. "Send." This definition adapts existing Article 2-201(38) by providing criteria relevant to electronic notices.

41. "Standard form." The definition refers to forms, not standard terms. Compare Restatement (Second) of Contracts 211 (referring to but not defining standard forms). A form consists of a groups of terms prepared for

frequent use as a contract. Use of standard forms in modern commerce is not only widespread, but virtually ubiquitous. The definition does not cover a tailored contract comprised of "terms" selected from many different prior agreements. The record, which is a composite of terms, must itself have been prepared for repeated use.

42. "Terminate." This definition generally conforms to existing Article 2-106.

[A. General Scope and Terms]

SECTION 2B-103. SCOPE.

(a) This article applies to:

(1) licenses and software contracts, unless the license or software contract is merely incidental to subject matter not governed by this article or subject matter excluded by subsection (b) or (c); and

(2) agreements related to a software contract included under subsection (a)(1) and under which a party provides support for, maintains, or modifies ~~information~~ software.

(b) If another article of [the Uniform Commercial Code] applies to a transaction, this article does not apply to the subject matter or related rights and remedies governed by the other article except as provided in this section and except to the extent that this article deals with financial accommodation contracts.

(c) Except as otherwise provided in this section, this article does not apply to the extent that an agreement is

(1) a license of a trademark, trade name, trade dress, patent, and related know-how, unless it is part of a license that is otherwise within this article;

(2) a sale or lease of a computer program embedded in goods and sold or leased as part of the goods, unless

(A) the goods are merely a copy of the program or are an information processing system in which the program is to operate,

(B) the program was developed specifically for the transaction, or

(C) the program was subject to a separate license with the transferee of the goods;

(3) contract for access to, use, transfer, clearance, settlement or processing of a:

(A) deposit, loan or other right to payment to or from a person,

(B) instrument or other item,

(C) payment order, funds transfer, credit card, debit card, automated clearing house or similar transfer,

(D) letter of credit, document of title, financial asset, investment property, or

(E) similar asset; or

(4) contract of employment of an individual other than as an independent contractor, or for performance of entertainment services by an individual or group, or a contract for performance of professional services by a member of a regulated profession.

(d) If this article governs part of a transaction but other contract law governs part, the following rules apply as to the entire transaction:

(1) This article applies to the information and the media that contains the information, its packaging, and its documentation, but

(A) Article 2 or 2A govern the other goods in the transaction including subject matter excluded under subsection (c)(2); and

(B) other applicable law governs as to services that are not within this article.

[(2) The contract formation rules of this article apply to the entire transaction if

(A) the contract involves a license or software contract but also involves services that are not within this article, and

(B) the subject matter that is within this article is the predominant purpose of the transaction.]

[(3) Except in a consumer contract, the parties may elect to have this article or

<u>other applicable law govern contractual rights and remedies for the entire transaction.]</u>

Definitional Cross Reference:

"Agreement". Section 1-201."Computer program". Section 2B-102. "Consumer". Section 2B-102. "Contract". Section 2B-102. "Copy". Section 2B-102. "Document of title". Section 1-201. "Information". Section 2B-102. "Information processing system". Section 2B-102. "License". Section 2B-102. "Money". Section 1-201. "Party". Section 1-201. "Person". Section 1-201. "Rights". Section 1-201. "Sale". Section 2B-102. "Software contract". Section 2B-102.

Committee Votes:

a. Rejected a motion to limit scope to "coded", "digital", "electronic" or similar concept. Vote:10-3.

b. Adopted a motion to limit scope to licenses of all information and software contracts. Vote: 10-0.

c. Rejected a motion to include all patent and trademark licenses in the Article. Vote: 9 - 3.

d. Rejected a motion to include all patent licenses. Vote: 8-4 (Feb. 1997)

e. Rejected a motion to delete exclusion of trademark and patent licenses. Vote: 7-4. (Feb. 1997)

f. Adopted the financial process exclusion in principle. Vote: 8 - 0 (Nov. 1997)

Notes to this Draft: Restructured for clarity. In addition, the following major changes are included:

1. Subsection (a)(1) contains an "incidental to" limitation on scope discussed at the November meeting. It avoids application of the Article to myriad situations where information is handed over as part of a transaction not within Article 2B.

2. Subsection (c)(3) contains a financial exclusion approved in principle in November.

3. Subsection (d) contains two proposals. (d)(2) proposes that, in cases where Article 2B subject matter predominates, Article 2B contract formation rules apply to the entire transaction. This is important, especially with respect to electronic commerce, to avoid anomalous results in which part of a transaction is governed as to formation by Article 2B and part is not. Subsection (d)(3) allows the parties by agreement to avoid spilt law application in cases where this Article and another body of contract law applies to the transaction.

Reporter's Notes:

1. This article deals with transactions in the copyright and information industries. These industries play a major role in the modern information age. The article does not cover all contracts in these industries or all contracts involving information. It focuses on license contracts and on transactions typically conducted in areas of commerce associated with digital technologies. The subject matter of these transactions and the source of the value contained in the transactions lies in the intangibles, their quality, and the rights to use the information that the licensee receives, and not in the goods that may be used to communicate that information.

2. A "license" contract focuses on rights and privileges to use information and expressly conditions the rights conveyed or expressly grants less than all rights in the information. Section 2B-102. Except with respect to computer software, this article thus does not deal with unrestricted sales of <u>copies</u> of books, newspapers or traditional print media; in these transactions, the copyright owner does not expressly condition use of the information, but authorizes a sale of the copy and relies on underlying copyright or other law to restrict misuses of the information contained in the copy. Implied conditions, which are present because of copyright law in any sale of a copyrighted product, are not in themselves adequate to place the transaction within the scope of Article 2B. The key facet of a transaction in software is that the contract imposes express limits on the use of the information. Because the emphasis is on the intangibles, rather than the goods, a license can and often does coexist with a transfer that constitutes a sale of a copy of the licensed subject matter. See <u>Applied Information Management, Inc. v. Icart</u>, -- F. Supp. --, 1997 WL 535813 (EDNY March 3, 1997); <u>DSC Communications Corp. v. Pulse Communications, Inc.</u>, 1997 US Dist. LEXIS 10048 (ED Va. 1997). The defining question of scope in such cases is whether the contract expressly limits use of the information or whether it is a software contract.

3. The article also does not deal with unrestricted sales of rights in information. With respect to information assets, modern law and practice recognizes a distinction between assignments of rights (e.g., absolute sale of all rights in the information) and licenses. The distinction parallels the distinction between sales and leases when one discusses transactions in goods. The two types of transaction involve very different practical and legal characteristics.

4. Subsection (a) states the scope of Article 2 as applicable to licenses and software contracts. Subsection (a)(1), however, contains an important limitation. Generally, Article 2B uses a gravaman of the action test

which recognizes that different bodies of contract law may apply to different aspects of a transaction. Subsection (a)(1), however, clarifies that, notwithstanding that basic principle, this Article does not apply if the licensed information is merely incidental to a services contract or otherwise excluded transaction.

"Incidental" in this context conveys two distinct meanings. One refers to information the transfer of which is an inherent incident of the excluded services. Thus, a services contract to provide legal advice to a client may result in the delivery of a memorandum or other document containing information whose use may be restricted by contract. The information aspect of the transaction does not fall within this Article; the services are not within the scope of the Article and the information is a mere incident of that services relationship. Of course, as various personal service provides engage in related, but broader activities, Article 2B applies. Similarly, where the services are those of an independent contractor hired to develop software, Article 2B governs the transaction since it directly applies to software contract even though the software is to be created as part of the contractual relationship.

The second aspect of the term incidental deals with information that is no more than a minor part of a transaction. What is meant here is not simply that the personal services predominate or that obtaining the services was the predominant purpose of the transaction, but that the licensed information is so small a part of the transaction that it would be cumbersome, confusing and awkward to apply Article 2B to that small part of the transaction.

5. As in every other context in which digital and other modern information technologies have had significant impact, they create difficult problems of placing the new technologies and technology products within legal categories. That issue affects tax law, communications law, intellectual property law, and many other fields. It affects Article 2B scope. The current scope definition is based on extensive discussion by the Committee and observers over a extended span of time and during many separate meetings. The Committee rejected proposals to limit the scope to digital information. Modern convergence of technologies makes reference to digital or a similar term unworkable and its link to a specific technology makes the long term viability of such a focus suspect. The Committee opted to focus on licensing and software contracts and to employ a general definition of "information" to which those contracts pertain.

Exclusion of unrestricted sales of copies of information leaves undisturbed major segments of the traditional information industry. For computer software, the more important factor involves the nature of the product. With the exception of some limited types of software products, all transactions whether licenses or sales are subject to either express or implied limitations on the use, distribution, modification and copying of the software. These limitations are commercially important because (unlike in newspapers and books) the technology makes copying, modification and other uses easy to achieve and essential to even permitted uses of the software. Bringing all transactions involving this subject matter into Article 2B reflects the functional similarity of the transactions and the need for a responsive and focused body of law applicable to these types of products. In addition, as a relatively new form of information transaction involving products with distinctive and unique characteristics, no common law exists on many of the important questions with reference to publisher and end user contracts regardless of whether a transaction constitutes a license or a sale of a copy.

6. Subsection (b) and (c) discuss issues pertaining to the interface between Article 2B and other UCC Articles. As this exclusion indicate, Article 2B adopts the "gravaman of the action" test. In general, this Article applies <u>to the extent</u> that the transaction involves subject matter within its scope, but not to the extent that a particular subject matter of aspect of a relationship is excluded. This reject the "predominant purpose" test that many courts use in reference to the scope of current Article 2. That test requires a court to determine, after the fact, whether the predominant purpose of the transaction was for goods or for common law subject matter. While this results in a single contract law applying to the entire transaction, the basis on which this occurs is often uncertain and subject to litigation, while its effect is often to apply a body of law suited to goods to transactional aspects involving personal services to which that law is inappropriate.

7. Under subsection (b), the primary rule in relation to other articles of the UCC excludes coverage of the subject matter covered by those other articles, any related rights or remedies associated with the subject matter. Subject matter refers to the general topic of the other article. Thus, Article 2B does not apply to an Article 4A funds transfer or any liabilities associated with that transfer. There are some exceptions to this. One involves the treatment in Article 2B of financiers as their contracts pertain to licenses and software contracts. This general subject matter is also covered in Article 9 and Article 2A, but as to the specific coverage here, Article 2B controls. Similarly, Article 2B governs goods that constitute copies of licensed information or software, or documentation related to that subject matter. On the other hand, subsection (c) excludes most computer programs embedded in goods that are not merely a copy of the software.

8. <u>Subsection (c) exclusions.</u> Because Article 2B brings into the UCC a variety of transactions that

were previously covered under common law, the broad scope of inclusion has be tempered by the development of specific exclusions. These are brought together in subsection (c).

a. Subsection (c)(1) excludes patent and trademark licenses not associated with the other subject matter of the Article. The basic principle is that, if the only basis for bringing a transaction under Article 2B consists of the existence of a trademark or patent license, the transaction is not under this Article. The rationale lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that are not contemplated by this draft. This is also true for trademark licensing. A similar analysis may also be true, to an extent that needs further discussion and clarification either in text or comments, for merchandising transactions and commercial tie-ins, such as those involving the use of images, film indicia, or graphics on a toy, apparel, or other tangible goods. Whether these licenses should be specifically excluded from the scope of this Article requires further analysis in like of concerns expressed by the affected industry and the fact that trademark licensing is current excluded.. As to trademark licensing, there is the additional consideration of coverage of aspects of that industry under federal and state franchising laws

b. Subsection (c)(2) excludes computer programs that are embedded in other products and sold as an integral part of the product. This excludes programs such as airplane navigation or operation software, software in automobile brake systems, and the like. Issues about this type of software are governed by the law governing the transaction in the entire product (e.g., Article 2 or Article 2A).

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

However, modern banks engage in many activities identical to licensing practice and online systems clearly within Article 2B, such as Netscape, Westlaw, Home Shopping, Microsoft Network, America On-Line, and others. As the information industries converge, so too is the banking industry converging into fields identical to that of the information industries. Bank ***entry*** into these fields is regulated, but this is scope regulation, not content regulation. These activities are covered by Article 2B.

d. Subsection (c)(4) deals with services contracts involving performance of individuals or groups, including employment contracts and entertainment services (e.g., actor, musical group performance, producer, etc.). The excluded cases involve personal services that entail different default rules than here. The entertainment services exclusion covers both direct contracts with individuals and various structures under which a party hires services of an individual or group through a loan contract with a legal entity with whom the individual or group is employed. This subsection also excludes professional services to avoid confusion between and the regulatory standards of regulated professions. The exclusion only pertains to regulated services and not to other contracts or services (e.g., law firm web site where legal advice is not given is treated the same as any other web site).

The exclusion does not cover situations where automation creates a digital replacement for activities previously characterized by human actors engaging in direct exchange with their clients. Also, it does not remove from this Article the various forms of software development contracts, many of which today are characterized by an individual (or group) contracting to design and develop software for a client. Inclusion of these contracts in Article 2B reflects one of the primary early reasons for the Article itself since, in the absence of that inclusion, courts are wildly split in terms of whether such contracts fall within Article 2 (sales) or common law (services). Article 2B resolves that issue by bringing the contracts into a coherent framework that does not hinge on this often arbitrary classification issue.

9. Subsection (d)(2) and (d)(3) present important proposals that have not been reviewed by the Committee. Subsection (d)(2) seeks to partially address an anomaly created by Article 2B contract formation rules and the fact that they validate electronic commerce practices that may not be effective under common law or under current Article 2 or 2A. The proposed solution applies Article 2B formation rules to the entire transaction <u>if</u> Article 2B subject matter constitutes the predominant purpose of the transaction itself. While not a perfect solution to a difficult problem, this at least allows maximum scope to the contract formation rules and electronic commerce. Of course, the problem

will be cured when and if states enact electronic commerce rules under other aspects of the U.C.C. and enact the developing uniform law on electronic contracting.

Subsection (d)3) allows the parties in a mixed transactions to elect full coverage under either Article 2B or other applicable law. This reflects a specific application of the underlying principle of contract choice that shapes this Article and states a rule that would most likely be applicable in any event under general contract law principles. The proposal excludes consumer contracts. At its November meeting, the Committee voted to delete a broader contract choice rule in former Section 2B-106. The recommendation is that this more narrow rule be adopted or that the broader rule be reinstated.

SECTION 2B-104. TRANSACTIONS SUBJECT TO OTHER LAW.

(a) Subject to subsection (b), in the case of a conflict between this article and a statute or regulation of this State as judicially construed, the conflicting statute or regulation controls, if it exists on the effective date of this article and:

(1) establishes a right of access to or use of information by compulsory licensing or public access or a similar law;

(2) regulates the purchase or license of rights in motion pictures by exhibitors; or

(3) establishes a consumer protection.

(b) If a law of this State existing on the effective date of this article applies to a transaction governed by this article, the following rules apply:

(1) A requirement that a contractual obligation, waiver, notice, or disclaimer be in writing is satisfied by a record.

(2) A requirement that a record or a contractual term be signed is satisfied by an authentication.

(3) A requirement that a contractual term be conspicuous or the like is satisfied by a term that is conspicuous in accordance with this article.

(4) A requirement of consent or agreement to a contractual term is satisfied by an action that manifests assent to a term in accordance with this article.

(c) A statute authorizing electronic or digital signatures existing on the effective date of this article is not affected by this article except that in the case of a this article controls.

(d) With respect to this article, failure to comply with a law referred to in subsection (a) has only the effect specified therein.

[Legislative Note: The state should review the statutes affected by subsection (b) to determine if that effect should not apply to some of those statutes.]

Sources: Section 9-104(1)(a); 2A-104(1)

Definitional Cross Reference:

"Agreement". "Conspicuous". Section 2B-102. "Consumer". Section 2B-102. "Court". Section 2B-102. "Electronic". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Notice". Section 1-201. "Purchase". Section 1-201. "Record". Section 2B-102. "Rights". Section 1-201. "Signed". Section 1-201. "Term". Section 1-201. "Writing". Section 1-201.

Committee Votes:

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

b. Reviewed without substantive change. (February, 1997) & (Nov. 1997).

Notes to this Draft: Edited for clarity.

Reporter's Notes:

1. *General Principles.* As with any Article of the UCC, many contracts that are governed as to contract law principles by Article 2B are also governed by other state statutes, regulations and common law principles. In most instances, the other legal principles are parallel or deal with different subject matter than does Article 2B or the U.C.C. generally. This is especially the case with respect to regulatory rules that mandate particular conduct in a designated industry or a particular marketplace. Mandatory rules in such situations typically coexist with a contract statute since, as in Article 2B, the contract law rules promulgated focus on general formation principles and default or background rules that are subject to contrary agreement or mandate.

Subsection (a) describes three types of statutes or regulations to which, if they are in existence at the time of adoption of Article 2B, this Article defers in the case of conflict. The reference is to the laws of "this" state. Since these are substantive rules, in multistate transactions, that refers to the states whose substantive law applies under choice of law principles. The conflict is measured as of the effective date of this article simply because subsequent regulations and statutes on any topic will contain their own provisions as to their impact on existing law which, in the case of subsequent enactment would of course include Article 2B.

There are many other laws that are not altered or over-ridden by Article 2B, of course. For these, however, the differences in subject matter and focus are sufficiently clear that it was not necessary to list the particular law. Thus, for example, Article 2B does not deal with property rights or privacy law. It deals with contract law. State law rules concerning trade secrecy and individual privacy are outside the scope of this Article except as they interact with contract themes. While these rights may be licenses by a contract within this article, Article 2B applies to the license but not the underlying right. For example, a state law might provide that an individual controls use of data concerning that person, but can contract away that right. The creation of the right and its scope, including the extent it can be waived are not considered in or altered by Article 2B. If, however, a contract were to be formed, Article 2B deals with general principles of contract formation, terms and remedies.

2. *Mandated Disclosure Laws.* Conflicting regulations that compel disclosure or other access to information prevail over any Article 2B rule in the event of conflict. In some situations, the relationships that develop because of the mandated disclosure may have contractual overtones, but equally often, they arise by operation of law. To the extent a relationship arises by operation of law, it does not fall within this Article. Furthermore, the relevant terms and conditions of the mandated relationship over-ride this Article and its default rules even if the relationship does also involve a license.

3. *Blind Bidding Laws.* Article 2B also does not affect various state laws that regulate blind bidding and other practices often specifically relevant to the motion picture industry. These regulations deal with obligations of pre-contract disclosure and purchasing practices. In large part, they would not, in any event, be affected by adoption of Article 2B since they deal with regulation of relationships for which Article 2B merely provides general contract formation rules and default rules that pertain in the absence of contrary agreement or mandate. Nevertheless, in some respects the statutes pertain to contract formation concepts that might be seen as in conflict with the general commercial

contract formation rules in this Article. To avoid uncertainty, the resolution of any such apparent conflict is made explicit here. As with consumer legislation, these statutes were developed through extensive discussion and policy debate. Article 2B does not disturb those judgments and that position is made clear here.

4. *Relationship to Consumer Law.* Article 2B does not generally alter state consumer protection rules as enacted and judicially interpreted as of the effective date of enactment of Article 2B. This deference to consumer protection law corresponds with the approach of existing Article 2. It reflects the fact that Article 2B deals with general contract law and commercial contract law principles. It does not purport to promulgate a body of consumer protection laws. Historically, consumer protection issues have been resolved differently on a state by state basis with often radically different outcomes. While the results differ, consumer protection laws reflect extensive policy review about the appropriate relationship between protection and contract freedom in each state. Article 2B, as a general, commercial contract statute, does not address or over-ride these judgments.

With the exception of the electronic commerce rules as stated in subsection (b), the relationship thus established between Article 2B and consumer protection law is identical to the relationship that exists between consumer protection regulations and sales of goods law under Article 2 or general common law in reference to subject matter dealt with by consumer protection law. To the extent that they are established by a state's consumer protection statutes or regulations, as judicially construed, specific regulations dealing with the enforceability of particular contract terms or that mandate particular obligations that arise when engaging in a particular type of transaction with a consumer trump the general contract law provisions of this Article. Thus, for example, a consumer protection statute that precludes disclaimer of warranty in a particular type of transaction with a consumer controls over the provisions of this Article dealing with disclaimer of warranty. A state regulation that mandates disclosure of local service outlets or the location of the licensor's main business office in a consumer transaction is not affected by any provision of Article 2B.

In addition, of course, Article 2B contains a number of consumer protection rules. These arise as a result of a specific reference to a consumer transaction in a provision of this Article, or by reference to particular transactions involving mass market licenses, a category that includes all consumer transactions. The provisions that fall into these categories augment existing consumer protection rules in a state. However, to the extent they conflict with existing consumer rules in that state, the existing protections control. A conflict, for this purpose, would be in the form of a rule that provides lesser protection for the consumer than does the consumer protection regulation. The provisions of this Article that deal with consumer protection <u>in specific terms</u> referenced to the mass market or to consumer transactions include: 2B-107 (choice of law; contract choice limited), 2B-117 (electronic error; consumer defense); 2B-208 (limitation on effect of mass market license; right to cost free refund); 2B-303 (limitation on effect of no-oral modification clause); 2B-304 (limitation on modification of continuing contracts); 2B-403 (implied warranty of merchantability); 2B-406 (disclaimer must be conspicuous); 2B-502 (license presumed transferable); 2B-607 (perfect tender required); 2B-618 (limitation on effect of hell and high water clauses).

4. *Laws on Computer Viruses.* Article 2B does not deal directly with liability for computer viruses and does not alter existing criminal or tort law on that subject. In general, a "virus" consists of computer code entered into a software or other system with the intended effect of disrupting the system or destroying information within that system. Law in most states and federal law makes the knowing or intentional introduction of a computer virus a criminal act. See, e.g., <u>Raymond Nimmer, Information Law</u> ¶ 9.04 (1997). The level of criminal sanction invoked ranges, but the statutes are being increasingly used as the public perception that a computer virus "problem" exists increases. The fact that most state activity concerning viruses falls within the realm of criminal law correctly suggests that most virus risks result from actions of third parties not involved in a contractual relationship with the victim.

Acts that cause law through the creation or distribution of a computer virus also gives rise to liability in tort. The cause of action may involve damage to property or trespass, or it may be grounded in general concepts of negligence and reasonable care. While few civil actions have been brought, the liability of a wrongdoer for actions that harm a third party involve issues other than under contract law.

As to contractual issues, virus problems typically arise between two, ordinarily innocent, contracting parties. In licensing law under Article 2B, they are handled as is any other type of contract risk. A virus present in information provided pursuant to a contract may cause the information to fail to perform within contract requirements. The remedy, in contract, is determined by the general rules of this Article. The remedy under tort law r the sanction under criminal law are determined by the rules of those particular bodies of law.

5. *Electronic Commerce Issues.* Subsection (b) states a general preemptive principle related to specific elements of Article 2B rules dealing with electronic commerce. The rule here holds that Article 2B over-rides any contrary state law requiring a "writing", a "signature" or a "conspicuous" term to the extent that it provides alternative,

electronic commerce compatible rules in reference to issues such as authentication and the like. This general premise, of course, operates only within the subject matter scope of this Article. It does not, for example, cover transactions in personal services. The rule is necessary to ensure optimal impact for the modernization themes developed with reference to electronic commerce.

There are hundreds of potentially relevant statutes that may affect electronic commerce. For transactions governed by Article 2B, the rules of this Article ordinarily supplant the other law as to contractual issues in full and the express preemption stated in this section is not necessary. That is not true for consumer transactions. In the consumer area, the four stated themes implement a limited effort that balances the modernization theme and the desire to not alter existing patterns of protection. The rule is very limited, however. It implements a balance between the modernization themes in Article 2B relating to electronic commerce and existing law on consumer contracts. The limited approach, adopted here, contrasts to non-uniform digital signature statutes enacted in several states which replace or amend all signature and writing requirements.

The policy debates that led in the past to requiring a "writing" were conducted without reference to digital alternatives. Article 2B expands the idea of a writing and a signature to include, respectively, a record and an authentication. Conspicuous is defined to deal with electronic contexts and expanded by an enhanced concept of manifestation of assent. In these respects, electronic concepts that were not at issue when existing consumer law developed, require adjustments appropriate to promote uniformity and certainty in commerce that is truly national in nature, while preserving the intent of the regulations. There is no change in substantive content of regulations, such as whether a disclaimer can ever be made, what language must be used, and like issues.

The balance here preserves the important policies (thus, the principle of general non-reversal with respect to consumer regulations), but extends the innovations in electronic contracting. In final form, the structure of Article 2B must reflect some state's constitutional and other laws that preclude general revision without specific authorization, of laws beyond the particular enactment. This will be through a legislative note.

An additional issue entails coordination between Article 2B and any existing electronic or digital signature statute. Digital signature statutes that predate Article 2B are not repealed or affected by Article 2B, except in the event of a direct conflict. In current enacted statutes on this subject, no conflict exists. The statutes create a procedure consistent with the more general Article 2B idea of attribution procedure and deal with additional subject matter to which Article 2B is not addressed.

SECTION 2B-105. RELATION TO FEDERAL LAW. A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption.

Source: None

Votes and Action:

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

b. At the 1997 NCCUSL Annual Meeting, the Conference adopted by a substantial majority a motion that Article 2B should not deal in its text with questions of federal preemption but should be neutral and that position should be stated in the comments.

c. Rejected a motion to delete the section and remove it to comments. 9 –3 (September, 1997)

Notes to this Draft: No changes.

Reporter's Note:

1. Article 2B deals with general contract law, not with issues addressed in federal property law and regulation. The relationship between federal law and state contract law pertaining to transactions in information is complex. Ultimately, however, if federal law invalidates a particular contract law rule or its application in a given contract, federal law controls. If federal law precludes a particular contract provision (or its enforcement) in a particular setting, that federal law rule controls. Nothing in Article 2B is intended to alter the balance between federal mandates and contract principles. Article 2B does not alter federal law or shift the balance in relation to property rights, property rights policy, competition policy, or other sources of contract regulation stemming from federal law and policy.

2. There a many potential sources of preemption. Some preemption questions stem from the fact that many of the property rights that underlie some of the transactions in this area come from federal property rights sources, rather than simply from state property rights law. In copyright, for example, Section 301 of the Copyright Act expressly preempts any state law that creates rights equivalent to copyright. As a matter of fact, this principle is seldom applied to contract terms since a contract deals with the relationship between two parties to an agreement, while property rights contained in the Copyright Act deal with questions of property interests good against persons with whom the property owner has not dealt. In addition to the statutory provision, in some cases, a preemption claim may arise under general constitutional law concepts of the Supremacy Clause or other aspects of the federal constitution. Of course, however, it is important to recognize that Article 2B is not simply an intellectual property rights licensing statute. Many Article 2B transactions do not involve the distribution of intellectual property rights.

3. Beyond intellectual property law, many situations involving disclosure, access, and transfer of information are subject to federal regulations, such as in Regulation E, the Electronic Communications Privacy Act, the Communications Act of 1996, the Freedom of Information Act, the Food and Drug Administration Act, and various other regulations or statutes. An enumeration of these regulations would be futile and the list would change over time.

4. The basic principle is that federal law controls if, as a matter of its own policies and terms, it preempts. When or whether that occurs is not a question of state law. State law, including the UCC, cannot alter that result and the balance it may entail and does not intend to do so. Thus, a federal rule that a specific format for disclosure creates an enforceable term cannot be altered by state law. Similarly, a limit on liability mandated by federal law cannot be abridged by state contract law. A requirement in federal law that there be a signed writing to effectively transfer a copyright cannot be altered by abolishing a state statute of frauds. A rule that precludes transfer of a licensee's rights under a non-exclusive license without the licensor's consent as a matter of federal law precludes a contrary state law rule. The approach of Article 2B has been to correspond state contract law to clear rules of federal law where appropriate and to take no position regarding controversial or context-determined rules whose application cannot be predicted and must of necessity await determinations by individual courts in particular cases or by congress as a general federal policy question.

5. The basic theme of preemption is supplemented in licensing law by the fact that federal competition, antitrust, and intellectual property rules also serve to monitor and exclude some contract terms or practices in licensing; use of particular terms in particular setting that may be viewed as abusive. These policies involve questions of federal law and policy that go beyond state law. Article 2B takes no position on the complex competition, social policy and other issues present here. Indeed, state contract law cannot alter those policy determinations. Article 2B sets out contract principles governing the contractual relationship in information transactions. It governs the contract relationship; federal law and policy determines whether a particular contract in a particular setting is barred by federal law.

In determining when such preclusive policies apply, courts accept that contract law generally prevails, but ask whether a particular contract clause in a particular setting conflicts with federal policies when balanced against the general role of contracts in the economy and legal system. How far the federal policies reach is uncertain in many respects. Article 2B approaches the issue from a posture of aggressive neutrality. As with contract law today, Article 2B sets out underlying contract law principles and leaves federal policy determinations to federal courts and federal law.

Not surprisingly, in light of digital technology, defining the proper scope of rights under federal property law has been controversial; it remains unresolved despite extensive negotiation and political discussion. Some disputed issues deal with reverse engineering copyrighted, but unpatented technology, while others deal with the scope of educational or scientific fair use of digital works. These are questions of federal policy. They must be resolved by courts and Congress, rather than state legislation. As applied to particular contexts or issues involving contractual relationships, there are two levels of determination in such contexts. One involves whether a contractual term exists and is enforceable as a matter of contract law. The second involves whether that contract term is enforceable under federal law. Article 2B takes no position on the latter question, whether the issue arises under antitrust law, intellectual property law, or other federal source. Article 2B merely provides a contract law framework.

To underscore this, the official comments will point to existing case law on several potentially important questions. Thus, for example, copyright case law holds that, in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). The scope of fair use here is not clear and it is also unclear to what extent a contract term alters the analysis. It is clear in reference to limited distribution information that contracts barring disclosure or reverse engineering are enforceable. In the mass market the issue in respect to reverse engineering is not settled under federal law.

Other doctrines may also apply. For example, the Fifth Circuit has suggested that a reverse engineering clause that in effect attempts to monopolize a different product market constitutes copyright misuse in that particular context. DSC Communications Corp. v. DGI Technologies, Inc., 81 F.3d 597 (5th Cir. 1996). Article 2B cannot and does not change the federal policy analysis which applies on a case-by-case basis.

Similarly, there is ample federal case law (and statutory provisions) which establish a federal interest in the broad distribution and use of ideas and concepts that have been distributed to the public. The issues stemming from that policy premise point in various directions, including concepts of fair use in copyright law and simple but fundamental ideas of free speech. See Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989). On the other hand, however, it is quite clear that the federal policy on dissemination of information co-exists with concepts about the ability of parties to make confidential disclosures and deal with information to be kept secret. See Computer Assoc. Int'l, Inc. v. Altai, Inc., 982 F2d 693 (2d Cir. 1992). Exactly where and how these themes interface and what limits they may place on particular contractual relationships is clearly a question of federal policy, rather than state contract law.

On these issues, Article 2B does not alter the relevant policy equation. For example, a contract term in a widely distributed consumer magazine that purports to prevent a reader of the magazine from using an idea or a factual summary or a brief quotation would (in addition to market place resistance) present serious questions of enforceability under copyright and constitutional free speech considerations. Some case law supports the view that, in some situations involving mass distribution of the information in a generally unrestricted form, the provision is unenforceable. See Consumers Union v. General Signal Corp., 724 F.2d 1044 (1983). On the other hand, in other situations, modern law clearly allows the creation of enforceable contract restrictions on the ability of a recipient to reproduce or publicly redistribute confidential information. See Restatement (Third) Unfair Competition.

Contracts already control most distribution of information. The contract law regime is not created by Article 2B. In most cases and with respect to most issues, contracts control as the method by which parties obtain value from information. While, as stated in the Copyright Act, federal property law precludes state law that creates rights equivalent to the property rights created under copyright, both as a practical and as a conceptual matter, copyright (or patent) do not generally preclude or preempt contract law. Indeed, contracts are essential to use one's own property, even when the property is tangible, let alone when it is intangible. A contract defines rights between parties to the agreement, while a property right creates rights against all the world. They are not equivalent.

6. With the transition from print to digital media as a main method of conveying information, major policy disputes have erupted concerning the redistribution of rights in light of the fact that the media of distribution allows many different and potentially valuable (for users or authors) uses of information products. The difficulty of balancing fundamental rights in this context is demonstrated by the fact that disputes about underlying social policy have erupted and been left unresolved in numerous contexts in the U.S. and internationally. These fundamental questions are beyond the scope of this Article. State law that conflicts with the resolution of those questions in federal law may be preempted if that is the policy choice made in federal law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

SECTION 2B-106. EFFECT OF AGREEMENT; RULES OF CONSTRUCTION; ISSUES DECIDED AS A MATTER OF LAW.

(a) Except as expressly provided in this article or in Article 1, the effect of any provision of this article, including allocation of risk or imposition of a burden, may be varied by agreement of the parties. However, except to the extent stated in the following sections, the agreement may not vary:

(1) the limitations on choice of law in Section 2B-107;

(2) the limitations on choice of forum in 2B-108;

(3) the right to relief from an unconscionable contract or clause in Section 2B-110;

(4) the procedures for manifest assent and opportunity to review in Sections 2B-111 and 2B-112.

(5) the limitations on enforceability in Section 2B-201.

(6) the rights in Section 2B-208;

(7) the limitations on disclaimer of warranties in Section 2B-406;

(8) the limitations on contractual transfer restrictions Section 2B-503(b);

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

(10) the restrictions on the statute of limitations in Section 2B-705(a); or

(11) the limitations on self-help repossession in Section 2B-716.

(b) In applying this article:

(1) The use of mandatory language or the absence of a phrase such as "unless otherwise agreed" in a provision of this article does not preclude the parties from varying the effect of the provision by agreement except as provided in subsection (a).

(2) The fact that a provision of this article states a precondition for a result does not of itself imply that the absence of that precondition yields the opposite result.

(3) Unless this article requires a term to be conspicuous, negotiated, or that there be manifest assent or express agreement to the term, these requirements are not a prerequisite to enforceability of the term.

(c) Whether a term is conspicuous or is a term excluded under Section 2B-208(a) is a question of law to be determined by the court.

Uniform Law Source: None.

Definitional Cross Reference:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Court". Section 2B-102. "Notice". Section 1-201. "Rights". Section 1-201. "Term". Section 1-201.

Notes to this Draft: Edited for clarity.

Reporter's Notes:

1. Article 2B adopts the basic commercial law policy of contractual freedom. Contract choices control unless there are direct, tangible and over-riding policy considerations that mandate direct restraints on contract choice. The parties are free, by agreement, to alter the effect of any provision of this Article except for the few mandatory rules provided in Article 1 or referenced in this section, subject, of course, to the basic contract law restraint that contracts and their terms must not be unconscionable.

The parties' ability to alter the effect of provisions of this Article by agreement does not require a formal, written contract and express terms to achieve that result. That may occur as the result of course of dealing, trade use or other aspects of the attending circumstances; the idea of "agreement" encompasses the entire bargain of the parties in fact.

2. The dominance of agreed terms over statutory default rules characterizes all of the U.C.C. transactional articles. It is especially important to state the principle here, however, because of the drafting style used in this Article. Provisions of Article 2B are drafted without use of the phrase "unless otherwise agreed" and frequently use mandatory language, such as "shall" or "must." As a general matter, these do not change the basic principle that the contract controls. Subsection (a) makes that clear. The stylistic preference does not alter the basic policy of contract choice. All of Article 2B is subject to the over-riding principle that all of the terms can be altered by agreement unless otherwise indicated. This section expressly rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware*, 910 F. Supp. 1009 (D. Del. 1995) (terms of Article 9 provision superseded the contract choice principle in UCC § 1-102).

Subsection (b) provides a cross reference to the limited number of contexts in Article 2B where a contract cannot alter mandatory rules. In addition, of course, term are some similar limitations in Article 1 and in some state regulations of contracting practice.

2. Subsection (b) deals with several concerns that also arise from the drafting style. Subsection (b)(2) resolves interpretation questions about the existence of a so-called negative pregnant in many of the rules in this article. Thus, if a section states that "If the originator of a message requests acknowledgment, then the following rules apply: ---" that does not indicate what rules apply in the absence of that request; in itself, it does not bar a court from adopting some or all of the same rules in the absence of a request, but merely states the affirmative proposition. If a more exclusionary result is intended, it is either made express or can be inferred from the context or the associated policies. Similarly, subsection (b)(3) states the premise that, for purposes of this Article, requirements of conspicuousness, assent or the like exist only when expressly imposed with respect to a particular term.

3. Subsection (c) provides that whether a term is conspicuous is a matter of law and applies that principle to related issues under 2B-208. This follows current law.

SECTION 2B-107. LAW IN MULTI-JURISDICTIONAL TRANSACTIONS.

(a) The parties in their agreement may choose the applicable law. <u>However, in a consumer transaction, the choice is not enforceable to the extent it varies a consumer protection rule which cannot be varied by agreement under the law of the jurisdiction whose law would apply in the absence of the agreement.</u>

(b) Except as otherwise provided by an enforceable choice-of-law term, the following rules apply:

(1) In an access contract or a contract providing for electronic delivery of a

copy, the contract is governed by the law of the jurisdiction in which the licensor is located when the agreement is entered into between the parties.

(2) A consumer contract not governed by subsection (b)(1) which requires delivery of a copy on a physical medium to the consumer is governed by the law of the jurisdiction in which the copy is delivered or, in the event of nondelivery, the jurisdiction in which delivery was to have occurred.

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

(c) If the jurisdiction whose law govern under subsection (b) is outside the United States, the laws of that jurisdiction govern only if they provide substantially similar protections and rights to the party not located in that jurisdiction as are provided under this article. Otherwise, the law of the jurisdiction in the United States which has the most significant relationship to the transaction governs.

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

Uniform Law Source: Restatement (Second) of Conflicts 188; U.C.C. §§ 1-105; 9-103.

Definitional Cross Reference:
"Access contract". Section 2B-102. "Agreement". Section 1-201. "Consumer". Section 2B-102. "Contract". Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Electronic". Section 2B-102. "Licensor". Section 2B-201. "Party". Section 1-201. "Rights". Section 1-201. "Term". Section 1-201.

Committee Votes:

a. Voted 9-1 to use consumer, rather than mass market.
b. Voted 8-5 to validate contract choice of law. (Feb. 1997)
c. Voted 11-0 to adopt significant relationship test as back-up rule. (Feb. 1997)
d. Voted 10-0 to make contract ineffective to alter mandatory consumer protections (Nov. 1997)

Notes to this Draft: Edited for clarity. Subsection (a) modified to reflect Committee vote.

Reporter's Notes:

1. *Contractual Choice of Law: General Rule.* This section addresses two questions. The first concerns the enforceability of contract provisions choosing the applicable law for a contract. Choice of law clauses are routine components of commercial licenses and are important in how parties structure commercial deals. The information economy accentuates that importance through expanded communications capabilities and, with respect to transactions in information, the fact that remote parties frequently engage in contract formation and performance through remote systems spanning two or more jurisdictions and not dependent on the physical location of either party or of the

information itself.

In light of the commercial importance of the practice, Article 2B adopts a strong, contract choice position validating choice of law agreements. A rule that validates choice of law agreements states an important policy in a context where an increasing number of modern information transactions occur in cyberspace, rather than in fixed locations. Because many transactions in this field are not related to tangible locations, the ability to choose an appropriate law provides an important commercial premise. In the absence of that right, even the smallest business entity on the Internet is potentially subject to the law of all fifty states and all countries in the world. Because that risk would have long term adverse effects on electronic commerce, this Section is one of the most important contributions of Article 2B to development of electronic commerce.

Common law generally enforces contractual choice of law in transactions in intangibles. See Finch v. Hughes Aircraft Co., 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985); Medtronic Inc. v. Janss, 729 F.2d 1395 (11th Cir. 1984); Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products, 229 U.S.P.Q. 335 (D. Md. 1985); Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co., 986 F.2d 607 (1st Cir. 1993). The major exception is if the choice contradicts a fundamental, mandatory policy of the state that would otherwise have its law apply; the reported cases applying this theory are typically consumer protection cases. Similarly, the Restatement allows contract terms to govern in any case (including consumer contracts) where the issue could be resolved by contract. In addition, **even** if contract rules might not otherwise govern, under the Restatement, the contract choice is presumed to be valid, subject to limited exceptions. Restatement (Second) of Conflict of Laws 187 (may be invalid if not resolvable by contract and either there was no "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.").

2. *Contract Choice: Consumer Contracts.* In an information economy, there are strong reasons to allow contract choice; those reasons encompass the rationale that led to the Restatement position years ago, but go further because of the increasing nationalization and internationalization of commerce. Despite strong reasons for enforcing contract choices, Article 2B takes the position that the contract cannot over-ride mandatory consumer protections that would otherwise apply. A mandatory rule is a rule that, under applicable law, cannot be altered by agreement. Such rules exist in most states, but their content varies widely. The reference to consumer protections includes under both the UCC and non-UCC law (see 2B-104(a)(3)). Within Article 2B, it includes mandatory consumer protection rules whether phrased in terms of consumer or "mass-market" rules.

3. *Contract Choice: Rejected Limitations.* Article 2B rejects current Section 1-105 which allows choice of law only if the chosen state has a "reasonable relationship" to the transaction. This rule is more restrictive than the Restatement and the law of most states outside Section 1-105. It reflects law that existed when the UCC was adopted five decades ago, but that has little merit in modern electronic transactions and does not fit with modern scholarship about choice of law as reflected in the Restatement (Second) and elsewhere.

It also rejects Article 2A-106 which, for *consumer* leases, restricts the contract choice to the jurisdiction in which the lessee resides on or within thirty days after the contract becomes enforceable. That rule is inappropriate for the intangible property and would create a situation in which an on-line provider would be subject to the law in all fifty states even though the states themselves have not designated their particular rules as mandatory. That would be true even though no discernible consumer protection interest justifies the contractual choice limitation. The residence rule does not exist under Article 2, Article 1 or the Restatement. As a consumer protection, it assumes that the domicile is more protective than any other state law. As a matter of logic, that **cannot** be true in all cases. In an information marketplace and especially in cyberspace transactions, the residence rule harms the consumer as often at it helps the consumer. In cyberspace environments, it frustrates goals of providing uniformity and being able to control the number of divergent laws with which a contract must comply.

4. *Default rule: no contract provision.* The second issue in this Section involves choice of law in the absence of contract terms and is covered in subsection (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain if they so choose and a basis for planning transactions with a reasonable understanding of the applicable risk. Under current general law, choice of law principles are often driven by litigation concerns and refer to questions about "reasonable relationship", "most substantial contacts", and "governmental interest." In the online environment, this does not support commercial development and creates substantial uncertainty. While Article 2B adopts the modern Restatement (Second) of Conflicts as a general rule, it provides two specific,

commercially useful and discernable rules that supersede the general background concept.

5. *Default rule: Internet Transactions.* The most important rule is in subsection (b)(1). It deals with electronic transactional environments and creates a presumptive choice of law based on the location of the licensor. Where an on-line vendor automatically provides direct marketing to the world through Internet, any other formulation would require the vendor to comply with the law of fifty states and 170 countries since it will often not be clear where the information is being sent. Some states or countries mandate such compliance through local laws, such as for example, recent amendments to California warranty law applicable to the sale of goods. Opting for a more stable and identifiable choice of law is an important in facilitating electronic commerce in digital products.

In this section, the licensor's location refers to its chief executive office (as in Article 9), rather than the location of the computer that contains or provides the information. Unlike other choices (such as the licensee's location, the location of the data), this choice provides a single, routinely identifiable background for commerce. 6.

Default Rule: Consumer Deliverables. Subsection (b)(2) creates a consumer rule for cases of physical delivery of tangible copies (not involving online contracts). The rule focuses on the location where the copy is received. In most, but not all cases, this will be the state in which the consumer resides. That location would typically be chosen under any choice of law regime, but this section makes the choice clear. Thus, for example, a consumer acquiring software in Chicago will be subject to the law of Illinois in the absence of contract terms. That rule is consistent with concerns about the "place of performance" and similar considerations under current law. It is also followed in many European consumer protection rules relating to contract choice of law involving sales of goods and services. This rule deals with situations in which the licensor will know where delivery will occur because it delivers a physical copy and is not engaged in an electronic communication. This allows electronic transactions to be governed by a choice of law rule that enables commercial decision-making based on an identifiable body of law and does not impose costs on the transaction by requiring that the electronic vendor determine what physical location corresponds to an electronic location.

The language in this Section, of course, only deals with contract issues. It does not affect tax or similar concerns. In Quill Corp. v. North Dakota, 504 U.S. 298 (1992) the Supreme Court held that no adequate nexus for tax purposes was established where the only contact of an entity with a state was advertising and delivery through common carrier. This Article, of course, deals only with contract issues.

7. *Default Rule: Restatement Concept.* The residual rule adopts the Restatement (Second) test and case interpreting it. The Restatement (Second) of Conflicts uses a "most significant relationship" standard to be judged by considering a variety of factors that include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. (f) the needs of the interstate and international systems, (g) the relevant policies of the forum, (h) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (i) the protection of justified expectations, (j) the basic policies underlying the particular field of law, (k) certainty, predictability and uniformity of result, and (l) ease in the determination and application of the law to be applied. Restatement (Second) §§ 6, 188.

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

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

SECTION 2B-108. CONTRACTUAL CHOICE OF FORUM.

(a) The parties in their agreement may choose an exclusive judicial forum unless ~~the chosen jurisdiction would not otherwise have jurisdiction under general standards of personal jurisdiction and~~ the choice is unreasonable and unjust.

(b) A choice-of-forum term is not exclusive unless the agreement expressly so provides.

Definitional Cross Reference:

"Agreement". Section 1-202. "Term". Section 1-202.

Committee Votes:

1. Rejected a motion to delete the section. VOTE 4 - 9 (February, 1997).
2. Voted to adopt the term consumer and not "mass market" VOTE: 8-5 (February, 1997)
3. Consensus that Draft should deal separately with arbitration clauses if at all. (February, 1997)
4. Rejected a motion to delete the section Vote: 10 -2 (Nov. 1997)
5. Applied the limitation on enforcement to all contracts. Vote: 7 - 3 (Nov. 1997)

Notes to this Draft: Edited to reflect Committee vote. Also, proposed deletion of reference to "otherwise have jurisdiction" as not needed. Choice of a state that would have jurisdiction in the absence of the contract choice should never be unreasonable.

Reporter's Notes:

1. *General Rule.* This section deals with choice of an exclusive judicial forum. It does not cover contract terms that permit litigation to be brought in a designated jurisdiction, but do not require that result. Permissive forum clauses are governed by general contract law. This Section adopts the modern view of the enforceability of choice of forum clauses. That view was first stated in Bremen v. Zapata Offshore Co., 407 U.S. 1, 10 (1972) (choice of forum clauses are "prima facie valid"). Subsequent case law, both in the United States Supreme Court and in state courts, increasingly conforms to the presumptive enforceability of choice of forum clauses, whether in customized agreements or in standard forms.

2. *Fairness Limitation.* Concerns about fairness and notice may limit enforcement of the clause. This Section adopts the approach to such questions established in the Breman decision and followed in most modern decisions. Breman indicated that the presumptively valid contract term could be rejected if it was "unreasonable and unjust." See Perkins v. CCH Computax, Inc., 106 N.C. App. 210, 415 S.E.2d 755 (1992); Lauro Lines v. Chasser, 490 U.S. 495 (1989); Sterling Forest Assocs., Ltd. v. Barnett-Range Corp., 840 F.2d 249 (4th Cir. 1988). While some later courts phrase this in the disjunctive, that difference in terminology does not apparently alter the general support for such clauses unless the primary or sole purpose is to obtain a grossly unfair advantage or to deny the other party its day in court without reason for the choice itself.

