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FOR DISCUSSION ONLY

UNIFORM COMMERCIAL CODE
REVISED ARTICLE 2B. LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

February 2, 1996, Draft

UNIFORM COMMERCIAL CODE
REVISED ARTICLE 2B. LICENSES

With Prefatory Note and Comments

The ideas and conclusions herein set forth, including drafts of proposed legislation, have not been passed upon by the National Conference of Commissioners on Uniform State Laws. They do not necessarily reflect the views of the Committee, Reporters or Commissioners. Proposed

statutory language, if any, may not be used to ascertain legislative meaning of any promulgated final law. UNIFORM COMMERCIAL CODE
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PART 1

GENERAL PROVISIONS

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

Uniform Law Source: UCC 2-102.

Reporter's Note:
1.The Scope of Article 2B is outlined in section 2B-103. While the scope covers more than licenses, the transaction used to develop this article involves licensing of information. The title follows the approach in Article 2 which is designated "Sales" because that was the primary transaction format used to develop provisions for that Article, but covers "transactions" in goods.

SECTION 2B-102. DEFINITIONS.

(a) In this article:

(1) "Access contract" means an agreement that transfers a right or privilege to have access to a resource containing information, a resource for processing information, a data system, or other similar facility of the licensor or a third party. The term includes a continuous access contract.

(2) "Authenticated" includes any symbol or action that is adopted or performed by a party or its electronic agent with the present intent to authenticate or manifest assent to a record, a performance, or a message. Actions or symbols adopted or performed by an electronic agent are with present intend to authenticate a record or message on behalf of a party if the party designed, programmed or selected the electronic agent with an intent that the agent produce that result and the electronic agent performs in a manner consistent with its intended programming. A record or message is authenticated is conclusively presumed as a matter of law if the parties agreed to an authentication procedure and the symbol or action taken complies with that procedure. Otherwise,

authentication may be proved in any manner, including by a showing that a procedure existed by which a party must of necessity have taken an action or executed a symbol in order to have proceeded further in the use or processing of the information.

(3) "Cancellation" means an act by either party that ends a contract because of a breach by the other party.

(4) "Commercial unit" means a unit of goods or information which by commercial usage is a single whole for purposes of transfer and whose division materially impairs its character or value in the relevant market or in use. A commercial unit may be any unit treated in use or in the relevant market as a single whole.

(5) "Communication" means .... [relevant for message and for delivery concept]

(6) "Computer program" means a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.

(7) "Consequential damages" means losses to the aggrieved party resulting from its general or particular requirements and needs which the breaching party at the time of contracting had reason to know would probably result from the breach and which the aggrieved party could not prevent by reasonable measures after breach.

(8) "Conspicuous," with reference to a term or clause, means so displayed or presented that a reasonable person against whom it is to operate would likely have noticed it or, in the case of an electronic message intended to evoke a response without the need for review by an individual, in a form that would enable the recipient or the recipient's computer to take it into account or react to it without review of the message by an individual. Whether a term is conspicuous is a question of law. Without limitation, a term or clause is conspicuous if it is:

(i) a writing or display and is in capitals;

(ii) language in the body of a record or display and is in larger or other contrasting type or color than other language; or

(iii) a term or clause referenced in the body of a record or in a display by conspicuous language if the term or clause can be readily accessed from the record or display in which it is referenced.

(9) "Consumer" means an individual who becomes a licensee of information is intended to be used primarily for personal, family, or household use. An individual who acquires information primarily for business, commercial, investment selection or management, or agricultural purposes is not a consumer as to that transaction.

(10) "Consumer contract" or "consumer license" means a contract between a licensor regularly engaged in the business of selling or licensing and a consumer with a total license fee not exceeding $2,500 during the first year of the contract.

(11) "Continuous access contract" means an agreement that transfers a conditional right or privilege to have access over a period of time to information, a resource for processing information, data system, or other similar facilities of the licensor or a third party, and gives the transferee a right of access at a time substantially of its own choosing subject to limitations on the general availability of the information, resource, data system, or other facility.

(12) "Copy" means information that is recorded 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 or other device.

(13) "Data" means facts or descriptions of facts.

(14) "Delivery" means the transfer of physical possession or control of goods, including a copy of information, or the creation of a copy of information or record by communication of the information to facilities controlled by the licensee or its

intermediary.

(15) "Electronic agent" means a computer program designed, selected or programmed by a party to initiate or respond to electronic messages or performances without review by an individual. An electronic agent acts within the scope of its agency if its performance is consistent with the functions intended by the party who utilizes the electronic agent.

(16) "Electronic message" means a record generated or communicated by electronic, optical or other analogous means for transmission from one information system to another. The term includes electronic data interchange and electronic mail.

(17) "Electronic transaction" means a transaction in which the parties, or their intermediaries, contemplate that an agreement may be formed through the use of electronic messages or responses, whether or not either party anticipates that the information or records exchanged will be reviewed by an individual.

(18) "Good faith" means.

Alternative A

honesty in fact in the conduct or transaction concerned.

Alternative B

honesty in fact and the observance of reasonable commercial standards of fair dealing in the conduct of the transaction concerned.

(19) "Goods" means all things, including specially manufactured goods, that are movable at the time of identification to the contract. The term does not include money in which the price is to be paid, obligations arising from foreign exchange transactions, investment

securities, documents, instruments, accounts, chattel paper, or general intangibles as defined in Article 9.

(20) "Incidental damages" include any commercially reasonable charges, expenses, or commissions: (i) incurred in inspection, receipt, transportation, care, and custody of property after the other party's breach; (ii) incurred in stopping shipment; (iii) incurred in effecting cover, return or resale of property; (iv) incurred in connection with reasonable efforts otherwise to minimize the consequences of breach; and (v) any other reasonable expenses incidental to the delay or other breach.

(21) "Information" includes data, text, images, sounds, computer programs, software, databases, and the like, and any associated intellectual property rights.

(22) "Informational content" means data, text, images, sounds and databases intended to communicate the information to an individual in the ordinary course of use of the information.

(23) "Information contract" means an agreement for a transfer of rights in information, whether the information exists at the time of the contract or is to be subsequently developed, compiled, or transcribed. The term includes a license, access contract, and software contract.

(24) "Intellectual property rights" includes all rights in information created under patent, copyright, trade secret, trademark and any similar state or federal law giving a person exclusive rights relating to the information.

(25) "Intermediary" means a person or entity that, on behalf of another , receives, transmits, stores, or provides other services with respect to a record or information. The term does not include a common carrier employed or used in that capacity.

(26) "License" means an agreement for a transfer of rights in information where the agreement expressly makes the rights conditional or limited, whether or not the agreement provides for delivery or sale of a copy of the information. The term includes (i) an access contract and (ii) a software contract if the parties did not

intend the transferee to become the owner of the intellectual property rights in the software. The term does not include the reservation or creation of a security interest in information. A nonexclusive license does not create a security interest in or a sale of the information even if by its own terms or by operation of law it is valid in perpetuity or for so long as an obligation of the licensor exists

(27) "Licensee" means a transferee of rights or any other person designated as a licensee in the contract or otherwise authorized to exercise rights under the contract.

(28) "License fee" means the price, fee or royalty payable under a contract.

(29) "Licensor" means a transferor of rights. In an access contract, as between the service provider and the customer, the service provider is the licensor, but as between the service provider and any provider of content for the service, the content provider is the licensor. If the consideration for a contract consists in whole or in part of an exchange of transfers of information, each party making a transfer is a licensor with respect to the information and rights that it transfers.

(30) "Mass-market license" means a standard form license whose intended use by the licensor frequently includes transactions making information available to the general public, including consumers, and which is used in a transaction in which (i) the licensor does not modify the information in a way that alters its functionality specifically for the particular transaction and (ii) the standard terms of the form are not altered for the particular transaction. The term includes
a consumer license and any contract for support or other services associated with the mass market license.

(31) "Merchant" means a person who deals in information of the kind or who otherwise by the person's occupation purports to have knowledge or skill particular to the practices or information involved in the transaction, or a person to whom knowledge or

skill may be attributed by the person's employment of an agent or broker or other intermediary who purports to have the knowledge or skill.

(32) "Nonexclusive license" means a license in which the licensor or other person authorized to make a transfers or license is not precluded from licensing the same information or rights therein to other licensees.

(33) "Pure license" means a license of intellectual property accomplished by the making of a contract without further obligation by the transferor and without any agreement by the licensor to provide to the licensee any property or services to enable the licensee to exercise the rights transferred.

(34) "Receive" or receipt" means to take delivery of a record or of information. An electronic record or information is received when it enters a information processing system in a form capable of being processed by that system if the recipient has designated that information system for the purpose of receiving such records or information.

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

(36) "Sale" means the passing of title from a seller to a buyer for a price.

(37) "Seller" means a person who sells, assigns or contracts to sell or assign goods or information.

(38) "Software" includes a computer program in source code, object code, or any other form, together with any associated data, program description, media, and supporting documentation.

(39) "Software contract" means an agreement to transfer of rights in a computer program, whether or not the software exists at the time of the contract or is to be developed by the transferor and whether or not the contract provides for transfer of copies of the software or for services to develop, support, or use it.

(40) "Standard form" means a record prepared by one party in advance for general and repeated use that substantially consists of standard terms and was used in the transaction without negotiation of, or changes in, the substantial majority of the standard terms. Negotiation or customization of price, volume, delivery time, or method does not preclude a record from being a standard form.

(41) "Standard terms" means terms prepared in advance for general and repeated use by one party.

(42) "Substantial performance" means performance of an obligation in a manner that does not constitute a material breach of contract.

(43) "Termination" means an act by a party to a contract under a power created by agreement or law which ends the contract for a reason other than for default or breach.

(44) "Transfer of rights" means a grant of a contractual or other right or privilege as between the parties for the transferee to have access to, modify, disclose, distribute, sell, lease, copy, use, have used on behalf of the transferee, display, perform, or otherwise take action with respect to information coupled with any actions necessary to enable the licensee to exercise those rights.

(b) In addition, Article 1 contains general definitions and principles of construction applicable throughout this article.

Sources: Sales (July, December); Licenses (September). Various other sources.

Reporter's Notes:

1. "Licensor" is used as a generic term that refers to the transferor in any type of transaction governed here. Similarly, "licensee" is a generic term, referring to the transferee of information. These terms are not limited to the parties in a license agreement. When distinctions are made in sections between the treatment of a license and the treatment of other types of transaction, the distinctions are established by reference to the transaction type itself, rather than indirectly by referring to the label of the parties involved.

2. In light of the current scope definition, this article covers a variety of transactions. When rules or principles are intended to be applicable to the particular transactions and not to all forms of contract, that is achieved in a section by designated the contractual type. Included are: licenses (express contract limitations on use), access contracts (right of access to an information resource), mass market transactions (general public transfers) , pure licenses of intellectual property, and contracts transferring information without placing express restrictions on use of the information since the vendor relies on whatever intellectual property rights it holds.

3. The definitions refer to consumers and consumer contracts without using the concept of "consumer property" present in the draft of revised Article 2. This reflects the general preference in this article to deal with contractual context and issues without dealing with whether or not particular forms of information can be properly described as "property." As a general matter, the definition of "consumer" has only limited relevance to the terms of this article which deal more generally with mass market transactions and transactions that are not made in the mass market. On the definition of consumer, compare 2A-103(1)(a) and Reg Z. These suggest the use of a dollar limit. The $2,500 limit reflects a realistic reduction from 2A-103(e).

4. The definition of mass market license is limited to transactions in which the information is provided pursuant to an agreement used for general licensing to the public, including to consumers. . It also explicitly covers support agreements associated with the mass market transaction. Online database transactions may often be mass market contracts.

5. The definition of "signed" was substantially modified and a new term "authentication" instituted to deal with situations involving authenticating acts not equivalent to a traditional signature. Authentication occurs if there is a signature, adherence to an authentication procedure, or another act a party intends to either manifest assent to a record or authenticate it as the party's own. A preprogrammed computer program can authenticate a record.

6. The definition of "electronic message" comes from the pending UNCITRAL model law on EDI transactions.

7. The term "intermediary" includes use of an E-mail system or similar depository. Based on discussions at the Drafting Committee meeting in January, 1996, a separate concept of "electronic agent" has been separated out and defined here. An electronic agent is a program designed to act on behalf of the party without the need for recurrent human review. As a general rule, a party adopting use of such agents is bound by (attributable for) their performance and messages.

8. The definition of "consequential damages" uses Article 2 language, but deletes a reference to personal injury to enable conformance to the development of tort case law and the current case law involving treatment of information contracts affecting personal injury. It also deletes terms providing a right to reduce consequential damages in reference to lost profits. This was controversial at the NCCUSL meeting in July, 1995 because it affects local law dealing with remittitur and other similar concepts. Many commentators suggested that it be deleted in Draft Article 2. Additionally, the

problem it addresses is covered in the right of the court to reduce awards that substantially over compensate the prevailing party.

9. Several key terms such as manifesting assent, opportunity to review, and attribution procedure have been removed from the definitions and placed in substantive sections, reflecting their content and importance for the overall draft.

SECTION 2B-103. SCOPE.

(a) This article applies to transactions in information, including licenses, access contracts, unrestricted transfers of information, sales of copies of information, and software contracts, and to agreements to support, maintain, develop, or modify information. A transaction is in information if the information exists at the time of the contract, is expected to come into being after the contract is formed, or is to be developed, discovered, compiled, or transformed as part of performance of the agreement, whether or not development, discovery, compilation, or transformation in fact occurs.

(b) Except as provided in (c), if an article of the Uniform Commercial Code applies to a transaction, this article does not apply to the part of the transaction governed by that other article.

(c) If a transaction involves information and goods other than copies of the information or of documentation pertaining to the information, this Article applies to the transaction, but article 2 or article 2A govern as to the involving performance of goods other than copies of or documentation pertaining to the information.

(d) This article does not apply to:

(1) a contract for the employment of an individual;

(2) a contract for performance of entertainment services;

(3) a contract for professional services involving performance by a member of a regulated profession with respect to services commonly associated with regulated aspects of that profession;

(4) to the extent not related to computer software or databases,a transfer of rights or privileges in trademarks, trade names, or trade dress, or the right of publicity or similar intellectual property right or of a patent, know how or similar right;

(5) a transaction intended to operate only as a security transaction except insofar as the article deals with the relationship between the a transaction and a informa- tion contract; or

(6) a sale or lease of a copy of a computer program that was not developed specifically for the particular transaction if the computer program is embedded in goods other than a copy of the program or an information processing machine and is not copied in the ordinary course of using the goods.

Uniform Law Sources: None. Previous appeared as: 2-2102 (Feb. 1994)

Selected Issues:

a. Should the scope extend to "information" or should it be limited to "electronic information"?

b. Should the exclusion in (d)(6) be dropped and the issue resolved under the more general rule in (c)?

c. Should there be a general exception for gratuitous transactions or should there be special treatment of such transactions in particular sections when necessary?

d. Is the exclusion of trademark licenses or the like justified given that these transactions involve many similar characteristics of other information license and that exclusions can be made for fran- chise, dealership and other similar statutes under state law?

e. Should the provisions of the exclusion in reference to security interests make a specific reference to the terms of this article that are reserved here?

Reporter's Notes:

1. Based on discussions with various groups and on debate at the Drafting Committee meeting, this draft moves away from a scope definition limited to "digital information." Most people who commented on that scope concluded that it was too narrow and too closely linked to a particular technology.The scope provision includes traditional print materials, including books and newspapers. This presents a major policy issue that was debated at the Drafting Committee meeting in January, 1996. No clear resolution was reached at that time about the proper parameters of coverage for the article. One alternative that is more narrow than the position in this draft is to limit scope to "electronic information" or some similar term. This draft presents the broader scope as a basis for discussion since that allows consid- eration of the variety of issues presented by including more than digital products. The position favorable to this outcome relies in part on the fact that the convergence of media in the information

industries argues in favor of inclusion by making any division or boundary line ultimately arbitrary.

> Example 1: A marketing company seeks a telephone contact list containing 15,000 names and telephone numbers. The company orders a "printed" list for use by telephone operators and a "digital" list contained on a computer disk for insertion into an automatic dialing computer. The lists contain the same data, should the contract law be the same for both lists?

Example 2: The New York Times delivers newsprint copies of its daily edition to one hundred thousand households. The Times also makes an online version of the daily editions available to one million subscribers. One subscriber, a nursing home, prints the online edition and delivers copies to its patients. Should different contract law principles apply to the different editions?

This draft assumes that the rules applicable to the electronic information will be the same as the rules applicable to their printed counterparts. The final decision relating to inclusion will be deferred pending action of the Drafting Committee and a determination of whether different contract law rules are appropriate based on how information is stored or transmitted. Various affected industries are being consulted and will have an opportunity for significant input before a final determination is made.

2. This scope shifts from definitions in early drafts of the licensing article. The earliest draft covered all licenses of intangibles, other than trademark licenses. The draft does, however, retain exclusions for patent and trademark licensing. Some have argued that all forms of licensing should be covered. Even if other forms of licensing are not included in Article 2B, contract principles developed in the UCC will affect how courts handle contract issues in other licensing transactions. Reasoning by analogy will occur. Arguably, it is better to adopt a broad scope to encourage full participation and involvement among the interested groups; indeed, consultation with patent law experts led to a substantial revision of the remedies provisions in this draft. A second rationale for a broad scope is that software contracts involve all forms of intellectual property and the lines between software and other intangibles blurs because of advancing technology. As media and networking capability expand the ability to place multiple components in a single product, drawing a line will be increasingly difficult if not impossible. This being said, however, the arguments that favor a narrower scope at this time have greater weight. Much of the impetus for developing this article has come from the poor fit between sales law and practices in reference to software and online systems. It is this branch of licensing that has been brought under the scope of Article 2 and that has been most closely studied as to modern commercial practice. Practices in biotech licensing, know how contracting and the like differ from practice with reference to software and related information assets.

3. The language in subsection (a) derives from original Article 2 which covers "transactions in goods." The scope definition covers all transactions in information, whether a sale of a copy, a license

or an access contract. "Information" is not limited to electronic information (See Reporter's Note 1). Modern technology and commercial developments make reliance for purposes of scope on any definition of "software" inherently unstable. As this is written, the most significant commercial development in the information industry is a blurring of the lines among voice, video, and data as a focus for commercial transactions in a new "multi-media" environment. The scope provisions must be sufficiently flexible so as to adapt to this evolving transformation and to those that are likely to follow in the future.