This section adopts the limiting language that has become the dominant theme in the better reasoned modern case law. "Unjust and unreasonable" has become the dominant standard to measure to determine whether to restrict enforceability. Indeed, many courts now suggest that choice of forum clauses are presumptively enforceable unless this joint standard is proven. The intent in this section is to conform to Supreme Court and other holdings in reference to what type of limits on choice of forum are appropriate.

The rule excludes clauses that choose an exclusive forum solely for the purpose of preventing a other party from being able to contest disputes that may arise under the transaction. Such choices may be unreasonable and their impact is unjust. On the other hand, clauses that serve valid commercial purposes are not invalidated simply because they adversely effect the other party to the agreement; this is true because the term to be a contract term must have been part of the contract itself.

3. *Internet and Cyberspace.* The importance of choice of forum provisions is recognized in general commerce, but is heightened in transactions in cyberspace as reflected by a line of contentious and inconsistent jpersonal jurisdiction ruling. The cases on personal jurisdiction in this environment are split between those requiring active involvement in a state in order to find jurisdiction from Internet activity and those that hold a passive Internet use sufficient to confirm jurisdiction on all states to which Internet reaches. In this context, the importance of being able to delineate by contract the scope of exposure is commercially crucial. The importance of this was emphasized in a 1997 White House Report on Global Electronic Commerce.

In Internet transactions, choice of forum rules should ordinarily be enforceable. The Supreme Court enforced a choice of forum in a standard form contract even though the choice effectively denied a consumer the ability to defend the contract and the choice was contained in a non-negotiated form and not presented to the consumer until after the tickets had been purchased. See Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991). The Court's comments have relevance to Internet contracting:

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

In an Internet transaction, the context suggests that choice of forum will often be justified on the basis of the international risk that would otherwise exist and, certainly, choice of forum at a party's location is reasonable.

SECTION 2B-109. BREACH OF CONTRACT; MATERIAL BREACH.

(a) Whether a party is in breach of contract is determined by the contract. Breach of contract includes a party's failure to perform an obligation in a timely manner, repudiation of a contract, or exceeding a contractual use restriction. A breach of contract, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach of contract is material if the contact so provides [or the breach is a failure to perform an agreed term that is an essential element of the agreement]. Otherwise, the following rules apply:

(1) A breach is material if the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the trade or industry, or the character of the breach, indicate that:

(A) the breach caused or may cause substantial harm to the aggrieved party, such as costs or loses that significantly exceed the contract value; or

(B) the breach substantially deprived or may substantially deprive the aggrieved party of a benefit it reasonably expected under the contract.

(2) A material breach of contract occurs if the cumulative effect of nonmaterial breaches is material.

Issue: Should subsection (b) and (c) be deleted and reliance placed on general law?

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

Definitional Cross Reference:
"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 2B-102. "Information": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Committee Votes:

a. Approved a motion to delete a list of acts that are material. Vote: 11 - 0 (Feb. 1997)

Notes to this Draft: Edited for clarity. Bracketed language in (b) proposed for consideration.

Reporter's Notes:

1. *Nature of a Breach.* A party must conform to its contract. A breach of contract 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.

2. *Breach Related to What Remedies Apply.* For purposes of administering remedies for breach, Article 2B distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 and Article 2A in all cases other that with respect to the acceptance or rejection of a single delivery of a product. The concept of material breach also corresponds to common law and the Restatement (Second) of Contracts. A similar standard exists in international law. The Convention on the International Sale of Goods (CISG) states: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1).

If one party fails to conform to the contract, the aggrieved party is entitled to remedies for breach. The aggrieved party's right to cancel the contract and refuse to perform its further obligations, however, hinges on whether the breach was material or immaterial. The party may not cancel the contract for a non-material breach. For immaterial breaches, the remedy is an action for damages. If the breach is material, however, it may cancel. 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." See 2B-601.Under this Article, as in Article 2, an intermediate remedy lies in the right of a party whose expectations of future performance are reasonably impaired by the other's acts or words, to suspend performance and demand adequate assurance of future performance by the other party. Section 2B-621.

The basic policy 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. The theory does not contemplate a right to not perform under the contract, but a rule that prevents forfeiture for minor flaws in performance. For example, a one day delay in payment may or may not be material. A failure to fully meet general, advertised claims of handling 10,000 files may not be material where the licensee's needs never exceed 4,000 if the system handles 9,999 and the contract did not expressly require 10,000 files

The material breach concept, which permeates U.S. and international contract law, rests on the common law belief that it is better to preserve a contract relationship despite minor performance problems and the related belief that allowing one party to cancel for minor defects may cause unwarranted forfeiture and encourage unfair opportunism. Materiality relates to the aggrieved party's perspective and the benefits it expected from full performance of the contract. The distinction between material and non-material breach applies to performance of both parties, except that a different standard applies to mass market transactions involving a refusal of a single delivery by a licensee; there, the Article follows existing Article 2.

3. *Contract Terms.* Materiality concept provides a flexible standard that allows courts to avoid unwarranted forfeitures. That flexibility, however, creates potential uncertainty in commercial contracts. It is important, therefore, that ideas of materiality hinge on the terms of the contract. The contract can define what is material. That can happen in any of three ways. The first two involve either expressly providing a remedy for a particular breach (e.g., failure to meet "X" test permits cancellation of the contract) or expressly defining a particular breach per se material. In either case, there is no reason to ignore what the parties have stated to be important to their bargain. The third involves what, under common law is described as "express conditions." These are express contract terms conformance to which is implicitly or expressly a precondition to the performance of the other party. Here, the nature of the express

agreement itself conditions the remedy.

Illustration 1. **I**n a development contract, the parties agree that the final product must meet 10 conditions before it is acceptable. One condition provides for operation at a speed of no less than 150,000 rev. per second. The delivered product fails to meet that standard, falling short by a relatively small amount. Since meeting that conditions was an express contractual standard, the failure to perform is material, justifying refusal of the product.

Illustration 2. **I**n a contract for delivery of a database to be used as a mailing list, assume that no specific delivery date is specified. The product is delivered but arguably somewhat later than expected. Whether the breach is material in the absence of an express term hinges on the effect of the delay on the overall value of the contract.

Illustration 3. The licensee agrees to specifications for a new word processing program. The standards expressly require a dictionary with no less than 5 million words. The actual dictionary has 4.99 million. The developer fails to meet the standard within the agreed time. The failure to meet the **express** standards constitutes a material breach. The licensee can refuse the product.

Illustration 4. A contract requires delivery of a database program but does not expressly describe the characteristics required of the program. The database meets its own specifications, but fails to function in a manner comparable to other similar programs. Materiality hinges on whether the defect causes substantial harm to the licensee. The terms of the contract control what constitutes a material breach.. They may do so directly, such as by specifying that particular breaches allow cancellation of the contract or indirectly, by designating specific aspects of the contracted for performance as critical. As in common law, if the parties agree to an express contract condition, that condition must be satisfied before the other party is obligated to perform its remaining portions of the contract.

4. *What constitutes a material breach?* One cannot define materiality in absolute terms any more than one can define concepts such as negligence, reasonable care, merchantability, or the like. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements: contract terms and the extent to which breach causes significant harm to the aggrieved party. See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) ("breach ... is material if it is so substantial as to defeat the purpose of the transaction or so severe as to justify the other party's suspension of performance").

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

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

SECTION 2B-110. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court as a matter of law finds that the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Uniform Law Source: Section 2-302; 2A-108. Conforms to 2-302.

Definitional Cross Reference:

"Contract". Section 2B-102. "Court". Section 2B-102. "Term". Section 1-201.

Conference and Committee Action:

1. At the 1997 NCCUSL Annual Meeting, the Conference adopted a motion that the three transactional articles should follow a consistent "core" definition..

Reporter's Note:

1. Article 2B follows current Article 2. Since many of the transactions covered by Article 2B are not now within the UCC, it expands the ability of courts to monitor transactions beyond the law that current governs. The intent is to adopt modern decisions on unconscionable contracts and terms. In addition, of course, courts should consider the nature of the subject matter and types of transactions covered by this Article in continuing to evolve concepts of what constitutes an unconscionable term.

An important expansion, however, is contained in 2B-208, which imposes procedural requirements on mass market contracts and allows courts to invalidate some terms even though they are conscionable.

2. Article 2B does not allow a court to invalidate a contract or a term based on unconscionable inducement. Traditional theories of fraud, duress and the like continue to apply of course, but the inducement concept is law only in Article 2A, where it is limited to consumer leases. While it may have a proper role in that context, there is no case law developing or suggesting the contours or limits of the theory and its applicability to general transactional environments is not established. The most recent proposal for revision of Article 2 likewise does not adopt this concept. In this article, of course, many situations where inducement may be an issue are dealt with by the concept of manifesting assent and opportunity to review.

SECTION 2B-111. MANIFESTING ASSENT.

(a) A person or electronic agent manifests assent to a record or term thereof if, acting with knowledge of, or after having an opportunity to review the record or term, it:

(1) authenticates the record, or

(2) engages in affirmative conduct or operations that the record conspicuously provides or the circumstances, including the terms of the record, indicate will constitute acceptance and the person had an opportunity to decline to engage in the conduct.

(b) Mere retention of information or a record without objection is not a manifestation of assent.

(c) If this article requires assent to a particular term in addition to assent to a record, a person does not manifest assent to that term unless there was an opportunity to review the term and the manifest assent relates specifically to the term.

(d) A manifestation of assent may be proved in any manner, including by a showing that a procedure existed by which a person of an electronic agent must have engaged in conduct or operations that manifests assent to the record or term in order to proceed further in the use it made of the information.

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

Definitional Cross Reference.

"Authenticate". Section 2B-102. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Committee Actions:

1. Reviewed without substantive changes

Notes to this Draft: Edited and organized for clarity.

Reporter's Notes:

1. Manifesting assent has several distinct functions, depending on the context. A primary function is as an indicia of agreement to or acceptance of a contractual relationship. Assent to a record containing the terms of the contract, in the form of an authentication or otherwise, frequently indicates not only assent to the terms of the record, but also an intent to undertake, that is accept, the agreement itself. That function is implicit in general contract law. The fact that Article 2B identifies additional functions of the concept of manifest assent, that is the concept of being bound by objective indications of assent through conduct or signature, does not alter or reject this underlying traditional function. Manifesting assent is one, but not the only way to indicate acceptance of, or agreement to a contractual relationship. Performance, oral statements and the like are also adequate to form a contract. Section 2B-202; 2B-203.

2. Beyond this role, in this Article and in general law, manifest assent also has a role in determining whether or when a party adopts the terms of a record as defining the terms of the contractual relationship. The term is used in the Restatement (Second) of Contracts § 211 and in the UNIDROIT Principles of International Commercial Contract Law in this sense. It provides a standard that defines when a party is bound to the terms of a standard form record. In these other bodies of law, the term is used, but not defined. In Article 2B, it is used in the same way, as one method of indicating assent to a record as defining the contract, but this Section and Section 2B-112 provide important procedural and substantive standards indicating when assent can be said to have been given to a record. The effect of assenting to, or otherwise accepting, a record is spelled out in Section 2B-207 and Section 2B-208.

The recognition of objective manifestations of assent is especially important in electronic commerce. In that environment, direct contact between individuals is less common and providers of information often must rely on actions as confirming the existence, or non-existence of a contract, and the acceptance or rejection of contract terms.

3. This Article also employs the concept of manifest assent with respect to the enforceability of particular terms of a record. Here, by requiring affirmative conduct (or signature) oriented to the particular term, the idea of manifesting assent creates an enhanced standard of protection for the assenting party, as compared to more traditional standards of conspicuousness. Manifesting assent is the higher standard in that it requires both that the term be called out and that there be affirmative conduct referring to that term itself. A conspicuous term binds a party so long as the person ought to have noticed the term. In both cases, the calling it to the attention function focuses on whether the term would or ought to be noticed by a reasonable person.

4. "Manifesting assent" entails objective indicia of assent to, or adoption of an agreement, a record, or a term in a record. Objective manifestations of assent bind a party to the record if there was an opportunity to review the record and an affirmative act indicating assent. In this Article, however, three elements are required before the objective manifestation constitutes assent.

a. The person manifesting assent must be one that can bind the party being charged with the benefits or restrictions of the agreement or the record. This Article does not generally address questions of agency law. See § 1-103. If a party proposing a record desires to bind the other party, it must establish that the person who acted for the entity to be bound had authority to do so or, at least, that the conduct of that entity accepted the benefits of the contract and, thus, ratified the conduct of the individual. Of course, however, if the person who acted did not have authority to contract and the contract was not ratified or otherwise adopted , there may be no license. Often, if this is the case, use of the information infringes a copyright.

In appropriate cases, Article 2B rules regarding attribution play a role in resolving the issue of whether the ultimate party is bound to the contract terms. Section 2B-111 spells out questions of when or whether, in an electronic environment, a party is bound to records purporting to have come from that party.

b. There must be an affirmative act to constitute assent. This requirement flows from the concept that manifestations of assent refer to objective indicia of assent. A signature or other authentication, of course, manifests assent, initials attached to a particular contract term assent to that term. So too, in the electronic world would an affirmative act figuratively pressing (e.g., clicking) a displayed button indicated as indicating assent and acceptance of a particular term or an entire record. Assent does not require a formal event, although notarization or other formalities certainly qualify.

This Article rejects the idea, suggested in some reported decisions, that a mere failure to object constitutes assent to a record. Objective indicia of assent under this Article requires an affirmative act that the circumstances or the record clearly indicate will have that effect. A failure to object is not assent, but affirmative use of the information or access to it can be assent if that act was defined as sufficient in the circumstances.

c. Assent must follow an opportunity to review. Assent requires proof that the party actually read the terms to which it assents. "Opportunity to review" is a defined in Section 2B-112. It requires that the record be called to the party's attention and be available for review. The terms need not all be in a single record, so long as their location enables review if the assenting party so desires. Thus, a hyper-link reference to a license actually contained in a different record would, all other conditions being met, satisfy the concept. However, the concept excludes devices or schemes designed to misled or conceal, rather than to obtain assent

Of course, in an electronic world, it will be necessary for the party, if it relies on the terms of linked text or other electronic records, to prove the content of the text at the time of the licensee's assent. One way of attempting to do so is to retain records of the content at all periods of time. The issues of proof, while potentially difficult, are matters of evidence law and reflect ordinary problems encountered in dealing with proof of electronic records.

Illustration 1: In its pre-registration information screen, NYT on-line states: "Please read the license. Click here to review the <u>License</u>. If you agree to the license, indicate your agreement by clicking the "I agree" button. If you do not agree to the License, click the "I decline" button." The underlined text is a hypertext link which, if selected, displays the license.

I Agree I Decline

Here, a party who indicates "I agree" manifests assent to the license. Its conduct in going forward to use the information also indicates it accepted the contract and adopted the terms of the license.

5. The section distinguishes assent to a record and, if required by other provisions of this article, assent to particular terms. Assent to a record involves 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 if the record conspicuously so provides:

Illustration 2: A license, which is available and readable on the outside of the envelope containing the diskette, 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, manifesting assent is an enhanced form of conspicuousness in that it requires an affirmative act with respect to a clause or term.

6. Manifestation of assent is not the only way in which parties define the terms of their deal. For example, clear indications that a product has specific characteristics can become part of an agreement even without a formal manifestation of assent; they in effect define the bargain itself. A party can license a database of names and addresses of intellectual property attorneys and rely on the fact that the product need only contain intellectual property attorneys since this is a basic term of the deal without its obtaining manifest assent to that part of the deal. The nature of

the product defines the deal itself in many cases if the party has notice of the terms, the terms are part of the bargain, or other methods are used to call attention to the term and the party accepts it.

Illustration 3: A copyrighted software package states: "THIS PRODUCT IS LICENSED FOR CONSUMER USE ONLY." It does not specify that opening the product or using it accepts this term. The circumstances here clearly indicate that the product is licensed solely for consumer use. The terms are effective as an inherent part of the agreement, without requiring pro forma language in a record or conduct accepting that record.

7. Assent by an unauthorized party is not assent as to the supposed principal unless concepts of apparent authority apply. Additionally, there must be a link between the person who has the opportunity to review the terms and one whose acts constitute assent. Thus, an email sent to the company at large, or to the company's computer, does not trigger assent to the email unless it comes to the attention of one who can and does act to commit the company to a binding assent to terms under rules of attribution or estoppel. Of course, a party with authority to act can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when she instructs the secretary to sign up for Westlaw online or to install a newly acquired program that is subject to a screen license. Questions of this sort lie in agency law as augmented in this Article.

SECTION 2B-112. OPPORTUNITY TO REVIEW; REFUND.

(a) A person or electronic agent has an opportunity to review only if the record or term is made available in a manner that:

(1) should call it to the attention of a reasonable person and permit review, or

(2) in the case of an electronic agent, enables the electronic agent to react.

(b) If a record or term is available for review only after the person becomes obligated to pay, that person has an opportunity to review only if has a right to a refund if it rejects the record or term. However, if the record or term is a proposal to modify a contract or is governed by Section 2B-207(a)(2), no refund is required.

Committee Action: Reviewed without changes.

Definitional Cross Reference.
"Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Notes to this Draft: Edited for clarity. Refund and bundled products principles were moved to a definition of "refund" in 2B-102. Reasonable person standard adopted to conform to concepts of conspicuous terms.

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. The opportunity to review can come at or before payment, or later. If the opportunity follows payment, there is no opportunity to review for purposes of this Article unless the party can return the product an receive a refund if it declines the terms of the record. This refund right does not exist in current law as a condition to the enforceability of records presented after payment. 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 prior to payment.

Illustration: Sam acquires a copy of the latest James Bond movie from Blockbuster on a three day rental agreement. When Same 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. What constitutes an opportunity to review may differ depending on whether one deals with a paper record or electronic terms. If access to the record is 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 forego or ignore the opportunity and proceed with a transaction does not mean that there was no opportunity to review. Thus, for example, contract terms presented to the party during an over the counter transaction or conspicuously made available in a binder as required for some transactions under federal law give an opportunity for review even if the party does not avail itself of that opportunity. This is not changed by the fact that the party may desire to hurry through and complete the transaction unless, of course, the other party uses undue pressure to cause that hurry or to force the party to not review the record.

4. Ideas of a refund opportunity associated with the opportunity to review do not alter law relating to the modification of an agreement of the provisions in Section 2B-207 dealing with commercial contracts where parties begin performance in the expectation that a record containing the contract terms will be presented later and adopted. In these cases, general contract law principles protect the party presented with the record.

5. While this section does not create an obligation to make a refund, it conditions the creation of terms of contract between the licensor and the licensee that arise after payment on that opportunity. Compare 2B-208. Failure to provide a refund is not a breach of contract, but results in failure of the terms to become part of the bargain. Under Section 2B-616, a retailer is required to refund the price paid if an end user declines the publisher's license. That right to a refund, if and when it occurs, fulfills the refund option stated here.

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

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

[B. Electronic Contracts: Generally]

SECTION 2B-113. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND SIGNATURES. A record or authentication may not be denied legal effect, validity, or enforceability solely on the ground that it is electronic.

Committee Action:

a. Reviewed without substantive change. (Nov. 1997)

Definitional Cross References:

"Authentication". Section 2B-102. "Electronic". Section 2B-102. "Record." Section 2B-102.

Reporter's Notes:

1. This section states a fundamental principle of electronic commerce. It derives from digital signature and electronic signature law in several states. The mere fact that a message or record is electronic does not alter or reduce its legal impact. Of course, this principle as stated here is restricted to the scope of Article 2B. As a result, it does not deal with instruments, documents of title, or similar applications of electronic commerce. Those areas present very

difficult questions about defining the equivalence or lack thereof between writing and electronic records. Under Section 2B-103, the subject matter of those other areas is excluded from Article 2B..

2. The Committee should consider the advisability of adding language to this section dealing with additional issues to the extent that they are within our scope. One observer has recommended the following additional language:

(b) In any legal proceeding, an electronic record or authentication is not inadmissible on the sole ground that it is electronic or, if the record or authentication was originally electronic, on the sole ground that it is not an original.

(c) If a rule of law requires a record to be retained in original form, or provides consequences for not being so presented or retained, that requirement is met by an electronic record that accurately reproduces the original record.

(d) If a rule of law requires that a record be retained, that requirement is met by retaining an electronic record that accurately reproduces the original record and is retained for as long as required by law.

If provisions of this type are included, a variety of additional policy issues should be reviewed in terms of the content and scope of application within the Article 2B framework to which the additional language applies.

SECTION 2B-114. ATTRIBUTION PROCEDURE.

(a) Except as otherwise provided in Section 2B-115 (a), if a person requires use of a procedure that would be an attribution procedure if it were commercially reasonable and a loss to the other person occurs because the procedure was not commercially reasonable:

(1) The person that required use of the procedure bears the loss unless it disclosed the nature of the risk to the other person and offered reasonable alternatives that the other person rejected.

(2) The liability of the person that required use of the procedure does not include losses that could have been prevented by the exercise of reasonable care by the other person.

(b) The commercial reasonableness of an attribution procedure is determined by the court. In making that determination, the following rules apply:

(1) An attribution procedure established by law or regulation is commercially reasonable for the purposes for which it was established.

(2) Except as provided in subsection (b)(1), commercial reasonableness is determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agree to or adopt the procedure.

(3) An attribution procedure may require the use of any security devices that are reasonable under the circumstances, such as algorithms or other codes, identifying words or

numbers, encryption, callback procedures, or any other reasonable security device.

Uniform Law Source: Article 4A-201; 202.

Committee Action:

1. Reviewed without substantive change.

Notes to this Draft: Edited for clarity. Former subsection (a) was moved to Section 2B-102.

Definitional Cross References:

Attribution procedure, Section 2B-102; court, Section 2B-102; person, Section 2-102.

Reporter's Note:

1. Attribution procedures are relevant to authentication of electronic records, attributing performance to a party, and allocating risk in reference to alleged errors or changes in a record or message.. If an attribution procedure is established between persons and followed, enhanced legal recognition is accorded to a message or performance. Conforming to an attribution procedure for that purpose results in an authentication as a matter of law. In other contexts, if there is a question of who sent the message or performance, compliance with an attribution procedure to identify a party makes the alleged originator of the message attributable for the message o performance. On the other hand, failure to use an authentication procedure does not indicate that there is no authentication or that the purported sender is not responsible for the message or performance.

2. An attribution procedure must be established by agreement or adopted by <u>both</u> parties. Section 2B-102. A procedure of which one party is not aware, does not qualify. On the other hand, agreement or adoption need not precede the transaction. Parties dealing for the first time may adopt a procedure for authentication of messages. The adopted procedure would have the full force of an attribution procedure if it is commercially reasonable.

3. To be given the treatment of an attribution procedure, a procedure must be commeercially reasonable. This requirement follows Article 4A rules regarding "security procedures." It buffers against over-reaching and protects parties who lack knowledge of technology. The cost of requiring that this standard be met lies in a degree of uncertainty that the parties cannot control by agreement. Yet, it is an important safety valve for users of these systems. Consider the following:

Illustration: General Motors creates a procedure with franchisees that requires merely that a message contain the franchisee's E-mail address as an identifier. A bad guy uses that system and causes loss of $100,000 in the name of the franchisee. If the contract controls, the franchisee is liable for the loss unless the procedure is commercially unreasonable. It would most likely be unreasonable in this case.

What is a commercially reasonable procedure must take into account the cost relative to value of transactions. This is implicit in the idea of commercial reasonableness. How one gauges commercial reasonableness obviously depends on a variety of factors, including the agreement, the then current technology, the types of transactions affected by the procedure and other variables.

4. Subsection (a) provides a liability standard dealing with potential abuse of procedures for attribution that may arise where one party insists on use of a particular procedure that is not in fact commercially reasonable. A procedure of that type, of course, does not establish the presumptions described in Section 2B-115 or in Section 2B-116. In addition, however, where the party insisted on use of the commercially unreasonable procedure, resulting loss falls on that party. The limitation of this loss reflect a principle of mitigation. The loss does not fall on the party that required the procedure to the extent that reasonable alternatives were offered or to the extent that the other person could have avoided the loss through the exercise of reasonable care.

SECTION 2B-115. ATTRIBUTION OF AN ELECTRONIC MESSAGE, RECORD, OR PERFORMANCE TO A PARTICULAR PERSON.

(a) Subject to subsection (b), an electronic authentication, message, record, or performance is attributable to a person if:

(1) it was in fact the action of that person, a person authorized by it, or the

person's electronic agent;

(2) the other party, using an attribution procedure for identifying a person, in good faith concluded that it was an act of the other person, a person authorized by it, or the person's electronic agent; or

(3) it resulted from acts of a person that obtained, from a source under the control of the person to whom it is attributed, access numbers, codes, computer programs, or the like the use of which created the appearance that it came from that person and

(A) occurred because of a failure to exercise reasonable care by that person; and

(B) caused the other party reasonably to rely to its detriment on the apparent source of the message or performance.

(b) Attribution under subsection (a) (2) creates a presumption that the authentication, message, record or performance was that of the person to which it is attributed.

~~(c) In a case governed by subsection (a)(3), the following rules apply:~~

~~(1) The relying party has the burden of proving reasonable reliance, and the alleged actor has the burden of proving reasonable care.~~

~~(2) Reliance that does not comply with an attribution procedure that exists between the parties is not reasonable unless authorized by an individual representing the other party.~~

~~(d) Except as provided subsection (a), if a loss occurs because a party relied on an electronic authentication, message, record, or performance as that of another party, as between the parties, the party who relied bears any loss caused by its reliance.~~

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

Definitional Cross Reference.

"Computer program". Section 2B-102. "Electronic agent". Section 2B-102. "Electronic message". Section 2B-102. "Good faith". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Presumption". Section 1-201. "Record". Section 2B-102.

Committee Votes:

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

b. Reviewed without change. (Nov. 1997).

Notes to this Draft: Edited for clarity, in addition:

1. The Draft deletes burden of proof language, leaving that issue to general law. The basic principle is that burden of proof allocations are properly left for judicial development under ordinary principles, rather than employed in a contract statute to influence loss allocation.

2. Former subsection (d) on loss where there is no attribution rule under (a) was also deleted. It is inconsistent with the use of presumptions for attribution procedures and sets out a single, broad rule that may not be applicable in the many complex cases to which it pertains. Various common law concepts, such as estoppel, waiver and the like may, in appropriate cases, create results not encompassed within the blunt liability rule suggested in that former subjection.

Reporter's Notes:

1. Attribution <u>to a person</u> means that the electronic record is treated in law as having come from that person. The section thus deals with risk allocation highly relevant to the anonymous nature of electronic commerce. The section balances goals of enabling electronic commerce in an open environment (as contrasted to the closed systems such as funds transfer and credit card transactions), while stating reasonable standards to apportion risk in that open system. The rules here do not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside Article 2B.

2. There are three circumstances under which a message or action is attributed to a party. The first (subsection (a)(1)) simply makes a person responsible for the record or performance if the person or its agent actually performed or actually created the record. General agency law applies where the issues deal with human agents. In addition, a person is responsible for the actions of its electronic agent. An "electronic agent" is an automated system that responds to or initiates actions without human review and is selected or adopted by a person for that purpose. Having opted to use an automated system, the person is held responsible for its operations. The idea of an electronic agent does not exist under current law, but has importance in electronic contracting for information because of the increasing use of preprogrammed software to acquire information assets. The principle underlying this concept is that a person who created and set out the automated system has responsibility for its conduct. The rules here parallel the UNCITRAL Model Law. Article 13 provides that as between the parties, a message is deemed that of the originator if sent "by an information system program by or on behalf of the originator to operate automatically."

3. Subsection (a)(2) focuses on attribution procedures for authentication. It makes a message attributable to a person if the other party used the procedure and reached the conclusion that it came from the other person because of that use. This establishes a level of certainty when the parties adopt a commercially reasonable system of identification. Attribution in this form creates a presumption that it was the party identified who in fact sent the message, created the record, or engaged in the performance or authentication. The presumption is rebuttable.

4. Subsection (a)(3) deals with when can a person be held accountable for messages not sent by it and not within an attribution procedure, but on which the other party relied. The underlying loss allocation principle recognizes a limited concept of protected reliance where the cause of the reliance lies in a lack of reasonable care by the person to whom the message is attributed. Since this is reliance-based liability, if the message, performance or context clearly indicates that the indicated source is incorrect or gives reason to doubt the source, reliance may not be protected. Where the reliance is reasonable, the receiving party has a protected right under this article if a lack of reasonable care lies at the heart of the actions that caused the reliance..

Current law uses several different approaches to analogous problems: 1) in the telephone system, a person is responsible for any charges incurred for long distance calls from its equipment and using its number; fault and authorization are irrelevant; 2) credit card and electronic funds regulations limit liability for a consumer for unauthorized use of its card or number; 3) in commercial funds transfers, the presence or absence of a "security procedure" conditions risk; 4) in check collections, an absolute liability rule is imposed on many recipients of fraudulent instruments unless the party whose signature was forged negligently contributed to the fraud.

The Drafting Committee elected the intermediate position reflected in this Draft. The position draws a balance between limiting the risk exposure of alleged senders and protecting reliance interests of recipients of messages. Unlike in credit card and funds transfer systems, one cannot safely predict the relative nature of the sending and receiving parties, their economic strength, or technological sophistication. Individuals with limited resources are as likely to be on either side of a transaction in electronic commerce as are large corporations. Because of this, the rule creating a dollar cap for consumer risk for credit cards and funds transfers is not viable in this open system, heterogeneous environment. In cases where the electronic process involves transactions between large businesses and consumers, allocation of the risk of fraud or false attribution developed in a way that responds to the better ability of the system operator to spread loss than the consumer. Our context requires a more general structure that goes beyond consumer issues; the problems will not routinely entail consumer protection questions or, even, a licensor with better ability to spread loss. Nor can the loss be placed on the operator of the system as a means of spreading loss since unlike in some other context, the messages here entail in a publicly run system.

One alternative would use communications law rules for allocation of risk. In telephone systems, the proprietor of a system (telephone) is responsible for all calls using that number, even if produced by a hacker engaged in entirely illegal and unauthorized access. The loss allocation there, of course, is between the owner of the system and the system operator. Here, however, it is between two other parties.

5. Some argue that the presumption created by use of an attribution procedure in good faith should be irrebuttable. The Drafting Committee has not adopted this view. In the open marketplace to which Article 2B refers, irrebuttable presumptions are often inappropriate.

SECTION 2B-116. ATTRIBUTION PROCEDURE FOR DETECTION OF CHANGES AND ERRORS; EFFECT OF USE. If the parties use an attribution procedure to detect errors or changes in the content of an electronic record, between the parties the following rules apply:

(1) An electronic message, record or performance that the attribution procedure shows to have been unaltered since a point in time is presumed to have been unaltered since that time.

(2) An electronic message, record, or performance created or sent pursuant to the attribution procedure to detect error is presumed to have the content intended by the person creating or sending it as to portions to which the procedure applies.

(3) If the sender complied with the attribution procedure and the change or error would have been detected had the other party also complied, the sender is not bound by a change or error.

~~(4) If the sender receives a notice required by the attribution procedure which describes the content as received, the sender must review the notice and report any error detected by it in a commercially reasonable manner.~~

Definitional Cross Reference.
"Automated transaction". Section 2B-102. "Consumer". Section 2B-102. "Electronic message". Section 2B-102. "Good faith". Section 2B-102. "Information". Section 2B-102. "Information processing system". Section 2B-102.
"Notifies". Section 1-201. "Party". Section 1-201. "Person". Section 1-201. "Presumed." Section 1-201. "Receive". Section 2B-102. "Record". Section 2B-102. "Value". Section 1-201.

Committee Action:

a. Reviewed without change. (Nov. 1997)

Notes to this Draft:
Edited for clarity. Deletes provision on obligation to respond to a content notice provided through the procedure; the parties should be free to define their own obligations.
Definitional Cross References:
Attribution procedure, Section 2B-102; electronic message, Section 2B-102; party, Section 2B-102; presumption, Section 1-201; record, Section 2B-102.
Reporter's Notes:

1. This Section deals with the effect of attribution procedures dealing with the detection of error or of changes in the content of electronic records. Use of such procedures creates a presumption regarding the accuracy or unchanged nature of the record.. Other presumptions may be appropriate depending on the nature of the procedure and this section does not foreclose their development by courts. The underlying principle is that, if the parties agree to or adopt a procedure, records created or transferred in compliance with that procedure are entitled to enhanced legal recognition. The presumption is rebuttable and is conditioned on the procedure used qualifying as an attribution procedure. This means not only that the procedure was agreed to or adopted by the parties, but that the procedure is commercially reasonable for the purposes for which it was used. The language here comes largely from pending Illinois Digital Signature statute which contains more detailed provisions regarding secure electronic records. Since the principle enacted here hinges on agreement and general considerations of commercial reasonableness, the concept is technologically neutral.

2. The presumptions are limited to issues to which the error detection procedure applies. Proof or disproof of alleged errors in other aspects of an electronic transaction are, with the exception of consumer cases, left to law outside this Article. The common law of mistake obviously applies as does the case law developed for dealing with the legal consequences of garbled transmissions or records that have been allegedly tampered with.

3. The presumptions here not only reflect a deference to the choices of the parties, if commercially reasonable, but the greater certainty available to parties through a commercially reasonable procedure also provides an incentive for commercially reasonable procedures to be developed and deployed in commerce. The development of Internet and similar technology for commerce will occur through numerous, private commercial choices that establish a viable marketplace. The provisions of this Section provide at least limited support for that development.

4. Subsection (a)(3) deals in a limited way with the effect of a failure of one party to conform to an existing attribution procedure. Where the sender complies, but the recipient does not, the sender is absolved from any liability under contract law for an error that would have been detected through compliance.

[SECTION 2B-117. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) In this section, "electronic error" means an error created by an information processing system, by electronic transmission of a record, or by an error of the consumer in an electronic system that did not reasonably allow for correction or avoidance of such errors.

(b) In an automated transaction with a consumer, the consumer is not responsible for an electronic message that the consumer did not intend and that was caused by an electronic error if:

(1) promptly on learning of the other party's reliance on the message, the consumer:

(A) in good faith notifies the other party of the error and that it did not intend the message received; and

(B) delivers all copies of any information received to the other party or, deliver or destroy all copies pursuant to any reasonable instructions received from the other party; and

(2) the consumer has not used or received value from the information or caused the information or value to be made available to a third party.]

Prior Uniform Law: None.

Definitional Cross Reference.

"Copy". Section 2B-102. "Electronic agent". Section 2B-102. "Good Faith": Section 2B-102. "Information". Section 2B-102. "Notify": Section 2B-201. "Party": Section 1-201. "Record". Section 2B-102.

Notes to this Draft:

Moved here from former 2B-117. Deletes burden of proof language regarding the consumer defense on the general principle that this Article should not deal with evidence issues.

Reporter's Notes:

1. Some observers of developing electronic commerce express concern about the capability of errors occurring in the automated systems to impose unexpected losses on persons who are not sophisticated in their operation. In terms of contract creation and performance, common law principles about mistakes provide the basic framework and fundamental principles against which such problems will be resolved. Nevertheless, this Section provides a specific application of those principles to establish a major new protection for consumers tailored for automated transactions. The defense to contract formation created here provides a simple method for an consumer to contest errors in his or her transmissions to a third party. Under common law, errors in contract formation would be resolved under common law theories and, in many instances, in the case of a unilateral mistake, the party making that error is liable for its consequences. This Section enables a consumer to avoid the consequences of the consumer's unilateral mistake by acting promptly to return materials and correct the mistake without receiving value from the other party's reliance on the error.

2. The defense is grounded in equity principles that allow a party to avoid the adverse consequences of its error if the error causes no detrimental effect on another party and does not produce a benefit for the person making the mistake. This is not a right to rescind a contract after agreed to performance is received simply because the consumer changes its mind regarding whether it desires that performance. It deals solely with errors in the creation of a contract. It is not sufficient to establish the defense that the consumer reconsidered its order. Rather, the standard requires that there was no intent to make the order or, at least, to order under the terms transmitted in error. It creates an error resolution system, allowing immediate return to place the other party in the position of having to establish that there was no error.

Illustration 1: Consumer intends to order ten copies of a video game from Jones. In fact, the information processing system records 110. The electronic agent maintaining Jones' site electronically disburses 110 copies. The next morning, Consumer notices the mistake. He sends an E-Mail to Jones describing the problem, offering to immediately return or destroy copies, and does not use the games.. Under this section, performing on these offers means that there is no presumption that the contract was as intended. If it desires to enforce the apparent contract, Jones must prove that there was no error.

Illustration 2: Same facts as above, except that Jones' system before shipping the materials sends a confirmation notice, asking Consumer to confirm that it ordered 110 games. Consumer sees the message and confirms 110 copies. This section no longer applies. If Consumer sees the confirmation request and does not respond, the section also does not apply. In either case, the system adequately allowed correction of the error.

SECTION 2B-118. AUTHENTICATION PROOF; ELECTRONIC AGENT OPERATIONS.

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

(b) Compliance with an attribution procedure for authenticating a record authenticates the record as a matter of law. Otherwise, authentication may be proven in any manner including by showing that a procedure existed by which a party or an electronic agent must engaged in conduct or operations that authenticated the record in order to proceed further in the use it made of the information.

Definitional Cross Reference.
"Contract". Section 1-201. "Electronic agent". Section 2B-102. "Electronic message". Section 2B-102. "Information". Section 2B-102. "Notice". Section 1-201. "Party." Section 1-201. "Receive". Section 2B-102.

Notes to this Draft: Edited for clarity.

Reporter's Notes:

1. Subsection (a) contains a specific application of the general principle that actions of an electronic agent bind the party that selected and deployed the agent for that purpose. An electronic agent is an automated system of response or originating messages or performances. A party that intend to use such systems is bound by its operations. This includes where the operations yield authentication of a record.

2. Under subsection (b), compliance with an attribution procedure for that purpose removes fact questions about whether an authentication occurred. The procedure exists and is used because of an affirmative choice by the party. In addition, the stated effect occurs only if the procedure is commercially reasonable Section 2B-102. Commercial reasonableness is an element of the definition of an authentication procedure.

3. In the absence of use of an authentication procedure, proof of an authentication can occur in any manner. Included in the methods of proving authentication is proof that shows that a process exists that required an authentication in order to enable an automated system to proceed further in use or other operations. This rule reflect on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

SECTION 2B-119. ELECTRONIC MESSAGES: TIMING OF CONTRACT; EFFECTIVENESS OF MESSAGE; ACKNOWLEDGING MESSAGES.

(a) Except as provided in subsection (b), an electronic message is effective when received even if no individual is aware of its receipt. If an electronic message initiated by a party or an electronic agent evokes an electronic message in response, a contract exists:

(1) a response signifying acceptance is received; or

(2) if the response consists of furnishing the information or access to the information, when the information or notice of access is received, unless the originating message prohibited that form of response.

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

(1) A message expressly conditioned on receipt of an acknowledgment does not bind the originator until acknowledgment is received and expires if acknowledgment is not received within a reasonable time after the message was sent.

(2) If the message was not expressly conditioned on acknowledgment and acknowledgment is not received within the time specified for receipt or, in the absence of a specified time, within a reasonable time after the message was sent, on notice to the other party, the originator may:

(i) treat the message as expired and ineffective; or

(ii) specify a further time for acknowledgment and, if acknowledgment is not received within that time, treat the message as expired and ineffective.

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

Committee Vote:

a. Approved current subsection (a) in principle.

b. Rejected motion to delete section containing current subsection (b). Vote: 5-6. (February, 1997)

c. Reviewed without substantive change. (April, 1997) (November, 1997)

Notes to this Draft: Edited for clarity. Incorporates former Section 2B-120 (acknowledgment of messages).

Reporter's Notes:

1. Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages. This rule is also followed in Article 4A (§§ 4A-406, 104(a)).

2. This section does not deal with attribution or liability questions. Questions of attribution are treated in Section 2B-115. For example: if a "response" purports to be from ABC Corp., the message, while effective at a given point in time under this section, does not bind ABC unless the message can be attributed to it under agency law or attribution rules in this Article or common law.

3. In Article 2B, a contract can exist even if no human being reviews or reacts to the electronic message or the information delivered. This adapts traditional theories of consent and agreement to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention; when parties choose to use these systems, there is no reason not to allow contract formation. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

4. Subsection (b) and (c) deal with electronic acknowledgments, providing default interpretations on the legal impact of requiring or requesting acknowledgment. The default rules are limited to acknowledgment of electronic messages. There, the effect of a request for acknowledgment depends on whether the request made the message conditional on acknowledgment or merely requested acknowledge. As a basic principle, the message sender can control the legal effect of its messages if it does so expressly and can specify the required type of response to its messages. Acknowledgment, of course, is not necessarily an acceptance; although an acceptance can and often will serve as sufficient recognition of the message to also as acknowledgment. Acknowledgment confirms receipt. In modern electronic systems, this often occurs automatically on receipt of the electronic message in the recipient's system.

5. This section deals with functional acknowledgments. As outlined in subsection (c), it does not create presumptions other than that an acknowledgment indicates that the message was received. Questions about accuracy of the received message and about time of receipt, content and other issues are not treated. Of course, by agreement the parties can extend this concept to cover such issues.

PART 2

FORMATION AND TERMS

[A. General]

SECTION 2B-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, an agreement is not enforceable by way of action or defense unless:

(1) the agreement contemplates

(A) no or nominal consideration for the rights acquired; or

(B) the total value of any payments to be made and any other affirmative obligations incurred is less than $20,000, excluding payments for options to renew or buy; or

(2) there is a record authenticated by the party against which enforcement is sought or to which that party manifested assent, sufficient to indicate that a contract has been made and to reasonably identify the copies or subject matter of the agreement.

(b) A record is not insufficient under subsection (a)(2) merely because it omits or incorrectly states a term, but the contract is not enforceable beyond the subject matter or copies shown in the record.

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

(1) ~~if it is a license for a term of less than 90 days;~~

~~(2)~~ performance has been tendered by one party and accepted by the other; or

(2) the party against which enforcement is sought admits in its pleading or testimony or otherwise in court that a contract was made but the agreement is not enforceable

under this provision beyond the copies or subject matter admitted.

<u>(d) Between merchants, if within a reasonable time a record in confirmation of the agreement and sufficient against the sender is received and the party receiving it has reason to know its contents, the record satisfies the requirements of subsection (a) against the party receiving it unless notice of objection to its contents is given in a record within ten days after the confirming record is received.</u>

(e) The provisions of Section 2B-307 or 2B-502 may not be varied except by a record that is:

(1) sufficient to indicate that a contract has been made; and

(2) authenticated or prepared and delivered to the other party by the party against which enforcement is sought.

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

(g) This article states the only formal requirements for enforceability for agreements covered by this article as a matter of contract law under the laws of this state.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Authenticate". Section 2B-102. "Contract". Section 2B-102. "Court". Section 2B-102. "License". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Rights". Section 1-201. "Term". Section 1-201. "Value". Section 1-201.

Committee Votes:

1. In debate on Article 2 at the Annual Meeting, repeal of the statute of frauds in that Article was sustained by a narrow vote (**65-52**). Subsequently, the Article 2 drafting committee voted to include a statute of frauds in that article.

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

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

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

5. By **consensus**, the Committee agreed to move former (f) on enforceability without filing into another section in part 5.

6. At the 1997 Annual Meeting, the sense of the house motion passed to harmonize the three articles with respect to the judicial denial requirement. **Passed**

7. At the 1997 Annual Meeting, a sense of the house motion to harmonize by deleting the "denial of agreement" exception was **rejected.**

8. After extended discussion, the Committee did not include a requirement that the party asserting the statute plead the non-existence of a contract. (September, 1997)

Notes to this Draft: Reorganized for clarity. Subsection (d) reflects the rule from current Article 2 on confirming memoranda; proposed to enhance correspondence with that statute. Draft also proposes deletion of the short term license exception based on view that issues it addressed are resolved by the confirming memorandum provision. The length of the license has no bearing on the value of the transaction or the risk of fraud.

Selected Issues:

a. Should the Committee approve subsection (d) which comes from current Article 2?

b. Should the dollar limit in (a) be reduced to $5,000 as I proposed Article 2?

Reporter's Notes:

1. *General Policy and Background.* A statute of frauds provides important protections in an area of commerce focused on intangible subject matter. While there is some movement away from a statute of frauds in sales of goods law, the need for statute of frauds protection is greater in information contracts than in the sale of goods. This is true because of the character of the subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights in one party while rights or privileges to use or to possess a copy vest in another party. These considerations augment arguments that propose that providing some protection against fraudulent practices and unfounded claims justify the cost of the statute. All of the areas of commerce governed by Article 2B were previously subject to statute of frauds provisions, whether under Article 2 or under general contract law. There has been little or no support outside academic contexts for repeal of the statute of frauds in reference to information transactions.

Current law imposes a statute of frauds in all Article 2 and 2A transactions as well as under the law of forty seven states for transactions outside the UCC. Restatement (Second) of Contracts ch. 5, Statutory Note, at 282 (1979). The rules for compliance and scope vary. Copyright law requires a writing for an enforceable transfer of a copyright. 17 U.S.C. § 204. A similar rule applies for patents. 35 U.S.C. § 261. A transfer of property rights occurs when there is an “assignment” or an “exclusive license.” The federal rules do not apply to transfers of rights in data. For discussion of the difference between data and copyright in data compilations, see Feist Publications, Inc. v. Rural Telephone Service Co., 111 S. Ct. 1282 (1991). Federal rules do not apply to nonexclusive licenses since a nonexclusive license is not a “transfer” of copyright ownership. However, in copyright law, a nonexclusive license that is not in writing may lose priority to a subsequent transfer of the copyright.

2. *Basic Rule: Subject Matter and Value.* The requirements for satisfying the statute must be tailored to the subject matter and the type of transactions involved. Article 2B focuses on a core requirement that the record, when required, must reasonably describe the subject matter and copies involved in the contract. This leaves significant elements of scope of a license not required in the required documentation. Disputes about these other elements of scope, however, may indicate that no contract exists. See Section 2B-202. Obviously, if not contained in the required record and not subject to dispute, the remaining elements of scope must be proven by parol evidence, as must other terms of the agreement.

3. *Basic Rule: Transactions Covered.* A record is required only if the transaction contemplates payments or other value in excess of $20,000. Unlike in the sale or lease of goods, the value of transactions in information is not measured solely in terms of monetary transfers. The rule does require, however, that value determined based on payments or affirmative obligations to deliver value to another party. Thus, the value of the contract is not measured by valuation of any obligation to not disclose confidential information.

The $20,000 amount excludes from coverage the large number of small value transactions which in ordinary practice frequently do not entail contractual formalities and do not present the same level of risk in the event a fraudulent claim is made. It compares to the $500 limitation in current Article 2.

Illustration 1: Booker acquires releases from various parties to enable completion and publication of its books. The releases are often not acquired for any payments to the releasing party. This section allows enforcement without a record because total payments were less than $20,000, i.e., no payments.

4. *Basic Rule: Record and Assent.* There is no requirement that the record be retained. Obviously, on questions of proof, retaining a record of contract term is good practice, but this Act merely requires that the record exist at one point in time. In electronic systems, 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 must be in this form. In copyright law, the cases do not impose a minimum time period for how long a copy must exist, but do distinguish between a copy and

an ephemeral manifestation of information. That distinction carries forward into Article 2B.

The record must either be authenticated or the party to be bound must manifest assent to it. The basic theme of a statute of frauds is that there be a record that documents the existence of a contract. Especially in electronic settings, assent to a record suffices to establish this effect, whether or not the assent qualifies as an authentication under 2B-102. This rule is consistent with subsection (d) which allows a confirming record to satisfy the statute as between merchants and reflects current law in Article 2.

A party 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.

5. *Transactional Exceptions: Performance and Admissions.* There are several circumstances in which the requirements of subsection (a) are moot because of other events in the transaction or the litigation. Two are described in subsection (c). The first, which is a variation of current Article 2, obviates the requirements of the statute of frauds to the extent that performance has been offered and accepted. This event adequately documents the existence of the contract to the extent of the performance and the minimal record required under the statute is not necessary. The second, also derived from Article 2, supplants the statutory requirements to the extent a person admits the existence of the contract in a sworn statement in connection with litigation. Here, again, the statement confirms the existence of the contract and supplants the writing requirement.

6. *Transactional Exceptions: Confirming Memoranda.* As in Article 2, this Section provides that, as between merchants, confirming memoranda satisfy the statute if the receiving party does not object within ten days after their receipt. This validates practice in a number of industries where the volume of transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum can be I various forms, but it serves to place the other party on notice that a contract has apparently been formed. This memorandum has a validating effect only as between merchants. It must be considered in connection with Section 2-201(c)(1) which deals more broadly with performance offered by one party and accepted by the other.

7. *Transactional Exceptions: Other Agreements.* Subsection (f) makes clear that trading partner or similar agreements are enforceable to alter the statute of frauds issue. The parties can agree to conduct their further business without there being a need for additional, authenticated writings. That prior agreement satisfies the statute and the policies of requiring that there be some indication that a contract was formed.

8. *Other Rules.* The statute of fraud provisions here supplant all other existing statute of fraud provisions pertaining to Article 2B subject matter. Thus, the one year of performance rule found in many state common law rules does not apply to Article 2B transactions.

SECTION 2B-202. FORMATION IN GENERAL.

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

(b) If the parties intend to make a contract, the following rules apply:

(1) An agreement sufficient to constitute a contract may be found even if the time that the agreement was made cannot be determined.

(2) Even if one or more terms are left open or to be agreed upon, or one party reserves the right to modify terms, a contract does not fail for indefiniteness if there is a reasonably certain basis for giving an appropriate remedy.

(c) Subject to Section 2B-203, in the absence of conduct or performance to the contrary, material disagreement about a critical term such as scope indicates that there is no intent to make a contract. ~~However, a contract is not formed if the parties disagree about a material term scope.~~

(d) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is fixed or agreed to, a contract is not formed if the term is not fixed or agreed to. In that case, each party shall return or, with the consent of the other party, destroy all copies of information and other materials already received. The licensor shall return any portion of the contract fee paid for which performance has not been received and retained by the licensee. The parties remain bound with respect to any obligation of confidentiality, or similar obligations, to which the parties have agreed.

Uniform Law Source: Section 2-204; 2-305(4); 2A-204.

Definitional Cross Reference:
"Agreement". Section 1-201. "Contract". Section 2B-102. "Contract fee". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Receive". Section 2B-102. "Remedy". Section 1-201. "Term". Section 1-201.

Committee Votes:

a. Committee voted unanimously to adopt the section in principle. (September, 1996)

b. Reviewed in November, 1997.

Notes to this Draft: Edited for clarity and to bring into closer conformance to existing Article 2. Subsection (c) changes reflect input of various parties regarding the treatment of scope issues on contract formation as compared to the treatment of material conflict over material terms.

Reporter's Note:

1. *Basic Rule.* Subsection (a) conforms to current Article 2 and continues without change the basic policy of recognizing any manner of expression of agreement, oral, written, electronic, or otherwise. It follows the language of current Article 2, but adds an express reference to the operations of electronic agents as a form of establishing or showing agreement.

This Article separates two distinct issues. One, discussed primarily in this Section and Section 2B-203, deals with whether a contract was formed. The second concerns what terms govern that contract. That issue is discussed in reference to records containing purported contract terms in Section 2B-207, 2B-208, and 2B-209. In many cases, the creation of a contract and the specifications of its terms are simultaneous events. But, increasingly in modern commerce, the two are partially separable processes. That is true, for example, where the parties exchange conflicting forms and subsequently perform in a manner that creates a contract.

2. *Electronic Agents.* Article 2B clarifies that a contract can be formed by the operations of electronic agents. An electronic agent is an automated system selected or used by a person for purposes of achieving contract-related effects such as offer, acceptance, performance, and the like without review by a human being. The fact that the operations of an electronic agent are attributable to a party that selected the agent is confirmed in Section 2B-115.

Ascribing this effect to an electronic agent can be described in several ways. One would observe simply that it gives force to a choice made by the party. That is, the party selected and deployed the automated system for a particular purpose and this Article acknowledges and enforces that purpose. Alternatively, it could be described as giving force to a form of indirect acceptance of a contractual relationship. The agent is in effect a mere extension of the person utilizing it and its actions constitute the actions of the individual. Under either approach, the basic theme is that the automated agent's operations bind the agent's creator or user. In article 2B, reference is simply made to the operations of agents as having specified effects in law and as being attributable in law under particular circumstances to a particular party.

3. *Open Terms and Layered Transactions.* Although recognizing a broad range of indicia of agreement, the standards adopted here require distinguishing preliminary negotiations or incomplete efforts to make a deal that do not create a contract and actions or statements that manifest an intent to be bound even though terms are left open or the time of formation cannot be determined. Ultimately, the distinction here as under current Article 2 from which these rules derive, often requires consideration of all of the circumstances relating to the alleged agreement.

As made clear in subsection (b), the distinction among these situations lies in the question of the existence of an intent to contract as manifested by the language, conduct or operations of the parties or their agents. Given an intent to contract and agreement on terms or performance that gives an adequate basis to grant a remedy, a contract can be formed despite the existence of terms remaining to be agreed and terms that are left open, that is, not addressed by the parties. In the latter case, this Article, general expectations of the trade, and general intellectual property law often provide background rules that flesh out the details of the relationship.

The background rules will typically not apply if the parties in fact disagree about the particular term. While disagreement may not bar the creation of the contract, it often indicates not merely an intent to rely on background law, but separately stated intentions to rely on the conflicting approaches asserted by the respective parties.

The rules of this Section provide the foundation for the recognition here, as in existing Article 2, of a layered process of contracting which typifies many areas of commerce and many major contractual relationships. There is no requirement that all of the terms and a complete agreement to a contract occur at one point in time. Rather, as this Article recognizes, contracts are often formed over a period of time, and contract terms are very often developed and adopted during performance of the contract, rather than entirely at the outset. In some cases, these later adopted terms might conceptually be viewed as a modification of an agreement, but it is often the case that the parties expect to arrive a terms and adopt records later in the deal. Rather than a modification, these are more aptly described as a fulfillment of prior expectations or normal practice. This Section recognizes that phenomenon and Section 2B-207 and 2B-208 provide some guidance on its operation with respect to the adoption of terms. If the parties do not intend to be bound unless the later terms are agreed to, subsection (d) provides some guidance for unwinding the relationship when ultimate disagreement occurs.

4. *Material Terms and Scope of a License.*

Subsection (c) clarifies an obvious principle, the absence of which as express law would create a risk of forcing the creation of contracts on parties who in fact have not agreed. It provides that simply that a material disagreement about an important (material) term indicates that no intent to enter a contract exists at that time. This rule is important in reference to general formation concepts in an environment where open terms and to be agreed terms are permitted. It is also important in the treatment of an exchange of purported offers and acceptances that contain varying terms. As described in Section 2B-203, a contract can be formed by an acceptance that varies the terms of the offer. Yet, if is clear that not all variances indicate an intent to contract. This Section makes the simple but important point that material conflict on a critical term indicates a lack of agreement. See White & Summers, The Uniform Commercial Code § (1995) (discussion of battle of forms).

In information commerce, the most significant terms of a contract deal with the scope of the license. Scope is a defined term. See Section 2B-102. It goes to the fundamentals of the transaction and what the licensor intends to transfer and what the licensee expects to receive.. Indeed, in many respects, in this field of commerce, the contract is the product and scope is the basic product description. Disagreements about this fundamental issue are like ordering a Corvette and confirming purchase of a Volkswagon. They indicate fundamental disagreement about the nature of the contract and its subject matter.

This Section does not require complete and detailed agreement about scope in order to form a contract. It does confirm, however, that material disagreement about scope indicates a lack of an agreement sufficient to form a contract.

SECTION 2B-203. OFFER AND ACCEPTANCE; VARYING TERMS; CONDITIONAL OFFERS.

(a) Unless otherwise unambiguously indicated by the language of the offer or the circumstances:

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

(2) An order or other offer for prompt or current shipment ~~performance~~ invites acceptance either by a prompt promise to ship ~~perform~~ or by the prompt or current shipment ~~performance~~ of conforming or non-conforming information, but a shipment ~~performance~~ of non-conforming information is not an acceptance if the party that provides the shipment information seasonably notifies the transferee that the shipment ~~performance~~ information is offered only as an accommodation to the other party.

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

(b) ~~Except as provided in subsection (c),~~ A definite and seasonable expression of acceptance in a record may create a binding obligation even if the acceptance contains terms that vary the terms of the offer, but if the acceptance materially conflicts with a material term of the offer or otherwise materially alters the offer, no contract is formed by the purported acceptance. If the acceptance is in a record that contains varying terms, the following additional rules apply:

(1) If the acceptance materially conflicts with a material term of the offer or otherwise materially alters the offer, no contract is formed unless from all the other circumstances including the conduct of the parties, it appears that an agreement existed. If a contract is formed under this subsection, the terms of the contract are determined:

(A) under Section 2B-207 or 2B-208, if one party agrees, by manifesting assent or otherwise, to the other party's terms other than by the terms of the acceptance that contained the varying terms; or

(B) under Section 2B-209 if paragraph (A) does not apply and the contract is formed solely by conduct.

(2) If there is no conflict with a material term and no material alteration, the terms of the contract are those of the offer as adopted under Section 2B-207 or 2B-208. Non-material additional terms contained in the acceptance become part of the contract but only if they are not objected to by the offeror within a reasonable time after notice of them is received.

(c) An offer or acceptance that because of the circumstances or the language is conditional on agreement by the other party to the terms of the offer or acceptance precludes contract formation except by agreement, by manifest assent or otherwise, to its terms. However, the following rules apply:

(1) Such conditional language in a standard form precludes the formation of a contract only if the party proposing the form acts in a manner consistent with that language, such as by refusing to perform, to permit performance, or to accept the benefits of the contract until the proposed terms are accepted.

(2) If a party agrees, by manifesting assent or otherwise, to an effective conditional offer in a record, it adopts the terms of that offer under Section 2B-207 or 2B-208, as applicable.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Information". Section 2B-102. "Notifies". Section 1-201. "Party". Section 1-201. "Receive". Section 2B-102. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Vote:

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

Notes to this Draft:

Edited for clarity. Subsection (a)(2) was edited to conform to 2-206(1)(b).

Reporter's Notes:

1. *Basic Premise and Coverage.* This Section deals with three sets of recurrent issues involving offer and acceptance in the creation of a contract: general methods of indicating acceptance, acceptances that vary the terms of the offer, and condition offers or acceptances. While the Section provides some guidance on determining the terms of a contract if one is formed, this Section must be read in connection with Section 2B-207, 2B-208and 2B-209 for that purpose.

2. *Methods of Acceptance and Formation.* Subsection (a) conforms to existing Article 2-206(1). It allows acceptance of an offer by a variety of means, including the exchange of conflicting standard forms and behavior, but also recognizes the right of the offeror to control the terms and nature of the acceptance if it does so unambiguously in the offer itself.

3. *Acceptance that Varies the Terms of an Offer.* Subsection (b) follows Article 2-207 and rejects the

mirror image rule which would permit a binding contract only if the acceptance fully matches the offer. This allows contract formation by offer and acceptance even though the acceptance varies the terms of the offer. That recognition corresponds to commercial practice throughout all areas of commerce. As in Article 2, the varying acceptance must be an acceptance; no contract is formed by a counteroffer unless that counteroffer is accepted.

Contract formation by an acceptances that varies the terms of an offer creates several conceptual and practical issues. The problems are not that the parties have paid inadequate attention to their contract, but that legal concepts must be fitted to a setting in which commercial practice does not necessarily focus on the details of conformance between an offer and an acceptance. In such unstructured settings, the purpose of the rules of contract formation and the rules that determine the terms of an agreement is to provide fair guidance that corresponds to the type of commercial issues that must be resolved in this open or unstructured environment.

3. *Varying Terms: Material Variance.* One issue, addressed in subsection (b), concerns how courts distinguish cases of a contract formed by a varying acceptance and cases where the variance indicates that no contract can reasonably be said to be formed by the offer and acceptance alone. Consistent with Section 2B-202, material variance, either a conflict with a material term or a material modification of the offer, precludes formation based on the purported acceptance. This reflects the basic policy that a contract requires a meeting of the minds; it is an underlying premise of existing Article 2 rules, although not specifically stated in that statute. The rule protects both parties in that it precludes the formation of a contract when a material disagreement about terms exists. What constitutes a material term or a material alteration of the offer depends on the context, including what the parties might reasonably expect to find in contracts in light of applicable trade use and course of dealing. Comments to Section 2-207 contains a list of what the drafters then thought would be material, but that list may or may not be applicable in modern commerce. In licensing, however, scope is always a material term since it defines the focus of the contract itself.

The rule does not preclude formation of a contract other than through the offer and purported acceptance. It allows contract formation by conduct or through a showing of other circumstances indicating agreement, even if the formal offer and acceptance materially diverge. This is spelled out in subsection (b)(1). The circumstances adequate to show agreement despite material conflict in the records exchanged by the parties as a purported offer and acceptance correspond to the broad concept of contract formation outlined in Section 2B-202. The relevant standard contemplates an inclusive, rather than limited consideration of relevant circumstances.

If a contract is formed based on the circumstances, the important issues center on what terms are applicable to the contract. By hypothesis, the records exchanged as an offer and acceptance materially diverge. Subsection (b)(1) contemplates two distinct approaches to determining the terms of the contract. The first arises if one party agreed to the terms of the other. In that case, the terms, if in a record, are adopted pursuant to and subject to the limitations in Section 2B-207 and 2B-208. The agreement to these terms can be manifested in any manner that is relevant except that it cannot be found solely in the "acceptance" that contains a materially varying term. thus, for example, if the parties exchange records that contain a material conflict, but one calls the other and agrees to either the other party's form or to otherwise delineated terms, the contract forms around those terms.

The second circumstance is where the exchanged offer and acceptance materially conflict, but a contract is formed by conduct. This places the relationship under Section 2B-209. That Section requires a court to apply general interpretation rules to discerning the terms that are part of the contract, unless the cases involves conflicting standard forms. In that latter situation, Section 2B-209 applies a "knock out" rule modeled on current Section 2B-209.

4. *Varying Terms: Non-Material Variance.* If the offer and acceptance do not materially vary, they form a contract. Subsection (b)(2) indicates that, as under general contract law and current Article 2, the terms of the contract are the terms of the accepted offer. Subsection (b)(2), however, also allows for the introduction of non-material additional terms from the acceptance unless the offeror timely objects to those terms. This rule is taken from existing Article 2. It does not apply to terms that provide conflicting treatment of the same subject matter. Where the offer and acceptance conflict on a term and the conflict or term is not material, the contract is governed by the terms of the accepted offer.

5. *Conditional Offers and Acceptances.* As recognized in subsection (c), as a matter of general contract law, a person has a right to state preconditions for its offer or its acceptance. The most common conditional offer or acceptance is one that conditions its effect on adherence to its own contractual terms. In effect, read literally, these conditional offers or acceptances state: "there is no contract except on the terms and conditions that I propose." There is no principle in contract law that would generally preclude a party from engaging is such conditional offers or acceptances and being able to rely on the conditional terms.

Subsection (c) recognizes that these conditional statements are entitled to recognition. Subsection (c)(2) provides the necessary corollary to this proposition. Agreement to the terms of a conditional offer or acceptance by the other party creates a contract based on the terms of that conditional offer or acceptance.

While language of condition should generally be acknowledged and enforced by courts, use of conditional language in standard form offers and acceptances creates special problems. The typical scenario occurs in a traditional "battle of forms" transaction in which either or both parties make the acceptance or offer expressly conditional on adherence to its specific contractual terms, but nevertheless proceed to engage in performance recognizing a contract irrespective of any acceptance of the terms of condition. Subsection (c) treats this as a question involving the effectiveness of the conditional language. There are three scenarios where forms are exchanged that contain varying terms and one or both contains conditional language limiting their legal effect in forming a contract to the condition that the other party accept all of the stated terms.

In the first, the party receiving the conditional form is contacted by the other party and assents to the conditions. Under these circumstances, the terms of the agreed to form govern the contract that was created.

In the second, nothing more happens other than the exchange of forms (e.g., no performance and no acceptance of a form by the other party), no contract exists. Since there is no performance, the behavior of the party stating the condition is consistent with that condition and the standard form cannot form a contract unless it is accepted by the other. No contract exists.

In the third, both parties proceed to perform recognizing the existence of a contract. Under current Article 2 law, it is not clear how this situation would be examined in the case where one of the parties' forms was conditional. Some would argue that the performance of the one accepts the conditional terms of the other. Other courts reject that analysis. Under subsection (c)(2), the fact that the person tendering the conditional form performed as it there were an agreement renders the conditional language ineffective. To be effective language of condition in a standard form, the party's behavior must be consistent with the conditions. Thus, the situation is shifted to a simple exchange of forms containing varying terms.

Illustration 1. Purchaser sends a standard order form indicating that its order is conditional on the Licensor's assent to terms on the form. Licensor ships with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. In this case, neither party acted consistent with the language of condition. A contract exists, however, based on conduct (e.g., shipment and acceptance). The terms are governed by 2B-209. If 2B-209 applies, the conflicting terms drop out.

Illustration 2. In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser of the conditions of shipment. It does not ship until Purchaser agrees to terms. Until that occurs, there is no contract. If it occurs, the contract exists based on terms actually agreed to (e.g., the Licensor's terms). See 2B-209 regarding the superseding effect of actually conditional offers.

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

SECTION 2B-204. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS.

(a) Operations of one or more electronic agents which confirm the existence of a contract, or indicate agreement, form a contract even if no individual was aware of or reviewed the actions or results.

(b) In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents. A contract is

formed if the interaction results in the electronic agents engaging in operations that confirm the existence of a contract or indicate agreement. The terms of the contract are determined under Section 2B-209(b).

(2) A contract may be formed by the interaction of an electronic agent and an individual.

(A) A contract is formed if an individual has reason to know that the individual is dealing with an electronic agent and the individual takes actions that

(i) the individual should know will cause the agent to perform, provide benefits, or permit use of the information or access that is the subject of the contract, or

(ii) are clearly indicated as constituting acceptance regardless of other expressions or actions by the individual to which the electronic agent cannot react.

(B) The terms of the contract are determined under Section 2B-207 or 2B-208, as applicable, but do not include terms provided by the individual in a manner to which the electronic agent could not react.

Definitional Cross Reference:
"Agreement". Section 1-201. "Automated transaction". Section 2B-102. "Contract". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Term". Section 1-201.

Committee Vote:
a.Approved in principle. (September, 1996). Reviewed without change. (Nov. 1997)

Notes to this Draft:
Edited for clarity. Deleted the illustrative actions previously in 204(b)(1), which will be moved to the comments.

Reporter's Notes:

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

Illustration 1. Tootie is an electronic system for placing orders for Home Shopping Network. When you dial the number, a voice comes on line instructing you to indicate your card number, the item number you will purchase, the quantity, your location, and other items. You indicate this by striking keys and numbers on your telephone. Tootie automatically orders shipment. Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the dresses being order if there is a 120 day no questions return policy. Otherwise: "I don't want the damn things." Tootie orders shipment.

There is a contract. The verbal addition or condition is ineffective. Stating conditions clearly outside the capability of the electronic agent to make a reaction 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 2. 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.

2. As between electronic agents operations that signify a contract form an enforceable contract. The automated agents were selected or used by the parties to achieve these results and Article 2B acknowledges the efficacy of the choice in law. See discussion in notes to Section 2B-202. The agents act within parameters set by their programming and selected by their principals. The terms of the contract are 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-205. FIRM OFFERS. An offer by a merchant to enter into a contract made in an authenticated record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term providing assurance that the offer will be held open which is contained in a standard form supplied by the party receiving the offer is ineffective unless the party making the offer authenticates the term~~] [manifests assent to that term]~~.

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

Definitional Cross Reference:

"Authenticate". Section 2B-102. "Contract". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Actions:

a. Committee voted unanimously to approve this in principle. (September, 1996)

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

c. Reviewed in April 1997 with no substantive changes.

Notes to this Draft: Edited to correspond to current Article 2. The Committee should determine if the shift back to "authenticate" a term is appropriate.

Reporter's Note: This Section adopts existing Article 2.

SECTION 2B-206. RELEASES; CONTRACTS FOR IDEAS.

(a) The following rules apply to releases of informational property rights:

(1) A release of informational property rights in whole or in part is effective without consideration if:

(A) it is contained in a record to which the releasing party manifested assent and which identifies the rights released; or

(B) it is enforceable under other law including estoppel, implied license, or other rules allowing enforcement of a release.

(2) A release continues for the duration of the rights released if the agreement does not specify its duration and does not require on-going affirmative performance:

(A) by the party granting the release; or

(B) by the party receiving the release, except for minor acts [such as giving acknowledgments or credits in subsequent uses of the information or providing a small number of copies of works utilizing the released information].

<u>(b) The following rules apply to submissions of informational content or an idea for the creation, development, or enhancement of information:</u>

<u>(1) If the submission is other than under a pre-existing agreement for such submission:</u>

<u>(A) A contract or obligation does not arise and is not implied from the mere receipt of an unsolicited disclosure. Engaging in a trade or industry that by custom or conduct regularly acquires ideas for the creation, development, or enhancement of information does not in itself constitute an express or implied solicitation of such information.</u>

<u>(B) If the recipient notifies the person making the submission that it maintains a procedure to receive and review such submissions, no contract is created unless:</u>

<u>(i) the information or idea is submitted and accepted pursuant to that procedure; or</u>

<u>(ii) the recipient expressly agrees to contractual terms concerning the submission.</u>

<u>(2) Unless the agreement expressly provides otherwise, an agreement to disclose an idea does not create an enforceable contract if the idea is not confidential, concrete, or novel to the trade or industry.</u>

Definitional Cross Reference:

"Agreement". Section 1-201. "Information". Section 2B-102. "Informational property rights". Section 2B-102. "License". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Release". Section 2B-102. "Rights". Section 1-201.

Committee Action: Reviewed without substantive revision.

Notes to this Draft: Edited for clarity. Bracketed language proposed for removal to comments. Material on submissions moved here from performance sections.

Reporter's Note:

1. *General Scope and Rationale: Releases.* Informational property releases are important aspects of practice in all of the information industries. They are a form of a license, but are ordinarily less formally negotiated or established and frequently obtained with little or no consideration paid over to the releasing party. While a release is a license it is a simple agreement not to sue, rather than a commercial transaction involving the elements present in a commercial license. The term "release" is defined in Section 1-102.

The release does not relate to claims based on breach of contract, but refers to releases of intellectual property and similar rights.

2. *Enforceability.* Subsection (a)(1) adopts the view that a release is enforceable without consideration, but places a limitation on that concept as an affirmative premise by focusing on a release contained in a record to which the releasing party manifested assent. The section clarifies existing law. It provides that a release of informational property rights in a certain form is enforceable, but does not alter other existing law with respect to when releases are enforceable.

This section applies to releases that occur in common "chat room" and "list service" systems in Internet. In these situations, it is common to indicate that participation in the service gives permission for the use of materials submitted. Arguably, these relationships are supported by consideration; this section makes clear that releases in such situations are enforceable based on assent to the record.

Illustration 1. West operates an on-line chat room. It uses comments of users in its monthly newsletter. The first time an individual joins the chat room, the screen stated that: "By participating in this on-line conversation, you grant West the right to use your comments as edited in subsequent publications in any medium." By joining the conversation, the participant releases its rights in its copyright comments for the purposes stated. Subsection (a) eliminates the need for consideration. The act of participating constitutes manifesting assent if the release language was prominent and called the party's attention.

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

3. *Duration.* Subsection (a)(2) is a specific application of rules in Section 2B-308, creating presumption that some single or no-payment contracts create rights for the duration of the underlying information property right if no definite term is specified. This deals with issues common to industries where parties develop products in part on reliance on general releases or waivers that do not contain specific duration terms. Leaving those cases to the general "reasonable time" standard in Section 2B-308 would create unwarranted and costly uncertainty.

4. *Idea Submissions.* Subsection (b) deals in a limited way with a problem that exists in all of the industries to which this Article applies: submission of informational content not pursuant to an agreement. It provides that, if a procedure exists for receipt and review of such submissions to which the submitting party is referred, no contract exists unless the submission was pursuant to that procedure or compliance with the procedure was waived by the licensee. This leaves undisturbed a vast array of doctrines dealing with adequacy of consideration, equitable remedies, and the like, but clarifies the legal effect of the submission in contractual doctrine.

[B. Terms of Records]

SECTION 2B-207. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in Section 2B-208, a party adopts the terms of a record, including a standard form, if the party agrees, by manifesting assent or otherwise, to the record:

(1) before or in connection with the initial performance or use of or access to the information; or

(2) at any time after the party has had an opportunity to review the record, if the parties commenced performance or use with the expectation that the agreement would be represented in whole or in part by a record that the party did not have an opportunity to review or that had not been completed at that time.

(b) If a party adopts the terms of a record, including a record that is a standard form, the terms of the record become terms of the contract without regard to the party's knowledge or understanding of individual terms of the record. However, a term that is unenforceable for failure to satisfy a requirement of this article or other applicable law, such as a requirement for conspicuous language, is not enforceable.

Uniform Law Sources: Common law decisions; Restatement (Second) of Contracts 211.

Definitional Cross Reference:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Votes:

a. Rejected a motion to add retention of benefits as manifesting assent.

b. Rejected a motion to make specific reference to excluding terms that are unconscionable in addition to general exclusion under section 2B-109. (September, 1996)

c. Consensus to expand the section to cover all records, rather than merely standard forms, provided that it be made clear that standard forms are covered. (September, 1996)

d. Reviewed without substantive change. (April, 1997)

Notes to this Draft: Edited and reorganized for clarity

Reporter's Notes:

1. Article 2B deals with the terms of a contract and with standard forms in three sections. This Section and 2B-208 deal with standard forms in "single form" cases. Section 2B-209 deals with cases where the records exchanged do not create a contract, but a contract exists because of the conduct of the parties indicating agreement. These sections do not address formation issues. If no contract is formed under other rule in this Article, the sections are inapplicable. What is addressed here is, given a contract, what are the terms?

2. A basic policy theme in Article 2B is that, while some contracts are formed and their terms delineated at a single point in time, in many transactions a rolling process occurs in which terms are provided, clarified or introduced at more than one point. Formation and term definition is a process, rather than a single event.

When a party agrees or assents to a record, whether a standard form or not, Article 2B clarifies the simple principle that this adopts the terms of the record. This section solidifies the enforceability of standard forms in commercial deals. This confirms an important aspect of commercial law. The principle, already followed in the vast majority of modern case law, flows from the belief that in the absence of fraud, unconscionable or similar conduct, commercial parties are bound by the writings to which they assent, without being able to later claim surprise or a failure to read the language presented to them. Assent does not depend on the party actually reading the terms. As subsection (a) clarifies, however, the adoption of terms does not circumvent separate rules requiring that a term be conspicuous.

Mass market transactions entail some need for protections which are provided in 2B-208.

3. This section applies the principle of enforceability to all commercial records. A party is bound by a record if it agrees to the record, including agreement by manifesting assent to the record. Given the definition of manifesting assent, this gives three ways of establishing that a record is binding. The most restrictive is "manifested assent." This concept focuses on objective manifestations of assent and adopts procedural safeguards allowing the party bound by the standard form an opportunity to review terms and to reject the contract if the terms are not acceptable. The two safeguards are in the concept of "opportunity to review" (see 2B-112) and "manifests assent" (see 2B-111). A party cannot manifest assent to a form or a provision of a form unless it has had an opportunity to review that form before being asked to react. Except in contract modifications, an opportunity to review does not occur unless the party has a right to return the subject matter, refuse the contract, and obtain a refund of fees already paid (if any). The second theme involves signing the record (authentication). Historically, this has been sufficient to show assent. Third, there is the possibility of "agreement to the record." This is more subjective and deals with the entire context. A party in a context covered by this section would generally prefer to construct its transaction to fall within the either of the other provisions.

4. Subsection (b) rejects the idea that a contract and all of its terms must be formed at a single point in time. Case law adopts a more fluid conception of the process of contracting, where parties define the agreement over a period of time that is not constrained to an instantaneous "closing" in most cases. See, e.g., Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997). This rolling contract concept reflects that, in many agreements, terms are considered at two different points in time (some at the initial discussion and others when the products arrives), while in still others, terms may continue to be created and modified over time.

Terms can and often are created in modern commerce by assent after beginning performance. Thus, in the entertainment industry and in many development contracts, contract terms are developed and drafted **while** performance occurs, not before performance begins. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section accommodates that process as well as the common practice of providing terms for assent at some point prior to the initial performance, even if not at the first step in the agreement process.

SECTION 2B-208. MASS-MARKET LICENSES.

(a) A party adopts the terms of a mass-market license for purposes of Section 2B-207(a) only if the party agrees to the license, by manifesting assent or otherwise, before or in connection with the initial performance or use of or access to the information. However, a term does not become part of the contract:

(1) if it is unconscionable; or

(2) subject to Section 2B-301 with regard to parol or extrinsic evidence, if it conflicts with ~~negotiated~~ terms to which the parties to the license expressly agreed.

(b) If a party does not have the opportunity to review a mass-market license before becoming obligated to pay for the information and does not agree, by manifesting assent or otherwise, to the license after having that opportunity, the party is entitled~~, on returning all~~

~~copies of the information dealt with by the license or destroying such copies pursuant to the licensor's instructions,~~ to:

(1) refund;

(2) reimbursement of any reasonable expenses incurred in complying with any instructions of the other party for return or destruction of the information or, in the absence of such instructions, reasonable expenses in connection with return of the information; and

(3) compensation for any foreseeable loss caused by the installation, including any reasonable expenses incurred in restoring the particular information processing system to its condition prior to the required installation, if the information must be installed in an information processing system to enable review of the license and the installation alters the licensee's system or information contained in the system but does not return the system to its original condition when the information is removed.

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

Definitional Cross Reference:

"Agreement": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 2B-102. "Information": Section 2B-102. "Information processing system": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Manifest assent: Section 2B-112. "Mass-market license": Section 2B-102. "Party": Section 1-201. "Refund": Section 2B-102. "Term": Section 1-201.

Committee and other Votes:

a. During Article 2 discussion at the annual meeting in 1996, a motion to delete special treatment there for consumer was defeated based in part on Article 2 Drafting Committee assurances that Article 2 would use an objective test.

b. Adopted by a vote of 10-1 a motion to delete the reference to terms consistent with "customary industry practice."

c. Adopted by a vote of 12-0 a motion to delete a safe harbor for terms giving no less rights than under a first sale.

d. Voted 12-0 to support an approach (b) that focuses on the perspective of the party proposing the form.

e. Rejected a motion to adopt ABA proposal to substitute refusal term concept with an affirmative, expanded refund right that covers cost of return and return of system to original state. Vote: 2- 6 (April, 1997)

f. Failed to adopt a motion to add the expanded refund right and restrict the refusal term concept to consumer transactions. Vote: 5 - 5 (April, 1997)

g. Rejected a motion to limit the section to consumer licenses. Vote: 2 - 8 (April, 1997).

h. Adopted a motion to delete refusal term concept and apply post-payment refund right proposed by an ABA committee. Vote: 10 – 2 (Sept. 1997).

Notes to this Draft: Edited for clarity. In Subsection (a), "negotiated" is replaced with "expressly agreed" terms to avoid the idea that dickering is a precondition to the licensee protection contemplated under this section. Also, given the definition of "refund" some detail was deleted from this section.

Reporter's Notes:

1. This section deals with all standard forms in the mass market, including 1) forms presented before a purchase fee is paid and situations where a publisher's terms are made available for assent by the user only after the end user pays the retailer.

3. **FORMS PRESENTED PRIOR TO PAYMENT.** Where the terms of a form are presented before a price is paid, the validity of the form involves issues that have been presented to courts for years. Cases generally enforce the contract. The fact that the terms are non-negotiable or a "contract of adhesion" results in close scrutiny of *terms* under interpretation and unconscionability theory, but seldom results in a decision that invalidates the contract itself. While neither party bargained for terms, the vendor did not agree to sell under any other terms than those set out in its contract and, as long as there is fairness, disclosure or notice to the other party, contract law does not vitiate those terms. Some argue that law should preclude a vendor from defining the terms under which it markets its product or service. That viewpoint argues that law should mandate terms, conditions and risks under which information is distributed. *This regulatory structure is not accepted in Article 2B.*

a. **Assent.** Subsection (a) states a principle in the Restatement (Second): by manifesting assent to a standard form record, a party adopts the terms of that record. Article 2B places significant restrictions procedurally on the idea of manifesting assent. These restrictions ensure that the record be available for review and that the assenting party make some **affirmative** indication of assent. Compare Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997) (assent to a form based on failure to object sufficient). In cases where the license arises through initial screens presented to the licensee before it pays, the issue is identical to paper-based formats, except for the automated nature of the contracting. The issues are whether there are adequate indicia of assent.

b. Unconscionability. Subsection (a) expressly references that terms in mass market licenses are not enforceable if they are unconscionable. This UCC concept would apply in any event, but the reference here makes clear that the policy is important in standard form contracting in the mass market. The idea of unconscionability is one that limits contract terms to avoid bizarre and oppressive results. Traditionally, the doctrine blends questions about the contracting process with questions about the substantive character of the terms themselves. It is aimed at preventing abuse and unfair surprise.

In the mass market, this doctrine might apply to invalidate terms that over-reach and are hidden in boilerplate. For example, a contract term buried in a mass market license that provides that default on the mass market contract involving a $50 software results in a cross default on all other licenses between two companies may be unconscionable in setting where there was no reason to suspect that the linkage of the small and the larger licenses. Similarly, a clause abrogating any responsibility for intentionally wrongful acts buried in a mass market form would violate general public policy in most states and, in addition to being unenforceable on that ground, might very well also be found to be unconscionable.

The essential character of unconscionability doctrine lies in a contextual analysis to avoid abuse and one thus cannot fully describe the various applications that might spell out its scope here without detailed information about various contexts. In information transactions, the doctrine is sufficiently flexible to encompass consideration of various underlying policies about fairness and protection of public interests in free flow of ideas. As discussed in the Notes to 2B-105, Article 2B and contract law generally must take a neutral position relating to the difficult federal policy issues that arise in reference to preemption, misuse and other law. Within that general approach, however, issues about the relationship between a clause and underlying principles of free speech, information flow, and the like in the mass market are appropriate elements in an unconscionability analysis. Thus, for example, a contract term purporting to prevent the buyer of a publicly distributing magazine from quoting the magazine's observations about consumer products might in context be considered to be unconscionable. In practice, however, as discussed in Section 2B-105, the primary standards under which such clauses would be measured come from concepts of copyright misuse, free speech, and related federal policy restrictions on contract enforcement. The fact that the contract itself is generally enforceable under Article 2B (if that is the case in particular setting) does not alter the application of these broader federal law concepts.

c. Negotiated Terms. Subsection (a) also provides that the form in itself cannot alter the negotiated terms between the parties to the license. This creates a balance that is found in the Restatement (Second) of Contracts, but does so in terms gauged to identifiable elements of actual transactions. The basic concept holds that the form cannot alter agreed-to terms in this marketplace.

Illustration 1: The acquisition librarian of University Libraries places an order with the sales representative of Zen Software for a copy of Zen's multi-media product to be used in University's public collection network and agreeing on a price for that use. The software is shipped for the agreed price, but the mass market license provides that the software is only for use on a single user system. University assents to the license. The single user provision of the mass market license is not part of the contract under subsection (a) because the parties had agreed otherwise.

Stating this concept in this section corresponds to the comments to Restatement (Second) 211 which talk about invalidating "bizarre" (unconscionable) terms and terms that vitiate the basics or essence of the agreement between the parties. In other standard form contexts, it is not clear when the language of a form adopted by a party supecedes or is subordinate to otherwise agreed terms.

The concept is especially important in mass market information transactions in that the importance of the contract is far greater here than in other settings. The contract defines the product (e.g., it defines what rights are conveyed and which rights are withheld). This concept is, of course, subject to the parol evidence rule. The express reference to that rule here is to correspond the section to the presentation of the section on express warranties and their disclaimer or limitation in current Article 2.

4. FORMS PRESENTED AFTER PAYMENT. In modern commerce, licenses and other contract terms are often presented after a price is paid to a retailer. These situations (which include so-called "shrink-wrap" licenses) present additional questions.

In many cases, the form contract gives benefits to the end user that are not present in the deal with the retailer. Typically, the license presented after payment is between the *copyright owner* and the end user, rather than between the end user and *the retailer*. In this three-party setting (end user, retailer, copyright owner), the post-payment license is important to the end user. The form establishes *for the first time* a relationship between the copyright owner and the end user that may be central to the end user's right to use the information. This is true because of a confluence of copyright law and how some products are distributed.

A copyright owner may elect to give distributors a right to sell copies of its work or it may preclude a right to sell and instead authorize distributors to license works under terms it specifies to the distributor. Copyright law supports either choice. If the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected under copyright law. Thus, a common distribution situation is:

1) copyright owner licenses distributor to distribute, but not sell, copies, and only subject to a license;
2) distributor (retailer) transfers copies to end users for a price, but under applicable law, this cannot be a "first sale" unless the copyright owner authorized sales;
3) if it is not a first sale, end user has possession, but an uncertain status in copyright until is assents to a license with the copyright owner
4) if it is a first sale, end user has some statutory rights, but cannot make a public performance, display or multiple copies of the work under copyright law.

The "post-payment" license is the first contract between the end user and the copyright owner. It is the only setting in which the end user can obtain rights that are in excess of rights to a first sale purchaser or any rights at all under copyright law if there was no authorized sale to it.

In post-payment license terms, the unique contract law issue is what protections does the end user have if the license terms are unacceptable. Under Article 2B, the a robust refund and reimbursement right is created. The intent is that, if there is no assent to the contract, the end user can return itself to the place that it was in before acquiring the copy and reviewing the license.

Illustration 2: End user desires information available under a mass market license. End user #1 goes to a web site and, after reviewing the license terms, provides his credit card number and downloads the information. Subsection (b) does not apply because opportunity to review the license contract existed before payment. End user #2 places a telephone order for the information and provides his credit card number, but the license is not available for review until the information arrives in the mail. Subsection (b) applies because there was no opportunity to review the license before payment was made.

Illustration 3: In the above example, End user #2 opens the package and finds a license printed on an envelope that contains a copy of the information inside. The outside of the envelope clearly states that opening the envelope constitutes consent to the license. The user reads the license and rejects it, deciding to not open the envelope. Subsections (b)(i) and (ii) entitle him to return the information with costs covered by the licensor. Subsection (b)(iii) does not apply; it was not necessary to install the license in order to read it.

Illustration 4: In the same circumstances, End user decides to test the information to see if he likes it. Subsection (b) does not apply because the end user assented to the license. Any right to test is governed by the inspection rules of Article 2B which assume the existence of a contract and focus on determining and providing a remedy for breach.

5. In single form cases, no appellate case law rejects the contract-based enforceability of the forms and recent cases support it. See Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997); ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). Compare Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th 1988) (applying a preemption analysis to statute validating a particular term after the lower court held otherwise the contract was invalid as a contract of adhesion; the appellate court did not address the contractual enforceability issue). Case law is less clear in the conflicting forms setting where the presence of differing terms creates questions about assent to either form. See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir.1991); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). These cases do not contest the underlying enforceability of standard forms, but deal with conflicting terms. See Douglas G. Baird & Robert Weisberg, Rules, Standards, and the Battle of the Forms: A Reassessment of ' 2-207, 68 Va. L.Rev. 1217, 1227-31 (1982).

6. Intellectual Property Issues. As noted in Section 2B-105 and earlier in these notes, important and difficult federal policy issues can arise about distribution of information in a mass market and the relationship between distributional restrictions by contract on the one hand and federal information policy on the other. Article 2B adopts a neutral position on these issues and nothing in this section should be understood to reverse or alter decisions and policy choices about under what circumstances particular contractual provisions might be preempted or otherwise precluded as a result of federal law and applicable, mandatory policies. In general, these federal policies, which include ideas of free speech and concepts of copyright (or patent) misuse, apply to particular clauses in contractual relationships. The fact that, under Article 2B, as under current law, the contract is enforceable in general does not alter decisions about which otherwise enforceable contract terms might be invalid under these policies and in what circumstances that policy choice is made.

To underscore this position, the comments will point to existing case law on several potentially important questions. Thus, for example, modern copyright case law holds that in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use as a matter of copyright law. See Sega Enterprises Ltd. v. Accolade, Inc., 977 F2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F2d 832 (Fed. Cir. 1992). In some contexts contractual bars on reverse engineering are enforceable. In others, they may not be enforceable. See Triad Systems Corp. v. Southeastern Express Co., 64 F3d 1330 (9th Cir. 1995); DSC Communications Corp. v. DGI Technologies Corp., 898 F. Supp. 1183 (ND Tex. 1995). Similarly, federal case law (and statutory provisions) establish a federal interest in the broad distribution and use of ideas and concepts that have been distributed to the public. See Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989). On the other hand, however, it is quite clear that the federal policy on dissemination of information co-exists with concepts about the ability of parties to make confidential disclosures and deal with information to be kept secret. See Computer Assoc. Int'l, Inc. v. Altai, Inc., 982 F2d 693 (2d Cir. 1992). Some case law supports the view that, in some situations involving mass distribution of the information in a generally unrestricted form, the provision is unenforceable. See Consumers Union v. General Signal Corp., 724 F.2d 1044 (1983). On the other hand, in other situations, modern law clearly allows the creation of enforceable contract restrictions on the ability of a recipient to reproduce or publicly redistribute confidential information. See Restatement (Third) Unfair Competition.

Exactly where and how these themes interface and what limits they may place on particular contractual relationships is clearly a question of federal policy, rather than state contract law. With the transition from print to digital media as a main method of conveying information, major policy disputes have erupted concerning the redistribution of rights in light of the fact that the media of distribution allows many different and potentially valuable (for users or authors) uses of information products. The difficulty of balancing fundamental rights in this context is demonstrated by the fact that disputes about underlying social policy have erupted and been left unresolved in numerous contexts in the U.S. and internationally. State law that conflicts with the resolution of those questions in federal law may be preempted if that is the policy choice made in federal law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

SECTION 2B-209. TERMS WHEN CONTRACT CREATED BY CONDUCT.

(a) Except as otherwise provided in subsection (b), if the records of the parties do not establish a contract but a contract is formed because conduct of the parties recognizes the existence of a contract, the court shall determine the terms of the contract considering the commercial context, the conduct of the parties, the terms on which the parties agreed, the informational property rights involved, the supplementary terms provided by any other provision of this [Act], and all other relevant circumstances.

(b) If a contract is formed by conduct and the only records exchanged are standard forms purporting to state the terms of an offer or acceptance, the terms of the contract are:

(1) terms ~~negotiated~~ expressly agreed to by the parties;

(2) terms on which the forms do not conflict;

(3) supplementary terms incorporated under any other provisions of this [Act].

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

(1) Terms stated in subsection (b) rank in priority in the order listed.

(2) If a standard form of one party deals with a subject, silence of the other standard form on the subject is not a conflicting term unless the term materially alters the contract otherwise established. In determining whether a term materially alters an agreement, a court shall consider the extent to which the term conflicts with ~~negotiated~~ expressly agreed terms and the course of dealing of the parties or the customs and practices of the applicable trade or industry for transactions of the type.

(3) If the parties have not expressly agreed on scope and the records exchanged by the parties conflict on scope, the terms of the licensor's record governs the scope.

(d) This Section does not apply if there is an authenticated record of the agreement or there was a conditional offer effective under Section 2B-203(c) to which the party to be bound agreed, by manifesting assent or otherwise. In either of these cases, the terms of the contract are determined under Section 2B-207 or Section 2B-208 as applicable, and general rules of interpretation.

Uniform Law Source: Section 2-207. Substantially revised.

Definitional Cross Reference:
"Agreement". Section 1-201. "Authenticate". Section 2B-102. "Contract". Section 2B-102. "Court". Section 2B-102. "License". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Record". Section

2B-102. "Scope". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Votes:

a. Consensus to strike or rewrite former subsection (c) (rewritten as subsection (b)(2)) to deal more effectively with terms that are basic to defining the product and, thus, not subject to the knock out rule.

b. Failed to adopt a motion that in the battle of forms the presumption should be no consequential damages apply. (4 - 4) (April, 1997)

Notes to this Draft: Edited for clarity. Replaces negotiated with expressly agreed terms.

Reporter's Note:

1. This Section deals with cases where the records, if any, do not establish that a contract exists, but a contract is formed by conduct. It deals in general with 2-207(c) in current Article 2.

2. Subsection (a) gives the general rule. It requires that the court consider the entire context. It generally conforms in that setting to common law principles. In cases involving an exchange of writings that do not entirely agree, the typical interpretation approach involves considering all of the terms of all of the writings and reconciling them in light of all the circumstances. See Abram & Tracy, Inc. v. Smith, 88 Ohio App.3d 253, 623 N.E.2d 704, 708 (1993) ("Generally, a writing should be interpreted as a whole and all the writings that are part of the same transaction should be interpreted together."); Restatement (Second) of Contracts § 202(1) (2) (1981); 2 Farnsworth, Contracts § 7.10 (1990). In such unstructured environments, requiring that a court adopt a "knock-out" rule such as that described here would needlessly place blinders and restraints on courts whose focus in such settings should more generally deal with determining the intent of the parties. Since Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., this rule allows courts to continue existing practice, rather than enforcing an entirely new regime on the interpretation process.

3. Current Article 2-207 is not limited to standard forms, but the cases and literature concentrate largely on the problem of the exchange of forms that disagree on important matters. **If the exchanged forms create a contract, this section does not apply.** Instead, under 2B-203, a contract forms around the terms of the offer with whatever additional terms are permitted there or, in the case of an effective conditional offer, around those terms. Subsection (d) confirms that.

4. If the standard form writing do not establish a contract (e.g., because of a material conflict in terms or because of a failure to assent to a conditional offer), but conduct does create a contract, this section adopts a modified knock-out rule. The battle of forms deals with a situation where the parties exchange forms, but undertake a contract regardless of whether the forms agree. Where this is true, the section states simply that, if the parties did not negotiate or limit their conduct to reflect the form, law will not retroactively create a rule in which the standard form terms have greater significance for either party than was suggested by their behavior. Discussing current UCC § 2-207, the Third Circuit Court of Appeals noted:

> The insight behind [Article 2] is that it would be unfair to bind [a party to the standard terms of the other party] when neither party cared sufficiently to establish expressly the terms of their agreement, simply because [one party] sent the last form.

The rule here essentially excludes conflicting terms in the forms, regardless of which form was the first received or sent.

Illustration 1:

a. In response to a standard order form from DuPont, Developer ships software subject to a form. The two forms disagree on warranty terms. Under (b), both warranty terms drop out and the default rules apply.

b. If Developer sends an E-mail or a letter rather than a standard form, rejecting the proposed warranty terms, but goes and ships without obtaining assent from DuPont to any change, determining what terms govern the contract poses a difficult, but ordinary contract interpretation issue inquiring into the intent of the parties, rather than an automatic knock-out rule. Subsection (a) governs.