4. Subsection (c) parallels draft Article 2. Rather than make categorical distinctions between the two articles as covering a particular transaction, an approach more oriented to the "gravamen of the action" is adopted. This article governs transactional aspects relating to the information and copies of that information. Article 2 (or 2A) governs as to goods that are not copies of the information itself.

5. Subsection (d)(3) reverts to the language of original Article 2 in the exclusion of treatment of security interests. It changes the language in the current draft of revised Article 2 which states: "If this article conflicts with Article 9, that article governs."

6. Subsection (d)(6) contains an important allocation of law principle. Computer programs are used in all forms of products. This article does not intend to cover the entire sphere of computer-assisted products. This subsection sets out criteria for when to exclude embedded microprocessor software and adds the concept that this article does not apply if the embedded computer program is not copied in the course of using the product. This language is taken from language in the Copyright Act relating to the copyright owner's rental rights but some observers have commented on the fact that the reference to not being copied in ordinary use has no relevance in this context and that a better focus would deal with excluding embedded products that are not part of an information system or merely copies in themselves.

7. Subsection (d) provides four other important exclusions. In each case, the contract area excluded is characterized by extensive local and federal law that reflects not only commercial law issues, but also issues that go beyond commerce and focus on protecting individuals in a manner that may be unique to the particular state.

(a) Employment contracts include various contractual provisions for the assignment of rights in inventions, for non-disclosure of confidential information, or for non-competition pledges by the employee. In each case, the balance of interests involves drawing lines in terms of how much restraint can or should be placed on an individual to preserve a company's interests while still enabling the individual to practice his or her profession or trade. The case law and regulation of such contracts is extensive and deals primarily with what contract restrictions are (or are not) enforceable. The contracts are also affected by the Uniform Trade Secrets Act. The UCC revision will not affect this law.

(b) Professional services (such as those rendered by accountants and lawyers in their professional capacity) are already regulated. The draft assumes that there is no need to deal with these contracts to the extent that they fall within general areas of professional regulation. However, organizations involving members of a regulated profession are covered to the extent that they are involved in transactions in information outside the scope of the regulated activities.

> Example 3: A lawyer prepares a list of all states allowing punitive damages for use by her client, a national company. Later, the same lawyer develops a list of state laws applicable to consumer warranty disclaimers. She publishes that latter list on the Internet as part of a newsletter available generally for $1 per month. The lawyer's services to the client are governed by norms of legal ethics and are outside this article. Assuming that the Internet publication does not constitute legal advice to clients, it falls within this article.

(c) Entertainment services such as musical performances, direction of plays and other forms of service within the entertainment industry are also governed by a stable body of law applicable to the entertainment industry and are expressly excluded in order to avoid the implication that this article would alter the existing legal framework developed there.

(d) Contracts relating to trademarks and similar intangibles are central to the franchising industry and are dealt with in a myriad of local and federal laws and regulations dealing with the types of relationships created in that industry and related dealership laws. Once again, the balancing involves issues that go beyond the commercial law framework for the UCC and the exclusion makes clear that body of law will not be affected by this revision process.

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

(a) Except as otherwise provided in subsection (b), in the case of a conflict between this article and any of the following, the conflicting law governs:

(1) a statute establishing a right of access to or use of information by compulsory licensing, limiting royalties, or public access or similar law;

(2) a law establishing privacy rights, rights of publicity, or similar rights in individuals;

(3) a consumer protection law of this State.

(b) In respect to a law referred to in subsection (a) as it applies to a transaction governed by this article, the following rules apply with respect to laws of this state:

(1) A requirement that a contractual obligation, waiver, or disclaimer be in

writing is satisfied by a record as defined in this article.

(2) A requirement that a particular agreement or term be signed is satisfied by a authentication as defined in this article.

(3) A requirement that a contract term be conspicuous or the like is satisfied by a term that is conspicuous as defined in this article.

(4) A requirement of negotiation, consent or agreement to a particular contract term is satisfied by actions that "manifest assent" to a term or a contract as defined in this article.

Sources: Section 9-104(1)(a); 2A-104(1); Massachusetts Bar proposal. Substantially revised. Previously appeared as: 2-2103 (Feb. 1994)

Selected Issues:

a. Are there additional state law rules that should be specifically preempted in order to implement a goal of validating electronic commerce?

b. Is the exception granted to privacy and similar rights too broad?

Reporter's Notes:

1. This section lists applicable law that may affect information contracts, but that is not displaced by this article.

2. The principle exception dealt with treatment of consumer protection or other laws regulating contracting practice. A balance needs to be drawn, preserving the important policies and diversity of these laws, but extending the effectiveness of important innovations that this article makes in reference to electronic contracting. How, for example, will statutes requiring a written agreement be affected by and interact with the approach in this article to replace writings with a general concept of a record? The approach adopted involves setting out a presumption that the other law controls, but then identifying out aspects of other law in subsection (b) and reversing that presumption as to those particular rules. This approach was adopted in lieu of a general repealer, reversing all state law that conflicts with this article. The broader approach risks inadvertent and undesired changes.

3. Subsection (a)(1) reflects the diversity of statutory and common law regulation of aspects of law relating to information assets. The intent is to focus this article on voluntary contractual arrangements and to not disturb any regulation that compels disclosure or other rights of access to the materials.

4. Subsection (a)(2) leaves undisturbed the law relating to privacy and personality rights. While these rights may be the subject of a license agreement which falls within this article, the underlying property right is not affected by the UCC. For example, a state may hold that individuals have rights to control use of data concerning them. A licensee of a computer database of addresses would have to

deal with the fact that each individual may be the required licensor. This article would not affect those individual rights, but would deal with contract terms and remedies. While privacy and public access laws are especially relevant for the increasing commercial use of information, this article deals with contract law, not property rights and, thus, leaves to these other contexts the development of appropriate rules on information as property. There are, however, several provisions in this article that create a contract principle based on a theme of protecting a licensee's privacy interests.

5. The original draft of this section expressly excluded any effect on federal property laws, treating this analogously to the handling of federal rules in UCC § 9-104. This provision is deleted because it states an obvious principle: federal rules preempt state law where the two conflict. Modern federal intellectual property law contains some limited contract rules. These include provisions regarding registration and writing requirements for effective creation of exclusive licenses and assignments, provisions that may limit rules on the termination at will of copyright licenses, and provisions about the rights received by an owner of a copy of software with reference to making back up and adaptive copies for its own use. If these rules apply, federal law preempts and covers that aspect of the transaction. Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993). Beyond this, state law consistently applies state law to most contract issues. See, e.g., McCoy v. Mitsuboshi Cutlery, -- F.3d. -- (Fed. Cir. 1995). (implied right to sell as a means to fix damages prevails over patentee right to preclude sale). Federal law has no relationship to transactions that involve pure data or secret and confidential material. Both are important in many commercial transfers of intangibles. See Raymond T. Nimmer & Patricia Ann Krauthaus, Information as Property: Databases and Commercial Property, 1 Oxford J. of Law & Information Technology 1 (1993).

SECTION 2B-105. APPLICATION TO OTHER TRANSACTIONS.

(a) Except as to laws described in Section 2B-104(a)(3), the parties to a transaction not otherwise governed by this Act may by agreement elect to have all or part of this article applied to their transaction to the extent that the:

(1) the agreement is expressed in a record other than a standard form record; and

(2) covers issues that could be resolved by the parties in their contract.

(b) In addition to transactions described in Section 2B-103(a), the provisions of this article concerning the formation and modification of contracts electronically apply to the following types of transactions:

[legislatures of each state to adopt all or part of following list]

(1) services contracts

(2) deposit account contracts

(3) sales of goods [remove this option on adoption of revised Article 2]

(4) leases of goods [remove this option on revision of Article 2A]

(5) unsecured loan contracts

Uniform Law Source: New.

Selected Issues:

a. Is an opt in approach to the use of Article 2B rules appropriate in that the article will not be developed with attention to other transactions?

b. What type of contracts should be suggested for possible legislative opt in as to electronic contracting rules?

Reporter's Notes:

1. Subsection (a) makes explicit an approach that has been generally discussed with respect to party autonomy and the rules of Article 2 sales. The basic concept is that a contractual election to apply the provisions of this article performs functions analogous to a choice of law clause in a contract. By agreement, the parties are able to determine, for example, that the warranty rules of this article are appropriate in a contract involving services unrelated to information assets. If there are no barriers in the state to the use of these rules, the choice of law made by contract governs.

2. Subsection (a) limits the choice of law to cases involving nonstandard form contracts in order to minimize the potential for abuse. Additionally, since the choice governs only as to matters that could be determined by the agreement of the parties, regulations, including consumer law regulations cannot be circumvented through use of this section.

3. Subsection (b) provides options to be considered by state legislatures regarding how far into validation of electronic contract practices the state desires to go. The five areas indicated above are illustrative. With respect to Article 2 and Article 2A, this section performs as a form of transition rule. Article 2 revisions, when adopted, will deal with electronic contracting formation.

SECTION 2B-106. LAW IN MULTI-STATE TRANSACTIONS.

(a) Except as otherwise provided in subsection (b), the rights and duties of the parties with reference to a transaction governed by this article are determined by the law of the State where the licensor is located at the time that the transfer of rights occurred or was

to have occurred.

(b) If a contract requires delivery of a copy to the licensee other than through electronic communication and the copy provides the means to exercise rights in or use the information, the contract is governed by the law of the State in which the copy is located when the licensee receives physical possession of the copy or, in the event of nondelivery, the State in which receipt was to have occurred.

(c) A party is deemed 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 other charter authorization if it has no physical place of business. Otherwise, a party is deemed located at its primary residence.

Uniform Law Source: Section 2A-105; Section 9-103; Section 1-105; Restatement (Second) of Conflicts § 188. Substantially Revised. Previously appeared: Section 2-2104 (Feb. 1994).

Selected Issues:

a. Should a special treatment or principle be developed with reference to foreign licensors in cases not governed by subsection (b)?

b. What rule is appropriate in © for an informal partnership?

Reporter's Notes:

1. This section applies in the absence of agreement by the parties as to the applicable law for the contract. See Section 2B-106. It outlines default standards on choice of law in several situations in which the nature of the subject matter creates imponderable choice of law problems. The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain for different terms if they so choose. In the online environment, this certainty is not developed by reference to concepts such as place of contracting, place of performance, or most substantial contacts. The draft opts for a focus on the licensor's location as encouraging certainty and expediting commercial transactions. That choice was generally supported at the Drafting Committee meeting.The argument favoring choice of the licensor's location relates to the fact that this will better enable consistency of planning for that party in a setting where the other party to the transaction may be located in any of fifty states, and which state applies may not be ascertainable by the licensor. Alternatives to subsection (a) would focus either on the licensee's location or on the location of the information resource. The latter was rejected because it will be essentially arbitrary and a location often unknown to the licensee. The licensee's location was rejected in the draft because that choice of law solution would require the licensor to contend with the law of all fifty states and do so in transactions in which the

licensee's location may in fact be unknown to the licensor at the time of the transaction and may change as the licensee changes location. By beginning with the licensor's location as the basic rule, this option lends certainty to the operations of the service provider. This rule was widely favored by industry representatives from both the licensee and the licensor community.

2. Subsection (b) deals with situations in which the licensor will know where delivery will occur because it delivers a physical copy. There, the choice of law follows where the property is when a copy will be delivered to the licensee. This covers many consumer transactions under current practice other than access contracts. The effect draws a distinction between physical delivery and electronic transactions, allowing electronic transactions to be governed by a choice of law rule that enables commercial decision-making based on an identifiable body of law. Some support was presented at the Drafting Committee for making the choice of law rule the licensor's location in both contexts in furtherance of the theory of this article that method of transfer should be irrelevant to legal rights.

3. Subsection (c) derives from Article 9 rules that deal with choice of law pertaining top third party issues (perfection and priority). A phrase is added in subsection (c) to deal with cyberspace businesses which may not have any place of business in the physical sense.

4. Current Article 2 does not contain a choice of law provision. Article 2A-105 adopts a limited choice of law principle for cases involving property covered by certificates of title. That provision illustrates a statutory effort to provide a stable solution to a particular choice of law problem generated by the type of property and type of contract involved in Article 2A.

5. Section 1-105(1) adopts a default rule that the Act as a whole applies to "transactions bearing an appropriate relation to this state."

6. Article 4A, also faced with the electronic nature of the subject matter it considered adopted specific choice of law rules applicable to the several relationships it covers.

7. Various choice of law standards are currently used by the states such as the "most significant relationship", the "interest analysis" and other variations. Current law is complicated by the fact that choice of law rules tend to differ for tort and contract law. The Restatement (Second) of Conflicts § 188 proposes a "most significant relationship" standard to be judges by considering a variety of factors.

SECTION 2B-107. CONTRACTUAL CHOICE OF LAW.

(a) Subject to subsection (b), a choice of law clause is valid.

(b) In a mass market license involving an individual as a licensee, a choice of law clause is not enforceable if

(1) it chooses the law of a jurisdiction other than the jurisdiction in which:

(i) the individual resides when the contract becomes enforceable; or

(ii) section 2B-106 places the choice of law; and

(2) substantially disadvantages the individual as compared to rights created under the law of the jurisdiction that would be selected by application of section 2B-106.

Uniform Law Source: Section 2A-105; Section 9-103; Section 1-105; Restatement (Second) of Conflicts § 188. Substantially Revised. Previously appeared: Section 2-2105 (Licenses, September); 2-109 (Prototype); 2B-106.

Selected Issues:

a. Should choice of law clauses be limited in effectiveness?

b. Is the protection for mass market licenses appropriate?

Reporter's Note:

1. During the Drafting Committee meeting in January, 1996, substantial sentiment was expressed to enhance the certainty of enforcement of choice of law rules and to apply more broadly the principle of freedom of contract. Changes in subsection (a) reflect that policy. Additionally, the invalidating clause of subsection (b) was modified to require proof that the operation of the invalidating clause would have severely disadvantaged the individual to whom it would have applied. Retaining some protection in the mass market context is an important part of dealing with the overall theme of balancing rights in a mass market context. In addition to this section, of course, it should be noted that many choice of law rules that pick unusual or unexpected states would not become part of the mass market license by operation of the protective rules in section 2B--- on mass market forms.

2. This section adopts a strong, contract choice position in reference to choice of law in contracts that do not involve mass market transactions. It deletes a prior limitation that the clause not offend or affect a fundamental policy of the state that would otherwise be applicable.The section does not adopt a second limitation applied in the Restatement that the chosen state's law must have some relationship to the transaction. The view here is that commercial parties can make choices in their contract with minimal regulation. This is consistent with the pro-contract position taken in Article 4A.

3. UCC Section 1-105 provides that, unless contradicted by specific rules in the UCC, "when a transaction bears a reasonable relation to this state [and to others] the parties may agree that the law either of this state or of such other state ... shall govern their rights and duties." Neither Article 2, nor Article 1 contain provisions relating to choice of forum clauses. A conforming amendment may be required for 1-105 if this position is retained alongside the position adopted in Article 4A.

4. Section 2A-106 invalidates choice of law and choice of forum rules in consumer cases unless the choice relates to the consumer's residence or the place of delivery in the case of a choice of law.

5. Common law generally enforces contractual choice of law. The major exception occurs where the choice contradicts the basic policy of the state that would otherwise have its law apply.

6. <u>Restatement</u> <u>(Second)</u> <u>of</u> <u>Conflict</u> <u>of</u> <u>Laws</u> § 187 provides:

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the state chosen by the parties ... will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) 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 and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen law.

SECTION 2B-108. CONTRACTUAL CHOICE OF FORUM.

(a) Subject to subsection (b), a forum selection clause that chooses an exclusive forum is valid if:

(1) the choice of forum clause was specifically negotiated; or

(2) the forum selected does not unfairly disadvantage the party against whom the forum selection is being asserted.

(b) If a judicial forum chosen by the parties to a mass market contract is a forum that would not otherwise have jurisdiction over the licensee, the choice of forum is not enforceable.

Uniform Law Source: Section 2A-106. Substantially revised. First appeared: Section 2-2105 (Feb. 1994). Previously appeared: 2B-108.

Selected Issues:

a. Should subsection (b) be retained or are its protections subsumed within (a)? b. Should ADR selections be given special treatment?

Reporter' Notes:

1. Choice of forum clauses are more controversial than choice of law clauses. In this section, the article deviates somewhat from the contract choice principle, providing a limitation on forum choice provisions in consumer cases because of their potential impact. It deals only with exclusive forum clauses in (a). The eventual notes to the section will describe what language creates an exclusive choice of forum.

2. Subsection (a) deals with commercial contracts. The general rule is in (a)(2) and allows enforcement of a forum choice unless there is unfair disadvantage to the party affected by the choice. The reason for this limitation lies in the fact that forum choice clauses can place a party in a potentially impossible position. This justifies some judicial scrutiny. In practice, on the unfairness issue a court

would consider not only the terms of the clause, but the process by which it became part of the contract,
including for example, whether the term was conspicuous and brought to the party's attention.

3. Subsection (a)(1) excludes overview if the clause was negotiated. If the parties bargained for the clause, questioning its fairness is inappropriate in a commercial deal. Bargaining, of course, seldom occurs in a mass market context. Some have argued that this provision should be amended to allow enforcement of the clause if there was manifested consent to the clause.

4. This draft does not deal separately with choice of nonjudicial forums. Federal law favors arbitration clauses as does the law of many states. In some states, requirements of conspicuousness or placement in a prominent portion of a written agreement are made. Yet, a blanket validation would ignore the fact that such clauses can be used for unfair advantage.

5. Subsection (b) places limits on choice of forum in mass market contracts. The clause cannot be used to create jurisdiction - that is, a New York consumer cannot be forced to sue in California unless independent bases exist for jurisdiction in that state. These restrictions are intended to prevent unfair surprise and prejudice. They are consistent with Article 2A and the treatment of mass market licenses in this article.

6. In a recent decision, the US Supreme Court held that a choice of arbitration under New York law in a standard form contract could not be enforced to apply New York law prohibiting punitive damage awards in arbitration where that substantive effect was not highlighted or brought to the affected party's attention.