5. This section identifies three cases where a knock-out rule would be inappropriate even though the parties exchanged standard forms.

a. The **first** involves a case where one party, by conduct **and** by its form, conditions its agreement to a contract on the other party's assent to its forms. Although a naked exchange of forms that conflict gives neither party priority, conditional offers or acceptances must be recognized and enforced when appropriate, even if made by a standard form. By matching the form with the behavior, a party expressly takes the transaction outside the battle of forms by <u>actually</u> conditioning participation in the contract on agreement to the terms of its form. Often, when this occurs, there is no agreement between the parties unless the other party assents to the conditional offer. See 2B-203.

b. A **second** situation that takes the case out of the knock-out rule occurs when the parties execute an authenticated record. Authentication (signature) of a record supersedes the standard forms. The record can come before or after the exchange of forms. The basic theme is that an executed agreement better indicates intent and throws the case outside the knock out rule. Clearly, it would be a major change in law to regard a signed writing as being no different in substance that unsigned and conflicting forms. Consistent with this section courts should use general concepts of contract interpretation to discern the meaning of the contract incorporated in a signed record.

c. The **third** situation occurs when the **forms conflict about the scope of the license**. Scope is a defined term in 2B-102 that refers to terms restricting field of use, duration and similar terms that in effect define the nature of the information product being licensed. The mere fact that one form disagrees with the licensor's form on issues of scope cannot be held to throw the case back on general default rules. A vendor who provides a consumer version of software cannot be forced to have given an unlimited, license in the software for development and other use simply because a competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms define the product being sold (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware of what can be granted (e.g., it holds rights to a screen play only for use in television). In cases where forms disagree on basic points, the true issue is whether a contract exists (that is, was there agreement). A knock-out rule would expose intellectual property to the vagaries of conflicting forms.

6. Taken together with the provisions on contract formation, the rule contemplated here involves inquiry about three issues in cases of conflicts on scope:

(1) Did the parties actually reach an agreement or was one purchasing a Corvette while the other was selling a Ford? Under the general formation rules, disagreement about scope means that there is no contract. Thus, in this section, the reference to the licensor's scope provisions becomes an issue only if there was no disagreement about scope.

(2) If an agreement exists, did the parties agree on scope and, if so, what agreement was reached? If there is an affirmative agreement on scope terms, that affirmative agreement governs and, pursuant to this section, the agreed terms take precedence over any terms in the forms of either party.

(3) If a specific scope was not agreed to by the parties, what terms on scope are contained in the licensor's form? As this indicates, rather than giving dominance to the licensor's form per se, this treats the issue of scope as a central aspect of the relationship and uses the licensor's terms only after concluding that an agreement exists and that there was no specific understanding about scope. If the parties agreed on scope, that agreement prevails over the forms of either party. Disagreement on scope of the license often indicates a lack of agreement on what is being purchased. Terms of a form that conflict with a negotiated agreement on scope do not control; the licensor's terms only control as against other non-negotiated terms.

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 such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented by:

(1) course of performance, course of dealing, or usage of trade; and

(2) evidence of consistent additional terms unless the court finds the record to have been intended as a complete and exclusive statement of the terms of the agreement.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Court". Section 2B-102. "Record". Section 2B-102. "Term". Section 1-201.

Committee Votes and Action:

a. Committee voted 11-0 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.

b. Reviewed in April 1997 without substantive comment.

c. At the 1997 Annual Meeting, a sense of the house motion was adopted to harmonize the parol evidence rules in the three articles.

Reporter's Notes: Follows current Article 2 verbatim.

SECTION 2B-302. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(a) Where the contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(b) The express terms of an agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other, but when such construction is unreasonable express terms control course of performance, course of dealing and usage of trade; course of performance controls both course of dealing and usage of trade; and course of dealing controls usage of trade.

(c) Subject to Section 2B-303 and 2B-6--, course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

UNIFORM LAW SOURCE: Section 2A-207; Section 2-208; Section 1-205. Revised.

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Party". Section 1-201. "Term". Section 1-201.

Committee Vote:

a. The Committee voted unanimously to adopt this section. (September, 1996)

b. Reviewed without substantive comment in April, 1997.

Reporter's Note: Conforms to Article 2.

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract within this article needs no consideration to be binding.

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

(c) The requirements of Section 2B-201 must be satisfied for if the contract as modified is within its provisions.

(d) An attempt at modification or rescission that does not satisfy the requirements of subsection (b) or (c) can operate as a waiver as provided in Section 2B-6--.

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

Definitional Cross Reference:

"Agreement". Section 1-201. "Authenticate". Section 2B-102. "Consumer". Section 2B-102. "Contract". Section 2B-102. "Merchant". Section 2B-102. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Committee Vote:

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

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

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

Reporter's Notes:

1. This Section follows existing Article 2-209 except for the use of "manifest assent" regarding the use of a no modification term in a consumer contract. The content of Section 2-209(5) is included in the separate Article 2B section on waivers, reference to which is made.

2. In subsection (2), Article 2 and Article 2A require no oral modification terms to be signed by the consumer; that concept appears here in the form of a requirement of manifestation of assent to the term, rather than signature. This allows the concept to operate in electronic environments where signatures / authentication is not feasible, while still providing protection in the form of binding the consumer only to terms where the consumer affirmatively and specifically adopted.

3. As in Article 2-209, the statute of frauds provisions are expressly applied to modifications by subsection (3). Thus, if the agreement of the parties limits enforceability to modifications that are in a record, that agreement will be enforced. The rule is especially important in the on-going relationships in many commercial licenses and development contracts.

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of a contract involving successive performances apply to all later performances unless the terms are modified in accordance with this article or the contract, even if the terms are not subsequently displayed or otherwise brought to the attention of the parties or electronic agents.

(b) If a contract provides that it may be modified as to future performances by compliance with a described procedure, a good faith modification pursuant to that procedure is effective if:

(1) the procedure reasonably notifies the other party of the change; and

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

(c) The parties may by agreement determine the standards for reasonable notification unless the agreed standards are manifestly unreasonable in light of the commercial circumstances.

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102."Electronic agent". Section 2B-102. "Good faith". Section 2B-102. "Mass-market license". Section 2B-102. "Notifies". Section 1-201. "Party". Section 1-201. "Term". Section 1-201.

Committee Action:

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

b.Voted to delete limitation that the change be materially adverse to licensee and substitute "unacceptable in good faith." (7-5) (April, 1997)

Notes to this Draft: Edited for clarity.

Reporter's Notes:

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 U.C.C. developments with respect to modifications. For example, under 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.

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

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

SECTION 2B-305. PERFORMANCE UNDER OPEN TERMS; TERMS TO BE SPECIFIED; PERFORMANCE TO PARTY'S SATISFACTION.

(a) If the performance required of a party and its timing is not fixed or determinable from the terms of the agreement or this article, the agreement requires performance that is reasonable in light of the commercial circumstances existing at the time of agreement.

(b) An agreement that is otherwise sufficiently definite to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. If a term of an agreement is to be specified by a party, the following rules apply:

(1) Specification must be made in good faith and within limits set by commercial reasonableness.

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

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

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

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

(1) the agreement expressly so provides, such as by providing that the satisfaction or approval is to be in the "sole discretion" of the party, or words of similar import; or

(2) in the absence of express contract terms, if the performance is the creation or delivery of informational content in a context in which it is to be evaluated in reference to aesthetics, marketability, appeal, suitability to taste, or similar characteristics.

Uniform Law Source: Section 2-305; Section 2-311; Restatement 228. Revised.

Definitional Cross Reference:
"Agreement". Section 1-201. "Contract". Section 2B-102. "Delivery". Section 2B-102. "Good faith". Section 2B-102. "Information". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Term". Section 1-201.

Notes to this Draft: Edited for clarity; subsection (b) conformed to 2-311..

Reporter's Notes:

1. *Open Terms.* Subsection (a) and (b) bring together rules relating to open terms under current Article 2.

2. *Performance to the Satisfaction of a Party.* Subsection (c) focuses on cases where performance is to be to the satisfaction of the other party. Two different approaches reflect different traditions and case law affected by Article 2B and differences in qualitative standards that are appropriate to the commercial relationships. The factor that distinguishes these industries is that many of the information products that they obtain entail judgments about aesthetics and marketability, leaving it important that the judgment of the licensee be unfettered. Here, to the satisfaction clauses create a subjective standard, rather than one defined by reference to a reasonable person test. The converse rule is more appropriate in cases involving the development of computer programs and the like.

Restatement (Second) of Contracts § 228 "prefers" a reasonable man approach <u>if</u> the context permits objective standards for determining satisfaction. This leaves too much uncertainty for the information industries affected here. The Restatement cites an entertainment industry example as one in which no reasonable standard of satisfaction is possible. The language in (c) provides guidance for determining when the subjective standard is appropriate for information industry performances.

Subsection (c)(1) provides safe harbor language, indicating what language achieves a subjective satisfaction standard.

SECTION 2B-306. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALING.

(a) A term that measures the quantity or amount of use by the output of the licensor or the requirements of the licensee means such actual output or requirements as may occur in good faith. No quantity or amount of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements may be tendered or demanded, but this limitation does not apply if the party in good faith has no output or requirements.

(b) A lawful agreement for exclusive dealing in the kind of information concerned imposes an obligation by a licensor that is the exclusive supplier to use good faith efforts to supply the information and by a licensee that is the exclusive distributor to use good faith efforts to promote the information commercially.

Uniform Statutory Source: Section 2-306.

Definitional Cross Reference:

"Agreement". Section 1-201."Good faith". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Term". Section 1-201.

Committee Vote:

1. Voted unanimously to approve the section in principle. (Oct. 1996)

Notes to this Draft: Edited for clarity and to more closely conform to 2-306.

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 information is 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.

2. Subsection (b) accommodates the various bodies of law that pertain to exclusive dealing relationships in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for resale by the other party. Article 2 and case law dealing with patent licensing create a best efforts default rule. Article 2-306 creates the same rule for goods. That rule, however, is not the law in other fields governed by Article 2B and, in any event, uses a standard that has been difficult if not impossible to define with reliability.

The approach here relies on a good faith standard - honesty in fact and adherence to commercial standards of fair dealing. This allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. Interpretation]

SECTION 2B-307. INTERPRETATION OF GRANT.

(a) A license grants all rights expressly described and all rights within the licensor's control during the duration of the license which are necessary in the ordinary course to use the expressly granted rights. A license contains an implied limitation that the licensee will not exceed the grant. Use of the information in a manner that was neither expressly granted nor expressly withheld does not breach~~es~~ this implied limitation ~~only~~ if the use was ~~not~~ necessary to the expressly granted uses, or ~~and~~ would ~~not~~ be legally permitted in the absence of the implied limitation.

(b) A license that does not specify the number of permitted users permits the number of users that is reasonable in light of the commercial circumstances existing at the time of agreement. ~~simultaneous users permitted only authorizes use by one party at any one time. However, if the license authorizes display or performance of the information, it permits viewing by any number of persons but only of a single display or performance at any one time.~~

(c) Neither party is entitled to any rights in improvements or modifications made by the other party after the license becomes enforceable, or to receive source code, object code, schematics, master copy, or other design material, or other information used by the other party in creating, developing, or implementing the information. A licensor's agreement to provide improvements or modifications requires provision of the agreed information as developed by the licensor from time to time for use by third parties and made generally commercially available.

(d) Terms dealing with the scope of an agreement must be construed under ordinary principles of contract interpretation in light of the commercial context. In addition, the following rules apply:

(1) A grant of "all possible rights and media", "all rights and media now known or later developed", or similar terms, includes all rights then existing or created by law in the future, and all uses, media, and methods of distribution or exhibition then existing or developed in the future, whether or not anticipated at the time of the grant. ~~However:~~

~~(A) A grant of "all possible rights", "all rights now known or later developed", or similar terms, includes only all rights then existing or created by law in the future, whether or not anticipated at the time of the grant.~~

~~(B) A grant of "all possible media", "all media now known or later developed", or similar terms, includes only use in all media, modes of transmission, and methods of distribution in all technologies or applications then existing or developed in the future,~~

~~whether or not anticipated at the time of the grant.~~

(2) A grant of a "quitclaim", or in similar terms between merchants grants the information without implied warranties as to infringement or as to the rights actually possessed or transferred by the grantor.

(3) A grant of an "exclusive license", or in similar terms, affirms for the duration of the license, that the licensor will not exercise and will not grant to any other party, rights in the same information within the same scope, and that the licensor has not previously done so in a contract in force at the time the licensee's rights commence.

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Copy". Section 2B-102. "Information". Section 2B-102. "Informational property rights". Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Receive". Section 2B-102. "Rights". Section 1-201. "Scope". Section 2B-102. "Term". Section 1-201.

Committee Action:

Reviewed without substantive change.

Notes to this Draft:

Edited for clarity. Also: 1) A substantive change is suggested in subsection (b) based on recommendations of licensee representatives. 2) Proposed deletion of two interpretive rules based on comments that the concepts are not clear and that issues they address are not consistent across areas of information commerce.

Reporter's Notes:

1. *Implied Licenses and Implied Limitations.* The first sentence of subsection (a) deals with a subject that common law courts often address under the general theory of implied licenses. It approach the question as one of interpreting a contract grant. The issue deals with the appropriate treatment of the case where rights not expressly granted are essential to the licensee's use of the information in a manner consistent with the expressly granted rights. The Section adopts the reasonable commercial law interpretation that the affirmative grant includes all necessary rights to use that grant, to the extent that these are within the control of the licensor. For example, a license to use a film clip in a CD ROM product impliedly conveys the right to crop or modify the size of the clip to fit the media unless that right to make a modification is expressly excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to make modified versions of that software. The implied license relates to rights transferred and to materials provided to the party; it does not require a transfer of additional materials (such as source code), unless that transfer was agreed to by the parties. Contract terms precluding this treatment are effective.

The second and third sentences in subsection (a) deal with a highly important interpretation issue that is accentuated as more information transactions occur among persons who are not expert in intellectual property law rules. The question involves what interpretation is placed on a grant "to do X." Under current law, it is clear that uses of licensed information outside the express scope of a license are breaches of contract if the scope is defined in terms of "this use <u>only</u>" or otherwise expressly precludes the use. If the word "only" does not appear, the cases are less clear and some case law suggests that the omission of the word in formal grant language means that there is no contract breach if the licensee exceed the grant. This concept is not universally followed and some federal policy holds that the proper interpretation is that any use not expressly granted is withheld. Unless dealt with here, the interpretation issue creates a trap for the unwary.

Subsection (a) adopts the ordinary commercial understanding that an affirmative grant impliedly excludes uses that exceed the grant and that, as a result, exceeding this type of grant creates a potential breach of contract. The implied limitation, however, is not as strong as an express limitation. The implied limitation does not preclude acts necessary to the uses contemplated in the express grant. Additionally, the implied limitation is not exceeded if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a direct quotation from a licensed text not covered by confidentiality restrictions if a fair use would not conflict with the implied limitation. Sitting in one's office doing a letter to a family friend using software that is under a commercial use license would likely not conflict with any implied limitation. However, if a grant is for use of a motion picture in one location but did not use the magic word "only" and the licensee uses the motion picture copy to make and distribute multiple copies for sale to home uses, that activity would violate the copyright (as a non-fair use) and breach the contract. The position that no implied limits are present creates a trap for the unwary licensor in that it contradicts normal contract interpretation ideals of viewing a contract in light of its commercial purpose. A grant to use software or a motion picture in Peoria implies the lack of a contract right to do so in Detroit.

Illustration 1: Disney licenses to Acme Theater the right "to show the movie Snow White during a six month period in Kansas." Acme, enamored with the musical score of the movie, digitally separates the music into a separate copy and uses it during that six month period in the Acme lobby. This infringes the copyright. Whether it breaches the contract depends on whether the grant creates an implied limitation that precludes other uses of the work and derivative copies. Under section (b), the implied limitation exists unless the use was a fair use without that limitation or was necessary to the primary grant. Neither condition is met here. The fact that Disney forgot to add the word "only" to its grant language does not create a different result than would be explicit in the presence of that language.

Illustration 2: Licensor grants the "right to use its software in motion pictures." The licensee uses the software to develop and distribute an animated movie. Later, it uses the software to develop and distribute a television series. Assume that a television program is not within the idea of a motion picture. When sued for breach, if the rule is that uses outside the grant are not breaches of contract, the grant terms are inadequate to give the licensor rights in this case. If there is an implied limitation as proposed here, the issue is whether television use "exceeds" the grant. It should, under an appropriate test.

Illustration 3: Same as illustration 2, except that the license grant states that it grants "the right to use its software solely in motion pictures." Under this framework, use in television violates and express condition of the license and is a breach. Whether such difference in result should flow from the addition or omission of the word "solely" is at issue. Requiring that word may be a trap for less well-counseled parties.

Illustration 4: Same as illustration 2, except that the license provides in addition to the grant that "all uses not expressly granted are expressly reserved to the licensor." This is the same as Illustration 3.

Illustration 5. EXL licenses software to Dangerfield. The license is silent regarding reverse engineering and consumer use, but expressly gives Dangerfield the right to use the software in the 1000 person network Dangerfield operates for its employees. Dangerfield reverse engineers the software to discover its interface with Digital Computer systems for purposes of making a new system. Also, a Dangerfield employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is authorized if it would be a fair use if the implied limitation were not present. The reverse engineering would involve the same analysis and, if found to be a fair use under case law allowing reverse engineering if necessary to discover interoperability requirements, would not breach the implied license term.

2. *Number of Users.* As redraft, subsection (b) proposes the adoption of a commercial reasonableness test to deal with cases where a license fails to specify the number of simultaneous users that are permitted for the particular information. In some cases, especially in the mass market, a single simultaneous user limitation would be appropriately assumed for a computer program. In other contexts, multi-use or network use concepts would be more appropriate. The ideas of the section is to guide a court, and the parties, by making reference to commercially reasonable assumptions about this important variable.

3. *Modifications.* As a basic principle a party receives no right in contract to subsequent modifications made by the other party, nor is access to typically confidential material. Arrangements for improvements and source code or designs constitute separate valuable relationships handled by express contract terms, rather than presumed away from their owner by the simple fact of forming a general contract.

Illustration 6: Word Company licenses B to use Word's robotics software. The license is a four-year contract. Three months after the license is granted, Word develops an improved version of the software. Party B has no right to receive rights in this improved version unless the agreement expressly so provides.

Illustration 7: In the Word license, two years after the license is established, Party B's software engineers discover several modifications that greatly enhance its performance. Word is not entitled to rights in these modifications unless the license expressly so provides. However, the modifications may create a derivative work under copyright law and a question also exists about whether the license granted the right to make such a derivative work.

4. *Grant Clauses.* Subsection (d) (1) provides guidance for whether (when) a license grants rights only in existing media or methods of use of information or whether it extends to future uses. The draft adopts the majority approach in a number of recent cases. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a fact sensitive interpretation issue. But the intent of the parties may not be ascertainable. In such cases, use of language that implies a broad scope for the grant without qualification should be sufficient to cover any and all future uses. This is subject to the other default rules in this chapter, including for example, the premise that the licensee does not receive any rights in enhancements made by the licensor unless the contract expressly so provides.

Subsection (d)(2) deals with how, in a commercial context, parties can transfer information without giving assurances about rights. The concept of a quitclaim of rights is most common in entertainment contexts, but like the idea of a quitclaim in real estate, it is essentially a grant only of whatever rights the grantor holds.

Subsection (d)(3) deals with the effect of language of exclusivity in a grant. The case law and treatises are in conflict. The issue focuses on two distinct elements: a looking forward and looking backward issue about exclusivity as to other persons, and the issue of whether the exclusivity also applies to actions of the licensor.

SECTION 2B-308. DURATION OF CONTRACT. If an agreement is indefinite in duration, except as provided by other applicable law, the following rules apply:

(1) Except to the extent otherwise provided in paragraph (2), if the agreement requires successive performances to be rendered to the other party, it is enforceable for a reasonable time in light of the commercial circumstances, but may be terminated at will by either party during that time on reasonable notice. The effect of termination on contractual rights is determined under Section 2B-626.

(2) The duration of a license is perpetual as to the rights and contractual restrictions on use of the information, subject to cancellation for breach, if:

(A) the agreement transfers ownership of a copy, or provides for delivery of a copy on a physical medium for a single fee fixed at the outset of the contract; or

(B) the license authorizes the licensee to integrate the licensed information into a product intended for distribution by the licensee.

Uniform Law Source: Section 2-309(1)(2).

Definitional Cross Reference:

"Agreement". Section 1-201. "Rights". Section 1-201. "Cancellation". Section 2B-102. "Contract". Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Notice". Section 1-201. "Party". Section 1-201. "Termination". Section 2B-102.

Committee Votes:

1. The Committee voted to approve this section in principle.

Notes to this Draft: Substantially rewritten to more closely correspond to Article 2, but to reflect differences in license issues raised by licensee representatives.

Reporter's Note:

1. *Basic Scope and Theme.* Paragraph (1) follows current Article 2, but contains provisions tailored to important licensing law issues that are not addressed in Article 2 because they are not relevant there.

The section applies to agreements that do not specify their duration. This requires that there be an agreement. In some cases, a failure to agree on duration will, like failure to agree on any other scope provision in a license, indicate that no contract exists. In addition, the section does not apply simply because a record that documents the agreement is silent. Agreement refers to the entire bargain of the parties. This includes oral agreements, trade use, and the entire commercial setting as relevant. This section applies only if the total of all of the circumstances defining the bargain yield no understanding about duration. Thus, for example, a license reached in an industry setting where, for the particular information, licenses are typically for hourly, daily, weekly, or monthly terms, would typically not fall within this section because the ordinary term for licenses of the type would supply the duration.

The Section does not deal with contracts that contain provisions defining their term, even if those terms do not specify a fixed date. Thus, a contract providing that a license continues for "the life of the edition" or "for so long as the work remains in print" defines the term of the license in the same manner as does a contract term of, for example, ten years. The contract terms control. On the other hand, decisions interpreting the analogous Article 2 rule for cases where there are commitments to "lifetime" service or "perpetual" maintenance, would provide guidance on whether language of that sort provides a definite term that takes the contract out of this section.

The basic policy in such cases is that the person making an open-ended commitment should be held to performance over a time that is reasonable in light of the payment and the type of commercial setting, but would typically not be placed in a position of perpetual servitude without a very clear indication that should be the case. Consistent with Article 2 and common law, this section makes the contract in such cases subject to termination at will on reasonable notice.

2. *Standard for Termination.* The basic rule is that in the absence of terms in the agreement referring to the duration of the contract, the duration of a contract involving successive performances is presumed to be a "reasonable" time. This follows both existing Article 2 and general common law. It makes explicit, however, that what is to be considered a reasonable time is gauged by the commercial context.

In some cases, what constitutes a reasonable term can be determined by reference to other law. In this field, there are various federal policy considerations that impinge on the duration of licenses and which may have an impact here. This can occur either by direct application of the other law or by its influence on determining what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed as extending for no more than the life and validity of the patent. A similar premise exists for an indefinite copyright license. It is important, however, that the reasonable time presumption only applies if the contract calls for successive performances. This is consistent with existing Article 2. This rule is limited to cases where a party has on-going, affirmative performance obligations to be rendered to the other party. These obligations may include payment obligations (e.g., royalties) or affirmative conduct (e.g., repair or maintenance). The premise here is identical to current Article 2.

3. *Effect of Termination.* This Section clarifies that termination occurs under and with the limitations indicated in 2B-626. Specifically, termination cancels executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. Thus, for example, assume a license for software that would be presumed perpetual under subsection (2), but with respect to which the licensor agrees to an indefinite obligation to provide telephone support to the end user. The successive performances in that support obligation create a situation to which subsection (a) applies. If the support provider properly terminates that obligation, it can end the executory obligation to provide support. That does not, however, alter the rights to use that are vested in the underlying license based on payment of the license fee.

3. *Perpetual Licenses.* Paragraph (2) differs from Article 2 and general common law in presuming a perpetual term for two types of licenses.

The first involves a license associated with the sale or delivery of a tangible copy. This rule corresponds to licensing practice in general. It applies, to cases where neither party has an obligation to deliver on-going affirmative performances to the other party. This language clarifies a result that, under current Article 2, would occur with reference to a contract that does not entail "successive performances." A rule analogous to that in Paragraph (2) is applied to intellectual property releases in another section.

The second deals with situations where the licensed information is intended to be incorporated into a product for third parties. The rule here recognizes the reliance concerns that would be affected by a termination right.

SECTION 2B-309. RIGHTS TO INFORMATION IN ORIGINATING PARTY.

(a) If an agreement between merchants obligates a party to handle or process commercial, scientific or technical information of the other party and the receiving party has reason to know that the information is confidential and not intended for republication, the following rules apply:

(1) As between the parties, the information and any summaries or tabulations based on it remain the property of the delivering party ~~or, in the case of commercial data, the party to which the information relates,~~ and may be used by the other party only in a manner and for the purposes authorized by the agreement.

(2) The party receiving the information and its agents shall ~~use reasonable care to~~ hold the information in confidence and make it available to be destroyed or delivered to the other party according to the agreement or the instructions of that party.

~~(b) In a case not governed by subsection (a), if technical or scientific information is developed during performance of an agreement, as between the parties, the following rules apply:~~

~~(1) If information is developed jointly, rights in the information are held jointly subject to the obligation of each party to handle the information in a manner consistent with protection of the reasonable expectations of the other respecting confidentiality.~~

~~(2) If the information is developed by one and is not within paragraph (1), the information is the property of that party, but the other party may use the information as provided in the agreement.~~

(b) This section does not apply to transactional data or information intended by the parties to be published by the licensee. "Transactional data" includes information collected to initiate or maintain a contractual relationship, maintained to effect or make a record of a transaction, or used to describe the subject matter of the transaction, or similar information.

Uniform Law Source: None.

Definitional Cross Reference:
"Agreement". Section 1-201. "Contract". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Rights". Section 1-201.

Committee Votes:

1. Approved the section in principle.

Notes to this Draft: Edited for clarity. Subsection (b) deleted due to uncertain overlap between it and the development contract section and recommendations of licensee representatives that the issue be left to common law and intellectual property rules.

Reporter's Notes:

1. Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person about whose business the commercial data relates maintains ownership of the data. This deals with an important issue in modern commerce relating to cases in which one party transfers data to another in the course of the transaction. The default rule applies to cases involving information that has not been released to the public and that the recipient knows is unlikely to be released. The default presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee. In effect, the circumstances themselves establish a presumption of retained ownership.

Illustration 1: Staten Hospital contracts to have Computer Company provide a computer program and data processing for Staten's records relating to treatment and billing services. Staten data are transferred electronically to Computer and processed in Computer's system. This section provides that Staten remains the owner of its data. Data held by Computer are owned by Staten because the records are not released to the public. There is an obligation to return the data at the end of the contract.

See Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351 (D.N.J. 1992) (respecting a contract dispute over a data processing contract in which Staten had a right to return of its information at the end of the contract; case assumed to be controlled by Article 2).

2. The remedies for breach of the obligations described in this section are for breach of contract. Ordinary contract remedies apply as do ordinary contract remedy limitations.

SECTION 2B-310. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, a "restraint" means a program, code, device, or other similar electronic or physical limitation that restricts use of information.

(b) A party entitled to enforce a limitation or restriction that does not depend on the existence of a breach of contract may include in the information and utilize a restraint if:

(1) a term in the agreement authorizes use of the restraint;

(2) the restraint merely prevents uses of the information that are inconsistent with the agreement, or with a licensor's rights under informational property law which were not granted to the licensee;

(3) the restraint merely prevents use of the information after expiration of the stated duration of the license [~~not more than 90 days~~] or stated number of uses; or

(4) the restraint prevents use when the license terminates [other than on expiration of a stated duration or number of uses] and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) Subsections (b)(2), (3) or (4) do not authorize a restraint that affirmatively prevents a licensee's access to its own information from its own resource without use of the licensor's information.

(d) A restraint authorized under subsection (b) is not a breach of contract and the party that included or used the restraint is not liable for any loss created by it. A restraint that prevents use permitted by the agreement is a breach of contract.

(e) This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy under an agreement with the licensee.

Definitional Cross Reference:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Delivery". Section 2B-102. "Electronic". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Notice". Section 1-201. "Party". Section 1-201. "Rights". Section 1-201. "Term". Section 1-201.

Notes to this Draft:

Substantive changes to correspond this section to the provisions on termination in Article 2 and Article 2B, neither of which requires notice when termination occurs on the happening of an agreed event. The revisions here do not go that far, but exclude notification where the termination occurs at the end of the license term or the stated number of uses (e.g., the end of a twelve month license).

Reporter's Notes:

1. This section deals with electronic limitations on use that involve enforcement of contract terms by preventing breach. It does not involve electronic devices used to make a repossession or force discontinuation of use in the event of breach. Those are covered in Section 2B-716. The electronic restrictions discussed here all derive from and enforce contract terms; they limit use consistent with contract terms or terminate a license at its natural end. Of course, the electronic regulation discussed here assumes that the licensor is enforcing a restriction that is, itself, enforceable under applicable intellectual property and contract law that may limit license terms in some cases. The few reported cases that deal with electronic devices support use of electronic devices even in the case of breach if disclosed to the licensee; the cases have not considered the less controversial use of restrictive devices not associated with enforcing claims of breach of contract.

2. The basic principle is that a contract can be enforced. Where the contract places time or other limits on a party's use of licensed information, electronic devices that merely enforce those limitations are appropriate. This reflects an important new capability created by digital information systems. The section does not state exclusive rules. Federal or other law (including other sources of contract law) may also allow limiting devices designed to enforce copyright and copyright management information. In effect, this section contains an affirmative statement of when such limiting devices are enforceable under contract law, without limiting the enforceability of other methods.

3. This Section distinguishes between active and passive electronic devices. An active device terminates the ability to make any further use of the information, while a passive device merely precludes actions that go beyond the license and would constitute a breach. Passive devices merely prevent unauthorized use, but leave the subject matter otherwise unaltered. Nothing in this Section authorizes active devices that impact the licensee's ability to access its own information through its own means other than the licensed information itself.

4. The provisions in Subsection (b) are alternative bases for the use of automated restraints. The first option arises if the contract authorizes the party to use the restrictive tool. In this respect, the authorization must be in addition to the contract term that the tool enforces.

5. Subsection (b)(2) provides that for passive devices, notice is not required if the electronics merely restrict use outside contract limitations or applicable informational property rights, without otherwise disabling the information. Thus, for example, assume that the contract restricts the lie licensee to making no more than one back-up copy of a work and that applicable copyright law rules provide that same limitation. This subsection authorizes use of a devices to enforce that limitation, so long as the device does not destroy the licensed information. The permitted restraint is one that enforces a contract, not one that imposes a penalty for its attempted breach. This is especially important for smaller suppliers whose ability to enforce contracts against often larger licensees is limited by costs of monitoring and judicial enforcement. The limitations, for example, might entail a counter which can be used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation inconsistent with the licensor's rights constitutes a breach of contract.

Illustration 1: The license provides that no more than five users may employ the word processing software at any one time. An electronic counter is embedded in the software and, if a sixth user attempt to sign on for simultaneous use, that sixth user is denied access until another user discontinues use. This limiting device is effective without prior notice or contractual authorization.

Illustration 2: The same situation as in Illustration 1, except that the limiting device permanently disables the software if a sixth user attempts access. This is not authorized by subsection (b)(2).

5. Subsection (b)(2) allows use of passive devices that merely preclude infringing intellectual property rights reserved to the licensor. Merely preventing the act does not require contract or other notice. Thus, for example, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so is authorized under (b)(2).

6. The devices described in subsections (b)(3) and (b)(4) deal with restraints that enforce termination of the license. Termination means the end of the license for reasons other than breach. As edited, subsection (3) corresponds to the licensor's basic right to terminate without notice either at the end of the fixed duration of the license, or on its termination on the happening of an agreed event. Both Article 2B and Article 2 recognize termination without notice in these cases and there is no principled reason to distinguish between termination enforced by automated means and any other form of termination. Subsection (b)(4), on the other hand, requires notice if termination is other than for the happening of an agreed event.

Illustration 3. A software license requires monthly payments of $1,000 due on the first of the month and covers a one year term with a right to renew based on written notice before the expiration of the term. Licensee makes a payment five days late because of accounting problems. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract.

Illustration 4. In Illustration 4, there was no late payment, but the licensee fails to give notice of renewal within the contractual time period. Licensor turns off the software. This action is covered by this section. The termination electronically is valid if either the contract contained a term authorizing that action, or the licensor or the device gave prior, reasonable notice of termination to the licensee.

6. Subsection (c) states the obvious. Actions consistent with a contract are not a breach and do not give rise to liability under this Article or the contract. The section permits enforcement of contract terms. It does not deal with rights to exclude, block out, or otherwise impact other information owned by or licensed to the licensee.

SECTION 2B-311. SHIPMENT TERMS. Shipment terms such as F.O.B., C.I.F. and the like must be interpreted according to the provisions of Article 2 of this Act and any applicable custom or usage of the trade.

Definitional Cross Reference:

"Term". Section 1-201.

Reporter's Notes:

This section was added to reflect the deletion of the detailed treatment of shipment terms found in existing Article 2.

Rather than to repeat or restate the variety of provisions in that statute or in applicable international or other laws, this section refers to Article 2 as a whole to provide meaning for such terms. The final comments to the Act will contain cross-references to the applicable provisions.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) A licensor of information that is a merchant regularly dealing in information of the kind but is not a financier, warrants that the information shall be delivered free of the rightful claim of any third person by way of infringement or the like <u>but a [merchant] licensee who furnishes specifications to the licensor must hold the licensor harmless against any such claim which arises out of compliance with the specifications [if no options were reasonably available to the licensor to implement the specifications without infringement].</u>

(b) A licensor warrants that:

(1) for the duration of the contract no person holds a claim to or interest in the information that arose from an act or omission of the licensor, other than a claim by way of infringement or the like, which will interfere with the licensee's enjoyment of its license interest; and

(2) in an exclusive license, the informational property rights that are the subject of the license are valid and exclusive within the scope of the license for the information as a whole.

(c) The warranties in this section are subject to the following:

(1) If informational property rights are subject by law to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) The ~~warranties~~ <u>obligations</u> under subsections (a) <u>and (b)(2)</u> apply solely to rights arising under the informational property laws of the United States or a State thereof and any other country specifically named in the scope of the license.

(d) A warranty under this section will be excluded or modified only by specific language or by circumstances which give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only such rights as it may have. In an automated transaction that does not involve review of the record by an individual, language is sufficient if it is specific and conspicuous as to that term. Otherwise, in other transactions, language in a record is sufficient if it states "There is no warranty of quiet enjoyment or against infringement", or words of similar import.

UNIFORM LAW SOURCE: Section 2A-211; Section 2-312. Revised.

Definitional Cross Reference:

"Conspicuous", Section 2B-102. "Contract", Section 2B-102. "Financier". Section 2B-102. "Information". Section 2B-102. "Informational property rights". Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Merchant". Section 2B-102. "Person". Section 1-201. "Record". Section 2B-102. "Rights". Section 1-201. "Scope". Section 2B-102. "Term". Section 1-201.

COMMITTEE VOTES:

a. Voted to adopt a "reason to know" standard in lieu of "knowledge."

b. Rejected a motion to bar disclaimer in "mass market" contracts.

c. Voted to move the section toward standards applicable under current Article 2. Vote 11- 0.

d. Voted to delete express exception for conduits and express the sense of the Committee that a mere passive transmittal entity is not intended to be covered in this context. Vote 12 – 0.

Notes to this Draft: Restructured and edited for clarity. Former (d) was moved to subsection (a) for conformance to existing Article 2.

REPORTER'S NOTES:

1. *Non-Infringement Warranty.* Subsection (a) contains the affirmative warranty of non-infringement. It is taken from Article 2. The language used here and in Article 2 requires the information to be delivered free of any claim of infringement or the like. This means (1) if the permits uses at the time the information is delivered, that if information were used in accordance with the contract at the time of delivery this use would not be subject to a claim of infringement and (2) that the delivery itself does not infringe a third party informational property right which would subject the licensee to liability for receiving that delivery. In the case where no infringement claim exists on this basis, but, for example, a contract grants a three year license when the transferor's rights are limited to two years, the cause of action is for breach of contract, not breach of the infringement warrant. Liability under this warranty accrues based on conditions at the time the copy is delivered. Compare Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N.D. Tex. 1986).

Since the subsection conforms, except for the bracketed language, to existing Article 2, the comments to existing law, Section 2-312, Comment 3, apply and describe the intended scope and effect of the subsection. The warranty is made only be a person that is a merchant in information of this kind. The "hold harmless" obligation only applies in cases where the infringement arises as a result of compliance with licensee specifications, not because of choices of the licensor in implementing general specifications or goals of the licensee.

2. *Non-Infringement and Passive Transmission.* The obligation in subsection (a) deals only with licensors of information and applies only within the scope of this Article. It does not apply to persons who merely provide transmission services, even though those services may transmit information from and two other parties. In the area of copyright infringement, the issue of under what circumstances a transmittal entity has liability for infringement is controversial. Article 2B is a contract statute and has no effect on or direct relationship to federal questions about what acts constitute direct or contributory infringement. See 2B-105. This section states an affirmative obligation which, as drafted, creates an implied warranty of non-infringement by licensors of information. This excludes many of the cases where the copyright infringement issue is most difficult. It follows the contract law premise that commitments about the absence of infringing material between two parties to a contract are appropriate in transactions where one party provides information to another, as compared to services contracts that might (or might not) constitute an access contract. Whether, a particular contracting party is a "licensor of information" for contract law, will depend on the

circumstances of the contract. It has no bearing on whether a passive transmission provider has liability to the owner of the intellectual property rights.

3. *Quiet Enjoyment Warranty.* Subsection (b)(1) deals with issues other than intellectual property infringement. The licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. Non-interference represent the essence of the contract. See General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175, 181 (1938); Spindelfabrik Suessen-Schurr v. Schubert & Salzer, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. den. 484 U.S. 1063 (1988). This "quiet enjoyment" warranty comes from Article 2A and is to be construed in a manner consistent with that Article. It basically reflects the licensor's implied commitment to not act in a manner that detracts from the rights granted to the licensee for the term of the license by interfering with the licensee's use.

4. *Public Domain and Exclusivity Warranty.* Subsections (b)(2) deals with two intellectual property risks in exclusive licenses. General intellectual property risks in contracting encompass three different issues:

public domain risk: Whether enforceable rights exist in the information transferred? This asks whether the information is in the public domain and thus useable by anyone with access to it.

exclusivity risk: Whether the transferor has the sole right to the information or whether that right is also held by third parties (e.g., assignees, joint authors or coinventors).

infringement risk: Whether the transferor can convey rights enable the licensee to exercise those rights without infringing third party rights in the technology?

Subsection (a) deals with the infringement risk. Subsection (b)(2) deals with the other two risks. Both of these are relevant only in contracts that purport to give exclusive rights since each focuses on whether the licensor can grant such rights good against all third parties.

Validity corresponds to the public domain risk. It important especially if a licensee relies on the rights transferred to create a product for third parties. The converse of validity is that the information is in the public domain and, thus, can be used or recreated by anyone. See M. Nimmer & D. Nimmer, The Law of Copyright ' 10.13[A]. See M&A Assoc. v. VCX, 657 F.Supp. 454 (E.D. Mich. 1987), aff'd, 856 F.2d 195 (licensor's failure to place appropriate copyright notices on motion picture violated warranty of title). Validity is not relevant to the ordinary end user license since it does not affect the licensee's right to use the information.

Subsection (b)(2) also deals with exclusivity: the risk that a portion of the rights may be vested in another person. Coequal rights exist where co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In either case, while a transfer may convey rights, it may be no more than equal to rights vested in and available for conveyance by the third party co-author. Depending on the underlying agreement, the existence of coequal rights in other parties may have no relevance to the transferee or it may be a critical limit on the licensee's ability to recoup investment.

Exclusivity is an important issue where a licensee undertakes significant investment on the assumption that its rights are exclusive as to other competitors. For non-exclusive licenses, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant. It does not alter the end user's ability to continue to use the licensed rights without challenge. A license from one co-owner adequately grants rights to the licensee and the dispute would then shift to one between the two co-owners to determine accounting for and distribution of the proceeds f the license.

5. *International Issues.* Intellectual property rights are territorial in character in that they extend only within the territory of the state that creates them, except as some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) parallels this facet of intellectual property law and provides that the obligations created about exclusivity and infringement extend only within this country and to a country specifically named in the scope of the license. Unless a country is specifically so designated, the assumption is that the licensor and the licensee undertake obligations only with respect t this country.

6. *Disclaimer.* Article 2B provides for disclaimer of the warranties under this Section based on language from existing Article 2. This requires specific language or circumstances indicating that the warranties are not given. In addition, consistent with the general approach of contract law as a planning tool, illustrative language is provided for purposes of disclaimer.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) Subject to subsection (c), express warranties by the licensor are created as follows:

(1) Any affirmation of fact or promise made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information required under the agreement will conform to the affirmation or promise.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will reasonably conform to the performance illustrated by the model, sample, or demonstration, taking into account such differences between the sample, model, or demonstration and the information as it would be used as would be apparent to a reasonable person in the position of the licensee.

(b) It is not necessary to the creation of an express warranty that the licensor use formal words such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, an affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics or market appeal of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) This section does not create any express warranty for published informational content but does not preclude the creation of an express warranty under other law or the creation of an express contractual obligation. If an express warranty or contractual obligation is established for published informational content and is breached, the remedies of the aggrieved party arise under this article.

Uniform Law Source: Section 2A-210. Section 2-313.

Definitional Cross Reference:

“Aggrieved party”. Section 1-201. “Information”. Section 2B-102. “Licensor”. 2B-102. “Party”. Section 1-201. “Published Informational Content”. Section 2B-102.

Committee Votes:

a. Deleted former subsection (b) that warranties are limited to the time of transfer based on the argument that this merely restates current law and that the issue can be made clear in the comments.

b. Motion to limit this section to the immediate parties, allow other parties to be included if courts decide to do so. Rejected: 4-5

c. Motion to amend by adding "except for published informational content" with the comments or the section to make it clear that it's neutral on the law development here. Adopted 7-3.

d. Motion to change the presentation of the except clause for published informational content, making an affirmative statement in (c) that leaves the development of obligations for informational content to common law under standards evolved therein. Adopted: 6-2 (June, 1997)

Notes to this Draft:

Edited for clarity and to increase conformance to existing Article 2.

Reporter's Note:

1. *Basis of the Bargain: General Approach.* This section adopts existing Article 2, except with respect to published informational content, where it preserves current common law rules relating to express obligations without changing standards applicable under this other law.

Subsection (a) retains the "basis of the bargain" standard from current Article 2 and Article 2A. This allows courts and parties to draw on an extensive body of case law for distinguishing express warranties from puffing and other, non-enforceable statements. While the cases involve many difficult factual determinations, they provide better guidance than would an entirely new standard. See, e.g., <u>Fargo Machine & Tool Co. v. Kearney & Trecker Corp.</u>, 428 F. Supp. 364 (E.D. Mich. 1977); <u>Computerized Radiological Service v. Syntex</u>, 595 F.Supp. 1495 (E.D.N.Y. 1984), rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986); <u>Management Sys. Assocs. v. McDonnell Douglas Corp.</u>, 762 F.2d 1161 (4th Cir. 1985); <u>Consolidated Data Terminal v. Applied Digital Systems Inc.</u>, 708 F.2d 385 (9th Cir. 1983); <u>Cricket Alley Corp. v. Data Terminal Systems, Inc.</u>, 240 Kan. 661, 732 P.2d 719 (Kan. 1987).

While there has been some dispute about the meaning of the traditional "basis of the bargain" standard, by retaining that current Article 2 standard, Article 2B allows courts to use the full panoply of doctrines that they have evolved. The basic concept is that express affirmations, promises and the like are enforceable as express warranties if they fit within the matrix of elements that constitute the bargain of the parties, but that they are not enforceable as express warranties if they are not part of the basis of the contractual deal. This standard does not require proof of reliance in the sense of a particular representation being relied on to make the deal, but rather enables a more general showing that the statements are part of the deal and basic to it.

2. *Basis of the Bargain: Advertising.* Subsection (a)(1) conforms to existing Article 2, except in one respect. It expressly provides that advertising or other forms of general communication may serve as a basis for the existence of an express warranty. This clarifies the rule and expands the scope of express warranty rules in some states. Statements made in advertising, of course, become express warranties under the standards applicable to any form of statement regarding the information. Mere puffing does not create a warranty and expressions of fact or promises are warranties only if they are part of the basis of the bargain. Of course, this requires that a bargain occur between the licensor making the representations and the licensee. In the absence of such a relationship, liability for advertising statements, if any arise, would not be under contract law, but under tort or advertising law rules.

3. *Basis of the Bargain: Samples and Models.* Subsection (a)(3) deals with samples and similar demonstrations. It expands current Article 2 rules by expressly referring to express warranties created by demonstrations of an information product.

The subsection also deals with beta models, which are employed in testing not yet completed products. A beta model may include elements that are not carried into the final product and may include defects that are not cured in the final product. In either event, the parties both expect that the product being demonstrated or used is not representative of what will eventually be the product and the exclusion here is designed to protect against harm to either party as a result (e.g., licensee believes a defect will be cured, but it is not cured; licensor elects to delete an element in the test model when it produces the eventual product).

More generally, the subsection indicates explicitly that the representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the sample. Thus, in the world of goods, showing a sample of a keg of raw beans by lifting out a cup-full and allowing the buyer to inspect it communications one inference as to a whole, while a demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files.

The standard stated in this text captures the approach of most courts to such issues.

4. *Published Informational Content.* Subsection (c) preserves current law for published informational content. While there are many reported cases dealing with express warranties in goods and using the standards adopted here, no case law exists for published informational content using the Article 2 standards. This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability risks pertaining to this subject matter must balance contract themes with more general social policies.

The intent in subsection (c) is to leave undisturbed any existing law dealing with under what obligations can be created and how they are established with reference to published information. Courts, if inclined to find contract liability for published information, may do so under any general contract law theory. Many will conclude that the broad risk in the published content situation and the potentially stifling effect that imposing contract liability in that realm might have on the dissemination of speech should lean toward limiting or excluding liability in that context. However, that dispute evolves in particular cases, merely adopting Article 2 concepts from sales of goods to this much different context would risk a large and largely unknown change or over-reaching of liability in a sensitive area.

The term, "published information content" focuses on information content not customized to particular end users. (Section 2B-102) The exclusion follows current law, requiring more than just general, undifferentiated statement for expanding liability in the public market of ideas and content. The basic assumption in current law is that liability for information content does not exist unless there is a special or direct relationship creating it. There are no cases using warranty theory for generally distributed information based on contract concepts and only a small number of cases under other contract theory.

SECTION 2B-403. IMPLIED WARRANTY: MERCHANTABILITY AND QUALITY OF COMPUTER PROGRAM.

(a) Unless excluded or modified, a warranty that the computer program and physical medium shall be merchantable is implied in a mass-market transaction if the licensor is a merchant with respect to computer programs of that kind.

(b) To be merchantable, a computer program and any physical medium on which it is delivered must:

(1) pass without objection in the trade under the contract description;

(2) be fit for the ordinary purposes for which it is distributed;

(3) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved; and

(4) be adequately contained, packaged and labeled as the agreement may require; and

(5) conform to the promises or affirmations of fact made on the container or label

if any.