7. Article 2A restricts the validity of choice of forum in consumer cases. § 2A-106. Neither Article 2, nor Article 1 deal with choice of forum issues.

SECTION 2B-109. TRANSFER OF RIGHTS

(a) A transfer of rights occurs when pursuant to the contract the licensor completes the acts required to make information available to the licensee in a form that enables the licensee to exercise the rights transferred and the licensee is or should be aware of this occurrence. If no acts are required to make information available to the licensee, the transfer of rights occurs when the contract becomes enforceable between the parties.

(b) If a contract does not specify how the information is to be made available to the licensee, the information may be made available in any manner consistent with the technological capabilities of the licensee of which the licensor has knowledge and the ordinary methods in the trade of making transfers of the particular kind.

(c) If a contract specifies how the capability to exercise rights in the information is to be made available to the licensee, the transfer must occur in that form or in a substantially equivalent manner unless the licensee agrees to a different means of transfer.

Uniform Law Source: None. Previously appeared: Section 2B-108 (Dec. 1995).

Selected Issue:

a. Should (b) rely exclusively on the ordinary course methods standard?

Changes:

a. Sentence on ongoing performance deleted as not relevant to current structure of the article.

Reporter's Notes:

1. The term "transfer of rights" describes one aspect of performance. It refers to the creation of rights under the contract as between the parties. A transfer of rights includes a combination of an agreement authorizing an exercise of rights in information and any steps necessary to make it possible for the transferee to exercise those rights.

2. Because rights and information constitute the prime value transferred, diverse methods of transfer are more prevalent than in sales or leases of goods which ordinarily require physical delivery. Information and rights in information can be "transferred" by writing information on-site in the client's computer, by giving the transferee remote access to a computer, by electronic transfer (downloading), or by delivery in a tangible item. Modern developments make the various methods of transfer increasingly fluid and interchangeable as witness the debate about the so-called "information superhighway." Changes in the method of making the transfer of rights should not alter the applicability of this article.

3. Article 2 on sales and Article 2A define delivery and tender of delivery as the initial stage of performance. "Delivery" is not always a characteristic of an information transaction.

4. Subsection (a) defines the timing of a transfer of rights in terms of a confluence of agreement, any required action, and awareness by the transferee. The second sentence deals with the situation that will most often be true in cases involving pure licenses. The licensor merely grants permission for the licensee to act. Subsection (a) does not require that the licensor notify the licensee that the acts necessary to make the transfer have occurred, but does require an awareness or reason to know by the licensee. In electronic systems, requiring actual notice imposes an unnecessary obligation on the licensor. For example, if the transfer relates to giving the licensee access to a remote database or data processing facility, the transfer will occur when the licensor takes whatever action it needs to take (such as by entering enabling codes) in its own system and communicates the access routine and codes to the licensee. Notification of when the codes are in the remote system may or may not be necessary.

5. Subsections (b) and (c) deal with the fact that, in the absence of specification of how a transfer will occur, a wide variety of technological means are conceivable. The obligation in (b) is to use methods that are both reasonable in the trade and consistent with the known capabilities of the transferee. Some support existed at the Committee meeting for going solely with the idea of reasonable standards of the trade.

SECTION 2B-110. BREACH.

(a) Whether a party is in breach is determined by the terms of the contract and, in the absence of terms, by this article. Breach occurs if a party fails timely to perform a performance obligation or exceeds a contractual limitation.

(b) A breach is material if the contract so provides or, in the absence of express contractual terms, if the circumstances, intent of the parties, language of the contract, and character of the breach indicate that the breach caused or may cause substantial harm to the interests of the injured party, or if it meets the conditions of subsection (c) or (d).

(c) A breach is material if it involves:

(1) knowing disclosure or use of confidential information of the injured party not justified by the license;

(2) knowing infringement of the aggrieved party's intellectual property rights not authorized by the terms of the license and occurring over more than a brief period; or

(3) an uncured substantial failure to pay license fees when due that is not justified by an existing, colorable dispute about whether payment is due.

(d) A material breach occurs if the aggregate effect of the nonmaterial breaches by the same party satisfy the standards for materiality.

(e) If there is a breach, whether or not it is material, the injured party is entitled to those remedies provided for in this article and the contract.

Uniform Law Source: Restatement (Second) Contracts § 241. Revised.
First appeared: 2-2106 (Feb. 1994). Previously 2B-109.
Selected Issues:

a. Should the presumptively material breaches exclude reference to infringement other than knowing disclosure of confidential material, leaving infringement questions to the general standard?

Reporter's Notes:

1. The section defines both breach and the concept of a material breach. Discussion during the Drafting Committee meeting in January revealed substantial concern about the formulation of specific, per se material breaches. The concern centered on proportionality considerations and on the risk that, when connected to self help remedies, too lax of a definition of materiality would create an imbalance in the relationship. Yet, there was also substantial support for the notion of contractual certainty. The three events in current subsection (c) were substantially rewritten to reflect these concerns (they were formerly subsection (d)).

2. A breach of contract entitles the injured party to remedies as provided in this article or in the contract. What remedies are available, however, depends on whether the breach is material or nonmaterial. Faced with a nonmaterial breach, the injured party can recover or recoup any damages that arise in the ordinary course as a consequence of the breach, but cannot cancel the contract or reject the tender of rights unless the contract expressly permits that remedy. Faced with a material breach, a wider panoply of remedies is available to the injured party, including the right to cancel the contract.

3. The idea of material breach derives from common law. Material breach parallels the idea of substantial performance. This is achieved through definitions in § 2B-102 which defines substantial performance as "performance of a contractual obligation in a manner that does not constitute a material breach of that contract." The material breach concept is based on the common law belief that it is better to preserve a contract relationship in the face of minor performance problems and that allowing one party to cancel the contract for small defects may result in unwarranted forfeiture and unfair opportunism, Materiality relates to the injured party's perspective and to the value that it expected from performance. It incorporates questions about the motivation of the breaching party. A series of minor breaches or slower than optimal performance 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 renegotiation, aspects of the deal that are otherwise important to it.

4. There are many reasons to adopt substantial performance in article 2B. This standard currently applies to contracts not governed by Article 2. Even more to the point, substantial performance concepts are well-suited to software and other information contracts, including licenses. Licenses involve ongoing relationships and the flexibility engendered by substantial performance concepts is an appropriate baseline for deriving contract and other principles of the relationship. An ongoing relationship often produces minor breaches or slightly tardy performance. Until these affect the substance and value of the contract relationship, they should not justify terminating the entire contract. For these minor defaults, the injured party has a right to damages, but cannot cancel the contract.

5. An A.B.A. Software Contract Task Force recommended that the perfect tender rule be abolished with respect to software contracts because of the complexity of the software product and the fact that minor flaws ("bugs") are common in virtually all software. The perfect tender rule is not well suited to this technology.

6. The definition here follows the approach in the Restatement (Second) of Contracts § 241. It does not employ the less fully explored language of Article 2A which refers to a breach that "substantially impairs" the value of a contract to the injured party.

7. Subsection (b) makes clear that a contract that provides that a particular breach of contract is material will control in determining materiality. This reflects the basic idea of contract freedom adopted in this article and deals with the many cases in which the parties understand and adopt in their agreement that an aspect of the performance of the one party is critical to the contract. The Restatement does not necessarily adopt this view, especially in reference to contract terms involving time of performance. Restatement (Second) of Contracts § 242 states:

> **In determining the time after which a party's uncured material failure to render performance ... discharges the other party's remaining duties ... the following ... are significant:**
>
> ********
>
> **(c) the extent to which the agreement provides for performance without delay, but a material failure to perform ... on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.**

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

8. The factors described in subsection (b) in cases where the contract is silent refer generally to common law considerations derived from the Restatement (Second) of Contracts § 241. This section allows a court to employ long-standing common law concepts to this area of contracting. The factors to be considered include (1) the injured party will be deprived of the benefit that it reasonably expected; (2) the failure to perform substantially impairs the value of the contract or the rights transferred to the other party; (3) the terms of the contract indicate that the performance to which the breach relates is important to one or more of the parties; (4) the injured party can be adequately compensated for the benefit of which it will be deprived; (5) the party breaching the contract will suffer a unjustified forfeiture if the breach is treated as material; (6) cure of the breach is possible and likely; and (7) the party whose nonconformity caused the breach acted in bad faith.

9. Subsection (c) deals with three instances in which, regardless of the other circumstances, the breach will be considered material. As revised for this draft to reflect discussions of the Drafting Committee, the three events require knowing or otherwise wrongful conduct. Inclusion as specific instances of material breach is intended to delineate the nature of this conduct and to limit uncertainty,

10. The alternative to a material breach (or substantial performance) standard is in the so-called perfect tender rule. In fact, however, the idea that perfect tender must occur before the other party has an obligation to perform in response is applied only under Article 2 and 2A and then, only in one relatively narrow setting. Article 2 applies a "perfect tender" rule only to one setting: the tender (transfer) of goods in a contract that does not involve installment sales. However, even in a single delivery context, 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. In addition, Article 2 does not allow the buyer to assert a failure of perfect tender in an installment contract.

11. Article 2A employs a perfect tender rule in the same contexts and with the same limitations applicable to rejecting a tender of goods as are used in Article 2. For other questions such as the right to cancel a lease based on nonperformance during the term of the contract, Article 2A adopts substantial performance incorporated in language which requires that a defect or default substantially impair the value of the performance to the injured party. See, e.g., Section 2A-523(2)(a). Other (nonmaterial) breaches give the injured party a right to recover for the "loss resulting in the ordinary course of events from the ... default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence" of the default. Section 2A-523(2).

12. The Convention on the International Sale of Goods (CISG) refers to "fundamental breach," which it defines as follows: "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.

13. Material breach and substantial performance rules currently apply to licensing transactions not governed by the Article 2 (and Article 2A). See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) (license for rights to reproduce photographs); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) (License to colorize four films; held, under New York law, "a breach of a contract 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"; this was met where there was an accounting failure and failure to complete colorization.); Compuware Corp. v. J.R. Blank & Associates, Inc., 1990 WL 208,604 (N.D. Ill. 1990) (Contract required Blank to develop and improve programs and obligated Compuware to use its best efforts to market the programs, requiring payment of royalties to Blank. Court held that termination would be justified only if there had been a material breach but that no such breach was proven. The idea of materiality hinges both on the cause and the effect of the breach. It involves the assumption the allegedly injured party performed properly to enable the other's full performance.).

14. The Restatement (Second) of Contracts lists five

circumstances as "significant" in determining whether a breach of contract is material: 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).

SECTION 2B-111. UNCONSCIONABLE CONTRACT OR CLAUSE.

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

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

Uniform Law Source: Section 2-302 (Sales, December); 2A-108. Revised. First appeared in 2-107 (Prototype).

Reporter's Notes:

1. This draft follows Article 2A.

2. The draft does not follow revised Article 2 allowing a finding that a contract was "induced" by unconscionable conduct. This produced substantial adverse comment in the deliberations on the Prototype Draft during the NCCUSL meeting in July, 1995 and extends current law by creating a form of fraudulent inducement defense grounded in unconscionability. It makes a substantial change in law and may be inappropriate for a developing area of commercial practice such as dealt with here.

3. Article 2A has an inducement provision (2A-108), but limits that provision to consumer transactions. That section also contains consumer remedy provisions that were essentially rejected in the Article 2 revision when extended to the broader inducement provision proposed there.

SECTION 2B-112. COOPERATION IN PERFORMANCE. A party must

reasonably cooperate within the limits of its agreed contractual obligations with the other party to enable performance of the other's obligations. If a failure to cooperate materially affects the other party's performance, the injured party is excused for any resulting delay in the party's performance and may treat the failure to cooperate as a breach.

Uniform Law Source: Restatement (Second) of Contracts; 2-309.
Revised. New.
Reporter's Notes:

1. This section states an important principle of general applicability. In situations where the performance of one party hinges in part on the availability and cooperation of the other, common sense and fairness place a duty to at least reasonably cooperate on the one party. Thus, for example, a licensee acquiring a specially developed database for its commercial use cannot refuse or unreasonably delay in providing the contractor with information about specific requirements and then sue for delay or non-performance by that contractor. This section would treats non-cooperation as a breach of contract.

2. The cooperation here is cooperation to enable performance, not cooperation in terms of modifying requirements or waiving contractual obligations. The party on whom a duty to cooperate falls retains the right to expect full performance of the other party's contractual obligations.

3. Article 2 has only limited provisions dealing with a duty to cooperate. These are grounded principally in situations where the contract leaves open to one party the right to specify what performance it requires. Of course,Article 2 deals with a transactional model in which interaction and cooperation are not necessary in many cases (e.g., delivery of a single item). This article deals with a wide range of transactions, many of which involve a need for ongoing and effective relationships.

4. The duty to cooperate exists in the common law of many states. It often arises as a by-product of the obligation of good faith.

5. UNIDOIT principles of international contract provide: "Each party shall cooperate with the other when such cooperation may reasonably be expected for the performance of that party's obligations." UNIDOIT art. 5.3. The comments state: "A contract is not merely a meeting point for conflicting interests but must also, to a certain extent, be viewed as a common project in which each party must cooperate."

SECTION 2B-113. AUTHENTICATION PROCEDURE.

(a) An authentication procedure consists of a commercially reasonable procedure established by agreement of the parties for the purpose of (i) verifying that records, messages or performances are those of the respective parties, or (ii) detecting error in the

transmission or the content of an electronic message, record, or performance. An authentication procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices.

(b) Commercial reasonableness of an authentication procedure is a question of law to be determined by the court in light of the commercial circumstances, the purposes of the authentication procedure, the relative position of the parties and the procedures in general use for similar types of transactions or messages.

Uniform Law Source: Article 4A 201; 202.
Selected Issues:

a. Should more specific provision be made for the determination of what is a reasonable procedure or should reasonableness not be used as a limit on the parties' contract?

Reporter's Notes:

1. This section is new. It relates to the adaptation of prior provisions dealing with electronic contracting and adapting the provisions of this article to the treatment of electronics that replace written documentation.

2. An authentication procedure has significance in this draft in two primary respects. In one, it deals with questions of attribution (discussed in the next section) and a presumption that authentication pursuant to an authentication procedure as described here allows the party using the procedure to rely on the fact that the other party is attributed with the message or electronic performance.

3. The second element consists of the fact that the article uses the concept of authenticated as a general term, replacing the more limited term "signed." Following an agreed authentication procedure as a matter of law constitutes authentication. See Section 2B-102.

4. The provisions of this section are modelled after the concept of a "security procedure" adopted in Article 4A for purposes of authentication of payment orders. since Article 2B deals with a more open environment and multiple parties of differing sophistication, resources and bargaining power, rather than only with banks and customers, the "authentication system" concept does not have the entirely dominant impact that security system has in Article 4A. It is simply not reasonable to anticipate that all parties engaged in transactions covered by this article will arrive at or even consider using agreements to establish specific procedures for authentication.

SECTION 2B-114. ATTRIBUTION OF ELECTRONIC RECORDS, MESSAGES AND PERFORMANCE. If an electronic record, message or performance is received by a party, as between the receiving party and the party indicated as the sender, the record, message or performance is attributable to the party indicated as the sender only if:

(1) it was sent by that party, by the party's electronic agent acting within the scope of its agency, by a person with authority to act on behalf of that party in the transaction, or by a person for whose conduct the party is otherwise responsible under the law of agency;

(2) the receiving party, in good faith and in compliance with the authentication procedure agreed to by the parties, concluded that the record, message or performance was sent by, or attributable to, the other party; or

[Alternative 1]

(3) the record, message or performance

(i) resulted from acts of a person who obtained from a source controlled by the alleged sender access numbers, codes, programs, or the like facilitating the appearance that it came from the alleged sender,

(ii) this access occurred under circumstances constituting a failure to exercise reasonable care by the alleged sender, and

(iii) the receiving party reasonably relied to its detriment on the appearances thus created.

[Alternative 2]

(3) The capability to create the impression that the message or performance came from the party purported to be the sender resulted from information obtained through a relationship between the actual sender and the purported sender of the message or performance which relationship was not adequately controlled to prevent reliance on a false message.

[Alternative 3]

[No further provision]

Source: Section 2B-607 (December, 1995 Draft), revised; Article 4A-202; UNCITRAL Draft Model Law on EDI.
Selected Issues:

a. Should the burden of proof be on the receiving party?

b. Should there be a dollar limitation on risk applicable to individuals?

c. Is it appropriate to place the predominant risk of loss for hackers on the receiving party?

Reporter's Notes:

1. This section was substantially revised based on discussions at the January meeting. In subsection (3), three options are presented to highlight the policy choices presented by attribution questions.

2. If a message is sent, received or responded to, who should have obligations deriving from that fact in the situation where the message was incorrect or incorrectly issued? This issue was controversial at the January Committee meeting. The primary concerns relate to allocating risk of loss in context of electronic transactions that are inherently anonymous.

3. The risk allocation approach taken here keys into whether a party named as the sender of an electronic record, message or performance can be held attributable for that material. Three distinct contexts are set out. The principle outcome here is that the party cannot be made attributable for third party actions in settings where there was not some level of fault on the part of the sender in enabling the fraud to occur.

4. In closed systems involving the transfer of money or similar valuables among entities that have prior, structured relationships, attribution issues can be based on compliance or non-compliance with established verification procedures. This approach was adopted in the creation of UCC Article 4A dealing with electronic funds transfers. In that context, a body of statutory and case law is slowly evolving to deal with cases of fraud and mistake based on who had the opportunity to prevent the loss under established procedures.

5. In cases where the primary electronic process involves transactions dealing with consumers, allocation of the risk of error, fraud or false attribution developed in a way that responds to the better ability of the system operator to spread and prevent loss than the individual consumer can achieve. This occurred in reference to electronic funds transfer systems under federal law. The methodology may involve, as in credit and similar cards, a monetary limit on consumer liability and an opportunity to prevent imposition of even that limited liability if the consumer acts promptly to prevent loss. In such cases, of course, the consumer risk needs to be coupled with a notification system (written or electronic) enabling the discovery of the error in a timely manner.

6. Our context requires a more general structure that goes beyond consumer issues because the problems addressed will not routinely be consumer protection questions. An individual, for example, may be an injured party or the wrongdoer. The transactions will often involve two businesses. How the underlying contract law attribution issues should be handled and, therefore, how ideas of loss allocation can be managed. Here, one may be inclined to look to communications law and the allocation of fraud risk there. In reference to telephone systems, pending resolution of current regulatory investigations, 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.

7. Viewed from a commercial law context, and given adequate safeguards built in for consumer protection, the basic issue in developing attribution rules is to define the electronic contracting environment as a functioning and reliable context. Of course, much of the actual reliability that it will achieve as electronics become more and more important will come from encryption and other technologies, including electronic signature requirements. Nevertheless, the legal reliability of messages on an electronic system provides an important backdrop for commerce in this form.

8. The provisions of this section are based in part on current drafts of pending proposals dealing with similar problems involving EDI transactions in an international environment. See UNCITRAL Draft Model Law on EDI (1995) and in part on Article 4A.

9. There are three circumstances under which one party is held to be bound by a message. The first, paragraph (a)(1), deals with common agency rules. It also adds the idea of an electronic agent acting within the scope of its agency. An electronic agent is defined in Section 2B-102 as a computer program programmed to respond or initiate without human review and selected by the party for that purpose. This, thus, calls into play a concept that, to be bound by purely electronic activity, a party must have affirmatively created the agency. That concept then carries through by virtue of the attribution concept to the offer and acceptance and other electronic contracting provisions of the article.

10. Paragraph (a)(2) focuses on agreed to secure procedures for authentication and makes a message attributable to one party if the other used the procedures and reached that conclusion. This would cover, for example, the case in which a stranger to the parties' relationship obtained a PIN or other identifier and used it without authorization. Liability in the form of being bound by the message occurs without regard to fault so long as the agreed procedure was used by the recipient party.

11. Paragraph (a)(3) deals with a form of fault and attributes the message to one party if the means of making the identification occurred by way of an intrusion into a source controlled by the "sender" and enabled by the sender's lack of reasonable care. This form of attribution occurs only if the receiving party relied..

12. This section presents several important issues for policy discussion:

a. What role should reliance play in attributing the message to a party? The attribution approach here uses reliance only in the last portion of the three rules. In cases of offer and acceptance, however, for the issue to arise, there would have to be a reciprocal act (e.g., acceptance of the attributed offer). One approach would be to make attribution occur only if the other party relied with reliance being defined to include electronic response. The arguments against this include the idea that it would lend uncertainty to a context where the goal of the provision is to establish legal certainty.

b. What provision should be made for consumer protection? As noted above, some current laws (not those related to telephone systems) implement consumer protection via placing monetary limits on

the liability involved for false transactions. This could be achieved here by referring, for example, to attribution occurring under paragraph (2) or (3) and limiting liability in those cases for consumers to, for example, $1,000. The counter arguments include the fact that, as the systems become increasingly important, such a carve out would inhibit use of electronic contracting as a stable means of commerce. Also, unlike in cases involving electronic funds transfers, the messages referred to here involve the creation or performance of contracts and the risk of financial loss without reciprocal value will typically be less.

c. How should cases involving pure hackers be handled? This draft places the loss from hackers on the receiving party unless the hacker defeats an agreed to authentication procedure or obtained the relevant information for identification from a source controlled by the party attributed with the message. The alternative, of course, places the loss on attributed sender of the message. An interim position would do so only if the attributed party was at fault in allowing the hacker to obtain the relevant information.

d. Finally, who has the burden of proof to show that attribution is or is not appropriate?

SECTION 2B-115. MANIFESTING ASSENT.

(a) A party manifests assent to a record or a term if, after having an opportunity to review the record or the term, it or its electronic agent acting within the scope of its agency

(1) engages in affirmative conduct that the record conspicuously provides will constitute acceptance of the record or of the particular term; and

(2) had an opportunity to decline to engage in the conduct after having an opportunity to review the record or the term.

(b) Merely retaining the information or the record without objection is not a manifestation of assent.

(c) A party's conduct does not manifest assent unless the particular term or the record was called to the party's attention by before the party acts.

Uniform Law Source: Article 2B-102(28) (December 1995)

Selected Issues:

1. Should specific provision be made for what constitutes manifestation of assent by an electronic agent?

2. Are the procedures for manifesting assent to a contract term sufficiently clear in this draft?

Reporter's Notes:

1. The concept of manifesting assent is used throughout this

draft as a means of identifying when a party assents to terms of the record. It is used in the Restatement (Second), but not defined there. The basic thrust of the term is that objective manifestations of assent bind a party to a term or to a record. This, rather than the subjective concept of agreement better provides indicia of assent.

2. Two fundamental steps are required. First, there must be an affirmative act. A signature, of course, manifests assent to the record, while initials attached to a particular clause manifest assent to that clause. So to, in the electronic world would an affirmative act striking a return key in response to an on-screen description that this act constitutes acceptance of a particular term or an entire contract. The second is that the manifestation of assent can only come after the party had an opportunity to review what it is assenting to. In general, it is not required that the party actually read the contract or the term, merely that it have had a clear and available opportunity to do so. "Opportunity to review" is a defined term in this article.

3. There are two types of assent addressed here. One goes to the contract as a whole. See section on standard form contracts. What must be brought to the party's attention here is that the designated act (e.g., signing, return key, opening a package) constitutes assent to the contract and that the contract is there in a form giving an opportunity to review it. On the other hand, the section also deals with manifestation of assent to a clause or contract term. Here, the clause must be available for review and must be brought to the party's attention.

4. Assent here assumes that the assenting party is attributable with the actions that constitute assent. Attribution in electronic contexts is dealt with in another section of this article. When the purported assent is made by a party without authority to do so, it is meaningless as to the other party.

. **SECTION 2B-116. OPPORTUNITY TO REVIEW.**

(a) A party or electronic agent has an opportunity to review a record or a particular term if the record or term is made available in a manner designed to call it to the attention of the party or to enable the electronic agent to react to the term or record

(1) before the acquisition of a copy of information;

(2) before the transfer of rights; or

(3) in the normal course of initial use or preparation to use the information or to receive the transfer of rights.

(b) In addition, except for proposals to modify a contract, a party has an opportunity to review only if it is authorized to obtain a refund of the license fees paid less the value received by the licensee, by discontinuing use and returning any copy following its opportunity to review the terms of the record. rights

Source: Section 2B-102 (December, 1995)
Selected Issue:
1. Under what circumstances should an electronic agent have an opportunity to review a record or term?

Reporter's Notes:
1. The concept of an opportunity to review corresponds to the idea of manifesting assent. Taken together, they enable assent in forms other than a writing, but place important procedural limitations on when and how this can occur. Unless a party had a prior opportunity to review the applicable term or clause, actions purporting to manifest assent are ineffective for purposes of this article.
2. Importantly, these concepts do not substitute for "agreement" as that term is defined in the UCC or in contract law generally. Assent and review are typically associated here with what terms become part of the contract. The fact that a party did not effectively assent to a form because there was no opportunity to review does not necessarily negate the existence of a contract, governed presumably by the default rules of this article.

. **SECTION 2B-117. EFFECT OF AGREEMENT.**

(a) Except as otherwise provided in subsection (b) or in the applicable section, the effect of any provision of this article may be varied by agreement of the parties.

(b) An agreement subject to this article may not limit or vary

(1) the obligation of good faith under Sections 1-203 and 2B-102;

(2) the use of parol or extrinsic evidence under Section 2B-301;

(3) the right to relief from an unconscionable contract or clause under Section 2B-109;

(4) the effect of Section 2B-406 on limitation of express warranties;

[other provisions to be specified]

Uniform Law Source: None. First appeared in February, 1994 draft.
Reporter's Note:
1. Subsection (a) states the broad principle favoring variation of the underlying rules of Article 2B by agreement. The phrase, "unless otherwise agreed", is no longer needed since this is the

general principle throughout the article. Subsection (b) lists provisions that cannot be varied by agreement.

2. During the drafting Committee meeting in January, substantial disagreement arose concerning whether use of this approach was desirable or whether it might lead to inadvertent changes in law. This section is retained pending resolution of that issue as a convenient way of cataloguing rules that are not variable by contract.

PART 2

FORMATION

SECTION 2B-201. [NO] FORMAL REQUIREMENTS. <If option 1 is selected, add "NO" to heading>

[Option 1]

(a) Except as otherwise provided in subsection (b) or Section 2B-303, a contract or modification thereof is

(1) enforceable, whether or not there is a record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year after its making, and

(2) effective and enforceable according to its terms between the parties, against purchasers, and against creditors of the parties without filing in any public record.

(b) A grant or limitation dealing with the subject matter of sections [single system use, use for any purpose, right to modify] may not vary the terms of those sections unless the grant or limitation is in a record authenticated by a party against whom enforcement of the contract term is sought.

[Option 2]

(a) Except as otherwise provided in this section, a contract is not enforceable by way of action or defense unless there was a record authenticated by the party against whom enforcement is sought sufficient to indicate that a contract has been made between the parties and describing the subject matter.

(b) Any description of the subject matter satisfies subsection (a), whether or not it is specific, if it reasonably identifies what is described.

(c) A grant or limitation dealing with the subject matter of sections [single system use, use for any purpose, right to modify] may not vary the terms of those sections unless the grant or limitation is in a record authenticated by a party against whom enforcement of the contract term is sought.

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

(e) A contract that does not satisfy the requirements of subsection (a), but which is valid in other respects, is enforceable if:

(1) the total value of the payments to be made and any other obligations incurred under the contract, excluding payments for options to renew or buy, is less than $1,000; or

(2) the licensor or a person authorized by the holder of intellectual property rights to do so transferred a copy of the information to the licensee.

(f) Except as otherwise expressly provided in this article, a contract is effective and enforceable according to its terms between the parties, against purchasers, and against creditors of the parties without filing in any public record.

Uniform Law Source: Option 1 new. Option 2, Section 2A-201. Revised.
First Appeared: 2-2201 (Feb. 1994)
Selected Issues: [This section has not been changed pending receipt of drafting suggestions from various groups].

a. Should this be set out as two options or should the draft adopt or expressly reject the statute of frauds?

b. If Option 1 is allowed, what sections should be subject to variation only by means of a record?

c. In option 2, should we reinstate a provision on judicial admission despite adverse comments and on action in California in reference to other UCC drafts?

Reporter's Notes:

1 This draft changes the terms of option 2 to reflect

discussions at the Drafting Committee meeting at which a split existed concerning whether the statute of frauds should or should not be retained for this type of property. The changes reduce the content of the basic statute by narrowing the required terms of a record to cover only the subject matter (not term, duration, etc) of the contract. Also, a variation of option 1 was incorporated into option 2, providing that for certain terms of an agreement, a record is required to vary default provisions.

2. The statute of frauds has been controversial. Draft Article 2 repeals the statute of frauds. At the NCCUSL meeting in July, 1995, this repeal was supported by a voice vote as the sense of the house. The Sales Committee voted for repeal on several occasions. The proposed repeal has met substantial criticism from industry and, in general, most industry representatives favor continuation of a statute of frauds in some form.

3. The arguments for and against repeal in our context do not engage a concern about the use of electronic contracting practices. This article adopts the term "record" to replace references to "writing" to accommodate electronic transactions. A record (electronic or other) with appropriate content meets the requirements of any statute of frauds.

4. The argument favoring abolition of a statute of frauds lies in part in the perceived reality of modern commerce. Many transactions are created by exchanges of electronic, verbal or other communications that cannot readily be incorporated in the idea of a signed "record." The regime of using a writing ten agreement is not one to which the general marketplace adheres, except in complex transactions. Such transaction are seldom concerned with statute of frauds rules in any case. Issues in complex deals center on parol evidence or interpretation matters (i.e. what is the deal, rather than whether the deal can be enforced). In this setting, there is no sufficient benefit to justify the cost of a statute of frauds. That cost derives from unnecessary litigation and, at least in the minds of some, the fact that statute of frauds are often circumvented by courts, but in some cases prevents a party from enforcing a valid contract.

5. In sales law, the statute of frauds serves a limited purpose in that it applies only to protecting against fraud in cases involving goods that have not yet been delivered. Reliance on litigation and on evidence rules to regulate fraud there makes sense so long as a statute of frauds causes any significant detriment to modern transaction formats. The PEB Study Committee on Article 2 presaged repeal in its comments on the statute of frauds:

> **§ 2-201 has generated considerable litigation without evidence that perjury on the making or terms of a contract for sale has been deterred. In fact, some argue that the statute of frauds stimulates rather than deters fraud.**

PEB Study Committee, Executive Summary 11 (1991). Neither British contract law nor the Convention on International Sales of Goods (CISG) require a record.

6. The need for statute of frauds protection is greater in information contracts than in the sale of goods, however. This is true because of the intangible character of the subject matter, the threat of infringement, and the split interests involved in a license

with ownership of intellectual property rights vesting in one party while rights to use or possess a copy of the intangible may vest in another party. These considerations buttress other arguments against repeal which include primarily the idea that the fraudulent practices and unfounded claims that this rule prevents justify the cost and that the statute codifies and encourages what might be regarded as desirable business practice.

7. Article 2A adopts a statute of frauds for leases. One could argue that this is appropriate because there is a separation of possession and title in a lease, the content of which requires documentation that goes beyond the mere transfer of possession of the goods. If the distinction based on a separation of ownership and possession is accepted as a reason for different treatment in the U.C.C. for sales and leases, a similar reason for not repealing the statute of frauds exists in intangibles contracts. In information, physical possession may be irrelevant. If there is a tangible copy involved in the transaction, there is a separation of ownership and possession under a license. A writing may be necessary to document under what claim of right the licensee holds the intangibles and under what circumstances the licensor can seek their return.

8. There is a lack of empirical evidence about whether a statute of frauds does or does not prevent fraud. Current law does not uniformly apply the statute of frauds to intangibles contracts (e.g., a patent license), yet no serious fraud issues have emerged in practice. On the other hand, while current Article 2 statute of frauds applies to many software transactions, there have been no reports of serious difficulties caused by the requirements of this statute.

9. There has been virtually no industry support for entire repeal of the statute of frauds in reference to information transactions covered by this article. Discussion Option 1 comes closest to repeal. It makes a general repeal, but adds language that deals with the most significant issues that engender a need for a record. The policy, suggested by some industry representatives, holds that, unless an authenticated record exists, the default rules of this Article dealing with certain basic licensing features apply. These provisions, in effect, cannot be altered by oral agreement. This cuts in both directions with respect to licensor and licensee. For example, since field of use constitutes one of the affected sections, a licensor cannot argue that there is an oral limit on the type of use allowed to the licensee, but since the single copy presumption is also covered, a licensee cannot argue that it received a right to make multiple copies of the software based on an oral license.

10. Option 2 retains the statute of frauds. Substantively, this option draws more from Article 2A than from Article 2. Three basic alternatives exist for enforceability. Subsection (a) states the basic rule that a contract cannot be enforced for purposes of a claim or a defense unless a record exists that covers the subject matter of the contract, the rights transferred to the licensee, and the duration of the license. The descriptions required are specified to be such as reasonably describe these elements of the deal, no detailed or elaborate descriptive standards are mandated. The record must be authenticated. This draft does not require an encrypted or otherwise secure symbol, although such entries made under modern

notary statutes would clearly suffice.

11. Representatives of the Information Industry Association suggested the following language as a means of dealing with authentication: "A contract created in an electronic transaction is enforceable if the party seeking enforcement can show directly or indirectly that the other party initiated or accepted the transaction by use of an identifier unique to it retained in a record under the control of either party."

10. No authenticated record is required in small transactions or in transactions in which a copy is delivered to the licensee. In the latter case, the intent is to parallel a provision in the existing Article 2 statute of frauds which limits the statute to executory contracts, excluding cases where the performance (delivery of goods) already occurred. The section requires that the copy be delivered, however, and this would require some proof that it was not obtained in an entirely illicit transaction.

11. Copyright law requires a written agreement 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).

12. 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.

13. The Drafting Committee could take the position that a parallel state law writing requirement should be adopted for information not covered by these federal law rules. In many contracts, federal property rights and state law issues blend together; differentiating between them would be difficult or impossible. In order to avoid cases in which part of a transfer is enforceable while another part is not enforceable because of an inadequate writing, the same rule might be adopted for each. On the other hand, the Drafting Committee could decide to not do this. Recent proposals indicate that there may be action in the future to eliminate the federal registration and writing requirement. More important, no cases have been discovered that create the difference in enforceability. There being no apparent problem, the Drafting Committee might elect to treat coordination between federal and state law rules as unimportant.

14. The common law rule is actually contained in statutes adopted in at least 47 states. Restatement (Second) of Contracts ch.5, Statutory Note, at 282 (1979). State law rules differ. In some, a nonexclusive license can be enforced without a writing. Gate-Way, Inc. v. Hillgren, 82 F. Supp. 546, aff'd, 181 F.2d 1016 (9th Cir. 1950); Sun Oil Co. v. Red River Refining Co., 29 F.2d 827 (7th Cir. 1928); Wang Laboratories, Inc. v. Applied Computer Sciences, Inc., 741 F. Supp. 992 (D. Mass. 1990) (not applicable to patent license). The issue most often disputed in licenses deals the requirement of a writing for contracts not capable of being performed in less than one year. See Commonwealth Film Processing v. Courtaulds, 717 F. Supp. 1157, 1158 (W.D. Va. 1989), app. dism., 892 F.2d 1049 (Fed. Cir. 1989)

(patent license extended beyond one year); Zysett v. Popeil Bros., Inc., 134 U.S.P.Q. 222 (N.D. Ill. 1963) (alleged to extend for five years); Sun Studs, Inc. v. Applied Association, Inc., 772 F.2d 1557 (Fed. Cir. 1985); Kurtz v. Ford Motor Co., 62 F.Supp. 255 (E.D. Mich. 1945); Kastner v. Gover, 19 A.D.2d 480, 244 N.Y.S.2d 275 (1963), aff'd 14 N.Y.2d 821, 200 N.E.2d 455 (1964).

SECTION 2B-202. FORMATION IN GENERAL.

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

(b) If the parties so intend, an agreement sufficient to constitute a contract may be found even if the time when the agreement was made cannot be determined, one or more terms are left open or to be agreed upon, or the standard form records of the parties contain varying terms.