(c) In cases not governed by subsection (a), unless otherwise excluded or modified, a licensor that is a merchant with respect to computer programs of that kind warrants to its licensee that:

(1) any physical medium on which the program is delivered is merchantable; and

(2) the computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation provided by the licensor at or before the delivery of the program.

(d) An affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics or market appeal, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty under subsection (b)(2).

(e) <u>Unless excluded or modified, other implied warranties may arise from course of dealing or usage of trade.</u>

(f) Warranties created under this section pertain to the functionality of a computer program, but do not pertain to informational content, including the quality, aesthetics, market appeal, accuracy, or other characteristics of informational content, whether or not the content is included in or created by a computer program.

Uniform Law Source: Section 2-314; 2A-212. Revised.

Definitional Cross Reference:

"Agreement". Section 1-201. "Computer program". Section 2B-102. "Contract". Section 2B-102. "Delivery". Section 2B-102."Information". Section 2B-102. "Informational content". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Mass-market transaction". Section 2B-102. "Merchant". Section 2B-102. "Software". Section 2B-102. "Value". Section 1-201.

Committee Votes:

a. Rejected a motion to add language warranting that the program will not damage ordinary configured systems because no "ordinary system" exists in modern licensing and the general premise is covered under the language of existing Article 2 as brought forward here.

b. Voted 10-2 to use "mass market" in this section, rather than "consumer." (Feb. 1997)

Notes to this Draft: Edited for clarity. New subsection (e) is added to correspond to existing Article 2. A conforming changes should also be made in reference to disclaimers through use of trade.

Reporter's Notes:

The Committee should consider the following replacement for the current Draft. The replacement eliminates the mass market distinction and focuses the terms of the warranty on criteria relevant to and useful in reference to software. It corresponds to the tradition in which the original merchantability warranty was developed.

(a) A merchant licensor of a computer program warrants to the end user that the computer program is reasonably fit for the ordinary purpose for which it is distributed.

(b) A merchant licensor of a computer program warrants to a retailer that

(1) the program is adequately packaged and labeled as the agreement or circumstances may require; and

(2) in the case of multiple copies, that the copies are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all the units involved.

(c) A warranty under this section does not pertain to the quality, aesthetics, market appeal, accuracy, or other characteristics of informational content whether or not the content is included within or created by a computer program or software.

General Notes:

1. Article 2B warranties blend three different legal traditions. **One** tradition stems from the UCC and focuses on the quality of the product. This tradition centers on the result delivered: a product that conforms to ordinary standards of performance. The **second** tradition stems from common law, including cases on licenses, services contracts and information contracts. This tradition focuses on how a contract is performed, the process rather than the result. The obligations of the transferor are to perform in a reasonably careful and workmanlike manner. The **third** tradition comes from the area of contracts dealing with informational content and essentially disallows implied obligations of accuracy or otherwise in reference to information transferred outside of a special relationship of reliance. Current law selects the applicable tradition in part based on characterizations about whether a transaction involves goods or not. That distinction is not reliable in information contracting, especially in light of the ability to transfer information electronically without the use of any tangible property to carry the intangibles.

2. This section and the next following section define the basis on which the different traditions apply, focusing on a distinction between "computer programs" and services or informational content. This expands the scope of the quality warranty here by including at least some cases where a court would otherwise conclude that the transaction is actually a services contract. See, e.g.,, Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W. D. Pa. 1991) (license of manufacturing process described as "services"). Compare Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992); The Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993)

3. The two implied warranties are not mutually exclusive. In many cases, both will apply to the same transaction and the same digital product (e.g., an encyclopedia). In the final comments to the statute, notes will be developed containing illustrations indicating the manner in which the warranties work together.

Illustration 1: Party A contracts to transfer software to Party B that will allow B to process its accounts receivable. Whether the transfer is by diskette or by electronic conveyance into B's computer, the implied warranty in this section applies. Under current law, this would be a transaction in goods with an implied warranty attached to the performance of the product.

Illustration 2: Party A licenses Party B to use a copy of the Marvel Encyclopedia. This warranty applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia. Under current law, this would be an information contract most likely involving no warranty about the accuracy of the information.

Illustration 3: Party A reaches a license with Party B. Party A will transfer its data to B's computer for processing there. B agrees to return various reports and summaries to A. The 2B-403 warranty does not apply since the contract did not deliver a computer program to A, but use of B's facility. Under current law, most cases hold that this is a services contract containing at most a warranty of workmanlike conduct; it is governed here under general standards of contract and by the implied warranty in Section 2B-404.

4. Merchantability sets the standard for computer programs in the mass market, where the idea of comparing a particular program to other mass market programs of similar type. This draft uses a substantial conformance to documentation standard for non-mass market software. That warranty is common in commercial licenses. The prevalence in commercial cases of disclaiming merchantability is such that virtually no software cases dealing with that warranty. The reliance on conformance to documentation reflects the wide range of variations involved in the non-mass market. The two standards both give assurances of quality, but focus on different reference points. Merchantability asks what are normal characteristics of ordinary products of this type, while the documentation warranty focuses on the manuals and contours of the particular product. Beside conforming to ordinary commercial practice (e.g., disclaim merchantability and give substantial conformance warranty), the substantive question here deals with whether merchantability is a relevant standard and at all protective in cases where software is often relatively unique. For example, assume a commercial computer program that provides data compression functions on an ABC computer with an XYZ operating system. Merchantability would ask whether that product passes without objection among all data compression products of all types (e.g., mass market, Windows-based, Apple systems, etc.) even though the particular environment, approach and capabilities of this product may be unique. How that standard protects the licensee is not clear and in fact it may set out standards well below what the documentation provides.

5. Most agreements disclaim merchantability; there are few reported commercial cases involving merchantability in any industry. Most licenses substitute a warranty of conformance to documentation. The section treats this as 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) Unless otherwise excluded or modified and subject to subsections (b) and (c), a merchant that provides informational content in a special relationship of reliance or that provides services within this article to collect, compile, process, or transmit 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) with respect to:

(1) the quality, aesthetics, or market appeal of the content;

(2) published informational content;

(3) informational content in manuals, documentation, or the like, that does not constitute a material portion of the value in the transaction; or

(4) a party that acts as a conduit and provides no more than editorial services in distributing informational content, if the distributing party identified the informational content as having been prepared or created by a third party, unless the distributing party's own lack of care or workmanlike effort caused the inaccuracy resulting in the loss.

~~(c) The liability of a third party that provides informational content is not avoided by~~

~~the use of a conduit described in subsection (b)(4) or by the fact that the conduit is not liable for errors under that subsection.~~

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

Definitional Cross Reference:

"Informational content". Section 2B-102. "Licensee". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Published informational content". Section 2B-102. "Value". Section 1-201.

Committee Actions: Reviewed without substantive change.

Notes to this Draft: Edited for clarity. Subsection (c) deleted as not necessary in light of scope of (b)(4).

Reporter's Notes:

1. This section creates a warranty applicable to consulting, data processing, information content, and similar contracts involving an information provider or processor dealing directly with a client and, with respect to content, where the provider tailors or customizes its information for the client's purposes or being in a special relationship of reliance with that client. No warranty of this type exists under current law, but the terms of the warranty reflect case law on information contracts. In Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (NY 1977), for example, the New York Court of Appeals rejected a UCC warranty of fitness for a purpose in a contract for the design and installation of a sprinkler system. "[Those] who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct ... unless the parties have contractually bound themselves to a higher standard of performance..."

2. Restatement (Second) of Torts § 552 regarding negligent misrepresentation provides a framework. It states that: "One who, in the cause of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."

In most states, this liability does not exist in the absence of a "special relationship" between the parties justifying a duty of reasonable care. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship); A.T. Kearney v. IBM, -- F.3d – (9th Cir. 1997). The obligation consists of a commitment that the content provided will not be wrong due to a failure by the provider to exercise reasonable care. Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (license of index; liability for inaccurate number tested under Restatement concepts in light of contractual disclaimer; information, although handled in commercial deals is not a product taking it outside this Restatement approach). Under Restatement case law, the obligation is limited to cases involving a special or fiduciary relationship. Under subsection (a) the obligation does not center on delivering a correct result, but on care and effort in performing. A contracting party that provides inaccurate information does not breach unless the inaccuracy is attributable to fault on its part. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Liability under the Restatement for inaccurate information exists only if the information was intended or designed to guide the business decisions of the other party. This section is not limited to cases involving business guidance.

3. The cases largely exclude liability for information distributed to the public. This concept is captured by the term "published informational content" in subsection (b)(2). "Published informational content" refers to information made available without being customized for a particular business situation of a particular licensee and where no "special relationship" of reliance exists between the parties. It is material made available in a standardized form to a public defined by the nature of the material involved. The information is not tailored to the client's needs. This definition and the liability exclusion reflects the vast majority of case law under the Restatement and modern values of not inhibiting the flow of content. The policy values supporting this stem in part from First Amendment considerations, but also from ingrained social norms about the value of information and of encouraging its distribution.

Illustration 1: Sam opens a website making available information on restaurants for a small monthly fee for subscribers. One item of information concerning Restaurant A is incorrect and a subscriber has a bad experience because of the error. Sam's website contains published informational content and creates no warranty or resulting liability. The same would be true of a restaurant review in the New York Times.

Illustration 2: Sam, an expert on restaurants, contracts with Able to provide advice about which restaurants should be included in Able's book on the "most profitable" Chicago restaurants. Sam makes a negligent error in providing a list of restaurants. Sam has liability under this warranty as to Able since the information is not "published informational content" but was tailored to the specific purposes of the specific client. When the book is published, however, no warranty exists for either provider to the end user since the book is published informational content.

4. Subsection (b) lists situations in which the warranty does not arise under current law. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy, an element present in current U.S. law and important in the publishing and entertainment industries affected by this Article. This point, although it could be inferred from the affirmative terms of the warranty, has substantial importance and language was added to this subsection based on suggestions from a licensee representative involved with entertainment issues.

5. Subsection (b)(4) states as a contract law principle case law that holds the publisher harmless from claims based on inaccuracies in third party materials that are merely distributed by it. In part, this case law stems from concerns about free speech and leaving commerce in information free from the encumbrance of liability where third parties develop the information. In cases of egregious conduct, ordinary principles of negligence apply. As a contractual matter, however, merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to that data by the third party. See Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991); Walter v. Bauer, 109 Misc 2d 189, 439 N.Y.S.2d 821 (S. Ct. 1981). Compare: Brockelsby v. United States, 767 F.2d 1288 (9th Cir. 1985) (liability for technical air charts where publisher designed product) (query whether this is a publicly distributed product).

6. The issue is important for information systems analogous to newspapers and are treated as such here for purposes of contract law. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship). The District Court in Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information."

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless excluded or modified, if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information:

(1) there is an implied warranty that the information will be fit for that purpose unless,

(2) from all the circumstances, it appears that the licensor was to be paid for the amount of its time or effort regardless of the suitability of the information, in which case, the implied warranty is that there is no failure to achieve the licensee's particular purpose caused by

the licensor's lack of reasonable care and workmanlike effort to achieve that purpose.

~~(a) Unless excluded or modified and except with respect to the quality, aesthetics, or market appeal of informational content, if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish a suitable information:~~

~~(1) there is an implied warranty that the information will be fit for that purpose if, from all the circumstances, it appears that the contract was for a price which would not be fully paid if the end product is not suitable for the particular purpose; but~~

~~(2) if, from all the circumstances, it appears that the licensor was to be paid for the amount of its time or effort regardless of the suitability of the end product, there is an implied warranty that there is no failure to achieve the licensee's particular purpose caused by the licensor's failure to exercise reasonable care and workmanlike effort to achieve the licensee's purpose in its performance.~~

(b) Subsection (a) does not apply to the quality, aesthetics, or market appeal of informational content, or to published informational content. However, it does apply to the selection among different items of existing published informational content for the purposes of a particular licensee.

(c) If an agreement requires a licensor to provide or select an integrated system consisting of computer programs, hardware or similar components and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components selected will function together as a system.

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.

Definitional Cross Reference:
"Agreement". Section 1-201. "Computer program". Section 2B-102. "Information". Section 2B-102. "Informational content". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Published informational content". Section 2B-102.

Committee Action:

a. Consensus to expand this section to cover all forms of information with the possibility of an exception or special treatment for published informational content and manufacturer/ publishers.

Notes to this Draft: Revised to reflect licensee concerns. This Draft presumes that the Article 2 rule applies, unless the circumstances indicate that a services contract is intended. See note 1 regarding the case where there is a contract with defined performance standards, but no "suitability" expectation.

Reporter's Note:

1. This section adopts existing Article 2-315 in subsection (a)(1). It also provides a standard to determine when a services law obligation, rather than a sale of goods obligation arises in subsection (a)(2). In either case, however, the implied warranty is in addition to express contract terms and does not supplant the obligation to conform to a contract. Thus, for example, if a contract calls for a development of information to specifications A and B, the licensor's basic obligation is to conform to the agreement and meet the specifications. If, in addition, there is a question of whether the licensee is relying on the licensor's expertise to create a product with those characteristics that is suitable for the licensee's intended purpose, but no contract term expressly so states, the implied warranties here provide additional obligations on the licensor as indicated.

2. This section does not over-ride the general law of services contracts for performance standards in that context. It applies only to situations where the parties are either dealing with selection among existing information

products or a contract for the development and delivery of information. A pure services or access contract is not covered under this implied warranty.

3. This Section reconciles several diverse traditions that exist in information industries and an unresolved dispute with respect to computer software in current Article 2 and common law. The issues raised here are most often encountered in development and design contracts. There, the basic issue is whether (if not disclaimed) the appropriate implied obligation involves an obligation to produce a satisfactory result (present in sales of goods contract) or an obligation to make workmanlike efforts (present in services contracts). The software cases choose between a warranty of result and a warranty of effort based on whether the court views the transaction as involving goods (result) or services (effort). The reported cases split on this issue, often turning on the subjective impressions of the court, rather than on any differences in the actual transactions. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. 108, 546 N.E.2d 888 (1989) (goods); Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987) (goods) with Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988) (services); Wharton Management Group v. Sigma Consultants, Inc., 1990 WESTLAW 18360, aff'd 582 A.2d 936 (Del. 1990) (services contract); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) (services).

2. Software development contracts are covered under Article 2B without regard to classification of the contract as involving services or goods. Given that coverage, subsection (a) presents a different approach to determining which type of implied obligation is appropriate. That approach in effect attempts to directly identify a consistent factor that will indicate which type of implied obligation is appropriate in the circumstances. The factor centers on whether the agreement hinges payment on the time and effort spent (services like) or only on the completion of an adequate product (goods like). While the section refers to all of the circumstances as providing the basis for this determination, it is clear that the express contract terms on the relevant point control.

3. During the June Meeting, the Committee expanded the section to cover more than computer program cases. Given that expansion, a third body of case law becomes important as to warranties. This is the body of case law that holds that, in some situations, as a matter of law, the implied obligation of either type stated in subsection (a) can never arise. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977) (An 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 (c) 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) Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty shall be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, disclaimer or modification is inoperative to the extent that such construction is unreasonable.

(b) Except as provided in subsection (c), to disclaim or modify an implied warranty or any part of it, other than the warranty in 2B-401, the following rules apply:

(1) Language of disclaimer or limitation 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, is sufficient as to Section 2B-404.

(3) To disclaim or modify an implied warranty arising under Section 2B-405, it is sufficient to state “There is no warranty that this information or my efforts will fulfill any of your particular purposes or needs”, or words of similar import.

(4) In a mass-market license:

(i) language in a record that disclaims or modifies an implied warranty must be conspicuous; and

(ii) to disclaim all implied warranties, other than the warranty under Section 2B-401, language in a record is sufficient if it states: “Except for express warranties stated in this cvontract, if any, this [information] [computer program] is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user,” or words of similar import.

(5) Notwithstanding any other provision of this subsection, language sufficient to disclaim or modify the implied warranty of merchantability under Article 2 or 2A is sufficient to disclaim or modify the warranties under Sections 2B-403 and 2B-404, and language sufficient to disclaim or modify a warranty of fitness for a particular purpose under Article 2 or 2A is sufficient to disclaim or modify the warranty under Section 2B-405.

(c) Nothwithstanding subsection (b), the following rules apply:

(1) Unless the circumstances indicate otherwise, <u>and except with respect to a mass market license</u>, all implied warranties are disclaimed by expressions like “as is,” “with all faults” or other language that in common understanding calls the licensee's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(2) There is no implied warranty with respect to a defect that before entering the

contract was known to, discovered by, or disclosed to the licensee, or that would have been discovered by the licensee if it made use of a reasonable opportunity provided to it prior to entering into the contract to examine, inspect, or test the information or a sample thereof, unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time.

(3) An implied warranty may also be excluded or modified by course of dealing or course of performance [or usage of trade].

(d) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer that complies with this section is effective with respect to all performances that occur after the contract is formed.

(e) Remedies for breach of warranty may be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy.

Uniform Law Source: Section 2A-214. Revised.

Definitional Cross Reference:

"Computer program". Section 2B-102. "Conspicuous". Section 2B-102. "Contract". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Mass-market license". Section 2B-102. "Record". Section 2B-102.

Committee Votes:

a. Voted to delete requirement of conspicuousness for non-mass market disclaimers.

b. Rejected a motion to delete conspicuousness for mass market contracts.

c. Rejected a motion to delete former (b)(5) by a vote of 3 - 6.

d. Accepted a motion to delete former (b)(6) by a vote of 6 -4 with the ability to rewrite to focus and clarify effects, perhaps in reference to known defects.

e. Adopted a motion to delete the reference to use of trade in former (b)(5) by a vote of 8 - 2.

f. Adopted a motion to restrict "as is" language to exclude coverage of 2B-405 because at that time that warranty created a services obligation. Vote was 6- 3.

g. Motion to adopt mass market, rather than the idea of consumer on disclaimers. Adopted 8-2 (Dec. 1996)

h. Motion to adopt language from Article 2 precluding disclaimer of consequential damages relating to personal injury, rejected by a vote of 2-8.

i. Motion to provide that a term that is conspicuous is not a refusal term under former 2B-308. Accepted 9-1

j. Voted 7-6 to use mass market, rather than consumer in this section. (Feb. 1997).

Selected Issue:

a. Should this Article deviate from existing article 2 by requiring that a disclaimer be in a record?

b. Should this Article conform to existing Article 2 and reinstate the bracketed reference to "trade usage"?

Reporter's Note:

Notes to this Draft: Reorganized and edited for clarity.

1. Subsection (a) restates current law, using language of "disclaimer" and "modification.".

2. Subsection (b) brings together provisions dealing with commercial disclaimers. Subsection (b)(1) requires that the disclaimer be in a record, thus not following the possibility in drafts of Article 2 that an oral disclaimer

suffices Subsection (b)(2) sets out a safe harbor for the merchantability warranties and also allows an Article 2 disclaimer to be effective in reference to the two merchantability like warranties in Article 2B. The purpose of this latter rule is to avoid requiring that the guess about coverage of the two articles. Importantly, as in existing and revised Article 2, the specified language is not mandatory, but merely sets out a safe harbor. This language works, but other language may also work. (b)(3) provides a more common language disclaimer treatment than in current law.

3. Subsection (c) deals with concerns expressed during the November meeting which deleted prior language taken directly from existing Article 2. The revised language emphasizes knowledge or opportunity to know of the defect and also expressly disallows a licensor's failure to disclose defects that it knows to be present. Equally important, by focusing on reasonable use and resulting disclosure, the redraft avoids the potential problem in which might disallow any implied warranty where inspection was as fully as the licensee "desired". In complex systems often provided through retail outlets, that standard is not workable.

3. Subsection (d) deals with mass-market disclaimers. The subsection adds two requirements applicable to mass market transactions that do not apply for other transactions. First, the disclaimer must be conspicuous. That requirement does not apply to commercial transactions in Article 2B. Second, if the intent is to disclaim all warranties in a single sentence, the subsection sets out a common language disclaimer based on proposals by the software industry as a means of giving more disclosure to the consumer of what is disclaimed. That language is a safe harbor, rather than a required statement.

5. Subsection (f) exempts disclaimers that qualify under this section from further consideration under the "refusal terms" concepts outlined in Section 2B-308.

6. Subsection (g) conforms to current law and revised Article 2.

SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM.

Modification of a computer program by a licensee which was not made using a capability of the program intended for that purpose in the ordinary course of operation of the program, invalidates any warranties, express or implied, regarding the performance of the modified copy of the program, but not the unmodified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to the computer program.

Uniform Law Source: None

Definitional Cross Reference:

"Computer program". Section 2B-102. "Copy". Section 2B-102. "Licensee". Section 2B-102.

Reporter's Notes:

1. This method of losing warranty protection applies only to warranties related to the performance or results of the software. It does not apply to title and non-infringement warranties. More importantly, the voiding of performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

2. The basis for the provision lies in the fact that because of the complexity of software systems changes may cause unanticipated and uncertain results. This language follows common practice. It voids the warranties whether the modification is authorized or not unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes in the program that are not part of the program structure or options itself. Thus, if a user employs the built-in capacity of a word processing program to tailor a menu of options suited to the end user's use of the program, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties as to the altered copy.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties, whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications displace an inconsistent sample or model, or general language of description.

(2) A sample displaces inconsistent general language of description.

(3) Express warranties displace inconsistent implied warranties other than the implied warranty under Section 2B-405(a).

Uniform Law Source: § 2-317.

Committee Action:

Approved in principle.

Notes to this Draft: Edited to conform to existing Article 2.

Reporter's Note: This Section follows existing Article 2, except that the reference to a sample is not limited to samples from "an existing bulk."

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for published informational content, a warranty to a licensee extends to persons for whose benefit the licensor intends to supply the information and that rightfully use the information in a transaction or application of a kind in which the licensor intends the information to be used.

(b) For purposes of subsection (a), a licensor in a consumer transaction is deemed to have intended to supply the information to all individuals in the immediate family or household of the licensee if it was reasonable to expect that the individual would rightfully use the information.

(c) A disclaimer or modification of a warranty, rights, or remedies that is effective against the licensee is effective against any third party under this section.

(d) A licensor's expressed intent to exclude or limit third-party beneficiaries excludes any contractual obligation or liability to the third parties other than persons in subsection (b).

Definitional Cross Reference:

"Consumer". Section 2B-102. "Copy". Section 2B-102. "Information". Section 2B-102. "Informational content". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Person".

Section 1-201. "Published informational content". Section 2B-102. "Rights". Section 1-201.

Committee Action:

a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

b. Reviewed without substantive comment or change.

Reporter's Notes:

1. This section defines third party beneficiary concepts. It neither expands nor restricts tort concepts that might apply with reference to third party risks in reference to information. The field of products liability remains outside this Article; governed by tort law in each jurisdiction. In the absence of prior law creating product or other tort liability for the subject mater covered by this Article, Article 2B allows the development of that theme to common law courts.

2. The section deals with when a beneficiary status exists. For a discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994). For a discussion of information liability to third parties, see Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts Restatement test; "By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information receive notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.").

3. Subsection (a) derives from and should be interpreted in light of both the 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 manufacturer which dealt directly with the laboratory).

While there may be a different policy dealing with software embedded in products, this Article does not deal with embedded products. Tort issues regarding, for example, the software that operates the brakes in an automobile falls within Article 2. No reported cases place products liability on software products that are not embedded in hardware products.

5. Restatement (Second) of Torts § 552 establishes a limited third party liability structure for persons who provide information to guide others in business decisions. This Section is consistent with that Restatement which limits liability to pecuniary loss suffered by the person or one of a limited group of persons for whose benefit and guidance he **intends** to supply the information or knows that the recipient intends to supply it; and through reliance upon it in a transaction that he **intends** the information to influence or knows that the recipient so intends or in a substantially similar transaction." In most states, no liability arises under this theory of action unless there is a "special relationship" between the information provider and the injured party. Modern case law is increasingly oriented toward the terms of the Restatement. See Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992). This is a contract law statute. To the extent that greater liability is desired, that should come from tort law development, rather than from an expanding notion of contract liability.

6. If the subject matter involves informational content, constitutional considerations and general considerations of policy often limit liability at least in respect of the liability of the publisher. See, e.g., Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991) (publisher of encyclopedia of mushrooms has no duty of care respecting accuracy); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer). Compare Brockelsby v. United States, 767 F.2d 1288 (9th Cir 1985); Saloomey v. Jeppeson & Co., 707 F.2d 671 (2d Cir 1983); Aetna Casualty & Surety Co. v. Jeppeson & Co., 642 F.2d 339 (9th Cir. 1981). Both of the latter cases deal with highly technical and highly specialized information products and impose liability on the author-publisher running to persons with no privity. They have not been followed with respect to any other information liability case.

7. Subsection (b) modifies beneficiary concepts to include the family of a licensee. This goes beyond the relevant alternative in current Article 2-318 which limits that extension to personal injury claims. The extension here covers both personal injury and economic losses.

8. Subsection (c) recognizes and flows from the fact that the basis of this section lies in beneficiary status, rather than product liability concepts. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. Thus, in Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993), for example, the court treated a license agreement involving Standard and Poors (SP), which provided data and index figures for daily closing of options based on the SP index, as an information contract. When SP provided an inaccurate number because of an error in the price of one stock, the court applied concepts of negligence and effort, rather than UCC warranty rules to gauge potential liability. The court held that concepts of negligent misrepresentation applied to this form of information service. The third parties were barred from recovery, however, based on a disclaimer in the original license agreement.

PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If an agreement transfers ownership of informational property rights and does not specify when ownership is to pass, ownership passes to the licensee:

(1) when the contract becomes enforceable, if the information is then in existence and is identified to the contract; or

(2) when the information is identified to the contract if the information is not in existence or is not identified when the contract becomes enforceable.

(b) Transfer of a copy does not transfer ownership of informational property rights in the information.

(c) In a license, the following rules apply to copies:

(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 grants the licensee a right to make and transfer copies to others, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(d) If the parties intend to transfer title to a copy and the agreement does not specify when title transfers, the following rules apply:

(1) Delivery of a copy on a physical medium transfers title to the copy at a time and place at which the licensor completed its obligations with respect to delivery.

(2) Electronic delivery of a copy to the licensee transfers title of the copy if a first sale occurs under federal copyright law in which case, at the time and place at which the licensor completed its obligations with respect to delivery.

(3) Refusal of the copy or the license revests title to the copy in the licensor.

Uniform Law Source: Section 2-401; section 2A-302. Revised.

Definitional Cross Reference:
"Agreement". Section 1-201. "Contract". Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Electronic". Section 2B-102. "Identified": Section 2-501. "Information". Section 2B-102. "Informational property rights". Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Rights". Section 1-201. "Sale". Section 2B-102.

Committee Vote:

a. Voted 11-0 to delete a sentence restricting exercise of rights until it pays according to the terms of the contract. That concept can be transferred to comments in a form that also accommodates in kind and other value.

Reporter's Notes:

[Edited for clarity and to reflect the policy that title vests in the licensee at the earliest reasonable stage.]

1. This section distinguishes title to the copy from ownership of the intellectual property rights, a point that is made explicit in subsection (b). This distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may carry with it some rights with respect to that copy, it does not convey ownership of the underlying rights to the work of authorship or the patented technology. This represents a basic theme in differentiating intangibles and tangible objects. The media here is not the message, but the conduit.

2. Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a

matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that limit. The subsection solves the problem in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article 2 theories of title transfer to goods to hold that title to an intangible (a computer program) being developed for a client could not pass until the program was fully completed and delivered.) The transfer of title hinges on completion to a sufficient level that separates the transferred property from other property of the transferor. See In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallows transfer of title in software where "new" code could not be separately identified from old or pre-existing code.).

In this Draft: A change was made in the timing of the transfer of ownership to accommodate concerns about the following circumstance: developer substantially completes the program, but client refuses to make any payment, even though there are no defects. In this case, given the breach by the client, title should not be in the transferee.

3. **Under subsection (c)**, in a license, the right to the copy of information depends on the terms of the contract and not on the label one applies to handling underlying media. As in Article 2A, this draft does not spell out title transfer rules with reference to licenses. The question of whether title to a copy in fact transfers in a license may depend on the terms of the license and the marketplace in which the license transaction occurs. Especially in many commercial licenses, it is inappropriate to presume that title does pass to the licensee in the absence of contractual reservation. The typical presumption is that the transfer there is conditional as reflected in the license terms. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (licenses transferred rights for exhibition or distribution and did not constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license not a sale).

The circumstances may be different in the mass market even where purchasers are aware that a license will be involved. As drafted, the section takes no position on that issue or how one distinguishes these cases. The mass market licensee receives protections under applicable default rules that are not based on title issues. If the issue were to become important in litigation and were not dealt with by contract, a court would presumably inquire about the intent of the parties as to title to the copy.

In subsection (c)(3), the primary rule is that a reservation of title in a delivered copy extends that reservation to all copies made by the licensee. That presumption is altered in cases where the license contemplates the licensee making copies for sale or other distribution. Thus, for example, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all the books. This concept does not apply where the expectation is that the licensee will transfer copies by a further license.

4. Subsection (d) deals with cases involving an intent to sell a copy and states various presumptions relating to when title passes to copies. The basic theme is that the contract controls. Absent contract terms, the draft distinguishes between tangible and electronic transfers. The rule for tangible transfers of a copy parallels Article 2 in current law. The electronic transfer approach defers to federal law on a potentially controversial issue. The White Paper on copyright in the Internet suggests and legislation is being considered to implement that the electronic delivery of a copy of a copyrighted work is not a first sale because it does not involve transfer of a copy from the licensor to the licensee. While state law could control questions of title to personal property, this draft suggests that the issue be left to federal policy.

SECTION 2B-502. TRANSFER OF PARTY'S INTEREST IN THE ABSENCE OF CONTRACTUAL TERMS ON TRANSFER. In the absence of a contractual term prohibiting or restricting transfers, the following rules apply:

(1) Except as otherwise provided in subsection (2), a party's rights under a contract may be transferred, including by an assignment or through a financier's interest, unless the transfer would materially change the duty of the other party, increase materially the burden or risk imposed on the other party, ~~cause a delegation of material performance,~~ disclose or

threaten to disclose trade secrets or confidential information of the other party, or impair materially the other party's likelihood or expectation of obtaining return performance.

(2) A transfer of a licensee's rights under a nonexclusive license is ineffective unless:

(A) the licensor consents to the transfer; or

(B) the transferee is subject to the terms of the license and:

(i) the non-exclusive license is a mass-market license [with a license fee of less than $1,000] under which the licensee has possession of a copy of the information, and the licensee delivers to the transferee or destroys all copies; or

(ii) the licensee owns title to the licensed copy, the license does not preclude transfer of the licensee's rights, and the transfer complies with federal copyright law for the owner of a copy to make the transfer.

(3) A transfer made in violation of this section is ineffective.

Uniform Law Source: Section 2-210. Substantially revised.

Definitional Cross Reference:

"Contract". Section 2B-102. "Copy". Section 2B-102. "Financier". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Mass-market license". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Nonexclusive license". Section 2B-102. "Party". Section 1-201. "Receive". Section 2B-102. "Rights". Section 1-201. "Term". Section 1-201.

Committee Vote:

a. Voted 7-1 to add a provision to allow transfer when the licensee owns the copy of the information.

b. Voted unanimously to use mass market, rather than consumer in this section.

Notes to this Draft: Edited for clarity. Bracketed language in subsection (2)(B) was added in response to concerns expressed by observers and Committee members about the effect of removal of dollar limitations on the definition of mass market license and the uncertainty that causes.

Reporter's Notes:

1. "Transfer" means a conveyance of rights and duties under a contract and contrasts to merely delegating or sub-licensing performance where the delegator remains primarily responsible and in control of the contract performance. It contrasts to the idea of delegation or sublicense which involve a shift of the performance to a third party without transferring the contractual rights. Section 2B-506 deals with delegation of performance or sublicensing.

2. The provisions of this Section apply in the absence of contractual restrictions. The effect of contract restrictions on alienation are treated elsewhere as is the enforceability of a security interest. Subsection (a) states a general principle of transferability subject to that being disallowed in cases where the transfer jeopardizes significant interests of the other party to the license contract. This is consistent with general UCC themes, except that the subsections spell out additional protected interests that block transfer and that are important here, but not in reference to sales of goods. Included among those interests are transfers that create and actual disclosure or threaten a disclosure of confidential material. Whether this occurs must be viewed in context of the original transaction. The application of this concept would be limited to cases where actual trade secret or confidentiality relationships had been established

with respect to some of the information that forms the subject matter of the contract.

3. Subsection (a) expressly refers to transfers that disclose or threaten to disclose trade secret or confidential material of the other party. Whether particular information is confidential or not will ordinarily be determined by other law, including common law contract and trade secret law. Application of this limitation on transfer hinges on the existence of such an interest. The restriction on transfer that results occurs only if the transfer increases the risk of confidentiality disclosure juxtaposed to the original transaction itself. Thus, for example, if arguable trade secrets are embedded in object code of a computer program, but the contract does not place confidentiality restrictions on the licensee, merely transferring the copy to another party, if that is otherwise permitted, does not jeopardize the secrets for purposes of subsection (b). With reference to both the transferor and transferee, in the absence of enforceable confidentiality restrictions in the contract or otherwise in law, discovery of the secret information may be appropriate and the degree of risk does not change for the secret owner. On the other hand, where confidential material is subject to restrictions or is directly disclosed as a result of the transfer, the limitation in (a) applies. Of course, even if the limitation grounded in confidentiality concepts does not apply, a non-exclusive license may be otherwise non-transferable under the other provisions of this section.

4. Subsection (b) holds that a licensee cannot assign its rights in a nonexclusive license. For patents and copyrights, this represents federal policy. The fact that this federal policy overrides state law was restated and accepted by the Ninth Circuit in 1996. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9^{th} Cir. 1996); Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972). The non-transferability premise flows from the fact that a nonexclusive license is a personal, non-assignable contractual privilege, representing less than a property interest. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (copyright); In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W. D. Tenn. 1987).

5. The Ninth Circuit explained the policy basis for this federal law rule in reference to patent licenses in the following terms:

> Allowing free assignability - or, more accurately, allowing states to allow free assignability - of nonexclusive patent licenses 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. As a practical matter, free assignability of patent licenses might spell the end to paid-up licenses such as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for per-use royalties, if the license could be assigned to a completely different company which might make far greater use of the patented invention than could the original licensee. Thus federal law governs the assignability of patent licenses because of the conflict between federal patent policy and state laws, such as California's, that would allow assignability.

Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9^{th} Cir. 1996). The approach to non-exclusive copyright licenses in federal law is the same. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984).

6. The three exceptions in subsection (b) situations in which the basis of this policy are not present. The first deals with the case of actual consent. The second, mass market licenses, indicates the fact that in a mass market environment the licensor has essentially chosen not to be concerned about the identity of the particular licensee, but rather places the information out to the general public. In the third exception, federal law rules relating to first sales apply and allow the owner of a copy to distribute that copy, presumably along with the right to use/ copy that work in the case of computer software. See 17 USC § 117.

7. Subsection (d) states a rule on the effectiveness or ineffectiveness of transfers of non-exclusive license rights by a licensee that makes the transfer ineffective unless authorized by this section. Given the carve outs for mass market and owned-copy transactions in subsection (b), this rule carries forward the federal policy and the underlying personal nature of the non-exclusive licensee's rights. Cases such as Everex indicate not only that the attempted assignment violates contract provisions, but that it is invalid without the licensor's consent. The Ninth Circuit in Everex indicated that federal law sets out a bright line test invalidating the transfer without consent and entirely independent of whether there was (or was not) actual impact on the licensor's interests. The predominant interest here

focuses on the licensor's intellectual property rights and control of to whom the intellectual property is given. Article 2A, dealing with tangible property, makes the contrary assumption in 2A-303(5), but would generally enable a lessor to cancel the lease because of the transfer. Under the intellectual property regime that governs here, that additional step is not warranted and may be barred by existing case law. It is important to recognize, however, that the net effect of this section and the parallel rule in Section 2B-503 is to increase significantly the transferability of licensee rights.

SECTION 2B-503. CONTRACTUAL RESTRICTIONS ON TRANSFER.

(a) Except as otherwise provided in subsection (b) and (c), a contractual restriction on transfer of a party's contractual interest or of a licensor's informational property rights in the information that is the subject of a license is enforceable. A transfer made in breach of an enforceable term that prohibits transfer is ineffective.

(b) <u>A party may create a financier's interest notwithstanding</u> a term that prohibits transfer of a party's interest or creation of a financier's interest, except to the extent that creation of the financier's interest is precluded under Section 2B-502. Creation of the interest in violation of the term constitutes a breach.

(c) A term that prohibits or requires the other party's consent for transfer of a party's interest in an account or in a general intangible for money due or to become due is not enforceable.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).

Definitional Cross Reference:
"Contract". Section 2B-102. "Financier". Section 2B-102. "Information". Section 2B-102. "License". Section 2B-102. "Licensor". Section 2B-102. "Money". Section 1-201. "Party". Section 1-201. "Rights". Section 1-201.
"Term". Section 1-201.

Committee Vote:

a. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license.

Reporter's Note:

This Section generally validates contractual restrictions on the transfer of a contractual interest. The primary exceptions to this policy relate to financing arrangements, the transfer of interests in a cash flow from a license and the creation of a financier's interest under this Article.

SECTION 2B-504. FINANCIER'S INTEREST IN A LICENSE.

(a) The creation of a financier's interest in a party's rights under a license without the consent of the other party to the license is effective if the creation would be permitted under Section 2B-502 and be effective under 2B-503. However, enforcement of a financier's interest that results in a transfer or change of possession that results from is effective only if the transfer or change of possession would also be effective and permitted under Sections 2B-502 and 2B-503.

(b) If the creation or enforcement of a financier's interest in a licensee's rights under a nonexclusive license is not effective under subsection (a), the following rules apply:

(1) Subject to paragraph (2), the creation or enforcement is effective only to the extent that it does not result in:

(A) an actual transfer or change of the use or possession of or access to the information, or

(B) a result precluded by Section 2B-502(1) other than as to the obligation to make payments to the licensor.

(2) Upon a <u>material</u> breach of the financial accommodation contract by the licensee, as between the financier and a licensee, the financier has the rights of an aggrieved party under Section 2B-715. However, the financier may take possession of copies of the information or related materials covered by its interest only if the licensor consents or taking possession is permitted under Section 2B-502(a). The financier may not transfer or otherwise use the information without the consent of the licensor.

(c) A person that creates or enforces a financier's interest and any transferee of the financier is subject to the terms and limitations of the license and to the licensor's informational property rights. The financier may not use, sell, or otherwise transfer rights in the license or copies of the information or access to the information unless the conditions of subsection (a) are met as to enforcement of the interest.

(d) The creation or enforcement of a financier's interest imposes no obligations or duties on the licensor with respect to the financier.

Definitional Cross Reference:
"Contract". Section 2B-102. "Financier". Section 2B-102. "Information". Section 2B-102. "Informational property rights". Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Nonexclusive license". Section 2B-102. "Party". Section 1-201. "Rights". Section 1-201. "Term". Section 1-201.

Committee Action:

a. Consensus that Article 2B should allow creation of limited rights in licensee side of non-exclusive licenses, but not permit sale and the like without consent of the licensor.

Notes to this Section: Edited for clarity.

Reporter's Notes:

1. This section reflects the general approach of Article 2B of combined treatment of security interests and financing leases in an integrated treatment. The definition of "financier" covers both secured parties and lessors. See 2B-102.

2. As redrafted, subsection (a) makes clear that, in general, a financier's interest can be created in any contractual right that can be transferred and that, in all other cases, consent by the other party to the contract makes transfer possible, but that the act of creating a security interest and the act of enforcing that interest are separable events. Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's rights are dominant. Thus, a critical limit on enforcement and, except for non-possessory interests, creation of a financier's interest lies in 2B-502(a) which disallows transfers that impinge on licensor interests of the type described therein.

3. For non-exclusive licenses, the transferability of a licensee's rights is even further constrained in law by federal policy limitations that presume non-transferability without licensor consent. See 2B-502(b). This Article pushes the scope of secured lending in the absence of licensor consent as far are possible in light of that strong contrary and preemptive federal policy. It assumes that the license is non-assignable and personal for reasons noted in the cases cited in Section 2B-502 notes, but tailors a right to **create** a security interest without the licensor's consent in a manner that avoids preemption by satisfying the policy interests that underlie the basic non-assignability principle. Thus, while an interest can be created, it cannot, without the licensor's consent, result in an actual change of control, access or use or any sale. This preserves the licensor's protected interest under federal law in controlling the resale market and the identity of the licensee to whom it transfers rights in its intellectual property. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996). See also In re Patient Education Media, Inc., 210 BR 237 (Bankr. SD NY 1997) (copyright license).

4. The approach is modeled after Article 2A-303(3) which limits the enforceability of lease provisions restricting security interests in the lessee's interests. It applies here to both a contract clause and to a non-exclusive license that contains no such clause because, unlike in leases, the underlying law does not routinely allow assignment of the licensee's interest. The comments to Article 2A-303 state: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3. As in Article 2A, the licensor (lessor) has a right to control who is in effective possession (including use and access) of the subject matter of the license. In many cases, this will preclude repossession or sale without the licensor's consent. It does not prevent repossession and sale if the licensed rights would be transferable under 2B-502 and 2B-503.

5. The provisions here allow creation of a security interest in many cases because mere creation does not make an actual change of possession, use, or access, nor does it delegate obligations. The argument against preemption is that "creating" a security interest does not "transfer" or assign the interest under the license. The **Everex** case indicated that one aspect of the federal policy was that the intellectual property rights holder has a protected interest in restricting the use of its intellectual property by persons other than those it specifically authorizes. The approach in this draft draws a balance that allows full pursuit of that federal policy, but gives substantial scope to the state law policy of allowing creation of security interests. The same would not be true, for example, with a rule that allows all assignment of rights under the other section of transferability, a rule that would be specifically subject to preemption.

6. The draft also parallels Article 2A in providing that the secured lender and any transferee take subject to the terms of the original license. The license is the dominant document in that it defines the licensee's rights. A lender does not have the ability to abrogate those rights and the limitations that are attached to the rights.

7. The result of the financing provisions allow creation of a security interest in any case where creation, in itself, alters none of the actual interests of the parties. When it comes to enforcement of the interest, however, the lender's rights are subordinate to actual interests of either party and to federal policies about transferability. The effect of the provisions is illustrated in the following examples.

Illustration 1. Financing a Licensor's Interest.

Creditor desires to finance the licensor's interest in a commercial license. To determine whether it can do this, the creditor must make the following determinations: a) under 2B-502(a) would creation of the interest make a change that impinges one or more of the interests listed there; b) if not, under Section 2B-503 is there an enforceable no transfer provision that precludes creation of the interest without consent; c) if not, then the interest can be created under 2B-504(a). However, if the transfer is precluded by either of the above, no security interest can be created.

If an interest can be created, the lender would make the same analysis in reference to enforcement (e.g., repossession or sale). The issues are different, of course, since repossession or sale precludes some further uses and changes the party in control in a way that may adversely impact the licensee. The result of the analysis would depend on the licensor's personal role in the on-going license. In cases of fully paid up, perpetual licenses, enforcement would not be barred unless, for example, it threatens trade secret rights of the licensee.

Illustration 2. Financing the Licensee in a Commercial License.

Assume creditor desires to finance the licensee's interest in a commercial, non-exclusive license. It would ask the following questions: a) is the creation of the interest blocked by 2B-502(a) in that it would cause an inappropriate delegation, deny the return expected by the licensor, or otherwise adversely impact the interests listed there; b) if the interest is **permitted** under 2B-502(a), it is still prohibited under 2B-502(b) unless it falls into one of the exceptions there (mass market, or title without contract restriction); c) if it is not within an exception, the Creditor would not need to consult 2B-503, if it did so, however, and there was a contractual limitation on creation of an interest or on transfer, that contract terms is effective since creation of an interest is barred under 2B-502; d) if creation is barred under either 2B-502 or 2B-503, 2B-504(b)(1) still permits creation of an interest if this does not violate 2B-502(a) or change possession, use or control of the information.

In most cases, the net of these provisions allows **creation** of an interest in a non-exclusive license, but this does not permit the full panoply of enforcement. The analysis must be repeated for any effort to enforce the interest. Enforcement will involve different issues because it changes possession or use. The first stages of analysis are the same. If repossession or sale is barred under 2B-502 or 2B-503, which it will ordinarily be, 2B-504(b) may not alter that result *as to enforcement.* Under (b)(1) enforcement is not permitted if it changes possession or use. Section (b)(2) is an over-ride that allows taking possession (but not sale) and barring use, **but only if these acts do not violate the rules of 2B-502(a).** In effect, enforcement without licensor consent cannot occur if it adversely affects the licensor's interest, including an adverse effect by making the licensor's return less likely to be received. In end user softw3are, this will often allow a court order to prevent use under (b)(1), but may will not allow repossession. Section (b)(2) does not authorize enforcement by sale in a licensee situation in any case without the licensor's consent.

Illustration 3. Financing an Entertainment Licensee Interest.

Assume that the commercial license in Illustration 2 involves a distribution license for a motion picture. Under 2B-502(a), while creation of an interest in the licensee rights may not be barred, any enforcement of those rights without consent would typically be barred because it would change (increase) the risk of the licensor not receiving a return expected from the contract. This is true regardless of the presence or absence of contract provision. Under Section 2B-504, creation of the interest may be permitted under (b)(1), but typically, no enforcement would be permitted because enforcement (barring use, taking possession) would adversely effect the return and other interests of the licensor.

Illustration 4. Financing a Mass Market Licensee Interest.

The treatment of a mass market license parallels other non-exclusive licenses, except that the exception stated in 2B-502(b) shifts the presumptions and, at least if the definition of mass market focuses on anonymous, true retail transactions where the licensee identity is not relevant, the nature of the product will often eliminate a major limitation on transfer. Section 2B-504(a) requires analysis under 502 and 503. Under 2B-502 and 2B-503, a lender can create an interest in a mass market license if the creation of the interest does not result in a 502(a) injury to the licensor. Under these same sections, a lender can enforce the interest if a) enforcement does not violate 2B-502(a) and b) enforcement is not barred by a contract provision against enforcement or transfer. If either of these conditions preclude enforcement, the focus shifts to 2B-504(b). This section does not allow sale, but does allow creating an interest and enforcement that does not violate 502(a). In effect, in the **true** mass market the lender can create and enforce its interest unless the licensor contractually bars transfer, in which case, creation is still allowed. This solution works so long as the idea of mass market does not encroach too strongly into commercial transactions.

SECTION 2B-505. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

(a) <u>A transfer of "the contract" or of "all my rights under the contract" or a transfer in similar general terms, is an assignment of contractual rights.</u> Any transfer or assignment of a party's contractual rights is subject to all contractual use restrictions and, unless the language or circumstances indicate to the contrary (as in a transfer for security), is a delegation of performance of the duties of the transferor. Acceptance of the transfer constitutes a promise by the transferee to perform those duties. The promise is enforceable by the transferor or any other party to the original contract.

(b) A transfer of contractual rights does not relieve the transferor of a duty under the contract to pay or perform, or of liability for breach of contract, except to the extent the other party to the original contract agrees.

<u>(c) The other party may treat any transfer which delegates performance as creating reasonable grounds for insecurity and may without prejudice to its rights against the transferor demand assurances from the transferee pursuant to Section 2B-621.</u>

Uniform Law Source: 2-210; 2A-303.

Committee Action: Discussed in November, 1996, without substantial comment.

Notes to this Draft: Edited to conform to Section 2-210(4). Subsection (c) added to conform to 2-210(5).