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

Uniform Law Source: Section 2-204, modifies (b). First Appeared: 2-203 (Prototype)

Reporter's Note:

1. The only change in this section transforms the term "intermediary" from the prior draft to "electronic agent" as defined in this draft. The change clarifies that the system creating the binding action on behalf of the party is a program (or similar electronic vehicle) selected and made available by the party.

2. This section parallels the formation section in Article 2, but relies primarily on language from Article 2A. The section adds language to confirm that electronic responses can reflect the existence of a contract. Including in subsection (a) would be a response from a passive computer program reacting to a request from another party.

3. The section adds a reference in (b) to standard forms to clarify that the conflicting term element deals with the formation issue handled under current Article 2-207 (battle of forms), which is the intent of the sales provision. In the approach to conflicting forms adopted here (and in Article 2 (revised)), the issue of whether there is an intent to contract despite there being conflicting terms is handled in this general section, rather than in the equivalent of Section 2-207 (battle of forms).

SECTION 2B-203. 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 no time is stated, the offer is irrevocable for a reasonable time not to exceed three months. A term of assurance in a record supplied by the offeree is ineffective unless the offeree manifests assent to the term/

Uniform Law Source: Section 2A-205; Section 2-205.
Selected Issue:
a. Should this section be limited to offers by merchants?
Reporter's Notes:
1. This section follows draft Article 2 language. Issues dealing with firm offers have not been presented to the courts in reference to information contracts, but the section may be important since it applies in cases of multiple level contracts as in development agreements.
2. This section does not limit the length of the firm offer. It requires a record. If a repeal of the statute of frauds occurs, the Drafting Committee may wish to revisit the policy rationale for requiring this type of an offer to be in a writing.
3. Article 2A requires that the term of assurance on a form supplied by the offeree be "separately signed by the offeror." The language here supplants the signature requirement with the concept of authentication and manifestation of assent.

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SECTION 2B-204. OFFER AND ACCEPTANCE.

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

(1) An offer to make a contract invites acceptance in any manner and by any medium reasonable under the circumstances, including a definite expression of acceptance that contains standard terms varying the terms of an offer.

(2) An order or other offer to buy, license, or acquire information for prompt or current transfer invites acceptance either by a prompt promise to transfer or by prompt or current transfer. However, a transfer involving nonconforming information is not an acceptance if the transferor seasonably notifies the transferee that the transfer is offered

only as an accommodation.

(3) A response by an electronic agent that signifies acceptance or that commences performance constitutes acceptance of an offer even if the response is not reviewed or expressly authorized by any individual.

(b) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance and who has not received the relevant performance within a reasonable time may treat the offer as having lapsed before acceptance.

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

Selected Issue:

a. Is the treatment of an electronic response appropriate?

Reporter's Note:

1. Authentication replaces signing as the applicable expression of the party to be bound. Also, as in other sections, this section was modified to change "intermediary" to "electronic agent", a defined term, that clarifies that a party is bound by electronic preprogrammed operations only if it programmed its available system to make such responses.

2. This section generally follows draft Article 2. It adds subsection (a)(3) to deal with electronic acceptances. Otherwise, the draft assumes that the general reference to enabling a response in any form reasonable under the circumstances adequately covers the analysis of whether an electronic offer invites an electronic response.

3. Subsection (b) has been modified from existing law to expressly reflect that there is no need for notification where the party receives actual performance within a reasonable time. This is significant in electronic performance where virtually instantaneous responses are possible (e.g., electronic transfer of data). Requiring notice in such contexts is not appropriate.

SECTION 2B-205. ELECTRONIC TRANSACTIONS: FORMATION.

(a) In an electronic transaction, if an electronic message initiated by a party or its electronic agent evokes an electronic message or other electronic response by the other or its electronic agent, a contract is created when:

(1) the response is received by the initiating party or its electronic agent, if the response consists of furnishing information or access to it and the message initiated by that

party did not preclude such a response; or

(2) the initiating party or its electronic agent receives a message signifying acceptance.

(b) A contract is created under subsection (a) even if no individual representing either party was aware of or reviewed the initial , the response, the reply, the information, or the action signifying acceptance. Electronic messages are effective when received even if no individual is aware of its receipt.

Uniform Law Source: None. First appeared: Section 2-2202 (Sept. 1994)
Selected Issues:
a. Should subsection (a)(1) require that the initial message invite performance as a response?
b. Is the exclusion of any requirement of human review appropriate?
Reporter's Notes:
1. The changes in this section parallel earlier changes in that they introduce a concept of electronic agent, rather than intermediary. That concept is narrowed to clarify that the programmed activity that can bind a party is an program accepted, developed or programmed to take action by the party itself. In reviewing this, reference needs to be made to the terms of the section in part 1 dealing with attribution of messages and performances to a party.
2. An electronic transaction is as "a transaction in which the party that initiates the transaction and the other party, or their intermediaries, contemplate that the creation of an agreement will occur through the use or electronic messages or an electronic response to a message." Section 2B-102. This definition does not require that the parties also intend performance to be electronic.
3. The principal application of this section lies in the growing realm of electronic commerce. The section sets out standards for determining when and whether a pure electronic contract can be enforceable. Note that electronic-related language consistent with this section is also included in sections on offer and acceptance as well as formation rules.
4. A principal contribution is in subsection (b) which indicates that a contract exists even if no human being reviews or reacts to the electronic message of the other or the information product delivered. This represents a modern adaptation away from traditional norms of consent and agreement. In electronic transactions, preprogrammed information processing systems can send and react to messages without human intervention and, when the parties choose to do so, there is no reason not to allow contract formation. A contract principle that requires human assent would inject what might often be an inefficient and error prone element in a modern format.
5. The information industry increasingly uses electronic "intelligent agents" and database products generally available on the

Internet or other electronic networks. This entirely automated means of utilizing information as a commodity creates a number of uncertain contract law issues some of which this section attempts to answer in a manner that facilitates the development of this branch of commerce.

6. Subsection (a) contains a nonexclusive statement of how a contract may be formed, giving the parties some guidance on how to structure messages to create or avoid contractual obligations. It hinges the creation of a contract on the response to an electronic message. If the response consists of furnishing the performance, the contract exists at the time that they are made available at a place and in a manner allowing the initial party (or its computer) to have access to or use the information. Notice that this response might occur without there being any decision by any individual involved with the responding to "accept" the offer. If the response consists of creating an opportunity (or offer) to make access to the information available, the contract exists if the initial party signifies acceptance by taking advantage of the opportunity created or by indicating that it intends to do so.

7. Former subsection (c) dealing with "receipt" has been moved to the definition section. In commentary to the September Draft, a number of people suggested that the original version did not deal well with the case of a delivery in the absence of a prior designation of a particular information system by the recipient and was not sufficiently open-ended to deal with changing technology.

PART 3

CONSTRUCTION

A. General.

SECTION 2B-301. PAROL OR EXTRINSIC EVIDENCE.

(a). Terms with respect to which the confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to the terms included therein may not be contradicted by evidence of any prior

agreement or of a contemporaneous oral agreement. However, the terms may be explained or supplemented by evidence of:

(1) a course of dealing or usage of trade or course of performance; and

(2) consistent additional terms unless the court finds that the record was intended by both parties as a complete and exclusive statement of the terms of the

agreement.

[Alternative 1 and 1a]

(b) The terms of a record that contains a clause indicating that the record completely embodies the agreement of the parties may not be contradicted or supplemented by evidence of any prior or contemporaneous agreement or additional terms if [the record is not a standard form or the contract clause is not a standard term] [the party seeking to contradict or supplement the record manifested assent to the contract clause]

[Alternative 2]

(b) A contract term in a record indicating that the record completely embodies the agreement of the parties is presumed to state the intent of the parties on this issue if the record is not a standard form.

Uniform Law Source: Section 2A-202; Section 2-202. Revised.
Selected Issue:

a. Should the section adopt a presumption enforcing merger clauses in commercial deals consistent with the UNIDROIT approach?

Reporter's Note:

1. This Draft adds language discussed in the Drafting Committee meeting designed to express the conclusion that in transactions other that standard form agreements, a clause expressing the intent of the parties regarding integration of their entire deal into the terms of a record will be given weight. Options 1 and 1a to subsection (b) create an absolute condition, while option 2 states a presumption applicable if the terms are not standard form terms.

2. Beyond these changes, this draft uses the language of Article 2A which parallels current Article 2. It rejects language changes made in revised Article 2 draft to avoid unintended changes in law. The Draft also does not adopt subsection (b) of the revised Article 2 which reads:

> (b) In determining whether the parties intended a writing or record to be final or complete and exclusive with respect to some or all of the terms, the court shall consider all evidence relevant to intention to integrate the document, including evidence of contract terms so indicating, of a previous agreement or representation, or of a contemporaneous oral agreement or representation.

3. In the Article 2 debates, this section produced substantial controversy following draft proposals that seemed to require a preliminary hearing in resolving parol evidence issues and indicated that so-called merger clauses, which indicate the parties' intent that the writing constitutes the full and complete expression of the agreement, are not conclusive on the issue of intent. Case law generally supports a conclusion that, in some states, courts look past such clauses to determine whether or not parol evidence is admissible. Yet, especially in negotiated agreements, merger or integrations

clauses are common and extremely important elements of commercial contracting.

4. UNIDROIT draft principles of international commercial contract law state: "A contract in writing which contains a clause indicating that the writing completely embodies the terms o which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing." Art. 2.17.

SECTION 2B-302. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(a) If a 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 party, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the agreement.

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

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

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

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

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

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

Reporter's Note:

1. This section uses the language of Article 2A with structural changes to clarify meaning.

SECTION 2B-303. MODIFICATION AND RESCISSION; WAIVER.

(a) An agreement modifying a contract does not need consideration to be binding.

(b) An authenticated record that contains a term that excludes modification or rescission except by an authenticated record may not be otherwise modified or rescinded.

(c) An attempt at modification or recision that does not satisfy the requirements of subsection (b) may operate as a waiver.

(d) A party who has made a waiver affecting an executory portion of a contract may retract the waiver by reasonable notification received by the other party that strict performance will be 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.

Uniform Law Source: Section 2A-208; Section 2-209. Revised. First Appeared: 2-209 (prototype)

Selected Issues:

a. Should this section deal with modification processes in reference to continuing, online contracts?

Reporter's Note:

1. This section adopts the language of Article 2A with changes. In substitutes "authentication" for signed. It does not adopt the requirement in Article 2A that a no modification clause in a consumer case be separately signed. Given the flexible nature of information transactions, the capability to limit terms relating to scope and the like is more significant and also applicable to consumer deals which frequently involve on-going performance. A sense of the house motion for the same change in the Sales Draft at the NCCUSL meeting failed by a narrow vote.

2. Subsection (c) follows current law . It contrasts to the change in law apparently contemplated in new Section 2-210 which reads "a contract term may be modified or rescinded by waiver." Old Section 2-209 read "An attempt at modification or rescission . . . can operate as a waiver." No reason for the change appears in current practice and case law. This draft is consistent with Article 2A.

3. Subsection (a) follows Article 2A and deletes language in Article 2 limiting the concept there to agreements made in good faith. An obligation of good faith is implicit and, to the extent that specific regulation of agreements is needed, that is accomplished through concepts of fraud, duress and the like. The basic principle of contractual freedom should not be compromised beyond these clear principles.

SECTION 2B-304. CONTINUING CONTRACT TERMS. Terms that become part of a contract involving repeated performances apply to all subsequent performances of the parties, their agents, or designees unless modified pursuant to this article even though the

terms are not subsequently displayed or otherwise brought to the attention of the parties or their intermediaries in context of the subsequent performance.

Uniform Law Source: None.
Reporter's Note:

This section is added to resolve uncertainty about the need, in continuous access, online licenses, and other continuing performance contracts to restate terms at intervals during the performance of the contract. It adopts that unsurprising principle that terms that become part of the agreement remain so despite an absence of subsequent redisplay of the terms. The material here, of course, does not relate to course of performance, but to the continuing validity of contract terms assented to by a party at the outset of the relationship.

SECTION 2B-305. OPEN TERMS.

(a) An agreement otherwise sufficiently definite to be a contract is not unenforceable merely because it leaves particulars of performance open, to be specified by one of the parties, or to be fixed by agreement.

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

(c) 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 of commercial reasonableness.

(2) An agreement providing that the performance of one party be to the satisfaction of the other requires performance sufficient to satisfy a reasonable person in the position of the other party.

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

(i) is excused for any resulting delay in the party's performance; and

(ii) may proceed to perform or to specify the open term pursuant to

paragraph (c)(1) in any reasonable manner or may treat the failure to specify as a breach.

(d) If a contract term is to be fixed by agreement and the parties intend not to be bound unless the term is fixed or agreed, a contract is not formed if the term is not fixed or agreed. In that case, the licensee shall return any copies of information, other goods, and other materials already received or, if unable to do so, pay their reasonable value at the time of transfer. The licensor is obligated to return any portion of the license fee paid on account for which value has not been received by the licensee. With respect to any confidentiality or similar obligations created by the parties, the parties remain bound to the same extent as if the obligations were part of a contract that was terminated or canceled.

Uniform Law Source: Section 2-305; Section 2-311. Section (c) (2) from Restatement (Second) of Contracts § 228. Previous: 2-2219 (Feb. 1994). Revised.

Reporter's Note:

1. Substantial discussion at the Drafting Committee meeting centered on whether a "to satisfaction" clause should be presumed to require a level of satisfaction that would suffice for an objective, reasonable person (as described here) or should allow purely subjective judgment. The prior draft and this draft continue to follow the terms of the Restatement (Second) and general common law, but the preferable, commercial result is unclear. At minimum, the comments to the section if adopted as drafted on this point will clarify how one moves away from this presumption. For example, contract terms that state that the product must be such that will satisfy the recipient "in its sole discretion" should be sufficient to import a subjective standard. 2. This section brings together the various rules found in article 2 relating to open terms and terms to be specified by a party or by agreement. These open term rules were omitted from Article 2A and the Drafting Committee may desire to take similar action here. On balance, however, as an initial draft it was decided to include coverage of these issues which may have significance in contracting.

3. Under subsection (b), "open terms" are to be read as requiring "reasonable" performance and, in the case of fees, a reasonable fee. The idea of an open term must be read in comparison to the coverage of terms to be specified by agreement or by a party.

4. Subsection (c) deals with the situation where one party is to specify performance. It draws on the provisions of Article 2-305 (open license fee) and 2-311 (options and cooperation). The basic restraint on the right to specify performance (or price) is an obligation of good faith and a general concept of commercial reasonableness.

5. Subsection (c) differs from the language in revised Article 2, 2-311(a) which appears to change current law. The language goes

back to the framework of the original statute holding that where there is an obligation to specify standards, the specification itself must be made in good faith. Revised Article 2 language seems to make good faith a condition of the enforceability of the contract.

6. The language in subsection (c)(2) comes from the Restatement (Second). It deals with cases common in development contracts that do not involve major commercial parties where the parties fail to specify the standard for satisfaction of the transferee. The language adopts the majority rule. This presumes a reasonable person standard applies to determine satisfactory completion, rather than a standard based on the subjective views of the particular party.

7. This section should be read in conjunction with the overall duty to cooperate under section 2B-111.

8. Language in subsection (d) is modified from Article 2 sales to reflect that a licensee may have received value from services or information before the fee setting term failed.

SECTION 2B-306. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALINGS.

(a) A term that measures quantity or volume of use by the output of the licensor or the requirements of the licensee must be construed as meaning the actual output or requirements as may occur in good faith. Even if actual output or requirements occur in good faith, a quantity or volume of use unreasonably disproportionate to any stated estimate, or, in the absence of a stated estimate, to any normal or otherwise comparable previous output or requirements, may not be offered or demanded.

(b) An agreement for exclusive dealing in the supply or distribution of copies of information, or in products produced by the exercise of rights in information imposes an obligation by a licensor who is the exclusive supplier to the licensee to use best efforts to supply the copies or products if the copies or products are to be provided by the licensor. The agreement also imposes obligation on a licensee who is the exclusive distributor of products created by use of the licensor's information to use best efforts to commercially promote the information or product if the license fee to the licensor is substantially measured by units sold or transferred by the licensee.

Uniform Statutory Source: Section 2-306. Revised. Previous: 2-2211 (Feb. 1994)

Selected Issues:

a. Should the best efforts standard be replaced by a standard focused on good faith or similar requirement?

Reporter's Note:

1. This draft alters language to clarify when the best efforts standard applies and to whom. The Drafting Committee also considered whether "best efforts" is an appropriate standard. The actual difference between this standard and a reasonable care or good faith effort standard is not entirely clear under case law. An issue of whether to retain that standard awaits further research into the degree of difference (actual or perceived) that the standard imports.

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

3. In practice, however, especially in transactions that involve distribution to retailers for resale or licensing to end users, the number of copies provided to the distributor is a potential issue. Recognizing that the section may not be relevant to most licenses, the policy expressed in Article 2 is left intact. The draft extends that policy to cases in which the contract measures performance in terms of volume of use.

4. Subsection (b) reflects current case law in the treatment of royalty and best efforts obligations involving intellectual property and related products. An exclusive dealing arrangement in products does not imply that there is an exclusive license. The obligation of best efforts is appropriate where the transferor's return hinges on the performance and marketing of the transferee. Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214 (1917). In the absence of an exclusive license, the concept of good faith does not require that the licensee use "best efforts" to promote or otherwise exploit the licensed product to optimize the commercial benefit of the licensor. In transactions in which the license is nonexclusive the licensor can rely on other parties to obtain a return on investment.

B. Forms.

SECTION 2B-307. STANDARD FORM RECORDS

(a) Except as otherwise provided in subsection (c) and Sections 2B-308, 2B-309, or 2B-310, if all or part of an agreement of the parties is represented by a standard form record, a party adopts the terms of a standard form record if, prior to or within a reasonable time after beginning to use the information pursuant to an agreement, the

party who did not prepare the standard form signs or otherwise by its behavior manifests assent to a standard form record.

(b) A term adopted under subsection (a) becomes part of the contract without regard to the knowledge or understanding of the term by the party assenting to the standard form and without regard to whether the party read the form.

(c) A term of standard form that does not comply with a provision of this article which expressly requires conspicuous language or assent to the term does not become part of the contract.

Uniform Law Sources: Restatement (Second) of Contracts 211; UNIDROIT Principles of International Contract Law. Revised. First Appeared: 2-2203 (Sept. 1994).