Reporter's Note:

1. This section implements a policy in current Article 2 and Article 2A. The recipient of a transfer is bound to the terms of the original contract and that obligation can be enforced either by the transferor or the other party to the original contract.

2. This section clarifies that an effective transfer (assignment or otherwise) of rights under a contract constitutes a transfer of those contract rights and, a delegation of duties if accepted by the transferee. This language follows Article 2 (which uses the word assignment) and Article 2A (which refers to transfers).

3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent to the novation.

SECTION 2B-506. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may delegate or subcontract performance of its contractual obligations unless:

(1) the contract prohibits delegation or subcontracting;

~~(2) transfer would be prohibited under 2B-503;~~ or

(2) the other party has a substantial interest in having the original promissor perform or control the performance.

(b) No delegation or subcontract of performance relieves the party delegating of any duty to perform or of any liability for breach of contract.

Committee Action:

Reviewed in November, 1996, without substantial comment except that adjustments should be made to clarify that the section is subject to restrictions on transfer.

Uniform Law Source: Section 2-210; Section 2A-303.

Reporter's Notes:

1. Delegation or subcontracting of performance refers to a party's ability to use a third party in making an affirmative performance under an information contract. It does not refer to authorization or other allowance of third party exercise of rights in licensed information. pursuant to in a contract is generally allowed. In both cases, while the performance may be made by the delegee, the original; party remains bound by the contract and responsible for any breach thereof. The ability to delegate performance must be read in contrast to the general limitations on transferability in 2B-502.

2. The ability to delegate is subject to contrary agreement. Thus, a contract that permits use of licensed information only by a named person or entity controls and precludes delegation. The result in such cases is determined by both the general principle that contract terms control and the more specific principle that the other party has, by the contract, expressed an interest limiting performance to the designated party.

3. In the absence of a contractual limitation, delegation can occur unless the circumstances come within one of three conditions are met. The first condition that prevents delegation arises if the transfer of an interest would be precluded under 2B-503. That section disallows transfers in cases where the contract prohibits such action. The second condition, arises if the contract is silent but the other party has a substantial interest in having performance rendered by the person with whom it contracted. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions outlined in 2B-502(a). On the other hand, neither of these provisions would deny a right to delegate or subcontract performance in a mass market transaction where, under Section 502, can be freely transferred by the licensee.

SECTION 2B-507. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer of ownership of informational property rights is subject to a previous nonexclusive license if the license is enforceable between the parties under Section 2B-201 and was in a record authenticated by the licensor before the transfer of ownership.

(b) A financier's interest created by a licensor is subordinate to a nonexclusive license:

(1) authorized by the financier;

(2) documented in a record authenticated by the licensor before the financier's interest was perfected; or

(3) transferred in the ordinary course of the licensor's business to a licensee that acquired the license in good faith and without knowledge that it was in violation of the financier's interest.

(c) For purposes of this section, a transfer occurs when the transfer is effective between the parties. However, if applicable informational property rights law requires filing or a similar act to obtain priority against other transfers, the transfer does not occur until the date on which priority begins.

UNIFORM LAW SOURCE: Section 2A-304. Revised.

REPORTER'S NOTE:

1. This is an area heavily influenced by federal copyright law as to copyright interests and the provisions here attempt to trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption in reference to data, trade secrets and other non-federal rights. For security interests and their relationship in terms of priority to the rights created under an intangibles contract, the priority questions might be dealt with in this article as was done in Article 2A or they may be dealt with in Article 9. Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. Under the Copyright Act, a prior non-exclusive license is subordinate to a later transfer of copyright ownership unless the license is in a signed writing. This rule, while awkward and somewhat inconsistent with modern trends, was made part of the Copyright Act in 1976; there are no indications of probable repeal. The restatement of that rule here alerts persons who engage in commercial transactions about a priority rule that may not otherwise be expected. This avoids traps for unwary licensees. Note, however, that by using the new terms "record" and "authentication" this section are not yet explicitly adopted in federal law.

Illustration 1: Computer Associates sells the copyright in its data compression program to Major Holdings Corp. Five days before that sale, Computer Associates entered a non-exclusive license with Boeing Corp. for a 100 user site license, which license was in an unsigned form. Three days after the sale, Computer Associates entered a non-exclusive site license with Standard Corp. Under subsection (b) **and** under federal law, the licensees' rights to copy (e.g., use) the software are subordinate to the copyright ownership of Major.

Illustration 2: Lotus enters into a non-exclusive distribution license with Distributor, allowing Distributor to make and distribute copies of 1-2-3 Spreadsheet in the mass market subject to a standard form license for end users. Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale, Distributor provides a copy of 1-2-3 to Smith, who assents to the license. If the distribution license was a signed writing, the distribution was authorized by the license which has seniority over Taylor. Smith has priority over Taylor because it took through the valid license. If the distribution license was not a signed writing, Taylor's purchase is senior to that license and Smith is not an authorized user.

3. Subsection (b) also presents a preemption problem under federal copyright law, but the case for preemption is less clear since the UCC generally controls priorities and other aspects of law relating to security interests and the federal concerns in the priority statute are more focused on title transfers. This section does not take a position on whether a security interest should be filed in federal or state records systems; it simply refers to perfection of the interest. It adopts priority rules for a security interest in conflict with a nonexclusive license that parallel priority positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions that enable the licensor whose intangibles are encumbered to continue to do business in ordinary ways.

4. Article 2A deals with the priority conflicts that arise when the licensor or owner transfers to a third party an interest in the property that is subject to a lease. The focus in such cases is on relating the rights of the

transferee to the rights of the lessee in the particular item. That situation does not arise in intangibles involving two nonexclusive licenses since intangibles can be licensed an infinite number of times and each licensee receives the same rights. In contrast, if there is a transfer of ownership of the information there may be a conflict between the transferee and the licensee. There are two types of priority conflicts in such cases and modern law lacks clear guidance or commercially viable solutions. One conflict is between two transferees of ownership. The other is dealt with in this section: conflicting claims of a nonexclusive licensee as against a transferee of ownership rights, including a secured party.

5. For rights not created by federal law, the priority issue raised is a question of state law. The same is apparently true for rights that arise under federal patent law. The Patent Act contains provisions that deal with the respective priority of transfers of patent ownership. A nonexclusive license is not a transfer of ownership and the relationship between the nonexclusive licensee and a transferee of a patent is not dealt with in current federal law. The situation is different in copyright law. Section 205(f) of the Copyright Act provides:

A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if:

(1) the license was taken before execution of the transfer; or

(2) the license was taken in good faith before recordation of the transfer and without notice of it.

17 U.S.C. § 205(f). There is no case law under this provision. Significantly, however, the provision does not allow a license made after recordation of the ownership transfer to attain priority under any conditions. Also, an unwritten license will lose even to a subsequent transfer of ownership if this section is regarded as a comprehensive priority rule.

6. Copyright Act § 205(f) can be viewed as a comprehensive rule of priority (e.g., an unwritten license never superior to a transfer of ownership and the priority status of a written license entirely controlled by Section 205(f)). Alternatively, one might view it as a minimum condition for a particular result (e.g., that a written nonexclusive license has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This draft adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, as a matter of enacted federal policy, a nonexclusive license prevails in the listed situations, but a nonexclusive license in cases not covered by Section 205 is not controlled by federal law. A contrary interpretation would mean that all mass market licenses currently are subject to being overridden by any subsequent transfer of the underlying copyright since many of these transactions may not qualify as involving a writing signed by the owner of the copyright. Clearly, an assignee of the copyright to Word Perfect software should not be able to sue pre-existing Word Perfect licensees for continued use of the program without a license from the current owner. Even if this position is not correct, the priority rules here would apply to all intangibles other than copyrights, leaving a wide variety of important situations to be addressed here.

SECTION 2B-508. PRIORITY OF TRANSFERS BY LICENSEE.

(a) A transferee of a licensee acquires no interest in information, copies, or rights of the licensee under a license unless the conditions for transfer under this article and the license are met. If a transfer is effective, the transferee takes subject to the terms of the license.

(b) Except for rights under trade secret law, a person that acquires information that is subject to the informational property rights of a third party acquires only the rights that its transferor was authorized by the third party to transfer, and those rights may be further limited by the agreement under which the person acquires the information.

Uniform Law Source: Section 2A-305

Committee Action: This section was considered in November, 1996, without substantial comment.

Reporter's Notes:

1. A license, previously created, governs rights in the information and in copies thereof. A transferee acquires only the rights that the license allows. As a general principle, a license does not create vested rights and is not generally susceptible to free transfer in the stream of commerce. Subsection (a) is generally consistent with Article 2A.

2. Subsection (b) states an important principle, mandated under current intellectual property law. The idea of entrustment, which plays a major role in dealing with goods, has less role in intangibles covered by patent or copyright law, since the value involved resides in the intangibles and the concept of possession being entrusted in a manner that creates the appearance of being able to reconvey the valuable property is not ordinarily a relevant concern. Intellectual property law does not recognize a buyer in the ordinary course (or other good faith purchaser) as taking greater rights than the information or copy than were authorized to be transferred. While copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, the first sale must be by a party authorized to make the sale under the terms provided to the buyer.

Illustration 1: Correll transfers copies of its software to DAC a distributor. DAC is licensed to transfer the software for educational uses only. DAC transfers a copy to Mobil Oil for use in a business application. Mobil has no knowledge of the Correll license restriction. DAC breached its contract and its distribution also constitutes copyright infringement. Mobil's copying (use) of the software is not authorized under copyright law since it did not receive an authorized distribution. The remaining question is whether Mobil should be subject to a contract action for violating the license in the DAC contract. This section takes no position on the issue.

3. Transfers in a chain of distribution that exceed a license or that otherwise are unlicensed and unauthorized by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase, but its use is likely to constitute infringement. As to software, this established principle was enforced by the court in Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). A retailer that obtained copies of software from third parties argued that the distribution was not a violation of copyright because it in good faith believed that it obtained the copies of the software through a first sale from an authorized party. The court held that there is no concept of good faith purchaser under copyright law and that the buyer cannot obtain any greater rights than the seller had. In the case where the seller is neither an owner of a copy or a person acting with authorization to sell copies to third parties, no first sale occurs and the "buyer" is subject to the license restrictions created under any license to the third party seller. In one instance, the defendant had purchased from a licensee who was authorized to transfer the Microsoft product in sales of its machines. In fact, however, it purported to sell the product as a stand alone. This clearly exceeded the license to it and the mere fact that the alleged buyer acted in good faith did not insulate it from copyright liability. "Entering a license agreement is not a "sale" for purposes of the first sale doctrine. Moreover, the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products." See also Major League Baseball Promotion v. Colour-Tex, 729 F. Supp. 1035 (D. N.J. 1990); Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077 (D. Md. 1995); Marshall v. New Kids on the Block, 780 F. Supp. 1005 (S.D.N.Y. 1991).

4. This section does, however, allow for a bona fide purchaser in reference to trade secret claims. The essential feature of a trade secret resides in enforcing confidentiality obligations. Where a party takes without notice of such restrictions, it is not bound by them and, in effect, is a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

5. Article 2A provides that a buyer from a lessee generally acquires only the "leasehold interest in the goods that the lessee had or had power to transfer, and ... takes subject to the existing lease." Section 2A-305(1). The exception to these principles in Article 2A occurs in the case of a buyer (or sublessee) from who acquires in the "ordinary course" of the lessor-seller's business. The buyer here takes free of the lease under theories of entrustment. For a buyer to acquire these rights, however, it must purchase from a "person in the business of selling goods of the kind." In effect, the goods were entrusted to a sales business. Also, the buyer must be in good faith and without knowledge that the sale violates the lease or ownership rights of the lessor.

PART 6

PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) A party's obligation 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) Tender of performance entitles a party to acceptance of that performance. A tender of performance occurs when a party, with manifest present ability and willingness to do so, offers to complete the performance. <u>If a performance by the other party is due at the same time as the tendered performance,</u> tender of the other party's performance is a condition to the tendering party's obligation to complete the tendered performance.

(d) <u>Except as otherwise provided in Section 2B-610, a party may refuse a tender of performance that is a material breach by the other party as to that performance or if refusal is permitted under Section 2B-609. Whether the aggrieved party may also cancel the contract is determined by the agreement and Section 2B-702.</u>

(e) If a party accepts a performance, the party shall pay or render any other consideration as required under the agreement for any performance it accepts. The burden is on the party that accepted the performance to establish a breach of contract with respect to the performance accepted.

(f) <u>The provisions of this section are subject to the rules regarding tender, inspection, delivery, and refusal or acceptance of copies as provided in this article.</u>

Uniform Law Source: Restatement (Second) of Contracts ' 237. Substantially revised.

Committee Vote:

a. Adopted motion to make exception to material breach rule for mass market contracts on the issue covered by Article 2. Vote: 12-0

b. Voted 10-3 to use mass market license, rather than consumer in this section.

c. 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:

Notes to this Draft:

Changed as part of the reorganization of sections in this part. Former subsection (c) in reference to mass market perfect tender rule deleted as redundant; former subsection (d) deleted as redundant. New subsection (c) stems from former 2B-607(a)(b) with the substantive change as indicated. Subsection (d) is new, but clarifies the relationship between refusal of a performance and cancellation of an entire agreement. Subsection (e) is former Section 2B-606. Subsection (f) clarifies that the more particular and specific rules of the sections on delivery of goods control over this general section in cases of conflict. **The Reporter's Notes have not be changed to reflect this revision.**

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 <u>Restatement</u>, that rule holds that a duty to perform is contingent on the prior performance by the other party without a material failure of performance. <u>Restatement</u>. <u>Restatement (Second) of Contracts</u> § 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 the International Sale of Goods (CISG) refers to "fundamental breach," which it defines as: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional law in requiring so-called "perfect tender." Even then, these statutes do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a performance standard for when the reciprocal performance is not required is virtually unanimous.

Illustration 1: Tom Jones has agreed to develop systems software for DNY. DNY promises to pay the purchase price of $300,000 in three installments once every three months. Jones fails to complete stage 1 in month 2 and this failure is material. When the first payment is due, if the failure remains uncured, DNY is not required to pay. It can cancel the contract or seek assurances of performance. To alter this result would require an express agreement severing the obligation to pay from the performance of the deliveries.

5. The concept is simple: A minor defect in the transfer does not warrant rejection of performance or cancellation of a contract. Minor problems constitutes a breach of contract, but the remedy is compensation for the value lost. The objective is to avoid forfeiture based on small errors and to recognize that, especially if performance involves ongoing activity, fully perfect performance cannot be the expected norm. This is especially true in information contracts. Software often contains "bugs" or imperfections. Information services often entail small errors and incompleteness. The policy choice here adopts general law and allows a party whose performance has minor errors to expect performance by the other party; subject, in appropriate cases, to offsets and compensation for the problems.

6. The substantial performance rule does <u>not</u> hold that substantial (but imperfect) performance of a contract is not a breach. Substantial (but imperfect) performance is a breach of contract. The significance of substantial performance lies in the remedy for the injured party. Substantial performance is sufficient to trigger the injured party's obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject

the initial tender or cancel the contract on that account, but it can obtain financial satisfaction for the less than complete performance.

7. This section creates a carve out of perfect tender in mass market transactions with respect to tender of deliver of a copy other than in an installment contract setting. This tender rule does not mean that the tendered information is in fact perfect, but that it meet the general contract description in light of ordinary expectations and trade use. As in Article 2, this rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the single performance in the transaction (e.g., delivery of a television set, delivery of the diskette containing the software). As under current law, however, substantial performance rules apply in reference to on-going performance for both parties, services such as continuous access, and deliveries of a series of copies in an installment contract.

8. Article 2 applies a "perfect tender" rule to only one setting: the initial tender (transfer) of goods in a contract that does not involve installment sales. Article 2 does not allow the buyer to assert a failure of perfect tender in an installment contract (that is, a contract characterized by an ongoing relationship). Even in a single delivery context, the theory of perfect tender is hemmed in by a myriad of countervailing considerations. As a matter of practice, a commercial buyer cannot safely reject a tendered delivery for a minor defect without considering the rights of the vendor to cure the defect under the statute or under commercial trade use. White and Summers state: “[we found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . .” Indeed, in one case involving software, a court applied a substantial performance test to a UCC sales transaction. See D.P. Technology Corp. v. Sherwood Tool, Inc., 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven economic loss).

9. Definitions in Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach is defined in Section 2B-108 and is discussed in the Reporter's Notes to that Section. The definition largely adopts the definition in the Restatement (Second) of Contracts ' 241, adding some specificity related to this commercial context. This article rejects the less fully explored language used in Article 2A (and some parts of Article 2) which refers to breaches that "substantially impair" the value of a contract to the injured party. A material breach is a breach that significantly damages the injured party's receipt of the value it expected from the contract, but reliance on language that is common in general law and legal tradition enables this article to fall back on themes that courts are familiar with, rather than on language in other UCC articles that has not been well explored in case law.

SECTION 2B-602. LICENSOR’S OBLIGATIONS TO ENABLE USE. A licensor must enable use by the licensee.

(1) Except as provided in Section 2B-603 and 2B-604, if enabling use requires delivery of a copy, Section 2B-607 applies as to tender of delivery of the copy.

(2) If no further act is required under the agreement to enable use, the licensor’s obligations with respect to enabling use are complete when the contract becomes enforceable between the parties.

(3) In an access contract, enabling use includes providing any documents, authorizations, addresses, access codes, acknowledgments, and other materials necessary to obtain the contracted for access.

(4) If applicable informational property rights law provides for filing of a record to establish ownership of informational property rights and a transfer of ownership is intended,

on request by the licensee, the licensor shall deliver a record for such purpose.

Reporter's Notes:

Notes to this Draft:

This Section was created as part of the restructuring of this group of sections. The provisions of the Section derive from former 2B-603(a)(b)(d) and are included in this general section based on the view that they reflect rules of general applicability that are relevant beyond delivery of copies in classic, goods-like transactions.

SECTION 2B-603. SUBMISSIONS OF INFORMATIONAL CONTENT: PERFORMANCE. If a party submits informational content under an agreement that requires that the informational content be to the satisfaction of the other party, the following rules apply:

(1) The provisions of this article regarding tender, inspection, acceptance or refusal of a tender, and revocation with respect to copies do not apply to the submission or to the receiving party's reaction to the submission, except as provided in this section,

(2) If the informational content is not satisfactory to the recipient, the parties may engage in efforts to correct the deficiencies over a period of time and in a manner consistent with the ordinary standards of the trade or industry <u>without that conduct being treated as acceptance or rejection of the submission.</u>

(3) Neither refusal nor acceptance of the informational content occurs unless the recipient makes an expressly refuses or accepts the submission.

(4) Refusal terminates the agreement. If subjective satisfaction is the contractual standard and the party refuses the submission, neither the refusal nor the submission is a breach of contract.

Prior Uniform Law: None.

Committee Action:

a. Reviewed without substantive changes in May, 1997.

Reporter's Notes:

Notes on this Draft:

This is former Section 2B-603 with the only changes as noted. The major substantive, proposed change is to broaden subsection (a) to cover any case where a submission pursuant to a "to the satisfaction of the party" clause occurs, rather than limiting the concept to informational content. Former subsection (b) was moved to 2B-206.

General Notes:

1. This section deals with a problem that was raised recurrently during the discussion of the Committee concerning the carrying forward of Article 2 rules concerning tender, acceptance and rejection into situations involving the informational content industries where practices are much different that in traditional sales of goods. The Section solves that conflict by carving out content submissions from the circumstances involved in reference to tender of a required performance in other respects.

2. For transactions involving traditional book and publishing upstream agreements, the solution lies simply in recognizing that the submission of a manuscript, even pursuant to an agreement, does not represent a tender of performance analogous to that involving a delivery of goods that requires immediate acceptance or rejection. Rather, the delivery of informational content in this context triggers a process that typically centers around the fact that the licensee has the right to refuse if the content does not satisfy its expectations. Once that fact is recognized, the inapplicability of the various rules on acceptance and the like becomes apparent. The provisions of subsection (a) attempt to capture basic principles of content submission in such case, but need to be reviewed by members of the industry for relevance and desirability.

3. An important aspect of the difference in the two circumstances lies in subsection (a)(3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since, by presumption, the circumstances are keyed to the subjective satisfaction of the receiving party.

SECTION 2B-604. SELF-COMPLETING PERFORMANCES. If performance involves delivery of information or services covered by this article that, because of their nature provide the licensee substantially with their value or other substantial commercial value and the value cannot be returned once delivery or performance is received by the licensee, the following rules apply:

(1) <u>Except as provided in this section, the provisions of this article regarding tender, acceptance or refusal of a tender, and revocation of acceptance of copies do not apply.</u>

(2) The rights of the parties regarding the issues in paragraph (1) are determined under Section 2B-601 and the ordinary practices of the applicable business, trade, or industry.

(3) Before payment, a party may inspect the media and label or packaging of a performance but may not view or receive the performance unless the agreement provides otherwise.

Committee Action:

a. Reviewed without substantive changes

Reporter's Notes:

Notes to this Draft:

This is former Section 2B-608 and is moved here as part of the overall restructuring. As indicated, subsection (1) is revised, but contemplates no substantive change. Several reviewers indicated that the prior language referring to specific sections was confusing.

General Notes:

This section deals with a problem arising from the nature of the subject matter covered in this article. Some subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection, rejection and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. The parties should be left to general, common law remedies as described in section 2B-601. If the delivered performance constitutes a material breach, the receiving party can obtain its money back or sue for damages, but it cannot demand full performance prior to payment as would be the case with anything other than the limited inspection right described in subsection (b).

SECTION 2B-605. CURE OF BREACH OF CONTRACT.

(a) A party in breach of a contract, at its own expense, may cure the breach if:

(1) the time for performance has not yet expired, the party seasonably notifies the other of its intention to cure and, within the contract time, makes a conforming performance; or

(2) the party without undue delay notifies the other party of its intent to cure and effects cure promptly before cancellation or refusal of a performance by the other party.

(b) Other than in a mass-market license, the party in breach must promptly and in good faith make an effort to cure if:

(1) it receives timely notice of a specified non-conformity and a demand for cure from the aggrieved party;

(2) the aggrieved party was required to accept a non-conforming performance that completed the initial enabling of use because the non-conformity was not a material breach of contract; and

(3) the cost of the cure effort for the party in breach of contract would not be disproportionate to the adverse effect of the nonconformity on the aggrieved party.

(c) A breach of contract which has been cured may not be used to cancel a contract or refuse a performances. However, mere notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source: Sections 2-508; 2A-513

Reporter's Notes:

Notes to this Draft:

a. This is former Section 2B-619, moved without substantive change as a part of the restructuring of these sections for clarity and flow. The rules on cure are generally applicable and not limited to performances involving tender of copies.

b. The Committee should consider whether 2B-605(a)(2) should be broadened, allowing a party in breach to cure despite refusal or cancellation. Current Article 2 provides, in addition to the language in (a)(1), that: "Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance, the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

General Notes:

1. In Article 2B, unlike in Article 2, the idea of cure applies in important respects in both directions. This, coupled with the fact that this Article uses a material breach concept like common law, makes the idea of cure as substantially different theme in Article 2B than in Article 2. Unlike in Article 2 transactions, it affects performance

obligations of both the licensee and the licensor. In Article 2 the sole emphasis is on the seller's right to cure. For licensees' cure often relates to missed payments, failures to give required accounting or other reports, and misuse of information. For licensors, depending on the context, the issues often focus on timeliness of performance, adequacy of delivered product, breach of warranty and the like.

2. In this Article, unlike in Article 2, except in mass market licenses, breaches that trigger cure typically do not occur unless there was a material breach of the relevant performance obligation. This shifts the equities in reference to the extent to which a right to cure exists. This Section does not create a "right" to cure. The basic policy is that, when there exists a material breach, the aggrieved party's interests prevail over the vendor's interests.

3. The idea that a breaching party may, if it acts promptly and effectively, alleviate the adverse effects of its breach and preserve the contractual relationship is embedded in modern law. Restatement (Second) of Contracts ' 237 provides that a condition to one party's performance duty in a contract is that there be no uncured material breach by the other party.

4. Although the idea of cure is embedded in modern law, there is significant disagreement in pertinent statutes and statements of contract law as to the scope and balance applied to the operation of a cure.

a. The UNIDROIT Principles go the furthest in establishing a **right** to cure indicating that a cure is not precluded even by notice of termination for breach and by not limiting the opportunity to cure in any manner related to the timing of the performance. That is, cure is neither more nor less possible as a right if it occurs during the agreed time for performance than if it occurs afterwards. The UNIDROIT Principles, of course are not enacted law in any state. They condition cure on "prompt" action and allow it if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing the cure. UNIDROIT art. 7.1.4

b. Article 2, in contrast, distinguishes between cure made within the original time for performance (essentially allowing a right to cure) and cure occurring afterwards (which it restricts to cases where the vendor expected the tender to be acceptable). Draft revisions of Article 2 are in flux, apparently attempting to blend the existing Article 2 concept with the Unidroit concept.

c. The UN Sales Convention does not distinguish between cures occurring within or after the original agreed date for performance. It allows the seller to cure if it can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty. Sales Convention art. 48. However, the cure right is subject to the party's right to declare the contract "avoided" (e.g., canceled) if the breach was a fundamental breach of contract.

5. This section is consistent with the Sales Convention. That approach is used because this Article employs the standard of materiality of breach as a precondition for cancellation or refusal of a performance. This Section allows cure if it is prompt, but does not create a right to cure. The cure is subject to prior cancellation or refusal by the other party. This places control in the aggrieved party who has suffered a material breach by the other person. In a mass market setting, it enables a clearly delineated right to end the transaction which many from the consumer context have viewed as significant.

6. Subsection (b) applies to cases where the licensee accepts a performance because the material breach standard is not met even though some defect exists. It creates an obligation to attempt a cure. Failure to undertake the effort is a breach, but consistent with comments to other sections, this will be pointed out in comments, rather than in the statute. One might ask whether this obligation should be mutual and apply to situations where the licensor has been required to accept nonmaterial breaches.

7. The final comments will discuss aspects of the substantive elements of cure. The elements that would be discussed include: fully perform the obligation that was breached, compensate for loss, timely perform on all assurances of cure, and provide assurance of future performance.

SECTION 2B-606. WAIVER OF BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record to which the party agrees, by manifesting assent or otherwise.

(b) Except in a failure to meet a contractual requirement that performance be to the satisfaction of a party, a party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection, waives the right to rely on the unstated defect to justify refusal or to establish breach if:

(1) the other party could have cured the defect if stated seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final record statement of all defects on which the refusing party proposes to rely.

(c) A party that accepts a performance knowing or with reason to know that the performance constitutes a breach of contract waives all remedies for the breach if the party fails within a reasonable time after acceptance to object to the breach.

(d) Waiver of breach of contract in one performance does not waive the same or similar breach in future performances unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance is required in the future of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Committee Action: Considered in1996 and1997 without substantive changes.

Reporter's Notes:

Notes to this Draft:

a. This is former Section 2B-620, moved here as part of the restructuring. Language in subsection (c) regarding the effect of accepting on the ability to revoke or cancel was moved to the section on acceptance of copies (2B-612) since it derives from current Article 2 and is applicable to revocation of acceptance for goods. Two substantive changes are suggested by the black lining. Subsection (b)(1) has been modified to correspond to existing Article 2 and existing common law. The same is true of the modification in (b) generally.

b. The Committee should consider whether the reference to "reason to know" should be deleted in that it is not present in current Article 2.

General Notes:

1. A "waiver" is "the voluntary relinquishment" of a right. As with respect to cure, ideas of waiver in this Article must be considered in both directions. Conduct and words may constitute a waiver by either the licensor or the licensee. This section brings together rules from various portions of existing Article 2 dealing with waiver issues and recasts those rules to fit the broader number and variety of types of performance that are involved in Article 2B transactions. The section also applies principles from the Restatement.

2. Subsection (a) stems from 2A-107. Waivers contained in a record are contractual modifications which, under current law and this Article, are enforceable without consideration. The Restatement is consistent with this view. **See** Restatement (Second) 277 ("a written renunciation signed and delivered by the obligee discharges without consideration a duty arising out of a breach of contract."). Subsection (a) does not preclude other ways of making an effective waiver, but that it merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a state, remains effective.

A similar concept exists under current Article 1, but requires both a signature and delivery of the record signifying waiver. The requirement of delivery seems unimportant and is not required for cases involving modifications under UCC rules. Developing Article 1 proposed revisions also eliminate that requirement. Depending on reconciliation between Article 2B and Article 1 revisions, this concept of waiver may be relocated into Article 1.

3. The language in (a) was modified as a result of discussions at the harmonization meeting dealing with Articles 1, 2, 2A, and 2B. In some cases, authentication will be needed to establish the written waiver, while in others, assent manifested to the waiver will be adequate.

4. Subsection (b) brings together rules from current Article 2-607(2) and (3)(a) and generalizes the language. In Article 2, the rules apply **only** to a tender by the seller and acceptance of delivery by the buyer. Here, the effect also applies to acceptance of tendered performance by the licensee (e.g., a payment of royalties). The rule does not apply to cases where the party merely knows that performance under the license is not consistent with the contract unless that defective performance is tendered and accepted. T his section on waiver is from current law in Article 2 and follows that rule. It is also consistent with the Restatement (Second) 246 which provides that retention of a performance with reason to know it was defective creates a promise to perform despite the breach. The following illustrates the rule here:

Illustration: Licensee has an obligation to pay royalties to the Licensor based on 2% of the sale price of products licensed for its manufacture and distribution. The royalty payments must be received on the first of each month. A 5% late fee is imposed for delays of more than five days and the license provides that delay of more than five days is a material breach. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts the tender it knows of the breach and cannot thereafter cancel the contract for that breach. If it fails to object in a reasonable time to the late tender and the nonpayment of the late fee, it is also barred from recovering that amount.

5. Subsection (d) states a presumption consistent with common law that, unless the intent is express or the circumstances clearly indicate to the contrary, a 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.

6. 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.

[B. Performance in Delivery of Copies]

SECTION 2B-607. TENDER OF DELIVERY OF COPIES.

(a) If performance requires delivery of a copy, the party required to deliver shall tender first but need not complete the delivery until the other party tenders any performance required at that time. If payment is due on delivery of a copy, the following rules apply:

(1) Tender of delivery of a copy is a condition to the other party's duty to accept the copy and to that party's duty to pay.

(2) Tender entitles the tendering party to acceptance of the copy and payment according to the contract.

(3) If it is commercially reasonable to do so, all copies called for by a contract must be tendered in a single delivery and payment is due only on such tender. However, where the circumstances give either party the right to make or demand delivery in lots, the contract fee if it can be apportioned may be demanded for each lot.

(4) If payment is due and demanded on delivery of copies or on delivery of documents of title, the other party's right to retain or dispose of the copies or documents as against the other party is conditional on making the payment due.

(5) Tender of payment is a condition to the other party's duty to tender and complete performance.

(b) Tender of delivery of a copy requires that the tendering party put and hold conforming copies at the other party's disposition, and give the other party any notification reasonably necessary to enable it to obtain access, control or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires the tendering party also to tender any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for the other party to obtain access to, control, or possession of the copy. The party receiving the tender must furnish facilities reasonably suited to receipt. In addition, the following rules apply:

(1) Except as otherwise provided in paragraphs (2), (3) and (4):

(A) the place for tender of a copy on a physical medium is the tendering party's place of business or if it has none its residence; but, in a contract for a copy on a physical medium which to the knowledge of the parties at the time of contracting is located in some other place, that place is the place for their delivery. Documents of title may be delivered through customary banking channels; and

(B) in an electronic delivery of a copy, tender requires that the tendering party make the information available in an information processing system designated by it and provide the other party with authorization codes, addresses, acknowledgments, and any similar information necessary to obtain the copy.

(2) If the contract requires or authorizes delivery of a copy held by a third party to be delivered without being moved, the tendering party shall deliver any documents, authorizations, addresses, access codes, and any similar information necessary for the other party to obtain the copy or access.

(3) Where the tendering party is required or authorized to send a copy of the information to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, then tender requires that:

(A) in a delivery of a copy on a physical medium, the tendering party

(i) put the copy in the possession of such a carrier and make such a contract for its transportation as may be reasonable having regard to the nature of the information and other circumstances of the case with expenses to be borne by the other party; and

(ii) obtain and promptly deliver or tender in due form any document, authorization, access code or similar information necessary to enable the other party to obtain possession of the copy as required by the agreement or, in the absence of agreed terms, by usage of trade.

(B) in an electronic delivery of a copy, the tendering party initiate a transmission that is reasonable having regard to the nature of the information and other circumstances with expenses to be borne by the other party.

(4) Where the tendering party is required to deliver a copy at a particular destination, the tendering party shall make a copy available at that destination with expenses to be borne by the it and tender any documents, authorizations, access codes or similar information necessary for the other party to obtain the copy or access.

(d) If an electronic transmission or delivery is required by the contract, information must be provided in a manner consistent with the technological capabilities of the receiving party known to the tendering party or the ordinary methods in the business, trade, or industry for transfers of the kind.

Reporter's Notes:

Notes to this Draft:

a. This is a composite section which has been restructured to reflect a focus on the tender and delivery of copies and to more closely correspond to existing Article 2 rules. The Section stems from former 2B-603(c)(e) and 2B-607(c).

b. The underlined material in (a) stems from current Article 2-507, reflecting the actual language of that section and from former 2B-604 and 2B-605, whose more general language is proposed to be left to common law concepts and industry practice. Subsection (a)(5) comes from current Article 2-511.

c. Subsection (b) is rewritten to reflect current law in Article 2.

SECTION 2B-608. LICENSEE'S RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as provided in 2B-603 and 2B-604, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, the party receiving the copy has a right to inspect at a reasonable place and time and in a reasonable manner in order to determine conformance to the contract before payment or acceptance.

(2) Expenses of inspection must be borne by the party making the inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method or standard does not postpone identification to the contract or shift the place for delivery or for passing of title or the risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was an indispensable condition whose failure avoids the contract.

(4) A party’s right to inspect is subject to the confidentiality of the information.

(b) If a right to inspect exists under subsection (a) but the agreement or the circumstances are inconsistent with an opportunity to inspect before payment, the party does not have a right to inspect before payment.

(c) If the contract requires payment before inspection, nonconformity in the tender does not excuse the licensee from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-609; or

(2) in a documentary transaction and despite tender of the required documents, the circumstances would justify injunction against honor of a letter of credit under Article 5.

(d) Payment made under the circumstances described in subsection (b) or (c) does not constitute acceptance of performance and does not impair a party's right to inspect or any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Section 2-512; 513. Substantially revised.

Reporter's Note:

1. Subsection (a)(4) deals with the relationship between confidentiality and the right to inspect. Absent contrary agreement, inspection prior to payment is not appropriate if the type of inspection involved would reveal designated trade secrets or confidential information. This does not bar any inspection, but merely indicates that a right to see trade secret information cannot be presumed. Also, the balance here is limited to situations where the licensor designates information as confidential or a trade secret.

2**.** Subsection (b) follows the rules stated in current UCC.

SECTION 2B-609. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and to Section 2B-610 on installment contracts, if a tender of delivery of a copy constitutes a material breach of contract as to the particular delivery, the party to which it is tendered may:

(1) refuse the tender;

(2) accept the tender;

(3) accept any commercially reasonable units and refuse the rest; or

(4) permit an opportunity to cure the nonconformity.

(b) In a mass-market license, a licensee may refuse a tender of delivery of a copy which constitutes the licensor's sole required performance if the tender does not conform to the contract.

(c) Refusal is ineffective unless it is made before acceptance and within a reasonable time after tender or completion of any permitted effort to cure, and the refusing party seasonably notifies the tendering party. [notifies the tendering party within a reasonable time after the breach of contract was or should have been discovered.]

(d) Whether a party refusing tender may also cancel the contract is determined under the agreement and Section 2B-610 or Section 2B-702, but where the contract provides for delivery of a single copy or single lot for payment of a fixed license fee for the copy or lot, refusal constitutes cancellation of the contract.

Uniform Law Source: Combines 2-601, 2-602, 2A-509. Substantially revised.

Votes:

1. The Committee adopted a "perfect tender" carve out for cases involving the tender of delivery of a copy in circumstances equivalent to those where the perfect tender rule applies in Article 2.

Notes to this Draft: Edited for clarity and to focus solely on refusal of copies. Subsection (c) was edited to conform to 2-602. Bracketed language alternative reflects prior Draft as modified.

Reporter's Note:

1. This section deals with refusal of tendered performance. The word "refuse" is used in lieu of the Article 2 term "reject" because the intent is to cover more broadly the circumstances under which a party can decline to accept a performance of any type, rather than merely to concentrate on cases of a refused (rejected) tender of delivery as the phrase is used in Article 2. Thus, for example, a party might refuse proffered services under a maintenance contract because of prior breach or of their failure to substantially conform to the contract. The right to refuse tendered performance hinges either on the substantial nonconformity of the particular performance or on the existence of an uncured, prior material breach by the tendering party.

2. This section and the section on cure give control of the situation to the licensee to whom improper performance is provided. In this Article, other than in the mass market, refusal or cancellation can occur only in the event of a material breach. This is unlike in Article 2 where even minor defects may allow rejection of a tender. Given the greater impact of the breach, the equities shift more clearly to the injured party and it is given a right to close out the transaction without waiting for cure. Cure cannot come after cancellation.

3. Subsection (b) implements the carve out for mass market transactions which are governed in this Article under standards that are consistent with Article 2 in the sale of goods.

SECTION 2B-610. INSTALLMENT CONRACTS; REFUSAL AND DEFAULT [new].

(a) In this section, installment contract" means a contract in which the terms require or the circumstances permit the delivery of copies in lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(b) In an installment contract, the buyer may reject any installment which is non-conforming if the non-conformity is a material breach as to that installment and cannot be cured or if the non-conformity is a defect in the required documents. However, if the non-conformity does not fall within subsection (c) and the party making the delivery gives adequate assurance of its cure, the aggrieved party must accept that installment and may not cancel the whole contract.

(c) Whenever non-conformity or default with respect to one or more installments is a breach that is material as to the whole contract, there is a breach as to the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

Reporter's Note:

This Section adds text from current Article 2-612 and similar text in Article 2A. If fills a gap left out prior drafts.

SECTION 2B-611. DUTIES FOLLOWING RIGHTFUL REFUSAL. After a rightful refusal of a copy, if the contract has not been canceled, the parties remain bound by contractual obligations. Whether or not the contract has been canceled, the following rules apply:

(1) Any use of the information or copies by the party refusing tender, or any disclosure of a trade secret or confidential information that violates with the agreement, constitutes a breach of contract and is wrongful against the licensor. However, use for a limited time solely to avoid or mitigate loss is not inconsistent with the licensee's refusal of the tender.

(2) A licensee in possession of refused copies or any copies made from them, shall return or deliver all copies and documentation to the licensor or hold them with reasonable care for disposal at the licensor's instructions for a reasonable time. In addition , the following rules apply:

(A) The licensee shall follow any reasonable instructions for return or delivery received from the licensor. However, instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

(B) If the licensor does not give instructions within a reasonable time after being notified of refusal, the licensee may, in a reasonable manner to avoid or mitigate loss, store the documentation and copies for the licensor's account or ship them to the licensor with a right of reimbursement for reasonable costs of storage and shipment.

(3) A licensee has no further obligations with respect to information or copies and documentation that were refused. However, both parties remain bound by any obligations of nondisclosure or confidentiality and any scope or other contractual use restrictions which would have been enforceable had the performance not been refused.

(4) In complying with this section, a licensee is held only to good faith and a standard of care that is reasonable in the circumstances. Conduct in good faith under this section does not constitute acceptance or conversion and is not the basis for an action for damages.

Uniform Law Source: Section 2-602(2), 2-603, 2-604.

Notes to this Draft: Edited to conform more closely to existing Article 2.

Reporter's Note:

1. This section does not give the licensee a right to sell goods, documentation or copies related to the intangibles under any circumstance. The materials may be confidential and may be subject to the overriding influence of the proprietary rights held and retained by the licensor in the intangibles. As Comment 2 to current ' 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in respect of information. The licensor's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

2. Subsection (1) limits the revoking person's right to use the information in its possession. Uses inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse. The section does permit, however, limited uses for purposes of minimizing loss. That use does not extend to disclosure of confidential information or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to reach the balance discussed in Can-Key Industries v. Industrial Leasing Corp.,593 P.2d 1125 (Or. 1979) and Harrington v. Holiday Rambler Corp., 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved here.

3. Subsection (3) makes clear that, following refusal or revocation, both parties remain bound by confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate.

4. The eventual comments to the Section will make clear that a wrongful refusal is not a refusal for purposes of this and other sections, but simply a breach of contract. That breach may or may not be material, but in either event, it triggers the sequence of remedies contained in the contract and this article, rather than the duties stated here.

SECTION 2B-612. ACCEPTANCE OF A COPY; EFFECT.

(a) Acceptance of a copy occurs when the party to whom the copy is tendered:

(1) signifies or acts with respect to the information in a manner that signifies that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(2) fails to make an effective refusal of performance under Section 2B-609 or 2B-610;

(3) acts in a manner that makes compliance with the licensee's duties after refusal impossible because of commingling; or

(4) substantially obtains the value or access from the copy without objecting and cannot return that value or access on refusal.

(b) Except in cases governed by subsection (a)(3) and (a)(4), if a right to inspect exists under Section 2B-608 or the agreement, acceptance of a copy occurs only after the party has a reasonable opportunity to inspect.

(c) If an agreement requires delivery of the information in stages involving separate portions of the information that comprise the whole, acceptance of any stage is conditional until acceptance of the completed information.

(d) Acceptance of a copy precludes refusal of the copy. ~~If acceptance is made with knowledge of or reason to know of a nonconformity, it cannot be revoked or the contract canceled because of the nonconformity unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured.~~ However, acceptance does not in itself preclude any other remedy provided by this article.

Uniform Law Source: Section 2A-515. Revised.

Notes to this Draft:

Edited for clarity and conformance to Article 2. Subsection (d) taken from existing law and former Section 2B-620. Former (a)(1) is deleted and covered in 2B-603. **The notes to this section have not yet been revised.**

Reporter's Note:

1. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general remedies sections.

2. Subsections (a)(2) and (3) conform to the language of Article 2A, clarifying as in Article 2A, that actions as well as communications can signify acceptance. This section does not adopt existing Article 2 provisions relating to actions inconsistent with the party's ownership since, as in Article 2A, there is a split between performance and retention of ownership in many cases. That split indicates that, as in 2A, the ownership standard is not relevant to use of information assets and other performance relevant here.

3. Subsection (a)(4) and (5) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(4), the key fact is that it would be inequitable or impossible to reject the data or information having received and commingled the material. The receiving party can exercise rights in the event of breach, but rejection is simply not a helpful paradigm. Recall that a rejecting licensee must return or to keep the digital information available for return to the licensor. Commingling does not refer only to placing the information into a common mass from which they are indistinguishable; it also includes cases in which software is integrated into a complex system in a way that renders removal and return impossible or where they are integrated into a database or knowledge base that they cannot be separated from. Commingling is significant because it precludes return of the rejected property.

4. The second situation (a)(5) involves use or exploitation of the value of the material by the licensee. In information transactions, it is the case that in many instances merely being exposed to the factual or other material transfers the significant value. Also, often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient of the information can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due.

Illustration 1: Licensee receives a right to use a mailing list of names of customers of Macey's store. It notices that the list contains no names from a particular zip code, but goes ahead with an initial mailing. It then seeks to reject the performance. While this would not fit within subsection (a)(5), the section provides that the acceptance already occurred if substantial value was received. Licensee can collect damages for the error and, if the breach was material, avoid obligation for the price. But it cannot reject because of (a)(1).

Illustration 2: A contracts with B to obtain the formula to Coca Cola and information from B about how to mix the formula. B delivers the formula, but the mixing information is entirely inadequate. If the mixing information is not significant to the entire deal, A cannot reject because it received substantial performance. If the mixing information is significant, a right to reject may arise because of a material breach. However, subsection (a)(5) bars rejection if A received substantial value by obtaining knowledge of the formula and cannot return that knowledge. Even though it can return copies of the formula, knowledge would remain. A can sue for damages, but cannot reject after the formula is made known to it.

Illustration 3: Intel contracts with John for a right to use John's list of the ten largest users of Motorola chips in the Southwest. The price is $1 million. John supplies the list, but there are two names that, through negligence, are not correct. After reading the list, Intel desires to reject the performance and cancel the contract. Subsection (a)(5) would ask whether Intel received substantial valuable knowledge and, thus, cannot reject. If so, its remedies are for breach under applicable sections involving a recovery for the difference in promised and received value. If it can reject, it can recover the part of the price already paid, plus any relevant and provable loss under the methods described in this Article.

Subsection (a)(5) may be deleted if the Drafting Committee adopts the proposed section 2B-608 on performances complete when delivered.

5. This section must be read in relationship to the reduced importance of acceptance. Refusal and revocation both require material breach in order to avoid the obligation to pay according to the contract. This is unlike Article 2 which follows a perfect tender rule for rejection, but conditions revocation on substantial impairment. Acceptance does not waive a right to recover for deficiencies in the performance.

SECTION 2B-613. REVOCATION OF ACCEPTANCE OF A COPY.

(a) A party that has accepted a copy may revoke acceptance if the nonconformity is a material breach as to that copy if the party accepted the performance:

(1) on the reasonable assumption that the nonconformity would be cured, and it has not been seasonably cured;

(2) during a period of continuing efforts at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the nonconformity, if the acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party notifies the other party of the revocation. Revocation is barred if the revocation:

(1) does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) occurs after a substantial change in condition or identifiability not caused by defects in the information; or

(3) occurs after the party attempting to revoke received a substantial benefit from the performance which benefit cannot be returned.

(c) A party that rightfully revokes acceptance has the same duties and is under the same restrictions with regard to the information and any documentation or copies as if the party had refused the copy. Whether the party can cancel the contract is determined by the agreement and Section 2B-610 or Section 2B-702.

Uniform Law Source: Section 2A-516; 2-608.

Reporter's Note:

1. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. This section deals with revocation of acceptance as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention of article 2.

2. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. It reduces the importance of when or whether acceptance occurs. In cases of continuing efforts to modify and adjust the intangibles to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both parties know that problems exist. The question is whether or not the licensee is obligated for the contract price, less a right to damages for breach by the licensor.

There has been substantial litigation in Article 2 on whether or not an acceptance occurred (or can be revoked) in a situation in which the licensee participates with the licensor in an effort to modify, correct and make functional the software that is being provided. The issue has importance because acceptance obligates the licensee to the purchase price unless that acceptance can be revoked due to a substantial defect, while prior to acceptance the licensee can reject for a failure to provide "perfect" quality. National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785, 787 (Mich. App. 1975) ("Here, the malfunctioning was continuous. Whether the plaintiffs could have made it functional is not the issue. The machine's malfunctions continued after the plaintiff was given a reasonable opportunity to correct its defects. [The] warranty was breached."); Integrated Title Data Systems v. Dulaney, 800 S.W.2d 336 (Tex. App. 1990); Eaton Corp. v. Magnovox Co., 581 F. Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may constitute a waiver); St. Louis Home Insulators v. Burroughs Corp., 793 F.2d 954 (8th Cir. 1986) (limitations bar); The Drier Co. v. Unitronix Corp., 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); Computerized

Radiological Service v. Syntex, 595 F. Supp. 1495, rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use precludes rejection); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573 (8th Cir. 1982); Aubrey's R.V. Center, Inc. v. Tandy Corp., 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App. 1987) (nine month delay did not foreclose revocation); Triad Systems Corp. v. Alsip, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years after the initial delivery of software and hardware system); Money Mortgage & Inv. Corp. v. CPT of South Fla., 537 So.2d 1015 (Fla. Dist. Ct. App. 1988) (18 month delay permitted); Softa Group v. Scarsdale Development, No. 1-91-1723, 1993 WL 94672 (Ill. App. March 31, 1993); David Cooper, Inc. v. Contemporary Computer Systems, Inc., 846 S.W.2d 777 (Mo App 1993); Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

3. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation does not, however, serve as a precondition to suing for damages. In the context of information transactions, revocation is not appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection (b)(3).

4. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received.

[C. Special Types of Contracts]

SECTION 2B-614. ACCESS CONTRACT.

(a) A licensee under an access contract for access over a period of time has rights of access to the information as modified from time to time and made generally available commercially by the licensor during the duration of the license. In addition, the following rules apply:

(1) A change in the content of the information is not a breach of contract unless it conflicts with an express term of the contract.

(2) Unless it is subject to contractual use restrictions in a license or in the access contract ~~or a record to which the licensee agreed, by manifesting assent or otherwise~~, information obtained by a licensee through an access contract is free of any use restriction by the licensor other than restrictions resulting from informational property rights of any person, or from other applicable law.

~~(3) The licensee may make a transitory copy for purposes of viewing or other~~

~~agreed use but may make a permanent copy of the information accessed only if authorized by the agreement.~~

(b) In an access contract for access over a period of time, access must be available at times and in a manner:

(1) conforming to the express terms of the agreement; and

(2) to the extent not dealt with by the terms of the agreement, in a manner and with a quality that is reasonable in light of the ordinary standards of the business, trade or industry for the particular type of agreement.

(c) In an access contract which, during agreed periods of time, affords the licensee a right of access at times substantially of its own choosing, intermittent and occasional failures to have access available during those times do not constitute a breach of contract if they are consistent with:

(1) the express terms of the agreement;

(2) ordinary standards of the business, trade or industry for the particular type of agreement; or

(3) scheduled downtime; reasonable needs for maintenance; reasonable periods of equipment, software or communications failure; or events reasonably beyond the licensor's control.

Uniform Law Source: None

Notes to this Draft: Edited for clarity. Proposed deletion of (3) is based on licensee recommendations.

Reporter's Note:

1. This section applies to a "access" transactions. In concept, access contracts are of two types. In one, the access and the contract creation or performance occur essentially at the same time and there is no on-going relationship between the parties. In the other, which some describe as a continuous access contract, the license contemplates that the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This latter type of relationship is characterized by on-line services such as Westlaw and Lexis. Access contracts of this latter type constitute an important application of an ongoing relationship rules involving information services. The transaction is not only that the transferee receives the functionality or the information made available , but that the subject matter be accessible to the transferee on a consistent or predictable basis. The transferee contracts for continuing availability of processing capacity or information and compliance with that contract expectation hinges not on any specific (installment), but on continuing rights and ability to access the system. The continuous access contract is unlike installment contracts under Article 2 which have more regimented tender-acceptance sequences. Often, the licensor here merely keeps the processing system on-line and available for the transferee to access when it chooses.

As outlined in the definition of "licensor", the model followed in three party access transactions, such as where the content provider makes content available through a third party access provider, entails two separate agreement and, in some cases, three separate contracts. The first is between the content provider and the on-line provider. This license may be an ordinary license to use the information or an access contract in itself. The second is between the on-line provider and the end user or other client. This is an access contract. The content provider is not necessarily party to or beneficiary of the contract. The third possible contract occurs when the content provider additionally contracts directly with or establishes terms with the end user or client.

2. Subsection (b) outlines two important default rules with respect to the treatment of information obtained through an access contract. The first is that, unless there are license terms dealing with the information obtained through access, information obtained by access is received on an unrestricted basis, subject only to whatever intellectual property rights apply. Thus, for example, if an access contract merely enables access to news articles, but does not further limit their use by the licensee, no limitation exists other than as applied under copyright law. In contrast, if the agreement contains license restrictions on use of the articles obtained by the access, those license terms would be governed under Article 2B and other law.

3. The second issue considered in subsection (b) concerns the making of copies. The default position here recognizes that access contracts will involve a wide variety of contexts, many of which do not contemplate that the license make and retain a copy of the information accessed (e.g., video on demand). The default rule assumes that transitory copies to enable viewing of the information are implicitly authorized.

4. Access contracts are a form of license in the pure common law sense that they entail a grant of a right to have use of a facility or resource owned or controlled by the licensor. This involves less of a traditional intellectual property license and more of a modern application of traditional concepts of licensed use of physical resources. 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 NE2d 517 (Ill. App. Ct. 1992) (license revocable at will). For a discussion of how one potential vendor handles these problems, see Proposed Rule Regarding Postal Electronic Commerce Service (39 C.F.R. ' 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed regulations and terms of use for Postal Service electronic commerce systems).

5. Under current law, these contracts are services or information contracts. The fault based warranties noted in the warranty sections apply insofar as one deals with the accuracy of content or processing. The contract obligation deals with an obligation to make and keep the system available. Obviously, availability standards are subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a database contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See Reuters Ltd. v. UPI, Inc., 903 F.2d 904 (2d Cir. 1990); Kaplan v. Cablevision of Pa., Inc., 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

6. In an on-going or continuous access contract, the transferee may receive substantial value before or despite problems in the overall transaction. The remedies provide for a concept of partial performance. For example, the fact that a company continues to use a remote access database processing system for several years while encountering problems and seeking a replacement system, may allow it to reject the future terms of the contract, but leaves the transferee responsible for the past value received. Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

SECTION 2B-615. CORRECTION AND SUPPORT CONTRACTS.

(a) If a party agrees to correct performance problems ~~errors~~ or provide similar services, the following rules apply:

(1) If the services ~~cover a limited time and~~ are part of a limited contractual remedy in a contract for the information between the parties, the party undertakes that its

performance will provide the licensee with information that conforms to that contract.

(2) In cases not covered by paragraph (1), the party shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the express terms, in a workmanlike manner and with a quality that is reasonable in light of ordinary standards of the business, trade, or industry. The party providing the services does not warrant that its services will correct all performance problems unless the agreement expressly so provides.

(b) A licensor is not required to provide support ~~or instruction~~ for the licensee's use of information or licensed access~~ after the initial acts enabling use~~. If a person agrees to provide support for the licensee's use of information or licensed access, the person shall make the support available in a manner and with a quality consistent with the express terms of the support agreement and, to the extent not dealt with by the agreement, in a workmanlike manner and with a quality that is reasonable in light of the ordinary standards of the business, trade, or industry.

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

Reporter's Notes:

1. The section deals with obligations to correct errors and obligations to provide support.

2. Obligations to correct errors are different from an obligation to provide updates or enhanced versions. In modern practice, contracts to provide updates, generally described as maintenance contracts, are a valuable source of revenue for software providers. Under Section 2B-310, no implied obligation exists to provide updates or new versions. A licensor may have an obligation to make an effort to correct errors in some cases even independent of a separate contract to do so.

The reference to error corrections covers contracts where, for example, a vendor agrees to be available to come on site and correct or attempt to correct bugs in the software for a separate fee. This type of agreement is a services contract. The other type of agreement occurs when, for example, a vendor contracts to make available to the licensee new versions of the software developed for general distribution. Often, the new versions cure problems that earlier versions encountered and the two categories of contract overlap. Yet, here we are dealing with new products .

3. Contracts to provide corrections are services contracts. As in any other services contract, the services provider must provide a reasonable and workmanlike effort to correct identified problems. Subsection (a) sets out this basic principle, but (a)(1) recognizes an important, alternative obligation that is presumed when the obligation to correct errors arises in lieu of a remedy under a contract.

4. Subsection (a)(1) deals with situations in which the circumstances indicate that promissor agrees to a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort. The obligation stated in subsection (a)(1) arises in any case where the repair/ correction obligation is set out as a form of remedy for any breach of the contract. The focus is on the classic "replace or repair" warranty. When the obligation to correct errors arises in that context, the promissor's obligation is to complete a product that conforms to the contract.

5. Subsection (a)(2) deals with the broader case of the general repair obligation outside of the limited remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a perfect result.

6. Subsection (b) provides a default rule regarding the time, place and quality of the services in a support agreement in the absence of contrary agreement. The standard reflects a theme of "ordinariness" that provides default performance rule throughout the chapter. It measures a party's performance commitment by reference to standards of the relevant trade or industry.

Example: Software Vendor agrees to provide a help line available for telephone calls from its mass market customers. If this agreement constitutes a contractual obligation, the availability and performance of that help line is measured by reference to similar services or by express terms of a contract.

SECTION 2B-616. PUBLISHERS, DISTRIBUTORS AND ~~RETAILERS~~ <u>END USERS</u>.

(a) In this section:

(1) "End user" means a licensee that acquires a copy of the information from a distributor by delivery on a physical medium for its own use and not for the purpose of distribution<u>, transmission, or public display or performance</u> to third parties.

(2) "Publisher" means a licensor other than a distributor if the licensor offers a license to an end user with respect to information distributed by a distributor.

(3) "~~Retailer~~ <u>Distributor</u>" means a merchant licensee that receives information from a licensor and sells or licenses the information to end users.

(b) In a contract between a distributor and an end user, if the end user's right to use the information is subject to a license from the publisher for which there was no opportunity to review before becoming obligated to pay the distributor, the following rules apply:

(1) The contract between the end user and the distributor is conditional on the end user's agreement to the publisher's license.

(2) If the end user does not agree to the publisher's license, the end user may return the information to the distributor and receive a refund. Refund under this paragraph constitutes a refund under Section 2B-112 and Section 2-208.

(3) The distributor is not bound by the terms of, and does not receive the benefits of, an agreement between the publisher and the end user unless the distributor and end user adopt those terms as part of their agreement.

(c) If a refund is made in good faith:

(1) a distributor that makes the refund to its end user because the end user did not agree to the publisher's license is entitled to reimbursement from the authorized person from which the distributor obtained the copy. Reimbursement shall be for the amount paid for the copy by the distributor and shall be made on delivery of the copy and documentation to the authorized person; and

(2) a publisher that makes the refund to the end user is entitled to reimbursement from the distributor of the difference between the amount refunded and the price paid by the distributor to the publisher for the information.

(d) If an agreement contemplates distribution of copies on a physical medium provided by the publisher, a distributor or other distributor shall distribute such copies and documentation as received from the publisher and subject to any contractual terms provided for end users.

(e) A distributor that enters into an agreement with an end user is a licensor of the end user under this article.

Uniform Law Source: None

Committee Action:

a. Reviewed twice with no substantive changes.

Reporter's Note:

1. This section deals with the three party relationship common in modern information transactions, especially in reference to digital products. The three party transaction involves a publisher, retailer, and end user. While the end user acquires the copy of information from a retailer, the retailer often lacks authority to convey a right to use a copyrighted work to the end user or, even, the right to transfer title to the copy. The right to "use" (e.g., copy) arises by agreement between the end user and the producer (party with ownership or control of the copyright). Often, in retail markets, this latter agreement is a screen license or a shrink wrap license. The enforceability of the terms of that license with respect to the licensee and publisher are dealt with elsewhere.

2. While there are three parties involved in separate relationships, it is clear that the relationships are linked. Subsection (b) deals with the relationship from the perspective of the **retailer's** contract with the **end user**. The basic principle in (b)(3) is that a retailer is not bound by nor does it benefit from any contract created by the producer with the end user. This mirrors modern law and limited case law dealing with sales of goods where manufacturer warranties and warranty limitations do not bind the retailer, but also do not benefit that retailer. A prior draft of this section stated the opposite position, but that met strong dissent. This means, of course, that the retailer does not have the benefit of warranty disclaimers made in a mass market publisher's license. That result can be changed by contract, of course. However, it gives the end user two different points of recourse - retailer and publisher.

Subsection (e) confirms that warranties exist on the part of the retailer by stating that the retailer is a licensor with respect to its licensee.

3. Subsection (b)(1) and (b)(2) deal with the reality that performance of the retailer's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the retailer and that this depends on the license between the producer and the end user. The net effect is to give the end user who declines a license a right to refund. and to not being forced to pay the purchase price to the retailer. This refund concept creates a refund *right*, rather than an option on the part of the retailer. It reflects the conditional nature of the transaction with the end user. It differs from the publisher's option to provide a refund opportunity as a means of enabling the effective assent to the publisher's license terms. While they are distinct, however, a refund made by the retailer under the conditions of subsection (b) satisfies the refund opportunity required under 2B-113 for creating an opportunity to review.

4. There are several ways to view the retailer-end user relationship in reference to the publisher's license. One is to treat the publisher's license in full as an element of the retailer contract, understood as present by both the retailer and the end user from the outset, even if the precise terms are not yet known. See *ProCD v. Zeidenberg,* 86 F.3d 1447 (7th Cir. 1996). An alternative treats the retailer's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter unless or until the end user assents to the publisher's license since, in most cases, the retailer's contract with the publisher authorizes only distributions subject to end user licenses and distributions that go outside this restriction constitute copyright infringement in cases where the information consists of copyrightable material. The end user's assent to the producer's license is then, as to its situation with the retailer, either a condition precedent (there being no final agreement until the end user can review and assent to or reject the license) or a condition subsequent (the agreement being subject to rescission if the terms of the license are unacceptable). In either case, if the end user declines the license, it can return the product to the retailer and obtain a refund or, if it has not already paid, avoid being forced to pay the contract fee. Subsection (b)(1) and (b)(2) create this result. The contract between the retailer and end user is a license in that the end user's use rights are subject to assent to and the terms of the publisher's license. When the end user assents to the license, the publisher's license in effect replaces the retailer-end user license except as to obligations expressly created and earmarked as continuing on the part of the retailer (such as a services or support obligation). Of course, in addition, if the information breaches a warranty, the right to recover from the retailer remains present unless it was disclaimed by the retailer's contract.

5. In a recent European case, *Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd.,* the court gave the end user a right to return the software and not pay the purchase price as to the retailer when the contract terms were unacceptable. The analysis was that the retailer's contract with the end user must have contemplated that the end user would have a right to copy/use the software, but that right could be obtained only through license or other agreement from the copyright owner. When the end user declined the license, in effect the conditions of the retailer's obligation were not met. The court did not treat this as a breach of contract, but as a failure to conclude the contract between the parties. No final agreement was present until the end user could review and accept or reject the license terms. In effect, the contract was concluded (or to be concluded) over a period of time, as opposed to at a single point in time over the counter.

Illustration 1: User acquires three different software programs from Retailer for a price of $1,000 each to be used in its commercial design studio. User is aware that each software comes subject to a publisher license. When it reviews one license, however, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the retailer did not provide a useable package and the end user did not pay simply for a diskette. Because the failed sale occurred due to the license terms, the refund under this section is from the retailer. An alternative refund option would be from the publisher who cannot obtain consent to its license unless it offers a refund for those who decline the terms. In most cases, of course, the publisher will establish this alternative refund process as at least initially coming through the retailer.

6. In most cases where an end user license is contemplated, the publisher's arrangements with distributors are licenses that retain ownership of all copies in the publisher and permit distribution only subject to a license. The legislative history of the Copyright Act indicates that, whether there was a sale of the copy or not, contractual restrictions on use are appropriate under contract law. "[The] outright sale of an authorized copy of a book frees it from any *copyright* control over ... its future disposition.... This does not mean that conditions ... imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).

7. To the extent that the retailer performs the producer's warranty obligations, the presumption is that it has a right of reimbursement from the producer. The provisions regarding refunds coordinate this section with the obligations incurred in creating an opportunity to review the terms of a license, which opportunity requires that there be a refund if the terms of the contract are refused. The consumer is entitled to refund of the retail price of the refused product and may obtain that either from the retailer or the producer. However, as between the producer and the retailer, the retailer can only receive reimbursement for what it paid to the producer. Thus, for example:

Illustration 2: Consumer refuses a program because it dislikes the license. It obtains a refund of the price paid to retailer ($100). Retailer is entitled to reimbursement from Producer of the $75 price that Retailer paid Producer for the product (if it returns the product). On the other hand, if Consumer obtains the $100 from Producer, Producer is reimbursed $25 from Retailer.

8. Subsection (d) sets out a basic default rule that corresponds with current law. The distributor is bound in its distribution by the terms of the contract with the producer and, as a default assumption, must redistribute in a form and subject to the conditions contained in the materials as received by it from the producer.

SECTION 2B-617. DEVELOPMENT CONTRACTS.

(a) In this section, "developer" means a person hired or commissioned to create or develop software for a client but does not include an employee of a client, and "client" means a person that hires a developer.

<u>(b) If the developer retains ownership of informational property rights in the software under applicable law, the client receives a nonexclusive but perpetual license to utilize the software in any manner consistent with the agreement.</u>

<u>(c) If the client obtains ownership of informational property rights in the software under applicable law, the following rules apply:</u>

<u>(1) If the contract is not a work for hire, ownership of the completed software vests in the client as provided in Section 2B-501, but revests in the developer if the developer cancels for breach of contract under Section 2B-702.</u>

<u>(2) The developer retains any ownership reserved to it under applicable law and the right to use methods, components or code developed before or independent of the contract, or developed during the contract but not required by the contract to be delivered to the client.</u>

<u>(3) The client has a nonexclusive perpetual license to use the components or code delivered as part of the software if the client does not obtain ownership of the informational property rights in those components or code under applicable law.</u>

<u>(d) Neither party has the right to use confidential information of the other party that was identified as confidential except as provided in the agreement.</u>

<u>(e) Language in an authenticated record is sufficient to indicate an intent to place</u>

ownership in the designated party if it states “All right, title, and interest in the software will be owned by [named party]”, or words of similar import.

(f) On request of the client made in a record delivered to the developer, the developer shall notify the client if it used independent contractors or information provided by other third parties and shall provide the client with a statement that either confirms that all applicable informational property rights have been obtained or will be obtained, or that it makes no representation about those rights beyond any stated in the agreement. The statement must be made within 30 days after the request is received unless the time for performance of the development contract is less than 30 days, in which case the statement must be before completion of performance.

~~(b) If an agreement requires the development of software, as between the developer and the client, the following rules apply:~~

~~(1) Unless an authenticated record provides for a different result, the developer retains ownership of the informational property rights except to the extent that the software includes information the rights in which are owned by the client or the client would be considered a co-owner under applicable law.~~

~~(2) If the developer retains ownership of the informational property rights, the client receives a nonexclusive but perpetual license to utilize the software in any manner consistent with the agreement.~~

~~(3) If an authenticated record or applicable informational property rights law provides that ownership of the informational property rights in the software passes to the client, but does not otherwise deal with the following issues, the following rules apply:~~

~~(A) Ownership of the software vests in the client as provided in Section 2B-501, but revests in the developer if the developer cancels under Section 2B-702.~~

~~(B) The client receives the software free of restrictions on use.~~

~~(C) The developer retains ownership of methods, components or code developed before the contract, or developed during the contract but not to be delivered to the client, and the client has a nonexclusive perpetual license to use consistent with the agreement the components or code as part of the software delivered to the client.~~

~~(4) Language in an authenticated record is sufficient to provide that ownership of informational property rights in the software will pass to the client or be retained by the developer if it states “All rights, title, and interest will be owned by [named party]”, or words of similar import.~~

~~(5) If the client requests response in a record, the developer shall notify the client if it used independent contractors or information provided by other third parties and shall provide the client with a statement that either confirms that all applicable informational property rights have been obtained or will be obtained, or that it makes no representation about those rights beyond any stated in the agreement. The response must be made within 30 days after the request is received unless the time for performance is less than 30 days, in which case the response must be before completion of performance.~~

Uniform Law Source: None

Committee Action:

a. Motion to delete the clause in (b)(2)(D) following the word “but”, rejected 2-5 (June, 1997).

b. Motion to delete (3)(D) on ownership allocation between licensor and licensee, accepted 8-1 (September 1997)

Notes to this Draft: This Draft substantially restructures basic features of this Section based n concerns expressed by licensee representatives and concerns about altering ownership issues in this development context. Under the redraft, ownership is expressly left to be determined by law other than this Article. This reactes to the concern of some that the prior Draft inadvertantly altered ownership distributions. The provisions of this section create non-exclusive rights to use to effectuate the relevant agreement, provide state law principles for when ownership vests, and give guidance about what language adequately reflects an intent to transfer ownership of informational property rights. **The notes to this Section have not been changed to reflect the new proposal.**

REPORTER'S NOTES:

1. This section deals with an important area of software contracting. It is an area affected by federal intellectual property law rules and also characterized by both, extensively negotiated contracts as well as very informal relationships. In many cases, the licensor-developer is a smaller firm dealing with larger companies. The section is specifically limited to development contracts relating to computer programs. The section has been controversial in that it attempts to develop contract themes that reflect what would be the most likely expectation of the parties in development contract and rules that provide a sound basis for allocating rights between the developer and client in the absence of addressing two important issues. The section creates an implied license for the client who does not have documentation capable of obtaining ownership rights under copyright law and creates an implied license in development tools for the developer who needs those tools to continue in business.

2. Federal copyright law provides that, unless there is an express transfer of the copyright in a writing, copyright ownership remains in the developer, rather than the client for whom the developer worked. The copyright rule was adopted after substantial deliberation and placed in the 1976 Copyright Act. It sets the background for default rules in this section. In addition, the default rules seek to balance the interests of the developer in continuing in business with the interests of the client in obtaining a right to use the information developed for it. In many cases, retention of rights in elements of a developed program is critical for the developer who will reuse program components and routines in subsequent projects. It should be noted that, while this section creates rights as between the parties pursuant to the contract, Section 201(b) of the Copyright Act, when applicable, may affect the enforcement of those rights against third parties who obtain transfers of copyright.

3. Subsection (b)(1)(A) states a default rule that corresponds to copyright law rules about ownership. In the absence of an employment relationship, ownership remains in the creative individual or company unless the contract expressly provides for a transfer of that ownership to the client (licensee). This rule states an important premise relating to the rights of the individual or other small developer to retain the primary rights in its intellectual work product unless it specifically and clearly transfers those rights. This policy reflect federal intellectual property law and protects small developers. Subsection (b)(1)(B), however, ameliorates the possibility of an adverse impact due to a misunderstanding by providing what amounts to an implied license for the client. The license is non-exclusive. A critical issue needs to be resolved about the scope of the license, with the two alternatives being to make the rights unrestricted or to limit the implied license to uses consistent with the developmental purposes.

The implied license approach is consistent with case law dealing with this type of case. In the reported cases, the implied license tends to be limited to uses consistent with the purposes of development.

4. Subsection (b)(2) provides important protection for a licensee not found in current law. The section stems from a problem created under federal intellectual property law, especially as to copyright ownership. Copyright law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to potentially avoid those problems.

5. Subsection (b)(3) deals with cases where the contract gives ownership of the intellectual property in the program to the client. The default rule is intended to provide protection for small developers and small licensees who may not address the basic questions presented. The theme is that ownership transfers in all code <u>developed for</u> and <u>included in</u> the program and that no conditions limit the licensee's use. However, two interests are balanced in the event that the contract does not deal with them: 1) the developer's right to continue to use general applicability code and tools and 2) the licensee's rights in code developed outside the project which are not clearly transferred to it. In each case, a split between ownership and a non-revocable license is used to give each party rights in the materials as a default rule. The developer retains ownership of previously developed materials, but the licensee has an irrevocable license to use them. In reference to included general tools, on the other, the licensee has ownership, but the developer

has a license to continue to use.

Subsection (b)(3) deals with ownership interests in the program itself and, therefore, does not cover ownership questions about tools or methods developed by the developed during the project, but not included or to be included in the deliverable (e.g., the completed program). These work product elements remain in the developer and are critical elements of its professional assets, unless of course, the contract expressly provides that the client acquires rights in them.

It should be noted, of course, that while Article 2B refers to an authenticated record, copyright law refers to a signed writing as required to transfer ownership in cases not involving employees. Whether the two will be treated eventually as equivalent is a question of federal law, but it would seem that the copyright law should be read in this regard in a manner that reflects modern commercial developments.

6. Subsection (4) provides safe harbor transfer language for effectuating a transfer. The terminology is designed to clearly indicate that more than a transfer of a copy was contemplated. **Comments** will indicate the language here deals solely with creating the transfer, while the timing and nature of the rights transferred is governed elsewhere, including in 2B-501(a) and, when applicable, other law.

SECTION 2B-618. FINANCIAL ACCOMMODATION CONTRACTS.

(a) A financier is subject to the license and to the informational property rights of the licensor. Except as otherwise provided under subsection (c)(1), the creation and enforcement of a financier's interest in a license is subject to Section 2B-504.

(b) If a financier is not a licensee that transfers the license to the licensee receiving the financial accommodation, the following rules apply:

(1) The financier does not receive the benefits or the burdens of the license.

(2) The licensee's rights and obligations with respect to the information are governed by the license and by any rights of the licensor under other applicable law and, to the extent not inconsistent with the license or other applicable law, the financial accommodation agreement.

(c) If a financier is a licensee that transfers the license to a licensee receiving the financial accommodation, the following rules apply:

(1) The transfer to the licensee is not effective unless:

(A) the transfer meets the conditions for transfer under Section 2B-502 and 2B-503; or

(B) the accommodated party agrees to the license; the financier becomes a licensee solely to make the financial accommodation; and before the licensor provides the information, the financier delivered notice to the licensor giving the name and location of the accommodated party and indicating that the accommodated party will be the only end user of the information.

(2) The financier in subsection (1)(B) may make only the single transfer contemplated by the notice unless the licensor consents to a subsequent transfer or any subsequent transfer is effective under Section 2B-504.

(3) After transfer to the licensee, the licensee becomes a party to the license and the licensee's rights and obligations with respect to the information are governed by the license and any rights of the licensor under other applicable law and, to the extent not inconsistent with the license or other applicable law, the terms of the financial accommodation agreement.

(4) On completion of an effective transfer to the licensee, the financier is no longer a licensor.

(5) The financier makes no warranties to the licensee other than any express warranties in the agreement and the warranty of quiet enjoyment,.

(d) Unless the licensee is a consumer, the licensee's promises under the financial accommodation and any related agreements become irrevocable and independent of the license as between the financier, the licensee and any transferee of either party, if the financial accommodation agreement so provides. They become independent upon:

(1) the licensee's acceptance of the license or payment by the financier, unless the information was selected, created, or supplied by the financier; the financier provides support, modifications, or maintenance for the information; or the financier holds informational property rights in the information; or

(2) transfer of the contract by the financier to a third party.

(e) As between the financier and the licensee, the financier is entitled to possession of any copies , improvements or modifications of the information provided by the licensor under the license if the financial accommodation agreement so provides, but the financier's rights with respect to the licensor are determined under Section 2B-504.

(f) On material breach of a financial accommodation agreement by the licensee, the financier may cancel that agreement but may not cancel the license, or may exercise its other remedies under he financial accommodation agreement or this article, subject to Section 2B-504.

(g) The licensor's rights and obligations with respect to the licensee are governed by the terms of the license and any rights of the licensor under this article or other law.

Committee Action:

a. In December, 1996, the Committee concluded, by a consensus, that treatment of financing arrangements should be limited and generic. The concept is to allow creation of an interest, but not sale without consent.

b. Did not adopt a motion that the "hell and high water" rules should apply even though the contract does not so provide. Vote: 5 - 5 (April, 1997).

Reporter's Notes:

1. This section is one of two sections that implement the integrated treatment of security interests and finance leases. This section deals with the relative rights among the parties, while Section 2B-504 on financier's rights deals with the creation of the interest. The term "financier" includes both a secured creditor and a lessor. The critical distinction, implemented here and in the definition of the term, is between a traditional loan arrangement where the financier does not become a party to the license and the relationship that exists more in reference to traditional tree party leasing where the lessor (financier) acquires the property (license) and transfers this down to the licensee.

2. An important licensee protection makes the financial accommodation conditional on the licensee's assent to the license. In the absence of such assent, the licensee may have no rights to use the information and, thus, the transaction is illusory from its standpoint. The definition of "financier" incorporates this concept, requiring that the licensee's assent be a condition to the creation of the lease. This transaction is different from the ordinary equipment lease because of the central importance of this license agreement and the provisions here recognize that importance. (see also the treatment of when promises become irrevocable).

3. Subsections (b) and (c) outline some attributes of the two scenarios. Subsection (b) involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract relationship with the licensee. The key factor here is that the lessor is not bound by the obligations of the license, but is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement. In subsection (c) we deal with the less common situation where the license is actually provided to the lessor and then passed down through to the licensee. Here, when the licensee takes on the license, the lessor is taken out of the transaction as between the licensee and financier for purposes of qualitative and other issues except for quiet enjoyment and authority to transfer consideration. The licensee becomes a direct party to the license.

4. Subsection (d) provides rules pertaining to hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context. Additionally, the provisions have been modified to reflect a problem not present in ordinary equipment leasing. Article 2A-407 provides that the promises become irrevocable on the lessee's acceptance of the goods. In the stereotypical transaction under that article, the goods are sold to the lessor and sent to the lessee. If there is non-payment by the lessor, the seller's remedies are against the lessor (not the lessee). In a license transaction, however, there are two different factors. First, in many cases, the licensee contracts directly with the licensor. Non-payment then may give a contractual right of action for the price against the licensee even though its lease called for payment by the lessor. Second, in a license, payment is typically a condition on the licensee's rights to continue to use the information. Thus, although the lessor was to pay, the licensee may be placed in a position of paying twice if the lessor fails to do so. To avoid this type of problem, the irrevocability concept is limited here not only to acceptance of the transfer, but also payment to the licensor. Comments to d(1) will indicate that selecting involves actual choices, rather than merely following orders.

5. Subsection (e) deals with a common area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As between the licensor, however, the general provisions of Section 2B-504 control.

6. Subsection (f) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. Performance Problems]

SECTION 2B-619. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes on a party an obligation on each party that the other's expectation of receiving due performance will not be impaired. When 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 the demanding party receives such assurance may if commercially reasonable 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 any assurance offered shall be determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

Committee Action: Considered without substantial substantive comment.

Uniform Law Source: 2-609.

Reporter's Note: Corresponds to existing Article 2.

SECTION 2B-620. ANTICIPATORY REPUDIATION.

(a) When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(1) for a commercially reasonable time await performance by the repudiating party; or

(2) resort to any remedy for breach even if it has notified the repudiating party that it would await the latter's performance and has urged retraction; and

(2) in either case, suspend its own performance or proceed in accordance with the provisions of this Article on the licensor's right to identify information to the contract notwithstanding breach or to cease work or to otherwise proceed under Section 2B-712.

(b) Repudiation includes but is not limited to language that one party will not or cannot make a performance still due under the contract or voluntary affirmative conduct that reasonably appears to the other party to make a future performance impossible.

Committee Action: Considered without substantial substantive comment.
Uniform Law Source: 2-609.
Reporter's Note: Corresponds to Article 2.

SECTION 2B-621. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) Until the repudiating party's next performance is due it can retract its repudiation unless the aggrieved party has since canceled or materially changed its position or otherwise indicated that it considers the repudiation final.

(b) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under Section 2B-621.

(c) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay caused by the repudiation.

Committee Action: This section was considered without substantial substantive comment.
Uniform Law Source: Section 2-610.
Reporter's Note: Corresponds to existing Article 2.

[E. Loss and Impossibility]

SECTION 2B-622. RISK OF LOSS.

(a) Except as otherwise provided in this section, the risk of loss as to a copy passes to the licensee on receipt of the copy. ~~In an access contract, risk of loss as to the information to be accessed remains with the licensor if the resource is in the possession or control of the licensor, but risk of loss as to a copy of information made by the licensee passes to the licensee when it makes the copy.~~

(b) If a contract requires or authorizes a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require delivery at a particular destination, the risk of loss passes to the licensee when the copy is delivered to the carrier even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the copy arrives there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered in a manner that enables the licensee to take delivery.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains on the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, or if a copy is to be delivered by making access available to a resource that contains the copy of the information, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing delivery or access or of access codes enabling delivery or access.

Uniform Law Source: Section 2-509

Reporter's Notes:

1. In an information contract, in most cases, risk of loss issues relate to copies of the information and eventually deal with the obligation to pay for or provide additional copies or additional access to obtain new copies of the information. For example, a licensee's data may be transferred to the licensor for processing and destruction of the processing facility may destroy the data. Alternatively, a purchaser of software transferred in the form of a tangible copy may (or may not) suffer a loss when or if the original copy is destroyed (depending of course on whether

additional copies were made before that time). This section uses a concept of transfer of possession <u>or control</u> as a standard for when risk of loss is transferred to the other party. Unlike in the sale of goods, buyer-seller environment, however, the issue may go in either or both directions as, in modern commerce, there are frequent transactions in which licensees provide copies of information to licensors. Basically, the premise of this section is that risk passes to the party who has access to, taken possession of copies, or received control of the information.

2. Subsection applies that basic principle to Internet or similar transactions. The risk remains with the licensor as to the basic information that it controls and retains, but as to copies made by the licensee passes on the making of the copy.

SECTION 2B-623. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Delay in performance or nonperformance by a party is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or

(2) compliance in good faith with any applicable foreign or domestic governmental regulation, statute, or order, whether or not it later proves to be invalid, if the parties assumed that the delay or nonperformance would not occur.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance. If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall also allocate performance among its customers in a manner that is fair and reasonable and notify the other party of the estimated quota made available. However, the party may include regular customers not then under contract as well as its own requirements for further manufacture.

(c) A party that receives notice in a record of a material or indefinite delay, or of an allocation which would be a material breach of the whole contract, may:

(1) terminate and thereby discharge any unexecuted portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(d) If, after receipt of notification under subsection (b), a party fails to terminate or modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.

Committee Votes:

a. Voted unanimously to delete former section 2B-624, with reporter free to replace some of the concepts in another section.

b. Voted 12-1 to delete section on invalidity of intellectual property.

Note: This section states the ordinary UCC formulation of force majeure and related impossibility themes.

[F. Termination]

SECTION 2B-624. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) Obligations that survive termination of a contract include:

(1) a right or remedy based on breach of contract or completed performance;

(2) a limitation on the use, manner, method, or location of the exercise of rights in the information;

(3) an obligation of confidentiality or nondisclosure;

(4) an obligation to return or dispose of information, materials, documentation, copies, records, or the like to the other party or to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes by means of alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for providing notice;

(8) an indemnity term~~ pertaining to future claims~~;

(9) a limitation of remedy or disclaimer of warranty~~ and a warranty that extends to future claims~~;

(10) an obligation to provide an accounting; and

(11) any right, remedy, or obligation stated in the agreement as surviving.

COMMITTEE ACTION:

a. Reviewed in December and June, 1997 with no substantive changes.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).

Reporter's Note:

1. Subsection (a) states the primary effect of termination, which refers to the discharge of executory obligations. This corresponds to current law.

2. Subsection (b) provides a list of provisions and rights that presumptively survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The exceptions deal with remedies. The list indicates terms that would ordinary be treated as surviving in a commercial contract and the intent is to provide background support, reducing the need for specification in the contract with resulting risk of error. Of course, under the basic theme of contract flexibility, additional surviving terms can be added and the terms provided here can be made to be non-surviving.

3. Subsection (b) is a default rule. The contract terms can clearly add additional surviving obligations. The contract can also negate the survival of the listed rights. To do so, however, the contract would require specific reference and negation. Mere failure to list an element of subsection (b) does not mean that it does not survive.

SECTION 2B-625. NOTICE OF TERMINATION.

(a) A party may not terminate a contract except on the happening of an agreed event such as the expiration of the stated term, unless the party gives reasonable notification of termination to the other party.

(b) An access contract may be terminated without notice. However, if the access contract pertains to a resource containing information owned by the licensee, termination by the licensor requires reasonable notification to the licensee.

(c) A term dispensing with notification required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for the nature and timing of notification is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)

Reporter's Notes:

1. Termination involves an end to the contract for reasons other than breach of the contract. This section indicates that, for termination based on an agreed event (e.g., the end of the stated license term), no notice is required. In cases where termination may occur based on judgments or decisions of the other party, notice must be given of the termination. The notice must be reasonable. What is reasonable varies with the circumstances. Of course, to terminate, the terminating party must have a right to do so under the contract or other applicable law.

2. Article 2 requires receipt of notice, but this section requires "giving" notice. The receipt standard creates potential uncertainty and the party here is merely exercising a contractual right. The uncertainty is especially important in online or Internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

3. Under subsection (b), termination of access contracts does not require notice. In these cases, the contractual rights granted to the licensee are to access a resource owned by the licensor. When the contract terminates, the access privilege also terminates. This is consistent with current law in reference to licenses of this type. *See Ticketron Ltd. Partnership v. Flip Side, Inc.,* No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned facilities). In fact, in many cases, unless the contract otherwise provides, a license to use resources or property of the licensor is subject to termination at will. The no-notice rule of subsection (b) is especially important in modern access contract situations where thousands of licensees may be involved and addresses may not be available. Of course, the concept of termination refers to events not associated with breach. Where the reason to end the access relates to the existence of a breach, the section on discontinuing access controls.

This section provides a limited exception to this common law rule to protect licensees in cases where the access contract involves information owned by the licensee. The language change in this draft was intended to clarify the circumstances under which this notice requirement occurs. Discussions with banks and other entities indicated that the prior reference to information "provided" by the licensee was too uncertain and could cover virtually all transactional settings. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

4. The language in the last part of (c) sets out a standard for measuring the validity of contract provisions relating to time, place and method of termination notice. Current Article 2 allows the dispensing with notice if the term is not unconscionable. Subsection (c) retains that concept. In addition, however, Article 2B refers to concepts set out in Article 9-501 allowing standards to be set for notification. As in Article 9, that standard creates substantial room for effective exercise of contract freedom. The subsection invalidates waivers that are unconscionable, but allows specification of standards for notice subject to a standard of manifest unreasonableness.

SECTION 2B-626. TERMINATION: ENFORCEMENT AND ELECTRONICS.

(a) On termination of a license, a party in possession or control of information, documentation, copies or other materials which are the property of the other party or are subject to a contractual obligation to be returned or delivered to that party, shall deliver all of those materials or hold them for disposal on instructions of the party to which they are to be delivered. If any materials are jointly owned, the party in possession or control shall make the jointly owned materials available to the other joint owner.

(b) If the information, documentation, copies or other materials were subject to restrictions on use or disclosure, the party in possession or control following termination shall cease exercise of the terminated rights. Termination discontinues all rights of use under the license. Continued exercise of the terminated rights or other use is a breach of contract unless it is authorized by a term that expressly survives termination or was designated as irrevocable.

(c) Each party is entitled to enforce its rights under subsection (a) and (b) by judicial process. A court may order the party or an officer of the court to:

(1) deliver or take possession of all materials to be delivered;

(2) render unusable or eliminate the capability to exercise rights in or use the licensed information and any other materials to be delivered without removal;

(3) destroy or prevent access to any materials to be delivered; and

(4) require that the party or any other person in possession or control of the

materials to be delivered assemble and make them available to the other party at a place designated by that party.

(d) In an appropriate case, the court may grant injunctive relief to enforce the rights under this section.

(e) A party may use an electronic means to enforce termination under Section 2B-310. If termination is for reasons other than expiration of the stated license period or the happening of an agreed event, the party terminating the contract by electronic means shall give reasonable prior notification to the other party either directly or through the electronic means.

Uniform Law Source: None.

Reporter's Notes:

1. This section only deals with licenses. Subsection (a) states the unexceptional principle that the expiration of the contract term justifies immediate termination of contract rights and performance.

2. Termination differs from cancellation in that cancellation applies only in cases of ending a contract for breach. Subsection (e) deals with electronic means to enforce contract rights, a phenomenon present in digital information products, but not generally available in more traditional types of commercial products. The provisions here involve use of electronics to enforce contract rights that are not characterized by enforcing a breach of the agreement. Enforcement in the event of breach is dealt with in 2B-715 and 716.

3. The ability to use electronic means to effectuate a termination does **not** allow use of those means to destroy or recapture records, but merely enables the licensor to preclude further use of the information. Section 2B-314 requires notice in the contract, except in stated cases. The electronic means to enforce termination would include, for example, a calendar or a counter that monitors and then ends the ability to use a program after a given number of days, hours, or uses, whichever constitutes the applicable contract term.

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) A court may deny or limit a remedy other than liquidated damages if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

<u>(c) A aggrieved party is not entitled consequential damages which are unreasonably</u>

disproportionate to the risk assumed under the contract by the party in breach.

(d) 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 aggrieved party must continue to comply with contractual use restrictions. Unless the contract otherwise expressly so provides, the aggrieved party also has the rights and remedies available to it under other law.

Uniform Law Source: Section 2A-523.

Reporter's Note:

1. The basic theme of contract remedies is set out in Article 1. The goal is to place an aggrieved party in the position that would occur if performance had occurred as agreed. This is stated in UCC Section 1-106(1) which provides that "remedies ... shall be administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." This Draft has been amended to not restate that basic principle here, relying instead on the principle that Article 1 rules apply unless expressly displaced.

2. Subsection (a) affirms that the remedies in this article are cumulative and there is no concept of election of remedies such as would bar seeking multiple forms of remedy. This is a fundamental approach in the UCC and expressed in Section 2A-501(4) as to leases.

3. Subsection (b) gives a court a limited right to deny a remedy if it would place the injured party in a substantially better position that performance would have. This is a general review power given to the court. It does not justify close scrutiny by a court of the remedies chosen by an injured party, but only a broad review to prevent substantial injustice. The basic remedies model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation idea as a safeguard. The limiting reference to "substantially" better position has been extensively debated in the Article 2 Drafting Committee and, in the current draft, remains used as a reference point consistent with the idea of allows the parties, rather than the court, to elect among the remedies provided.

SECTION 2B-702. CANCELLATION.

(a) A party may cancel a contract if the other party's conduct constitutes a material breach of contract which has not been cured or if the agreement so provides.

(b) Cancellation is not effective until the canceling party notifies the other party of cancellation.

(c) On cancellation the following rules apply:

(1) A party in possession or control of information, materials, or copies shall comply with Section 2B-628.

(2) All obligations that are executory at the time of cancellation are discharged.

(3) The rights, duties, and remedies described in Section 2B-626(b) 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.

(e) Unless the contrary intention clearly appears, expressions of “cancellation” or “rescission” of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach .

Uniform Law Source: 2A-505; Sections 2-106(3)(4), 2-720, 2-721. Revised.

Reporter's Note:

1. Cancellation means putting an end to the contract **for breach** and is distinct from termination (this terminology is not common in licensing practice, which treats 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 such a breach, while this draft treats non-payment of fees as material only if substantial. The primary issue in this section concerns whether the injured party must give notice to the other party before the cancellation for material breach is effective.

2. In an ongoing relationship, the remedy of cancellation is important in two different ways. First, it is important to the injured party because it ends the party’s duty to continue to perform executory obligations under the agreement. Thus, for example, cancellation in a continuous access contract would end the access provider's obligation to continue to make access available. Second, in licenses that involve intellectual property rights, cancellation ends the contractual permission to utilize the information in ways that would otherwise infringe the licensor's intellectual property rights. This creates the possibility of intellectual property remedies for infringement that co-exist with contractual remedies for breach. This is true because, at least in most cases, cancellation of a license coupled with continued use (e.g., copying) by the licensee infringes the property rights of the transferor. In practice, in licensing, contract damages are often not sought because a licensor relies on the infringement claim, rather than on contract law for recovery, but both types of recovery exist and the ability to cancel the license may trigger the intellectual property recovery right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228 (2d Cir.1982). Damages for copyright infringement include "actual damages suffered by [the copyright owner] as a result of the infringement **and** any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages...." 17 U.S.C. ' 504(b). There is also a statutory damages provision.

A license is a permit granted by the licensor to the licensee that allows the licensee to use, access or take whatever other actions are contracted for with respect to the intangibles without threat of infringement action by the licensor. If the license terminates, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying intellectual property rights of the licensor exposes itself to an infringement claim. Intellectual property remedies are in addition to contract remedies. The infringement and the contract remedies deal with a different injury (breach of contract expectation or damage to exclusive rights).

3. The right to cancel **also** affects judicial jurisdiction issues if the information is covered by federal intellectual rights. An infringement claim places the licensor within **exclusive** federal court jurisdiction. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992). Schoenberg comments: "If the breach would create a right of rescission, then the asserted claim arises under the Copyright Act." In order to sue for infringement (in addition to or in lieu of the breach of contract), the licensor must establish that the contract no longer grants permission to the licensee to do what it alleges that the licensee is doing. A contract claim arises under state law and comes under federal jurisdiction under diversity or pendent jurisdiction concepts.

4. Of course, the fact that a material breach occurred does not require the injured party to cancel. It may continue to perform and collect damages under other remedial provisions. Under the section dealing with cure, the ability to cure a material breach is subject to the injured party’s right to cancel. Thus, there is no obligation to wait

for a possible cure. Cancellation may be immediate. However, if cure precedes cancellation, cure precludes cancellation.

5 Cancellation is effective when the injured party notifies the other party. In a single delivery in the mass market, refusal of delivery itself provides the required notice. "Notifies" is defined in Article 1 (1-201(26)) as taking steps reasonably required to inform the other party of the fact, but does not require **receipt** of the notice. An obligation to ensure receipt would be inconsistent with the balance of rights here and other law, such as in Article 9. Since cancellation requires a material breach, however, the Committee should consider whether a precondition of notice should be imposed at all or whether cancellation without notice is appropriate. That requirement apparently does not exist in current Article 2.

6. Subsection (d) clarifies the enforceability of contract terms that provide that a licensee's right cannot be canceled, even for material breach. This type of remedy limitation is especially common in transactions where the licensee contemplates distribution of the information product developed or licensed by the other party and makes a significant investment in developing the information product based on the license. The non-cancellation term has as much or more importance in information industries as does the refund and replacement term in transactions involving the sale of goods.

7. Subsection (e) is from current Article 2.

SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may add to, limit, or provide a substitute for the measure of damages recoverable for breach of contract or limit a party's other remedies, such as by precluding the party's right to cancel, limiting the remedies to return of, or delivery to the other party all copies of the information and refund of the contract fee, limiting the remedies to repair and replacement of copies of the information.

(b) Resort to a modified or limited remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. An exclusive remedy precludes resort to any other remedies. However, if an exclusive remedy requires performance by the party that breached the contract and the performance of that party in providing the agreed remedy fails to give the aggrieved party the remedy, the aggrieved party is entitled to specific enforcement of the agreed remedy or, to the extent that the performance failed to provide the agreed remedy and subject to subsection (c), to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of terms excluding or limiting consequential or incidental damages if the contract makes those terms expressly independent of the performance of the agreed remedy.

(d) Consequential damages and incidental damages may be excluded or limited by agreement unless the exclusion or limitation is unconscionable.

UNIFORM LAW SOURCE: Section 2-719 (revised).

COMMITTEE ACTIONS:

a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

b. Considered in June 1997.

c. Adopted requirement that consequential damages clause be expressly independent of other agreed remedy in order to survive failure of remedy. Vote: 12 – 0. (Nov. 1997)

REPORTER'S NOTE:

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 is subsection (a) is not an exclusive statement of appropriate option, 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 scope of Article 2B (see 2B-103). Under these circumstances, the draft does not adopt the sales law presumption that exclusion of loss for personal injury in **consumer** cases is prima facie unconscionable. An assumption that limitation of such loss is wrongful is not appropriate since the availability of such a remedy is not generally established in law. On the other hand, the Draft does provide that personal injury in appropriate cases does fall within the definition of consequential damages. The Draft simply takes no position on the issue of the conscionability of excluder clauses.