Selected Issue:

a. Should manifest assent to a term replace rules regarding conspicuous terms?

Reporter's Notes:

1. This is the first of four sections that deal with contracting through standard forms that were first put together in the Prototype Draft. This section deals with cases involving documentation in a single standard form. Cases involving mass market, electronic forms, and conflicting forms are handled in subsequent sections. The terms of this section are subject to the provisions of the other two sections. Because mass market transactions are covered elsewhere, this does not deal with consumer contracts.

2. This section adopts procedural safeguards allowing the party bound by the standard form an opportunity to discover problem terms and to reject the contract if the terms are not acceptable. The two safeguards are in the concept of "opportunity to review" and "manifests assent." Both terms are defined in Section 2B-102. This draft deletes specific reference to "opportunity to review" in this section because that concept is incorporated in the definition of "manifest assent."

3. Subsection (a) adopts a position of the Sales Drafting Committee. Subject to compliance with the procedural protections, signature or other conduct adopting a form in a commercial contract adopts all of the terms contained therein even if the terms were not actually read by the party adopting the form. Limiting principles such as good faith, unconscionability, and fraud protect the party who did not prepare the form. The policy is that commercial parties are bound by the terms that they adopt and that, in effect, there is an obligation to read or review what is placed before you in a commercial deal. The vast majority of all reported cases dealing with commercial contracts apply this same proposition.

4. A party manifests assent to a form if, after having an opportunity to review the record, or the contract term, the party or

intermediary engages in conduct that the record provides will constitute acceptance of the record or the particular term. By definition, the conduct cannot involve simply retaining the information or the form without objection. This intends a process that calls attention to the fact that a given action (signature or other) constitutes a significant event assenting to the contract form. In electronic media, this may be hitting a return key or entering an identification code. Mere silence does not suffice.

5. "Opportunity to review" is the second safeguard and is a precondition to being able to "manifest assent." An "opportunity to review" exists "if the record is made available to the party before the party's acquisition of a copy of information or ... before the transfer of rights ... , or is provided in such a manner that the terms will be conspicuous in the normal course of initial use or preparation to use the information or receive the transfer of rights. In addition, if the opportunity to review occurs only in the course of initial use or preparation to use the information or receive the transfer, a party has an opportunity to review only if the party assenting to the form is authorized to obtain a refund of license fees paid that exceed the value received by the licensee by returning the copy or in the case of information requiring use in order to perceive the license terms, by discontinuing use and returning any copy following its opportunity to review the terms of the record." Section 2B-102.

6. Given these safeguards, the form governs if assented to within a reasonable time after agreement or initial use occurs. A reasonable time will be described in comments as a period closely related to the initial use. The section intends to enable licensors to use notification and review techniques connected to the utilization of information systems (such as by way of a screen display highlighting the agreement and giving an option to accept or reject) regardless of whether a technical or actual agreement occurs before the screen or similar system can be utilized.

7. This section intends to reverse a line of cases that evolved in reference to conflicting forms and purchase order transactions which holds that a telephonic agreement renders the subsequent form to be a proposed modification of the original, oral agreement even as to standard terms. That approach renders subject to challenge virtually all standard for contracts because a prior oral agreement often leads to the assent to a standard form. The intent here is to create a concept of continuing transaction where form arrives in time and sequence at a point where it is intended to be part of the agreement. That intent is acted on through the requirement of a reasonable time and through the idea that, to manifest assent, there must be an opportunity to review (and return) the subject matter of the deal.

8. The basic issue in standard form contracts lies with what presumption one makes about a contract. One model holds that contract terms consist only of those terms that the parties actually agree to in fact. This would invalidate many provisions of standard contracts because in many transactions neither party reviews or bargains about every term of the agreement. This model hinges on <u>actual</u> agreement. Its chief flaw is that it requires conduct that is not common in commercial or consumer practice. Many commercial transactions involve standard form agreements not fully negotiated or read. The

alternative assumes that assent to the contract implies assent to all terms. In many court opinions, this is explained in terms of a duty to read and understand the contract or in terms of an objective assessment of contract terms. The contract contains the terms to which you objectively, not subjectively, assented. The Restatement uses this latter model with restrictions designed to avoid unfair surprise.

9. There are other proposals that have been considered regarding standard form contracts, but which should arguably not apply in the commercial world where use of forms is common and an obligation to read exists. The Restatement (Second) of Contracts 211 refers to adoption of standard terms in the form by manifestation of assent if the use of a form was to be expected and unless the other party has reason to believe that the party who manifests assent would not do so if that party knew that the writing contained a particular term, that term is not part of the agreement. This focuses on the expectations of the party who prepared the form.

10. A UNIDROIT proposal deals with standard terms and validates those terms are such that the "party could not reasonably have expected" them. In such cases, there must be specific agreement to the term. UNIDROIT art. 2.20. Unlike the Restatement, this places the emphasis on the reasonable expectations of the assenting party and creates, one suspects, an impossible burden for a licensor who must structure its forms to fit diverse transactions and diverse contexts, especially in the mass market. This approach is also particularly suspect because it centers on terms that are standard, rather than such terms within standard forms. That focus should not be used in a U.S. law article because of the common drafting practice in which counsel uses terms previously used in other contracts in comprising even the most customized of agreements.

11. Neither this section, nor the sections on electronic or mass market contracts supersede other more specific regulation of the enforceability of terms. For example, provisions on disclaimer of warranty currently require that the disclaimer be conspicuous. If that requirement is not met in a standard form contract, then the disclaimer is not enforceable even though the party may have adopted the terms of the contract. This point is clarified in subsection (c).

SECTION 2B-308. MASS MARKET LICENSES.

(a) Except as otherwise provided in subsection (b) and in section 2B-309, a party adopts the terms of a mass market license if, before or within a reasonable time after beginning to use the information pursuant to an agreement, the party signs or otherwise by its behavior manifests assent to a mass market license.

(b) Terms adopted under subsection (a) include all of the terms of the term without regard to the knowledge or understanding of individual terms by the party assenting to the

form.

However, except as otherwise provided in subsection (c), a term does not become part of the contract if:

(1) the term creates an obligation or imposes a limitation that is not consistent with customary industry practices and that a reasonable licensor should know would cause most licensees in transactions of similar type to refuse the contract if the term were brought to the attention of the licensee; or

(2) the term creates an obligation or imposes a limitation which conflicts with the negotiated terms of the prior agreement of the parties relating to the transaction and the party assenting to the form does not manifest assent to that term.

(c) A term excluded under subsection (b) becomes part of the contract if:

(1) the term creates rights for or restrictions on the licensee which give the licensee no fewer rights than would be given to a purchaser at a first sale under federal intellectual property law; or

(2) the licensee manifests assent to the term.

(d) A term of a mass market license that does not comply with a provision of this article which expressly requires conspicuous language or assent to a particular term does not become part of the contract.

Uniform Law Source: Restatement (Second) of Contracts § 211. Substantially revised. First appeared: Section 2-2204 (Feb. 1994)

Selected Issues:

a. Are the limits in subsection (b) appropriate or should a different approach be taken?

b. Should additional limits be placed on the effectiveness of a form made available at the time of performance as compared to the time of initial agreement?

c. Is the safe harbor provision of (c)(1) appropriate or should it be deleted?

Reporter's Notes:

1. Special treatment of mass market licenses is essential in this article because of the significance of the contracting approach in modern commercial practice and a need to clearly resolve issues about enforceability. This section supplants the general section on

standard form contracts, but as provided in subsection (d) does not supplant specific requirements in other sections about conspicuous or specific assent to particular terms. In a recent survey of computer law professionals, a strong majority of respondents (65%) believed that "shrink wrap" licenses, a form of mass market contract, should be enforceable. Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995)

2. The basic issue in standard form contracts lies with what presumption one makes about a contract. One model holds that contract terms consist only of those terms that the parties actually agree to in fact. This would invalidate many provisions of standard contracts because in many transactions neither party reviews or bargains about every term of the agreement. This model hinges on actual agreement. Its chief flaw is that it anticipates or requires conduct that is not common in commercial or consumer practice. In fact, many commercial transactions are conducted with written agreements that are not fully negotiated or read. The alternative of enforceability is followed in most cases. It assumes that assent to the contract implies assent to all terms. In many court opinions, this is explained in terms of a duty to read and understand the contract or in terms of an objective assessment of contract terms. The contract contains the terms to which you objectively, not subjectively, assented. The Restatement uses this latter model with restrictions designed to avoid unfair surprise. This draft adapts the approach of the Restatement (Second) of Contracts § 211 to standard form licenses with modifications to suit a mass market environment in which the use of standard licenses is commonplace.

3. This section generally follows the approach for standard form records. They are enforceable subject to procedural safeguards relating to manifesting assent after an opportunity to review the form contract. See discussion 2B-307. Procedural safeguards ensure the mass market party can protect itself against seriously problematic form clauses, but allow a licensor to place information on the market subject to restrictions and disclaimers that are important to it.

4. A risk of surprise rises in the mass market setting because the transactions are less likely to be gauged to produce actual knowledge of and reaction to contract terms. Unlike section 2B-307 which assumes commercial parties are involved, the focus on mass market deals assumes that the transactions may involve consumers and other parties not highly skilled in contract interpretation. This section, accordingly, adopts specific protections for the licensee against surprising terms. The protections require that the licensor call these terms to the licensee's attention and obtain express assent to the term.

5. Since a mass market license consists of a standard form record, the concept developed applies not only to so-called shrink wrap licenses, but to the various mass market contexts that arise in online contracting for database or other access rights. Thus, for example:

Assume that party A accesses the front "page" of party B's database of periodicals dealing with television shows and is confronted with a legend stating that "These materials are provided subject to an agreement relating to their use and reproduction that can be reviewed by clicking on the "license" icon. By striking the [return] key you assent to all of the terms of that license agreement, including the price to be charged for access rights." Depending on the breadth of the distribution of the database, this is a mass market license. A has an opportunity to review the license (assuming that if A reviewed the license it could leave the contract without charge) and is provided with an instruction that a particular action constitutes acceptance of the license. By doing so, A adopts the license even if it did not review its terms.

6. Subsection (b) deals with cases in which it would be unfair to adopt the theory of general consent to create specific <u>contract terms.</u> The chief variables are two-fold: (1) terms which unfairly surprise and disadvantage the licensee should not in all cases be incorporated in the agreement <u>based</u> <u>on</u> <u>general</u> <u>consent</u>, and (2) that the idea of general consent should not yield terms that alter prior, expressly negotiated terms. There are various ways to implement protection against surprising terms. Recall, however, that the protections arise only if we assume that a person or company with an opportunity to review and return the information product nevertheless assented to the entire form. Against this background, the unfair surprise standards in subsection (b) adopt a conjunction of 1) whether the term is consistent with customary industry practices and 2) whether the party proposing the term had reason to expect will be objectionable. Basically, if a party desires to use unusual terms in its mass market forms and does not wish to risk their unenforceability, that licensor must structure the transaction to obtain express assent by the licensee to the particular <u>term.</u> Under the definitions used here, that requires that the term be called to the licensee's attention and assent obtained against a background in which the licensee could return the information product for a refund it did not assent to the term.

7. This draft does not adopt the Restatement test (see below) which focuses on the licenor's reason to believe a term would be objectionable since, in a mass market, it will often be impossible to know another person's expectations. Similarly, the draft does not follow the UNIDROIT proposal because of the uncertainty created by a standard that focuses on a licensee's expectations.

8. Terms excluded under subsection (b) may be included under subsection (c)(2) if the licensee expressly consents to the term. Based on the definition of manifesting assent, this would require that the term be made available to the licensee and that it take an action defined in the license as manifesting assent to the term. To meet this standard, there must be an affirmative action by the licensee and the licensee must have a right to decline the license and obtain a refund if it disagrees with the term. An earlier draft of this section contained a definition of "express consents to a term" which required that the party "by its behavior if the term is conspicuous and, given the opportunity not to do so, the licensee engages in conduct that signifies acceptance of that term." It is believed that the concept of manifesting assent to a term is better suited to protect the licensee against surprise.

9. The structure adopted here not only attempts to balance the interests of licensor and licensee, it also attempts to create a structure in which transactions can occur. This is not a litigation

standard, but an approach that says to the licensor: if you wish to impose an unusual term, the only safe procedure you can adopt entails one in which that term is brought to the licensee's attention and specifically assented to by the licensee.

10. This section reverses Wyse Technology v. Step-Saver, where the court used § 2-207 to hold that a shrink wrap license in software packages delivered after a prior telephone contract did not become part of the sale contract. See also Arizona Retail Sys., Inc. v. Software Link, Inc., 831 F. Supp. 759, 22 UCC Rep. Serv2d 70 (D Ariz. 1993) (shrink wrap enforceable in transaction where no prior agreement, but not enforceable where there was a prior telephone agreement). That approach leaves open a great many issues in commercial practice where oral agreements exist before forms are assented to by the parties. The section provides that a form assented to under the appropriate procedural standards as outlined where become the adopted contract terms even if there was a prior oral agreement as to use of the product. The intent is that the form must be adopted in the flow of initial use of the product. Assent to the form requires more than mere receipt and failure to object; it requires some overt act manifesting that the assent occurred. What actions fit this definition may be a question of fact in particular cases.

11. Because it reverses Wyse the section deals with conflicts between the form and prior agreements. Prior negotiated terms control unless the affected party "expressly assents" to the terms. This takes the common sense approach of favoring negotiated terms over general consent theories. This applies, however, only to terms which conflict with negotiated terms rather than the default rules of this article.

12. Subsection (c) identifies clauses that are not excluded from the mass market license because they are common in the industry or are within the property rights of the licensor or its predecessor in interest. In intellectual property law, a "first sale" has significance in transferring rights to the buyer and excluding control by the seller. For copyright law, these are stated in Section 117 with reference to computer program. Subsection (c)(1) holds that as long as the license grants rights to the licensee that are equal to or greater than the "first sale" rights, there is no argument that they are unenforceable.

13. Subsection (d) clarifies that adopting terms of a form under this section does not reverse or over-ride any specific policy decisions made with respect to notice, invalidity or conspicuousness in other sections of the article.

14. The Restatement (Second) of Contracts § 211 deals with "standardized contracts." It provides:

> (1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing and has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing ...
>
> (3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.

The Restatement emphasizes whether the terms of the agreement are

within the reasonable expectations of the party against whom the terms are asserted.

15. UNIDROIT International principles provide:

> **No term contained in standard terms which is of a character that the other party could not reasonably have expected it, is effective unless it has been expressly accepted by that party.**

UNIDROIT art. 2.20

16. In Angus Medical Co. v. Equipment Corp., 840 P.2d 1024, 17 U.C.C. Rep. Serv.2d 724 (Ariz. Ct. App. 1992) an issue of fact existed about whether a contract limitation on the time to bring a claim was enforceable. The court used Section 211 to hold that limiting the time to 18 months might be invalid. The Restatement standard was described in the following terms: "Although customers typically adhere to standardized agreements and are bound by them without even appearing to know the standard terms in detail, they are not bound to unknown terms which are beyond the range of reasonable expectation. [A] party who adheres to the other party's standard terms does not assent to a term if the other party has reason to believe that the adhering party would not have accepted the agreement if he had known the agreement contained the particular term."

17. Article 2 incorporates common law if not displaced by specific Article 2 provisions. The Restatement section is not inconsistent with Article 2 and applies if it truly represents common law.

18. In Wyse Technology v. Step-Saver, the court used § 2-207 to hold that a shrink wrap license in software packages delivered after a prior telephone contract did not become part of the sale contract. According to the court, § 2-207 treats warranty disclaimers and similar contract terms in such a case as proposals for additional terms that do not become part of the agreement unless the proposing party (vendor) by words and deeds indicates that no contract exists unless the additional terms are agreed to by the other party.

19. In ProCD v. Zeidenberg, -- F.Supp. -- (D. Wisc. 1996) a District Court held that a shrink wrap license was not enforceable where the party did not have what the court viewed as any reasonable opportunity to review the form before expressing consent. The court relied in part on the language of a predecessor to this section to show that assent requires an ability to review. The court also suggested that, because of the subject matter involved (an uncopyrightable database of telephone numbers) it believed that copyright law would have preempted the contract in any event. On this latter point, serious dispute exists and this court is the first to hold that a contract is preempted by a statute creating property rights and which expressly preempts only governmental action.

20. Arizona Retail Sys., Inc. v. Software Link, Inc., 831 F. Supp. 759, 22 UCC Rep. Serv2d 70 (D Ariz. 1993) raised issues about what the court treated as two separate and distinct settings. The case involved multi-user operating system software that was acquired from the producer by a value-added retailer. The substantive issue presented was whether a warranty disclaimer on the shrink wrap license was enforceable. In the first context, the court held that the license could be enforceable. Arizona Retail (AR) ordered a copy of the software for evaluation and received an evaluation diskette along

with a separate, fully "live" copy contained in a shrink wrap package. AR was entitled to return both if the evaluation was unsatisfactory. After using the test disk, however, it elected to keep the product and opened the shrink wrap. The shrink wrap license stated that, by accepting the product, the user accepted the terms of the license. Under these circumstances, the court concluded that a contract was not formed until after the evaluation period and, thus, the contract terms offered on the license were part of the contract. On the other hand, as to subsequent purchases, the court followed the reasoning used in the Step Saver case to hold that a shrink wrap disclaimer of warranties was not enforceable under the rule in Wyse commenting that "[A] conditional acceptance analysis very rarely is appropriated in cases where a contract has been formed ... by performance, but the goods arrive with conditions attached."

21. In McCrimmon v. Tandy Corp, 202 Ga. App. 233, 414 S.E.2d 15 (1991) written language about a warranty return period in a computer sale precluded a buyer's effort to rely on inconsistent verbal representations by sales agent. The terms of the warranty were on a sales receipt; the court held that since full text of the warranty was contained in the owner's manual and mentioned on the sales receipt: "The sales receipt was tendered to him at the time of purchase along with the equipment. It was his responsibility to read it." Compare Altronics of Bethlehem, Inc. v. Repco, Inc., 957 F.2d 1102 (3d Cir. 1992) (limitation of consequential damages contained in a shipping invoice did not become part of a contract for the sale of security systems).

22. Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th Cir. 1988) (state statute specifically authorizing detailed terms of a shrink wrap contract was preempted by federal law to the extent that the license attempted to bar "reverse engineering" by the "licensee" who "owned" a copy of the relevant software. The lower court had held that, under state contract law, the shrink wrap license was an unenforceable "adhesion contract" in the absence of the state statute specifically authorizing it. This set the stage for the federal preemption. The statute in effect created a right denied by federal copyright or patent law without a basis in contract.

23. Use and other restrictions in a shrink wrap case deal with a background of intellectual property law that hinges in part on whether the licensee purchased an item containing the information in a "first sale" of the item. Some restrictions on use in the context of a first sale may be precluded by federal policy. Section 117 of the Copyright Act gives the owner of a copy of a program certain rights to make back-up copies and adaptations for personal use of the program. Most computer law professionals, in any event, believe that certain first sale rights should not be reversible through a shrink wrap license (e.g., single copy, back up copy). Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995).

24. Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992) (single use restriction placed on a patented medical device could be enforceable if the original sale was validly conditioned on this term under the law applicable to licenses and sales). Compare Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141 (1989) (state statute law cannot prohibit use of products

sold on open market to appropriate design and other information regarding the products that was not protected by federal intellectual property law).

SECTION 2B-309. CONFLICTING STANDARD TERMS.

(a) If the parties exchange standard forms that purport to contain the terms of the agreement and the forms contain varying standard terms, the varying standard terms do not become part of the contract unless the party claiming inclusion establishes that:

(1) the other party knew of and manifested assent to the particular term; or

(2) the records of both parties agree in substance with respect to the particular term.

(b) In cases governed by subsection (a), the terms of the contract are:

(1) standard terms on which the standard forms do not conflict;

(2) standard terms included under subsection (a);

(3) other terms, whether or not contained in a record, to which the parties have agreed; and

(4) supplementary terms incorporated under any other provision of this article.

Uniform Law Source: Section 2-207. Substantially revised.
Selected Issue:
a. Should the section deal with prior negotiated terms?
b. Should the terms of a form to which the licensee manifests accent over-ride the other form?
Reporter's Note:
1. This section deals with cases where two standard forms are traded between the parties involving differing terms. In cases of two conflicting forms, this section controls over the prior two sections on standard forms and mass market licenses. The problem in conflicting forms cases is that, even though the behavior of the parties makes it clear that they intend to engage in a transaction, the terms of the forms disagree on the contracts. This results not from an error, but from the commercial practice of handling forms as if they are nonessential elements of the relationship.
2. This section modifies language in Draft Article 2 relating to the so-called battle of forms. The primary changes are:
a. First, in lieu of "expressly agreed" as used in

Draft Article 2, this section substitutes "manifested assent" as the standard to deal with assent to a conflicting term. The concept of manifesting assent to a record or a term runs throughout this draft and substitutes for the more subjective concept of "agreed". A party does not manifest assent by mere silence or retention of a form. Assent requires an affirmative act that reflects agreement to terms that the party had an opportunity to review and reject. See definition of "opportunity to review" and "manifest assent" in Section 2B-102.

b. Second, subsection (a) is amended to make clear that the context dealt with here involves use of two standard forms whose terms vary. This is the prototypical battle of forms and the problem to which this section addresses its provisions. If only one form exists, other sections apply even if one could argue that there was a prior oral agreement of the parties before the form entered into the deal.

c. Third, the section deletes a standard for inclusion based on knowledge or on expectation from course of dealing or trade use. That element injects uncertainty because, presumptively, the test only applies if terms conflict. Where there are conflicting terms, it seems anomalous to allow one to be included because of a general reference to course of dealing or trade use in the face of an express contrary term in the other form. Conflicting terms simply drop out.

3. This draft does not hinge any outcome as to terms of the contract on the language of the competing forms such as "ship only if you agree to these terms. Or "any terms outside of my own conflict with this form". In the conflicting form case, neither party actually reviews or reacts to the terms of the other except for the nonstandard quantity, price and shipment date terms. What effect an express reservation should have would be decided under a different section of this article dealing with whether there was an offer and acceptance with intent to be bound despite the conditional language and the conflicting terms.

4. Members of industry have argued that, in a conflict of forms case, the default rules should apply, but that the rule relating to consequential damages should be modified so as to exclude consequential unless expressly agreed to by the parties. This draft does not adopt that proposal.

SECTION 2B-310. ELECTRONIC TRANSACTIONS: TERMS.

(a) In an electronic transaction, the terms of a contract are:

(1) terms agreed to by the parties as applicable to the transaction prior to the exchange of the electronic messages;

(2) terms on which the electronic messages and electronic records of the parties do not conflict and terms on which they substantially agree;

(3) the supplemental terms incorporated under any other provisions of this article as to issues not otherwise made part of the contract by paragraphs (1) and (2).

(b) If terms included in a contract under subsections (a)(1) and (2) conflict, terms included under subsection (a)(1) control unless the electronic transaction involved review of the electronic message by an individual representing the party against whom the term is asserted and that individual manifested assent to the term contained in the message.

(c) Except as otherwise provided by terms included under subsection (a)(1) or (a)(2), if the subject matter of an electronic transaction is information content, neither party is entitled to consequential damages in the event of a breach by the other.

Uniform Law Source: None. First Appeared: Section 2-2202 (Licenses, September).
Selected Issue:

a. Should the terms of a form to which the licensee manifests accent over-ride the other form?

Reporter's Note:

1. Subsection (a) creates presumptions regarding the applicable terms. Its effect parallels that of the section on conflicting standard forms and the treatment of single standard form contracts. Essentially, the negotiated terms of an agreement control areas they cover, but beyond that, the electronic transactions is treated as a standard form transaction.

2. A negotiated agreement involving <u>individuals</u> who represent the companies controls. Next in order of priority are terms on which the electronic messages agree. Finally, the supplemental terms of the UCC apply.

Example: A agrees to make its database available to B with charges to be computed based on the type of information requested. The contract provides that B need not pay for information that is more than one week old. Later, B's computer initiates an electronic inquiry for data on the price of cotton. Its preprogrammed terms require information require a guaranty of accuracy. It does not mention price. A's computer provides the data in a message containing no contractual terms. The contract exists when the data are furnished to B's computer. The guaranty of accuracy does not become part of the contract, but supplemental UCC warranty rules apply. B need not pay for data more than one week old.

3. Subsection (a) provides a coordination concept between this section and the sections on standard form records (mass market and non-mass market). In essence, form provisions in an electronic transactions must comply with the terms of this section. After that step is completed, the conflict or priority resolutions sections of (b) apply.

4. Subsection (e) excludes consequential damages unless

contracted for by the parties. This is based on analogy to the treatment of wire transfers in Article 4A. The electronic contracting for information and data is an industry that is growing and that thrives on efficiency and low cost of distribution. The exclusion of consequential as a basic premise here creates a base from which this low cost growth can continue. Furthermore, in most cases, the vendors of this type of data are insulated from liability for content errors under general policy standards applicable to information industry participants. See Daniel v. Dow Jones & Co., 137 Misc. 2d 94, 520 NYS2d 334 (NY Civ. Ct. 1987).

C. Interpretation.

SECTION 2B-311. INTERPRETATION OF GRANT.

(a) A contract conveys nonexclusive rights to the licensee.

(b) Terms dealing with the scope and subject matter of an agreement must be construed under ordinary principles of contract interpretation in light of the commercial context. If the context and the terms are ambiguous:

(1) a grant of "all rights", "all uses", or similar terms without qualification covers all uses considered by the parties as well as all uses in reference to technologies then existing or that are developed in the future unless the language is limited by the contract; and

(2) subject to Section 2B-319 and 320, a contract grants all rights described in the contract and all rights within the licensor's control which are necessary to use the rights transferred in the manner anticipated by the parties at the time of the contract.

Uniform Law Source: None. First Appeared: 2-2204 (Feb. 1994).

Selected Issues:

a. Is an ordinary commercial interpretation appropriate for licenses or should an idea of licensor protection be followed?

Reporter's Note:

1. This section provides guidance on the interpretation of a license. It deals with two issues: exclusivity of rights and general interpretation approaches including the treatment of future technology applications and implied ancillary rights.

2. The grant to the licensee contains two elements: (1) an indication of what technology rights are transferred and (2) what restrictions are imposed on the licensee. Subsection (a) establishes the presumption that the licensor retains all rights not expressly granted to the licensee in that the license is treated as nonexclusive unless otherwise agreed. This is consistent with the view of a license as a limited transfer, creating a privilege to use rather than a property right in the transferee. See Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir 1988); Fantastic Fakes, Inc. v. Pickwick Int'l, Inc., 661 F.2d 479 (5th Cir 1981).

3. Subsection (b) provides two interpretation principles that deal with recurring issues in licensing practice. Subsection (b) requires application of ordinary contract interpretation principles to interpreting the scope of a license. There is some dispute about whether a federal policy exists to create a narrow interpretation that essentially interprets ambiguities in a license to favor maximum retention of rights by the licensor. That policy arguably stems from a view that one purpose of federal copyright law is to create and protect author's rights. This section rejects that view as a basic interpretation approach. If a federal policy to the contrary exists relating to copyrights or patents, that policy preempts ordinary commercial standards. In most cases, however, ordinary interpretation rules do not violate federal policy and the better reading of modern case law involving licenses applies ordinary rules in most cases. Contract law should enforce the choices of the parties. Ordinary plain meaning and similar concepts provide the predicate for analysis. Devlin v. Ingrum, 928 F.2d 1084 (11th Cir. 1991).

4. Subsection (d)(1) provides guidance for dealing with a recurring problem: whether a license grants rights only in existing media or methods of use of an intangible or whether it extends to future uses. This adopts the majority approach. 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. See § 2-2205.

5. Subsection (d)(2) states an obvious proposition: if a use is granted under the license, the license grant must encompass all applications necessary to use the rights expressly transferred in a manner reasonably anticipated by the parties at the time of the contract. This is not an implied license, but an approach to interpreting the contract.

Current Law:

6. In general, principles of contract law are applicable in the construction of copyright and patent licenses. 3 Melville Nimmer & David Nimmer, Nimmer on Copyright § 10.08 at 10.71 (1992). See Pearson Inc. v. Rust, Inc., 268 S.W.2d 893 (Ark. 1954); Republic Eng'g & Mfg. Co. v. Moskovitz, 376 S.W.2d 649 (Mo. Ct. App. 1964); Bartsch v. Metro-Goldwyn Mayer, Inc., 391 F.2d 150 (2nd Cir. 1968). Licenses that do not involve federal intellectual property rights are clearly

governed entirely by state contract law principles. See E.I. Du Pont De Neumours & Co. v. Shell Oil Co., 498 A.2d 1108 (Del. 1985). Some courts hold that federal policy affects the extent to which courts may use interpretation rules to infer transfers not express in the agreement. See Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir 1988). But federal policy does not preempt contract interpretation rules. Fantastic Fakes, Inc. v. Pickwick Int'l, Inc., 661 F.2d 479 (5th Cir 1981); Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150 (2d Cir.), cert. den. 393 US 826 (1968)

7. In SOS, Inc. v. Payday, Inc., 886 F.2d 1081 (9th Cir 1989), the court indicated that state law could not imply a grant of the right to make derivative works from software licensed for remote use only. Since SOS had drafted the license, Payday argued that common law principles required that the contract be interpreted strictly against the drafter. The Ninth Circuit rejected this, holding that the common law principle could not apply if it conflicts with the general principle under copyright that "licenses are assumed to prohibit any use not authorized." A leading Treatise argues that the SOS court improperly applied principles reserved for cases in which the question is whether a grant for one media covers new media. M. Nimmer & D. Nimmer, The Law of Copyright § 10.08.

8. In Apple Computer, Inc. v. Microsoft Corp., 759 F.Supp. 1444 (N.D. Cal. 1991) the question was whether a Windows user interface was protected by the earlier license agreement. The Court applied general contract principles that ambiguities are interpreted against the drafter and the idea under copyright that a grant should be interpreted narrowly to withhold rights not expressly granted. Both rules indicated a result contrary to Microsoft.

9. A number of cases employ a commercial reading of a license without discussion of federal policy overlays. SAPC, Inc. v. Lotus Development Corp., 921 F.2d 360 (1st Cir. 1990) (asset transfer agreement which used broad inclusive language conveyed all rights in a program and in related trade secret and competition claims; "party seeking to deviate from the terms of a broad and general conveyance [such as this] has the burden of proving the asserted specific exception."); Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150 (2d Cir.), cert. den. 393 US 826 (1968) (broad conveyance of motion picture rights encompassed all uses within the medium described by the license); Brown v. Twentieth Century Fox Film Corp., 799 F. Supp. 166 (D.D.C. 1992) (agreement precluding use of name, voice, or likeness in commercial uses did not bar use of clip of television program and mentioning performer's name); Bourne Co. v. Tower Records, Inc., 976 F.2d 99 (2d Cir. 1992) (extended period of use outside the terms of the grant potentially foreclosed assertion of rights against subsequent new uses of the licensed property).

10. In "new technology" cases, one asks whether a license made in one era covers new technologies not foreseen at the time. If the contract makes an express decision in one way or another, no problem arises. A license can cover all uses of a work including uses in as yet unidentified technology. No policy restricts full enforcement of an express intent to do so. If the contract is ambiguous, some courts use standard interpretation approaches, asking in effect: "Did the parties contemplate a license for this specific technology?" Phrased thus, the true answer often is that the parties had no contemplation

about new technology at all. Some courts approach this as an issue of policy: should we protect the licensee or the licensor? Melville B. Nimmer and David Nimmer, 3 The Law of Copyright § 10.10[B], 10-85 (1992). Alternatively, a court could ask the intent question not about a specific technology, but about whether the parties intended the grant to be broadly effective or narrow.

11. A grant of "complete and entire" rights in a particular medium indicates an intent that technology advances in that medium are covered. The licensor is attempting to cede all rights to the licensee. See Murphy v. Warner Bros. Pictures, Inc., 112 F.2d 746 (9th Cir. 1940) ("complete and entire" motion picture rights covers later sound picture technology); Platinum Record Co. v. Lucasfilm, Ltd., 566 F. Supp. 226, 227 (D. N.J. 1983) (videocassette rights covered by license to "exhibit, distribute, exploit, market, and perform [a movie containing musical composition] by any means or methods now or hereafter known."). Expansive language should be interpreted as an effort to cover most or all future uses associated with the granted right. See ABKCO Music, Inc. v. Westminster Music, Ltd., -- F. Supp. --, 1993 WL 505286 (S.D.N.Y. 1993) (a license giving the licensee "all rights" in copyrighted songs permitted the licensee to exploit newly developed technologies that were not in existence at the time the contract was written); Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150, 155 (2d Cir.), cert. denied, 393 US 826 (1968) ("[i]f the words [of the license] are broad enough to cover the new use ... the burden of framing and negotiating an exception should fall on the grantor" of the licensed rights).

12. A grant with a narrow definition indicates a more limited intent. Thus, a license granting rights to "exhibition of [a] motion picture [containing the work] by means of television," but reserving to the licensor "all rights ... in and to said musical composition, except those herein granted" would not cover later videocassette technology." Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir. 1988). See General Mills, Inc. v. Filmtel International Corp., 599 N.Y.S.2d 820, 821 (N.Y. App. Div. 1993) (License granting exclusive rights to exhibit "on television and in theaters without limitation" did not necessarily include the right to distribute the cartoon series on videocassette. This is an "entirely different device involving an entirely different concept and technology" from television, but television was in existence at the time of the license.); Tele-Pac, Inc. v. Grainger, 570 N.Y.S.2d 521 (N.Y. App. Div. 1991) (license to distribute motion pictures for "broadcasting by television or other similar device" did not cover video cassette rights. Court applied the "plain meaning" interpretation approach.); SAPC, Inc. v. Lotus Development Corp., 921 F.2d 360 (1st Cir. 1990). Compare Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir. 1988).

13. A second issue deals with to what extent rights not specifically mentioned in the license can be inferred as having been granted if essential to the intended use of the intangibles. If the client contracted to acquire the program and the licensor performed this contract, there is every basis to imply a license to use the program if the contract is silent or no written contract exists. See Effects Associates, Inc. v. Cohen, 908 F.2d 555 (9th Cir. 1990) (company that created and delivered footage impliedly granted nonexclusive license to use film); Yojna, Inc. v. American Medical

Data Sys., Inc., 667 F. Supp. 446 (E.D. Mich. 1987) (software contractor gave implied license to customer for use of management program). The scope of the license depends on how the parties performed their contract and on the terms of any written agreement. SOS, Inc. v. Payday, Inc., 886 F.2d 1081 (9th Cir 1989) (not imply a grant of the right to make derivative works from software licensed for remote use only). This implied right does not imply a conveyance of the copyright itself. Engineered Mechanical Services v. Langlois, 464 So.2d 329 (La. Ct. App. 1984).

SECTION 2B-312. IMPROVEMENTS AND ENHANCEMENTS.

(a) An information contract, other than a continuous access contract, transfers rights in information as it exists at the time of the transfer. A continuous access contract grants rights of access over the term of the license to the information as modified from time to time.

(b) In determining the licensee's right to make modifications, the following rules apply:

(1) In a license of digital or similar information, a licensee may make only those modifications or improvements contemplated or intended to be enabled by aspects of the information available for use in the ordinary course and such modifications as are necessary to the licensee's use in a manner authorized by the contract unless the contract expressly prohibits modifications.

(2) In a sale of a copy of information, the licensee may make any modifications consistent the intellectual property rights of the licensor.

(3) In a license of information not covered by subsections (1) or (2), the licensee may make only those modifications that are authorized by the license.

(c) If a contract contemplates redistribution of copies of the information in the ordinary course under the contract, the licensee shall distribute the information and any related documentation as received from the licensor.

(d) A licensee is not entitled to rights in improvements or modifications made by the

licensor and a licensor is not entitled to rights in improvements or modifications made by the licensee.

Uniform Law Source: None. Adapted from Mass. Bar Proposed Article. Previous: 2-2204 (Feb. 1994).

Selected Issues:

a. Should the redistribution language in subsection (c) be broadened or altered to accommodate cases where software tools are licensed to be redistributed in other products?

b. Does the general rule in subsection (b)(3) provide an appropriate back-up presumption in cases not governed by the other rules of that subsection?

c. Is it appropriate to go beyond federal law and grant to licensees of digital information a version of rights that are granted to owners under copyright law?