2. Subsection (b) begins with language from current article 2: a contractual remedy is not the exclusive remedy unless the terms of the contract expressly so provide. The second sentence of subsection (b), however, reflects modern case law and clarifies the test for failure of a remedy under current Article 2. Current Article 2 provides that a contractual limit is eliminated if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential purpose". This language has led to a myriad of case law rulings and does not clearly describe what is at issue in failed remedy cases.

The need for clarification was suggested from the floor of the NCCUSL meeting in 1995. The basic principle in this subsection is that, if a party agrees to specified performance as an exclusive remedy in lieu of other remedies, its failure or inability to perform its that agreement on remedies both vitiates the exclusive nature of the remedy limitation or allows specific performance at the aggrieved party's option.

3. This Draft follows current law under Article 2 in that it does not restrict the ability of the parties to control their remedies by contract through a statutory concept that there must be a so-called “minimum adequate remedy”. Under current law, that phrase appears only in comments to Section 2-719. In some reported cases, those comments have been used as a basis to challenge contractual remedy limitations, but the challenges have been effective in only a few cases and typically only if the remedy limitation essentially denies any remedy to the party. That being said, the standards for what constitutes a “minimum adequate remedy” are not clearly delineated either in current comments the Article 2 of in the reported cases. See, e.g., **Cognitest** case.

The Comments to current Article 2-719 tie the idea of a minimum adequate remedy to two legal analyses, both of which are present under this Draft. In one respect, they seem to refer to an idea of a failure of mutuality or consideration and resulting questions about the enforceability of the entire contract. (e.g., “If the parties intend to conclude a contract for sale ... they must accept the legal consequence that there be at least a fair quantum of remedy ...”). Alternatively, the concept is connected in the comments to the idea of unconscionability, a standard against which all contract clauses are tested in this Article. (e.g., “Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion ...”).

Since these generally applicable and more widely accepted themes remain present in reference to all contract, the decision to not elevate the commentary to statutory law avoids creating a new and undefined basis for invalidating important contract terms without substantively altering the rights of the parties under current law.

The provision regarding exclusive remedies in this context is exclusive only as to contractual remedies, it does not refer to being exclusive as to all "rights" of a party, such as the right to prohibit use or copying, or disclosure unless the contract expressly so provides. See Section 2B-701(e)

4. **Subsection (c)** provides a basis for resolving an issue that yields inconsistent results in reported decisions under Article 2. That situation involves an interpretation problem where a contract contains both a limited, exclusive remedy and a contractual exclusion of consequential damages. Cases split on whether in such situations a failure of the exclusive remedy also invalidates the consequential damages exclusion. Most states holding that the failure of one remedy does not necessarily exclude enforceability of the other limitation. This is essentially a contract interpretation issue in that it asks whether the one contract clause is dependent (or independent) of the other clause. The Draft requires express independence for the consequential limitation to survive. This requirement assures that the other party will have notice of the intended result, even if the particular point is not negotiated.

SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach of contract by either party may be liquidated in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. A term fixing unreasonably large liquidated damages is unenforceable. If a term liquidating damages is unenforceable, the aggrieved party has the remedies provided in the agreement or this article. However, the unenforceability of that term does not affect the enforceability of terms limiting or excluding consequential damages or incidental damages unless the separate terms are expressly made subject to the liquidated damages terms.

(b) A party in breach of contract is entitled to restitution of the amount by which the payments it made for which performance was not received exceeds the amount to which the other party is entitled under terms liquidating damages in accordance with subsection (a).

(c) A party's right under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under the agreement or this article other than under the terms liquidating damages in accordance with subsection (a) and the amount or value of any benefits received by the other party directly or indirectly by reason of the contract.

Uniform Law Source: 2-718. Revised.

Committee/ Other votes:

a. At the annual meeting, in reference to Article 2, that Drafting Committee accepted a motion from the floor to clarify that no after the fact determination of excessive or too minimal damages is intended.

b. At the June 1997 meeting, the Drafting Committee by consensus agreed to delete a restitution formula contained in current Article 2, but which has had limited or non-existent use.

Reporter's Note:
This draft continues the presumption that contractual choices should be enforced unless there is a clear, contrary policy reason to prevent enforcement or there is over-reaching. If the choice made by the parties was based on their assessment of choices at the time of the contract, that choice should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. In essence, if two commercial parties negotiate the clause, it is essentially per se reasonable. The comments will describe this approach.

SECTION 2B-705. STATUTE OF LIMITATIONS.

(a) An action for breach of contract under this article must be commenced within the later of four years after the right of action accrues or one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued. By agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues and may extend it to a term of not longer than eight years.

(b) Except as otherwise provided in this Section, a right of action accrues when the act or omission constituting the breach occurs or should have occurred, even if the aggrieved party did not know of the breach. Except as provided in subsection (c), breach of warranty as to a copy of information occurs when tender of delivery occurs. However, if a warranty explicitly extends to future conduct, breach of warranty occurs when the conduct that constitutes the breach of warranty occurs or should have occurred, but not later than the date the warranty expires.

(c) A right of action for breach of warranty under Section 2B-401, an express warranty covering similar subject matter as Section 2B-401, a warranty against third party claims for libel, defamation or the like, or for a breach of contract involving disclosure or misuse of confidential information accrues on the earlier of when the act or omission constituting the breach is or should have been discovered by the aggrieved party.

(d) A right of action for a failure to provide an indemnity accrues on the earlier of when the act or omission that constitutes a breach of the obligation to indemnify is or should have been discovered by the indemnified party.

(e) This section does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; 2-725. Revised.

Reporter's Note:

1. This section combines a discovery rule with a rule of repose. The discovery rule extends the limitations period for one additional year if applicable.

2. The cause of action as a general rule in this draft when the conduct constituting a breach occurs. In ordinary warranties, including all implied warranties, the warranty is met or breached on delivery of a product or service, even if the performance problem may not appear until later. Performance, in the sense of ongoing operation of a program, is not the measure of when the breach occurs. Performance in the sense of completion of one's required conduct in the transaction is the measure.

3. This draft follows Article 2A and Article 2 and adopts a four year limit for the contract action, but allows extension by one year if the breach could not have been discovered earlier. Article 2A uses a "discovery" rule. In a license, this can create an extended period of exposure to suit because of the long term nature of the contract and because many defects in software and similar intangibles do not become manifest until particular conditions arise. Additionally, of course, breaches occur during the contract performance and do not relate to circumstances present at the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause of action arises, except in cases where warranty extends to future performance and the breach cannot be discerned until that performance occurs. In most warranty cases, the breach of warranty arises on delivery. See Intermedics, Inc. v. Ventritex, Inc., No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) (cause of action for contract breach related to the misappropriation would not entail a continuing breach); Computer Associates International, Inc. v. Altai, Inc., (Tex. 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute of limitations in trade secret misappropriation claim). A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

4. Subsection (a) applies the basic principle of contract freedom and holds that parties can contract for a longer period of limitations than under the statute. Modern practice routinely allows and relies on "tolling agreements" in contractual disputes. The basic issue is whether a contract can extend as well as limit the term. The draft allows extension with a eight year maximum.

5. This section deletes the "future performance" remedy exception as defined in current Article 2 and substitutes a standard that avoids the litigation that the current standard generates. In current Article 2, the time of accrual standard is dropped entirely if a warranty extends to future performance.

SECTION 2B-706. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission nor a claim for rescission of the contract nor refusal or return of the information shall bar or be deemed inconsistent with a claim for damages or other remedy.

Reporter's Note: From Article 2.

[B. Damages]

SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) If there is a breach of contract, an aggrieved party may recover as [direct] [general] damages, compensation for the loss resulting in the ordinary course from the breach as measured in any reasonable manner, together with the present value of any incidental and consequential damages, less the present value of expenses avoided as a result of the breach of contract.

(b) The remedy for breach of contract relating to disclosure or misuse of information in which the aggrieved party has a right of confidentiality or which it holds as a trade secret may include compensation for the benefit received by the party in breach as a result of the breach. A remedy under the agreement or this article for breach of confidentiality or misuse of a trade secret is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.

(c) Except as otherwise provided in the agreement or this article, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(d) In the case of published informational content, neither party is entitled to consequential damages unless the agreement expressly so provides.

Committee Votes:

a. Voted 7-6 to allow consequential damages only in cases where parties agree to that remedy. March, 1996.

b. Voted 14-0 to return to consequential damages rule of common law, but consider specific circumstances in which consequential damages should be allowed only if agreed to by the parties. September, 1996.

c. Rejected motion to reverse consequential damages presumption in battle of forms. (5-7) December, 1996,

d. Consensus to retain the exception for published informational content. (December, 1996)

e. Reviewed without substantive comments in June, 1997.

Reporter's Notes:

1. Subsection (a) defines a broad approach to remedies. Unlike in Article 2, formula-driven damage computation is often not appropriate in Article 2B. Breach does not ordinarily entail defects in delivered products or failures to pay.. Article 2B covers a wide range of performances and this section allows a court and a party to resort to general, common sense approaches to damage computation for such occurrences.

2. Article 2A-523(2) provides for recovery of "the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner ... less expenses saved in consequence of the lessee's default." The UNIDROIT Principles provide: "[An aggrieved party] is entitle to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain by the aggrieved party resulting from its avoidance of cost or harm." UNIDROIT art. 7.4.2.

3. A party may elect to use the measure of damages in (a) in the case of either material or non-material breach. This is subject to general limitations on double recovery and the like. However, the principle is that the aggrieved party controls the choice, while the court (or jury) controls the computation. The Restatement (Second) provides for computation of damages in the following manner: "Subject to [limitations], the injured party has a right to

damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or deficient, **plus** (b) any other loss, including incidental or consequential loss, caused by the breach, **less** (c) any cost or other loss that he has avoided by not having to perform."

4. Subsection (a) maintains the distinction between general or direct damages and consequential damages. The measurement provided here is intended to relate only to direct loss and the definition suggested in 2B-102 should be considered in placing limitations on this concept. That definition provides: "Direct [general] damage" means compensation for losses to a party consisting of the difference between the value of the expected performance and the value of the performance received." Direct [or general] damage refers to the value of the performance received, while consequential loss refers to foreseeable losses resulting from the inability to use the performance.

The Restatement (Second) of Contracts defines recoverable damages as consisting of three elements: (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform. Restatement (Second) of Contracts § 347.

Illustration 1: OnLine Corp. provides access to stock market price quotations for a fee of $1,000 per hour. It fails to have the system available during a period that proves to be critical for Meri-Lynch, a client, during a ten minute period. Meri-Lynch can recover as direct damages under this formula, the value of the breached performance (e.g., the difference in the value of the monthly performance if perfect and as delivered), but losses from not being able to place profitable investments during the ten minute period are consequential damages, if recoverable at all.

Illustration 2: Sizemore Software licensed its database software to General Motors, restricting the licensed use to no more than twenty simultaneous users. General Motors used the system with an average of twenty two simultaneous users over a two month period. Sizemore can recover as direct damages the difference in the value of a twenty-two person license for the applicable term and the value of the twenty person license, or may recover the value difference as measured in any reasonable manner. The excessive use is also likely to constitute copyright infringement.

5. Subsection (c) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. The idea that an injured party must mitigate its damages permeates contract law jurisprudence, but has never previously been stated in the UCC. The basic principle flows from the idea that remedies are not punitive in nature, but compensatory. Especially in context of the information products considered here, the need to consider whether mitigating efforts occurred are significant given the potentially wide ranging losses that breach might entail.

6. This draft excludes consequential damages for "published informational **content**." As noted elsewhere, published informational (Internet and newspaper) invokes many fundamental and important values of our society. Whether characterized under a First Amendment analysis or treated as a question of simple social policy, our culture has a valued interest in promoting the dissemination of information, this Article should take a position that strongly advocates support and encouragement of broad distribution of information content to the public. Indeed, a decision to do otherwise would place this Article in diametric contrast to how modern law has developed. One aspect of promoting publication of information is to reduce the liability risk; that principle has generated a series of Supreme Court rulings that deal with defamation and libel. Beyond the global concern about encouraging information flow, there are other principles that suggest the same result. As indicated in the definition of published informational content, the context involves one in which the content provider does not deal directly with the data recipient in a setting involving special reliance interests. The information is merely compiled and published. That activity should be sustained. Furthermore, the information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. Finally, with few exceptions, modern law recognizes the liability limit even under tort law and the exclusion would merely decline to change the law on this issue. The Restatement of Torts, for example, limits exposure for negligent error in data to cases involving an intended recipient and even then to "pecuniary loss" which courts typically interpret as direct damages.

Illustration 3: Dow Jones distributes general stock market and financial transaction information through sales of newspapers and in an on-line format for a fee of $5 per hour or $1 per copy. Dow, the financial officer of Dupond, reviews information in the online system and relied on an error to trade 1 million shares of Acme at a price that caused a $10 million loss. If Dupond was in a situation of special reliance on Dow Jones, the consequential loss would be recoverable. If this is published content, Dupond cannot recover for the consequential loss.

Illustration 4: Disney licenses a motion picture to Vision Theaters. Vision shows the movie to audiences under a ticket contract that qualifies as an access contract (e.g., on-line). One member of the audience who pays five dollars hates the movie and spends a sleepless week because the movie was more violent than expected. That audience member should have no recovery at all, but if it can show that there was a breach, the individual could not recover consequential loss because this is published content. If liability for a violent movie exists, it exists only under tort law.

SECTION 2B-708. LICENSOR'S DAMAGES.

(a) Except as otherwise provided in subsection (b), for a material breach of contract by a licensee, the licensor may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, the value of accrued and unpaid contract fees or other consideration for any performance rendered by the licensor for which the licensor has not received the contractual consideration, plus:

(A) the present value of the total unaccrued contract fees or other consideration required for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;

(B) the present value of the profit and general overhead which the licensor would have received on acceptance and full payment for the performance that was to be delivered to the licensee under the contract and was not accepted by or delivered to the licensee because of an improper refusal or a repudiation of the contract; or

(C) damages calculated pursuant to Section 2B-707; and

(2) the present value of any consequential and incidental damages~~, as permitted under this article, determined~~ as of the date of entry of the judgment.

(b) If the breach of contract makes possible a substitute transaction concerning the same subject matter that would not have been possible in the absence of breach, the damages in subsection (a) must be reduced by due allowance for the proceeds of any actual substitute transaction or the market value of the substitute transaction made possible because of the breach, less the costs of the substitute transaction.

(c) The date for determining present value of unaccrued contract fees and date for determining the sum of accrued contract fees under subsection (a) is:

(1) if the initial enabling of use never occurred, the date of the breach of contract;

(2) if the licensor cancels and discontinues the right to possession or use, the date the licensee no longer had the actual ability to use the information; or

(3) if the licensee's rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.

(d) To the extent necessary to obtain a full recovery, a licensor may use any combination of damages provided in subsection (a).

Uniform Law Source: Section 2A-528; Section 2-708.

Reporter's Note:

1. This section gives the licensor a right to elect damages under three measures described in (a). Each damage formula is subject to subsection (b). The basic principle assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables a double recovery. Thus, no order of preference is stated for the three options.

2. Licensor remedies are formulated in a manner that differs from those made available for lessors or sellers. The most significant difference lies in the intangible character of the value with reference to which the transactions was conducted. Given their ability to be recreated easily and rapidly, with little cost, contracts involving digital information assets are prime candidates for damage assessment focusing on net return or profit lost to the licensor. Most importantly, this draft eliminates the resale remedy standard. That approach to damages results from a focus on the goods as the critical element of the contract and does not apply to cases where the value of the transaction lies in the services, information, or other non-goods elements. Instead of that resale or contract market focus, this Draft centers damages on the contract fee and lost benefits of the licensor. This is consistent with common law approaches in similar cases.

3. Unlike for goods, information can be replicated many times over with little cost or none. Thus, the remedies do not relate to resale or re-license of the particular diskette or copy. Instead, the approach taken here allows a court to consider cost savings and alternative transactions made possible by the breach. The reference to alternative transactions is in subsection (b). This due allowance approach is appropriate in this setting because of the nature of the subject matter and the variety of circumstances that can be encountered. Similar language is employed in the Restatement. In addition, of course, the injured licensor is also subject to an obligation to mitigate damages.

Illustration 1: Chambers agrees to supply a master disk of its software to Wilson Distributing and agrees to allow Wilson to distribute 10,000 copies of the software in a wholesale marketplace. This is a nonexclusive license. The cost of the license is $1 million. The cost of the disk is $5. Wilson fails to pay, but instead repudiates the contract. Under (a)(1)(A), Chambers recovers $1 million less the $5. Chambers recovery is also to be reduced by dues allowance for (1) any alternative transaction made possible by this breach (e.g., another transaction in a market created by the lack of the 10,000 products, and (2) by any failure to mitigate under 2B-707.

Illustration 2: Same as in Illustration 1, except that the contract also requires Chambers to deliver manuals, boxes and other distribution materials for Wilson to distribute the software. The cost of 10,000 of these materials is approximately $800,000. In computing damages, the $800,000 cost savings is deducted from the $1 million. In considering what "due allowance" should be made for any alternative transactions, a court should take into account that this expense adjustment already reflects some accommodation to the alternative transaction, but if a second deal had the same terms, the issue would be whether the second transaction was made possible by the breach.

Illustration 3: Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, Chambers makes an identical license with Second Distributor for a fee of $900,000. This transaction was possible because the first was canceled. Chambers recovery is $100,000 less any net cost savings that are not accounted for in the second transaction.

4. This draft retains the lost profits concept that had been developed in parallel to Article 2. See Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996) (discussing of the application of the alternative transaction concept in reference to a lost profits claim relating to a license breach).

Illustration 4: Compart licenses robotics software designed to operate aircraft engine plants making a particular type of engine. There are five such plants in the world. One is operated by Boeing. Boeing decides to sell the plant to Douglas and, since the license is not transferable, it repudiates the license at the time of sale. Douglas enters into a separate license with Compart. The second transaction was made possible because of the breach by Boeing. The profit and contract fees it generates off-set any profit or fees lost in the Boeing breach.

Illustration 5: Parkins grants an exclusive license to Telemart to distribute products comprised of copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches the license and Parkins cancels. It sues for damages. Its recovery is the present value of the remaining contract fees with due allowance for alternative transactions made available by virtue of the breach and subject to a duty to mitigate. Here, since the breached license was exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution of the encyclopedia.

5. The damages rules follow common law and give both the licensor and the licensee a right to consequential damages. See Restatement (Second) of Contracts § 347. The UN Sales Convention applies the same approach. UN Convention art. 74. Recovery of consequential (or any other damages), of course, is limited by the principle that the loss must be proven with reasonable certainty. See Section 2B-102 ("consequential damages"); Restatement (Second) of Contracts § 352. A number of cases reject claims of recovery for licensor o potential profits as being too speculative. This Article does not disturb the basic rule requiring adequate proof of loss.

The formulae in subsection (a) relate to direct (general) damages. The additional consideration referred to in that section refers to consideration agreed to as a fixed measure invariant compensation, not the possible gains that the party expected from using the information.

Illustration 6. I receive a promise to be paid $10,000 for an item that cost $1,000 and receive a further commitment of 3% royalties for any sales of copies of that item. Assume that the licensee repudiates the entire contract. As direct damages under (a), I receive $10,000 less any expenses saved. The potential loss of royalty profits is treated as potential consequential loss. It can be recovered only if proven with the degree of certainty required under general contract law cases in the applicable jurisdiction.

6. If a breach relates to use or disclosure restrictions, consequential damages are appropriate. See Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) (On breach of license, under California law, "Universal was entitled to recover the profits it lost as a result of [defendant's] breach ... The court correctly undertook to determine (1) which of the sales that [defendant] made after the agreement was terminated would have been made by Universal if [defendant] had not violated that provision and (2) the profit Universal would have made on those sales."); United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) (Premature publication entitled licensor to lost profits).

7. For consequential damages, present values are measured as of the date of the entry of the judgment. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. As to the direct damages, a distinction will often be required between when a fee is accrued and when a fee is not accrued. The provisions of subsection (c) provide guidance on this issue, making computation of accrued and unaccrued fees occur on the same date.

Illustration 7: A five year license requires that the Sony pay a $5 royalty to Smith, the licensor, for each copy of the Power Rangers video game that it produces for the retail market from a master copy given to it by the licensor. Payments are made on a monthly basis. After non-payment for three months, Smith notifies Sony that it is canceling the license. Assume that $50,000 of royalty fees would accrue each month of the ten year contract. Under (c)(2), the date for distinguishing accrued and unaccrued fees arises when Sony no longer had possession or the ability to continue use of the information. Assume that it returned the master disk at the end of month 3. The sum of accrued and unpaid fees is $150,000, while the unaccrued fees total (assuming this can be proven or reliably estimated) $50,000 times the remaining 57 months of the license. The present value of that amount would be determined as of the end of the third month. If Sony's performance also breached quality requirements in the license, Smith may be able to recover consequential loss to the value of the images as computed on the date of judgment.

8. The licensor may have remedies under other law. The primary alternative is intellectual property law. Default by the licensee introduces the possibility of an infringement claim if (a) the breach results in cancellation (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the default consists of acting outside the scope of the license and in violation of the intellectual property right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir.1982); Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) ("[Under] federal and state law a material breach of a [copyright] licensing agreement gives rise to a right of rescission which allows the non-breaching party to terminate the agreement. After the agreement is terminated, any further distribution would constitute copyright infringement."); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

9. Remedies for copyright infringement include both monetary recovery and a right of action against the infringing works and the infringer's future conduct. The two remedies are not mutually exclusive and are simultaneously available. 17 USC ' 504. Loss is measured in terms of wasted advantage, lost profit or the like. See Data General Corp. v. Grumman Systems Support Corp., Civ. A. No. 88-0033-S, 1993 WL 153739 (D. Mass. May 11, 1993); Harris Market Research v. Marshall Marketing & Comm., Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing fees due under sublicenses were admissible on the issue of damages under theory of breach of license agreement); Engineering Dynamics, Inc. v. Structural Software, Inc., 785 F. Supp. 576 (E.D. La. 1991) (infringing user manual; damage award adjusted to reflect the fact that losses suffered by copyright owner stemmed from factors other than actions attributable to improper use of the manual); Deltak, Inc. v. Advanced Systems, Inc., 767 F.2d 357 (7th Cir. 1985) (damages measure value of the infringing use; in case in which no directly attributable profit could be discerned, each infringing copy "had a value of use equal to the acquisition cost saved by the infringement instead of purchase which [defendant] was then free to put to other uses.")

10. Infringement of a patent entitles the patent holder to damages computed so as to place the patentee in the position that it would have been in had the infringement not occurred. 35 U.S.C. ' 284 (damages "adequate to compensate for the infringement.") The Patent Act also authorizes a court to award treble damages in the event of a willful infringement. Actual damages are assessed in terms of loss suffered by the patent holder with the measure of "loss" frequently gauged in terms of loss of profits in reference to the patented invention. Zegers v. Zegers, Inc., 458 F.2d 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132 (1972); Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959).

11. Trade secret law is grounded in state law relating to the enforcement of confidential relationships relating to information. There are three sources of trade secret law: the Restatement (First) of Torts ' 757, the Restatement (Third) of Unfair Competition, and the Uniform Trade Secrets Act (UTSA). While the first Restatement has dominated this field, the majority of all states have now adopted the UTSA. Restatement: in addition to injunctive and other relief, the trade secret owner may recover "damages for past harm ... or be granted an accounting of the wrongdoer's profits" and provides that the owner of the trade secret can have two or more of these remedies in the same action. Restatement (First) of Torts ' 757 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may recover damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust enrichment caused by the misappropriation that is not taken into account in computing damages for actual loss."

12. Licensors often opt for intellectual property remedies, rather than contract remedies under current law because the recovery is often greater and the standards for damages are more clearly defined. Federal intellectual property remedies do not preempt or displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general principle is that all remedies are cumulative, except that double recovery is not permitted. See Harris Market Research v. Marshall Marketing & Communications,

Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing and processing fees due under sublicense admissible on the issue of damages under either the theory of copyright infringement or of breach of license agreement); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (award of damages for a breach of license contract and copyright infringement by unauthorized display was not an award of double damages).

SECTION 2B-709. LICENSEE'S DAMAGES.

(a) Subject to subsection (b), on material breach of contract by a licensor, the licensee may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, the value of any payments made or other consideration provided to the licensor for performance that has not been rendered, plus :

(A) the present value, as of the date of breach, of the market value of performance not provided minus the contract fee or other consideration for that performance;

(B) damages computed pursuant to Section 2B-707; or

(C) if the licensee has accepted performance from the licensor and not revoked acceptance, the present value, at the time and place of performance, of the difference between the value of the performance accepted and the value of the performance had there been no defect, not to exceed the agreed contract fee or other contractual consideration required for the performance; and

(2) the present value of incidental and consequential damages~~, as permitted under this article,~~ resulting from the breach as of the date of the entry of judgment.

(b) The amount of damages calculated under subsection (a) must be reduced:

(1) by expenses avoided as a result of the breach; and

(2) if further performance is not anticipated under the agreement, by any unpaid contract fees for performance by the licensor which has been received by the licensee.

(c) Market value is determined as of the place for performance. Due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contractual terms, performance, and information that were similar in terms, quality, and character to the agreed performance.

(d) To the extent necessary to obtain a full recovery, a licensee may use any combination of the measures of damages provided in subsection (a).

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2). Revised.

Reporter's Notes:

1. As in licensor remedies, this section allows the licensee to choose among alternatives. Given a court's general overview to prevent excessive damages, there is no reason to prefer one option over another. Also, the type of breach involved here is more varied; greater flexibility is needed. Because of the diverse problems that might be involved in dealing with breach of a license, the narrow structure of Article 2 remedies for a licensee (buyer) is not appropriate. Article 2B makes the choice of remedy broader and eliminates the hierarchy set out in current Article 2. The options in this section should be read in conjunction with the general damages concepts of mitigation and avoiding double recovery.

2. Option 1 parallels the Article 2 concept of comparing contract price to market value for performance not received. It is predicated on the initial assumption that the breaching party will also return any contract fees already received for that performance. Unlike in Article 2, there is no provision dealing with a remedy based on contract price compared to "cover." In dealing with intangibles that are, by their nature, often distinct or unique, "cover" is often not viable and uncertain of application. In Article 2B, alternative transactions are given "due weight" in determining market value under subsection (c), but a failure to effect an alternative transaction does not bar recovery unless it affects concepts of mitigation. This approach builds on ideas in Article 2A. For purposes of subsection (a), performance has not been provided by the licensor if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, and with respect to any performance that was executory at the time that the licensee justifiably cancels.

Illustration 1: Amoco Oil contracts for a 1,000 person site license for database software from Meed Corp. The contract price is $500,000 in initial payment and $10,000 for each month of use. The contract term is two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and sues, applying subsection (a)(1). It is entitled to return of the $500,000 payment plus recovery of any difference between the contract price and the market price for a similar site license of similar software.

Illustration 2: Same facts as in Illustration 1, but Amoco goes to Oracle Software and obtains a license for a 1,000 user site license for the Oracle database software. The contract terms involve a $900,000 initial payment and a monthly use payment of $12,000. The term is two years. In its lawsuit, if the issue is raised, the court must consider to what extent this second transaction gauges the market value applicable to the Meed contract. The issue would involve the terms of the license, the nature of the software and any other relevant variables.

Illustration 3: Same facts as in Illustration 2, but Amoco obtains a license for the Meed software from an authorized distributor (Jones) for a $600,000 initial fees and under other terms identical to the Meed contract. The issue of similarity is the same, but giving due weight to this alternative transaction will presumably limit the Amoco recovery to its initial payment, $100,000, and any incidental or consequential damages.

3. The third alternative is limited to cases in which the breach relates to performance that has been delivered and accepted. It parallels the provisions of current Article 2, but caps the recovery by the contract price. This is based on a differentiation between consequential and direct or general damages. For "accepted" goods under Article 2 (sales), the damages formula is in Section 2-714, consisting of any incidental and consequential damages resulting from the seller's plus: (1) the "loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable" or (2) "the measure of damages for breach of warranty [which is] the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." UCC ' 2-714. Section 2A-519(3) provides that the measure of damages for accepted goods is: "loss resulting in the ordinary course of events from the lessor's default as determined in any manner which is reasonable" plus incidental and consequential damages less expenses saved. Article 2A provides that for breach of warranty the measure of damages is the present value of the difference between the value of the goods as warranted and their value as accepted.

4. As a general rule, the "value of the goods as warranted" focuses on the market value of the property if it were consistent with the represented quality it was to have. This should most often equal the purchase price, but it is not always so limited by courts. See <u>Chatlos Systems, Inc. v. National Cash Register Corp.</u>, 670 F.2d 1304 (3rd Cir.

1980) (allows value measure that encompassed the value that the buyer would have obtained from a perfect computer system with specific capabilities, including advantages in inventory control, profits and the like, in excess of the contracted price). This draft reverses that approach. The additional value loss (e.g., lost benefits) are consequential damages and covered by treatment of that type of damage in the contract and under the article. This draft allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality. Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F.Supp. 364 (E.D. Mich.).

5. Courts apply a flexible approach to licensee damages outside the UCC. If the damages are proven with reasonable certainty, they can include lost profits in this context. In Western Geographic Co. of America v. Bolt Associates, 584 F.2d 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits that the licensor earned from licensing following breach. In Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984) a company was entitled to recover lost profits when a California distributor of motion pictures breached licensing agreement where California distributor knew that the owner was attempting to obtain films for redistribution in Europe and should have known that owner and company intended to resell films. In Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir. 1989) the court approved a lost profit recovery based on a failure of a licensor to make available to the licensee various films for showing in European markets. In Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir. 1989) a licensee brought action for breach of contract and for wrongful termination of license related to trademarks and manufacturing know how. The contract breach consisted in part of actions taken by the licensor in violation of the territorial exclusivity provisions of the license. The court approved an award of lost profits for breach of contract based on estimates of lost sales, but reversed on the basis of how the profits were computed requiring computation of profits based on a marginal cost approach. Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

SECTION 2B-710. RECOUPMENT.

(a) Except as provided in subsection (b), a party on notifying the party in breach of its intention to do so, may deduct all or any part of the damages resulting from any breach of the contract from any part of the payments still due under the same contract.

(b) If a breach of contract is not material, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Section 2-717. Revised.

Committee Action

a. Discussed in June, 1997; requirement of prior notification suggested.

Reporter's Note:

1. Subsection (a) adopts language from Article 2 and Article 2A. The injured party can employ self-help by diminishing the amount that it pays under the contract. Unlike in the sale of goods, the obligations of the parties here often run continuously and in complex ways back and forth.

2. Subsection (b) applies that principle to the case of nonmaterial breaches, recognizing the different interests that are involved in ongoing performance contracts and minor breaches. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach. Importantly, this Article creates an obligation to cure nonmaterial breaches where the cost of that cure is not disproportionate to the harm.

[C. Performance Remedies]

SECTION 2B-711. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance of any obligation, other than the obligation to pay for information or services already received, if:

(1) the agreement expressly provides for that remedy and an order for specific performance will not constitute an undue administrative burden for the court; or

(2) the contract was not for personal services, but the agreed performance is unique and monetary compensation would be inadequate.

(b) A decree for specific performance may contain any terms and conditions the court considers just but must provide adequate safeguards consistent with the terms of the contract to protect the confidential information and informational property rights of the party ordered to perform.

~~(c) An aggrieved party has a right to recover copies of information to be transferred to and owned by it if the information exists in a form capable of being transferred and, after reasonable efforts, the aggrieved party is unable to effect reasonable cover at a reasonable price and within a reasonable manner or the circumstances indicate that an effort to obtain cover would be unavailing.~~

Uniform Law Source: 2A-521. Section 2-716. Revised.

Committee Action:

a. Discussed without substantive changes in June, 1997.

Notes to this Draft: Edited for clarity. Subsection (c) proposed for deletion in that it was either redundant of the general standard or created an inappropriate restriction on a licensee's rights.

Reporter's Notes:

1. This section affirms the right of parties to contract for specific performance, so long as a court can administer that remedy. Literature clearly supports that this contractual option promotes freedom and flexibility of contract. This premise is consistent with the overall approach in this Article to favor and support freedom of contract. The principle excludes the obligation to pay a fee, however, since this is essentially equivalent to a monetary judgment and not relevant to the principle of contract remedy choice. [Comments will discuss how this works with respect to development contracts; it depends on the type of commitment made in the contract.]

2. The second principle in subsection (a) outlines a common basis for specific performance (the unique nature of the performance). That principle cannot apply to a "personal services contract" in light of traditional concerns about not imposing judicial obligations requiring work or services by an individual. Article 2 does not deal with this latter issue, since it is not involved in transactions that might fall within this category. Excluding specific performance of the price element of a contract avoids creating a surrogate form of contempt proceeding. Of course, if there is a specific performance order requiring transfer of property under court order, a reciprocal obligation to pay any relevant fees is an appropriate condition of the specific performance decree.

3. Article 2 allows specific performance "where the goods are unique or in other proper circumstances." UCC 2-716(1). The comments state: "without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with specific performance of contracts of sale." UCC § 2-716, comment 1. There are few cases ordering specific performance in a sale of goods. In most cases, a court concludes that adequate substitutes are available and that any differences in quality or cost can be compensated for by an award of damages. Article 2A has a similar specific performance section. § 2A-521.

4. In common law, despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance in the form of allowing the licensee continued use of the property. Courts often rule that a monetary award fits the circumstances, unless the need for continued access is compelling. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985); Johnson & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co., 715 F. Supp. 110 (D. Del. 1989). Very few cases award specific performance in information-related contracts.

5. The Restatement (Second) of Contracts distinguishes between specific performance awards and injunctive relief. Restatement (Second) of Contracts § 357. Specific performance relates to ordering activity consistent with the contract. The most common use concerns injunctions against acts that the defendant promise to forebear or mandatory injunctions demanding performance of a duty that is central to preserving the licensor's position. The Restatement states: "The most significant is the rule that specific performance or an injunction will not be granted if damages are an adequate remedy [to protect the expectation interest of the injured party]." Restatement (Second) of Contracts § 357, Introductory note. Non-uniform case law deals with under what circumstances a damage award is or will be considered to be inadequate. The Restatement catalogues the following circumstances under which damages may be inadequate:

(a) the difficulty of providing damages with reasonable certainty,
(b) the difficulty of procuring a suitable substitute performance by means of money ...,
(c) the likelihood that an award of damages could not be collected.

Restatement (Second) of Contracts § 360. The most frequently discussed illustrations of when these conditions are sufficiently met are cases in which the subject matter of the contract is unique.

6. Subsection (b) recognizes judicial discretion, but provides an important protection for confidential information that is relevant for both the licensor and the licensee. The section casts the balance in favor of a party not being required to specifically perform in cases where that performance would jeopardize interests in confidential information of the party. Confidentiality and intellectual property interests must be adequately dealt with in any specific performance award. Article 2A allows the court to order conditions that it deems just, but does not deal with confidentiality issues.

7. A licensee has a right to force completion of a contractual transfer if, at the time of breach, the information is identified to the contract and the licensee would own the information had the transaction been fully performed. It applies, for example, in cases of software development where the software is developed, but not yet delivered. Compare In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992).

SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, an aggrieved licensor may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization complete the information and identify the information to the contract, cease work on the information, re-license or dispose of it, or proceed in any other reasonable manner. The licensor remains bound by all of the terms of the agreement concerning restrictions on disclosure of confidential information of the licensee and its rights under this section are subject to those obligations. In any case, the licensor may recover

damages or pursue other remedies.
Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.
Reporter's Notes:
1. This section adopts the premise of both Article 2 and Article 2A that the licensor faced with a material breach by the licensor while a development contract is in process can choose to complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to damages and other remedies gauged by the situation in which it finds itself following the choice. If the transferor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails. Article 2A-524 (2) provides: "If the goods are unfinished, in the exercise of reasonable commercial judgment ... the [lessor] may either complete the manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner."
2. This section does not use language in Article 2 and Article 2A that refers to a seller's right to identify goods to the contract or to treat goods "demonstrably intended" for the contract as a subject of resale even if they have not been finished at the time of the breach. These sections follow a policy similar to that adopted here, but deal with facts specifically linked to transactions in goods. The rights implied in the other language, to the extent appropriate, are covered within the more general theme in this section. As a general matter, identifying and completing the intangibles will be inappropriate since most intangibles have infinite number of transfers contained in or available with respect to one fund of information. The notion of resale as a way of relieving loss is often inappropriate.
3. This draft applies the cases in which contracts involve development or compilation. In such cases, intangibles may not have a general market. The option to complete often will often be commercially reasonable

SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, the licensee that has not canceled may continue to use the information under the contract. If the licensee elects to continue to use the information, the following rules apply:

(1) The licensee is bound by all of the terms of the agreement, including restrictions as to use, disclosure, and noncompetition, and any obligations to pay contract fees or royalties.

(2) Subject to Section 2B-620, the licensee may pursue remedies for breach of contract of contract.

(3) The licensor's rights other than being subject to the licensee's remedies for breach remain in effect as if the licensor had not been in breach.
Reporter's Note:
This section makes clear the consequences of a licensee's decision to accept flawed performance by the licensor and pursue remedies that do not involve a cancellation of the contract obligate the licensee to continued performance of the intangibles contract itself. A licensee faced with breach by the licensor can elect to continue the contract and claim damages for the breach. This section clarifies that, if this choice is made, the licensee is bound by the contract terms. However, it retains rights of action with respect to the prior, defective performance.

SECTION 2B-714. RIGHT TO DISCONTINUE. Notwithstanding Section 2B-715 and 716, in an access contract, in the event of a material breach of contract or if the agreement so provides, a party may discontinue <u>all contractual rights of </u>access by the party in breach or instruct any third person that is assisting the performance of the contract to discontinue its performance.

Reporter's Notes:

1. This section deals with the right of a party in an access contract to stop performance under two significant circumstances. It was read without comment or objections at the 1997 Annual Meeting. The ability to act quickly in an access contract is potentially critical to party's ability to avoid continuing liability risk, as might occur where the basis of the breach includes use of the access system to distribute infringing, libelous, or otherwise damaging material. More generally, it corresponds to current common law principles regarding access to facilities – treating these as arrangements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides. The right to discontinue is recognized in licenses whose basic nature entails a contractual permission to access or use a resource owned or controlled by the licensor. In such cases, the contract will be treated as preemptively subject to termination a will (even without a breach). See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned facilities). This right operates independently of Sections 2B-715 and 716.

In cases where the information available for access is information of the breaching party, the breaching party's rights to recover the information are protected under other provisions of this Article.

2. This section does not create a right to retake transfers already made, but merely to stop future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This subsection derives in part from Section 2A-525(1). It does not create special rules for insolvency. Cases of insolvency will be handled either in the definition by contract of material breach or in the rules dealing with insecurity about future performance. This grants lesser rights to the transferor than do either Article 2 or 2A. Both give a right to stop shipment in the event of discovered insolvency.

SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) On cancellation of a license, the aggrieved party has

(1) a right to possession of all copies of the information in the possession or control of the party in breach whether delivered to or made by the party in breach and any other materials that by contract were to be returned by the party in breach; and

(2) a right to prevent the continued exercise of rights in the licensed information by the party in breach.

(b) A court may enjoin the party in breach from continued use of the information and may order that the aggrieved party or an officer of the court take the steps described in Section 2B-626. If the agreement so provides, a court may require the party in breach to assemble all copies of the information and any other materials relating thereto and make them available to the aggrieved party at a place designated by that party which is reasonably convenient to both parties.

(c) The aggrieved party has a right to an expedited hearing on prejudgment relief to enforce or protect its rights under this section.

(d) The right to possession under subsections (a) and (b) is not available if the information, before breach and in the ordinary course of performance under the license, was altered or commingled so as to be no longer reasonably identifiable.

Uniform Law Source: Section 2A-525; Section 9-503; Section 2A-525(1);. Sections 2A-526; 2-705. Revised.

Reporter's Notes:

1. This section deals only with judicial action. The right to obtain possession and to control use of information in the hands of the other party in commercial practice may run either to the benefit of the licensor or the licensee. This is true because in many commercial settings, the licensee provides information to the licensor. While in a simple software license, the information flows from licensor to licensee, that is not true in other situations and the principle which gives the injured party a right to recover and control use of its information should not be restricted to a licensor.

2. To reduce the need for self-help, subsection (c) provides for a right to an expedited hearing to enforce rights or possession and restriction of use. No effort has been made to define the contours of what that hearing timing may entail. Based on the recommendation of several Commissioners, the Committee should consider whether that right should be presented in a more elaborated manner to encourage resort to judicial, rather than self-help remedies.

3. The right under 2B-715 flows from the conditional nature of the transaction. It arises only in the case of a license and only in the event of cancellation. The section differentiates between the right to obtain possession and the right to prevent on-going use of the information. The right to possession is contingent on there being no commingling in the ordinary course of the license such that the information cannot be identified or reasonably separated from the property of the party in breach. This deals, for example, with cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible and the reason it is impossible lies in the expected performance of the parties under the contract.

If an image, trademark, name or similar material is incorporated and inseparable from other property of the party in breach, that fact does not in the case of a material breach and cancellation, preclude the injured party from preventing further use of the information by the party in breach. Thus, a license of the “Mickey Mouse” character which results in placing that image on hats produced by the party in breach does not prevent the other party from barring continued use of the image on the hats in commerce.

SECTION 2B-716. LICENSOR’S SELF-HELP.

Alternative A

(a) A licensor may exercise its rights under Section 2B-715 without judicial process only if this can be done without a breach of the peace <u>and without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information</u>. In addition, when applicable, the licensor must comply with subsection (b).

(b) If the licensed information is not informational content, but is rightfully used in, and is material to, ~~process other information held by the licensee or to operate~~ the licensee's business, the licensor may use electronic means to exercise its rights under subsection (a) only if:

(1) physical possession of a copy is obtained by the licensor without a breach of the peace and the electronic means are used with respect to that copy; or

(2) the following conditions are met:

(A) a term in the license to which the licensee manifested assent authorizes use of electronic means; and

(B) the licensor gives notice of an intent to exercise the remedy in a record:

(i) to a person designated by the contract for this purpose or, in the absence of a designation, to a senior officer, managing partner or managing agent of the licensee;

(ii) within the time and manner specified in the agreement or, in the absence of agreement, not less than ten business days before utilizing the electronic means.

(c) The parties by their agreement may specify the timing, method and manner of giving notice under subsection (b) unless the terms are manifestly unreasonable.

(d) A licensee has a right to an expedited hearing to contest the licensor's right to proceed under subsection (b).

(e) An action that violates this section constitutes a breach of contract by the licensor unless the action is authorized by other law.

(f) The licensee cannot waive the protections of this section before breach of contract.

Alternative B

(a) Subject to subsection (b), a licensor may exercise its rights under Section 2B-715 without judicial process if this can be done without a breach of the peace and without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

(b) This article does not authorize a party to proceed without judicial process by electronic means, but a party may do so as allowed by other law.

Uniform Law Source: Section 9-503. Revised.

Committee Action:

a. Considered and substantially revised in January 1996.

b. Motion to delete the section and adopt alternative B was withdrawn. Sept. 1997

d. Motion to endorse alternative A approach, passed 10-1 (Nov. 1997)

e. Motion to make personal injury risk applicable to all self-help, withdrawn.

f. Rejected a motion to delete the right to an expedited hearing. Vote: 4-7 (Nov. 1997)

g. Adopted a motion to indicate that the time of notice is as specified in the agreement or, in the absence of specific terms, a time no less than ten days prior to exercise of the right. Vote: 10-0

h. Adopted a motion that the person to be given notice is as specified in the agreement and, in the absence of contract terms, one of the listed persons. Vote: 12 –1 (Nov. 1997)

i. Rejected a motion that consequential damages under this section cannot be waive by contract. Vote 5-7 (Nov. 1997)

j. Rejected a motion giving the state jurisdiction over a foreign party who exercises this right against a resident of the state. Vote: 5 –7 (Nov. 1997)

Notes to this Draft: Edited and restructured based on Committee votes.

Reporter's Notes:

1. This section deals with two issues: self-help repossession and "electronic self-help." The basic self-help remedy is consistent with remedies under current Article 2A and Article 9. The basic right is constrained by the standard of "breach of the peace" and, in a clarifying step, by reference to whether the actions entail a foreseeable risk of harm to persons or property. The breach of the peace concept is the only restriction in Article 9 and 2A.

2. Electronic Self-help. The electronic self-help provisions are controversial. Alternative A focuses on ensuring notice to the licensee and granting a right to judicial access on an expedited basis as the primary protections. Alternative B basically leaves the issue to other law.

a. The case law on electronic self-help is limited, but supports the remedy if notice or agreements allow it. In *American Computer Trust Leasing v. Jack Farrell Implement Co.*, 763 F. Supp. 1473 (D Minn. 1991) the court held that remote deactivation was permitted for a breach of payment obligations on a software license. The court's analysis was premised on the view that a breach of the license entitled the licensor to terminate the relationship by whatever means it could so long as no violence occurred. The transaction in Farrell involved a combined hardware lease and software license. Also important was the court's assumption that the licensee agreed to or authorized the remedies taken by the licensor. "ADP had a legal right to deactivate the defendants' software pursuant to the contracts and the extortion statutes do not apply." Several cases disallowed use of this device where no prior authorization or notice was given. See *Franks & Son, Inc. v. Information Solutions,* Computer Industry Litigation Rep. 8927-25 (ND Okla. 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of inclusion); *Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc.*, 157 App. Div. 2d 689, 549 NYS2d 789 (1990).

b. Current law includes rights of self-help repossession under both Article 9 (security interests) and Article 2A (leases). In each area, self-help is allowed except if it causes a breach of the peace. Each recognizes the right to self-help by "rendering unusable" goods used in business or trade. That can be done physically or electronically in the digital world. It is already being done electronically with automobile rentals and other limited term or limited use contracts. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC § 2A-525, Comment 3. Materiality can be determined by contract (which cannot occur in this draft) and applies in concept to any failure to pay rent (in this context, the failure must be material). Article 2A does not regulate or limit the ability of the parties to contractually define damages and procedural issues relating to self-help repossession or disablement of leased equipment.

c. Alternative A. The basic principle is that self-help remedies are appropriate. The primary concerns focus on the leverage it creates in business and other settings in which the information is used in business or other processing activities that may be critical to the licensee. The prefatory language in (b) limits the additional protections to these circumstances.

Subsection (b)(1) makes clear that ordinary methods currently used to enforce rights through physical repossession are not invalidated simply because a machine may eventually be involved. Thus, for example, an access card that is repossessed by an ATM or similar device refusing to return the card is subject to the general rule of breach of the peace, rather than to the more elaborate protections established for electronic self-help.

(1). Subsection (b)(2) outlines a series of restrictions on electronic means in all other cases of operation software where the licensee's risk is high. Electronic self-help remedy is restricted by contractual consent and prior notice before implementing the right. The notice is important because the licensee is given a right to an expedited hearing to contest the electronic shut off. In addition, the self-help remedy cannot be implemented unless there is no foreseeable risk of injury to person or property.

(2). This Alternative leaves the Licensor's rights under this Article significantly more constrained in reference to electronic remedies than is the case under Article 2A or Article 9. In each case, the sole restrictive measure on the right to repossession and to disable use of equipment is that the action not breach the peace. Neither article requires prior notice or contractual consent.

d. Alternative B: This acknowledges the right to physical action to repossess, akin to that granted in Article 2A and 9, but leaves issues about the ability to use electronic self-help to be resolved by other law, including those statutes. The rationale is simply that, in current circumstances, the issue involves a too hotly contested question to be resolved here. Recognizing physical self-help remedies is consistent with the other aspects of the UCC and with the desirable result of coordinating law in cases where mixed packages of rights and property are involved in a particular transaction.