Reporter's Notes:

1. This section deals with contractual presumptions and enforceability relating to developments made after the initial contract is created. As in all other cases, the principles here are subject to contrary contractual terms.

2. Subsection (a) and (d) state the basic principle that no right to subsequent modifications made by the other party is presumed. Arrangements for improvements constitute a separate valuable part of the relationship handled by express contract terms. This presumption states common commercial practice.

Example: 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.

Example: 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.

3. Subsection (b) applies solely to digital information contracts and gives a licensee a presumptive right to make modifications necessary to its authorized use. This is consistent with the rights of an owner of a copy of a program under federal law, but applies here independent of title to the copy. Modifications, of course, may alter warranty protection.

4. Subsection (c) clarifies an important difference between end user and distribution licenses and makes a presumption that distribution licenses for software involve distribution of the package for the software as delivered.

5. This draft deletes former subsection (d) dealing with "grant-back" clauses and restricting the enforcement of those clauses based on concepts of commercial reasonableness stemming from common law concepts about invalid restraints on trade. The deletion leaves enforcement of such contracts to common law. A possible formulation

of such a clause would be:

> A term that transfers exclusive rights in new developments or modifications made by a licensee to a licensor who did not develop the improvements or modifications is enforceable only if reasonable. Such transfer is reasonable if new developments or modifications were an intended result of performance under the license. Otherwise, reasonableness of the term is determined in light of industry standards, the extent to which the developments are unrelated to the original transfer of rights, the rights left in the developer, and the terms over which the right extends.

Current Law:

6. There is no case law holding that a license conveys rights in future technology of the licensor unless the contract specifically provides. There are differences in how various types of intellectual property are treated in ownership or control over improvements made by the licensee due to differences in the scope of the intellectual property. See Roger Milgrim, Trade Secrets § 17.01; Raymond T. Nimmer, The Law of Computer Technology § 4.07 - 4.08.

7. If technology is protected under trade secret law, infringement occurs only if there is misappropriation. A person who discovers a secret without misappropriation is free to use it in his own work. Misappropriation occurs if the discovery and modification occurs by breach of a confidential relationship.

8. Under patent or copyright law, the proprietor has statutory rights that restrict the licensee or owner of a copy of a product. Actions that conflict with those rights and are not licensed by the proprietor constitute infringement. In both areas of law, however, the owner of a copy of the product may have a right to make modifications for personal use. The first sale exhausts some of the owner's patent or copyright to that item. For example, the owner of a copy of a book may underline, annotate or cut sections from the book without infringing the author's right to prepare derivative works. To the extent of these rights, the user can be said to own the modified item. The ownership rights are limited by the dominant statutory right and the owner of a copy cannot generally manufacture or make additional copies.

9. The Copyright Act grants the copyright owner the exclusive right to prepare "derivative works," but Section 117 authorizes the owner of a copy of a computer program to make adaptations of the program as "an essential step in the utilization of the computer program in conjunction with a machine." Copyright law restricts what the owner of the copy can do with the modified versions of the work. Furthermore, this ownership right does not apply to a license where the underlying copy of the work was not sold. Control over creation of derivative works is an exclusive right reserved to the copyright owner by the fundamental grant of copyright. This gives the copyright owner a direct right of control independent of license restrictions to the extent that modifications or adaptations create a derivative work.

SECTION 2B-313. LOCATION AND USE RESTRICTIONS.

(a) If an agreement does not specify the location where the licensee may use the

information, the amount of use permitted, or the purposes for which it may be used, the licensee may use the information for any purpose and in any location that is consistent with the intellectual property rights of the licensor.

(b) If the license limits the purposes, amount of use, location where use may occur or other characteristics of use, the licensee receives the right to use or otherwise employ the information in any manner consistent with the terms of the agreement and this article, but exercise of rights that exceeds the limits in the license constitutes a breach of contract.

(c) A contract for a copy of digital or similar information transfers only the right for a single user at a single time to use, copy or otherwise employ the information on a single information processing machine. Making or retaining additional copies in more than one machine or permitting simultaneous use by multiple users without authorization from the licensor is a breach of contract, except that a licensee may make a reasonable number of additional copies as back-up copies.

(d) In licenses not governed by (c), the licensee may only make such additional copies as are expressly authorized by the contract. In all other cases, the licensee may make such additional copies as it desires consistent with the intellectual property rights of the licensor.

Uniform Law Source: None. First appeared: 2-2212 (Licenses, Feb. 1994)

Reporter's Note:

1. This section adopts the relatively straightforward principle that, in the absence of express use restrictions or location restrictions, the transaction gives a licensee basically unfettered rights to use the information in whatever manner it desires. This principle, of course, is subject to over-riding federal intellectual property law restraints. The section establishes a presumption that the licensee can make any use that is consistent with the general context of the agreement and with the intellectual property rights retained by the licensor.

Example: Carter obtains a license to use the Mercer database software system. The transaction occurs in Texas, where Carter has its main offices. Under subsection (a), Carter can use the copy of the software in any location it pleases and for any purpose consistent with the type of use

licensed. However, making additional copies or allowing simultaneous use is not permitted unless specifically authorized.

2. Subsection (b) validates location and use restrictions. The enforceability of use limitations is well accepted in case law. It constitutes the underpinning of significant litigation dealing with the ability of a licensee to utilize third party maintenance providers despite contract provisions limiting use of software to the particular licensee company. See MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993). Limits on use by the licensee are major components in commercial software contracting. They can be sustained under general contract law concepts relating to the agreement of bargaining parties. Common restrictions in practice preclude use of software other than for "personal or corporate" internal use or at locations of CPU's not identified in the contract itself. Interestingly, a majority of computer law professionals responding to a survey indicated that they believed that a shrink wrap license should not be able to prevent the licensee from moving the licensed computer program among different locations. Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995)

3. The section also clarifies that use outside of the scope of the license constitutes a breach of contract. This resolves a controversy about whether exceeding the scope of a license constitutes breach of contract or is merely an infringement of the intellectual property rights. Both a contract and an infringement action are proper.

4. Subsection (c) creates a presumption applicable to all digital information products that a contract involving such products establishes a right for a single user single system use of the digital information. Beyond that however, it also establishes as a presumption an important benefit for licensees in that it allows the creation of a reasonable number of back-up copies in any transaction involving digital information. This contrasts to and expands on the end-user protections contained in copyright law which extend this right only to "owners" of a copy.

5. Subsection (d) creates presumptions as to back-up copies with respect to all transactions other than transfers of copies of digital information. The basic principle stated here holds that a combination of contract and intellectual property law determine the rights of the licensee in such cases.

6. Limiting the presumptive scope of a digital information license to a single user CPU, but creates a right to make a backup copy which right under current law exists only if the program copy was sold to the end user. Licenses for multi-users must state that scope. The section does not limit who the user may be, but assumes that multiple parties might be covered by the license so long as only one uses the program at a particular time. Whether the contract restricts use to a particular person is discussed elsewhere. Thus, for purposes of this section, a wife can permit her husband to use the software and a secretary is authorized to use by a license obtained by his employer. In each case, there is compliance with the contract so long as the two people do not simultaneously use the program.

7. The single CPU presumption fits with mass market and

commercial practices. The creation of multiple CPU or site licenses typically requires a specific agreement of the parties. The default rule in subsection (b) conforms to the opinions expressed in a recent survey of computer law professionals holding that a single loaded copy, a right to make a back up, and a limit to single user at a time was appropriate. Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995). A substantial majority rejected the idea that more than a single user at a time be permitted.

SECTION 2B-314. LIMITATIONS ON PARTIES.

(a) If an agreement does not specify or limit the parties or individuals to whom use of the information is restricted other than by identifying the licensee, the information may be used by any party authorized to do so by the licensee, but the party using the information pursuant to authorization is bound by the terms of the contract.

(b) If a license expressly limits the party or individual permitted to use the information pursuant to license, use by a party or individual other than the designated party or individual constitutes a breach.

Uniform Law Source: New
Selected Issue:
a. Should (b) apply to contracts other than a license?
b. What provisions should be made in the notes or otherwise to clarify how or when a limit to a particular party is intended?
Reporter's Note:
1. This section is designed to deal with both the use of licenses in family contexts and the use within a business. The principle adopted is that if the licensor desires close limits on who can use the information, it must expressly state those limits. This states the common expectation that a transaction gives uses that are not precluded. The comments to the enacted section will specify or describe language that triggers (or does not trigger) the terms of subsection (b).
2. An alternative approach would be to allow use by others only if the contract so provides. That approach might be reasonable in reference to some version of computer software, but not with reference to other forms of information. Equally important, if such an approach were adopted, it would presumably be necessary to except out from the rule all cases involving mass market licenses where use by related parties is not only common, but the absolute norm. Of course, the party restriction, of lack thereof, must be read in connection with the other default rules in this article and in light of underlying intellectual property law limitations.

3. Current law enforces express limitations in a license. See MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993).

SECTION 2B-315. NOTIFICATION OF RIGHTS ACQUISITION. **If an agreement requires the development or creation of information by the licensor, the licensor must notify the licensee that it used independent contractors in its performance. On request of the licensee, the licensor, prior to the transfer of rights, shall provide the licensee confirmation that all applicable intellectual property rights have been obtained from the independent contractors.**

Source: New. Recommended by ABA Task Force.

Reporter's Notes:

1. This section provides important protection for a licensee in development contracts. The basis for 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.

2. The section places an obligation on the developer of software in a development context to notify the licensee of the contractors used and to confirm that rights were acquired from each. The section will not apply to most mass market contracts because it relates to development contracts.

SECTION 2B-316. PLACE OF DELIVERY. **If an agreement requires delivery of a copy of all or part of the information to enable the exercise of rights by the licensee, the following rules apply:**

(1) If the agreement requires a transfer of an existing tangible copy to the licensee, the place for delivery of the copy is the licensor's chief place of business or, if there is none, the licensor's residence. If the agreement involves identified copies that to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery.

(2) If the agreement requires the creation of a copy, by electronic transmission or otherwise, in an information processing system of the licensee, the place for delivery is the system designated by the licensee. If no system for delivery is designated, the licensor fulfills its delivery obligation by making the information available to the licensee on an information processing system of the licensor and notifying the licensee of its availability.

Uniform Law Source: Section 2-308(1). Revised. First Appeared: 2-2215 (Feb. 1994).

Reporter's Notes:

1. Subsection (1) applies to cases in which the transfer of rights involves the use of tangible property to make the information available to the licensee. The rule stated in subsection (a) is from Article 2. It contemplates that the licensee will pick up the property from the licensor's location.

2. Subsection (2) covers electronic transfers. The obligation here differs depending on whether or not the licensee has designated a place (e.g., computer) in which the copy is to be created. If a place is designated in the contract, delivery requires the creation of the copy at that location. If none is designated, the licensor makes delivery by making available at its location the capability for the licensee to create the copy in its own location (e.g., making the information available for downloading). As noted in section 2-2101, the idea of delivery includes either a transfer of physical possession, or a transfer of control.

3. This section does not cover continuous access contracts because it refers to a contract that requires the transfer or creation of a copy. While copies may be made in performance, they are not required. Delivery is not a relevant term; the contract obligation involves making the information available for access.

4. The draft omits subsections 2 and 3 from Section 2-308 because sales of identified goods and use of documentary drafts are less pertinent to intangibles contracts than in ordinary sales of goods.

SECTION 2B-317. DURATION OF CONTRACT. An agreement that does not specify its duration is indefinite in duration. If an agreement is indefinite in duration, the following rules apply:

(1) If the agreement involved a sale of a copy of information or delivery of a copy pursuant to a mass market license, the contract rights of the licensee are perpetual, subject to cancellation for default by either party, but the term of any support or service obligation is

subject to paragraph (a)(2).

(2) In all other cases, subject to contrary federal law, the agreement is for a reasonable time, but may be terminated at will at any time by either party on reasonable notice to the other party.

Uniform Law Source: Section 2-309(1)(2). Previous: 2-2216 (Feb. 1994)

Reporter's Notes:

1. Subsection (a)(1) applies to mass market licenses and sales of copies of information where there is no agreement as to length of the license, but the transferee assumes that it owns the copy that it purchases. It enacts a presumption that fits with the standard or ordinary expectations of the licensee in such cases.

2. Subsection (a)(2) states the rule that currently applies in Article 2 and in common law regarding termination of indefinite contracts. See Zimco Restaurants, Inc. v. Bartenders & Culinary Workers' Union, Local 340, 165 Cal. App. 2d 235, 331 P.2d 789 (1958); 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). This applies to both nonexclusive and exclusive licenses. The section assumes a contract of indefinite duration and does not apply to term licenses.

3. The reference in subsection (a)(2) to contrary federal law highlights the fact that copyright law may bar enforcement of such a contract rule in the face of statutory provisions that restrict the termination of some licenses at will. In Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993). the Ninth Circuit held that the common law rule was preempted by the Section 203 provisions that indicate that a copyright license is terminable at the will of the author only during a five-year period beginning at the end of thirty-five years from the date of execution of the license unless it explicitly specifies an earlier termination date. 17 U.S.C. § 203(a). In cases where this applies, the license cannot be terminated at will. It can be terminated (or rescinded) under state law in case of a material breach.

4. Subsection (b) resolves an issue that arises with the advent of Article 2A and its redefinition of security interest. The definition of security interest gauges a lease as a security interest if it covers the entire economic life of the goods. In licensing, perpetual licenses are common and are not security interests even though they, by definition, cover the full life of the information as to that particular copy.

D. Confidentiality.

SECTION 2B-318. CONFIDENTIALITY NOT PRESUMED.

(a) A party is not obligated to retain in confidence information given to it by

another party.

(b) A license that creates conditions of confidentiality or nondisclosure is enforceable unless it imposes those conditions on information that is in the public domain or to continue those conditions in information that becomes part of the public domain other than through an act of the party on whom duties of confidentiality and nondisclosure are imposed. If the combination of
items of information, some of which may be in the public domain is not generally know, the combination is not in the public domain.

(c) If the circumstances or the agreement create conditions of confidentiality or nondisclosure, the party on whom the conditions are imposed may not disclose intentionally or knowingly the confidential information, except pursuant to an order of a court of appropriate jurisdiction, and shall exercise reasonable care to maintain confidentiality, including giving notice to the other party of its receipt of a court order that may cause disclosure of the information.

(d) The remedy for breach of a duty of confidentiality may include compensation based on the benefit received by the breaching party.

Uniform Law Source: Restatement (Third) Unfair Competition; UNIDROIT 2.16. First Appeared: 2-2207 (Sept. 1994)

Selected Issues:

a. Is it appropriate to extend enforcement of confidentiality to precontract negotiations even if no agreement is concluded?

Reporter's Notes:

1. Most information contracts that deal with potentially confidential material speak directly to confidentiality issues. In the absence of contract terms, a license in itself does not create a confidential relationship. Subsection (a) states this proposition. See, e.g, Hyde Corp. v. Huffines, 158 Tex. 566, 314 S.W.2d 763, 777 (Tex. 1958); Luccous v. J.C. Kinley Co., 705 S.W.2d 193 (Tex. App. 1985). This is consistent with the public interest in free flow of information that was most recently recognized in the Restatement (Third) of Unfair Competition on trade secrets.

2. Although this section recognizes no automatic implied duty in a license, the circumstances of disclosure, the terms of the agreement and the general relationship of the parties may create one. This is consistent with the Restatement (Third) of Unfair Competition.

Also, a general obligation of good faith exists under the UCC. In some cases, that obligation may prevent a licensee from undertaking steps made possible by the license to place itself in competition with the licensor. See, e.g., SAS Institute, Inc. v. S&H Computer Systems, 605 F. Supp. 816 (M.D. Tenn. 1985) (licensee violated good faith standard under common law by using licensed software to create competing product and then engaging in competition with licensor). Compare Conan Properties, Inc. v. Mattle, Inc., 712 F. Supp. 353 (S.D. N.Y. 1989).

3. This draft deletes former Subsection (b) which previously stated a principle adopted in UNIDROIT Principles of International Contract Law, art. 2.16. It clarifies common practice that confidentiality obligations, if created by the circumstances or an agreement survive a failure to reach final agreement in reference to the information contract. Indeed, many courts treat the negotiation stage as presumptively confidential and potentially creating implied nondisclosure obligations.

4. Subsection (b) follows both common practice in reference to confidentiality clauses and public policy considerations favoring free flow of information. This section, however, applies only to duties of nondisclosure or confidentiality, it does not disturb the general rule that royalties or other fees under a trade secret license continue to be enforceable even after the information enters the public domain. See Restatement (Third) of Unfair Competition. Subsection (c) excludes enforcement of nondisclosure agreements against truly public information. Such limitations are common in modern licenses, serving as a cap on the obligations that a licensor can place on a licensee. The information must be truly public, however, and the language in this subsection accounts for the possibility of so-called combination secrets where the essence of the secret lies not in the individual items of information, but in how they are brought together.

5. Although there is no implied duty of confidentiality, such a duty may arise from circumstances that establish an effort, communicated to the licensee, to keep material secret or that clearly indicate the expectation that secrecy will be followed. See Raymond T. Nimmer, The Law of Computer Technology ¶ 3.07[2][b]; Eden Hannon & Co. v. Sumitomo Trust & Banking Co., 914 F.2d 556 (4th Cir. 1990); Data General Corp. v. Computer Controls Co., 357 A.2d 105 (1975).

6. A duty of confidentiality may arise from express contract terms. See Telerate Sys., Inc. v. Caro, 8 U.S.P.Q.2d 1740 (S.D.N.Y. 1988). This often entails a nondisclosure clause. Under modern practice, nondisclosure clauses in licenses are generally not subjected to restrictions based on a court's conclusion that the agreement is or is not "reasonable."

7. Subsection (c) states an affirmative obligation if confidentiality is established. Intentional disclosure is always wrongful. The standard of care short of intention will vary depending on the type of transaction. For businesses, the appropriate standard relates to the standards of the relevant industry or trade and to the standards of care that the licensee maintains with reference to its own confidential material. Indeed, this latter standard is commonly mentioned in license agreements.

SECTION 2B-319. NO RIGHT TO UNDERLYING INFORMATION OR CODE. **A contract conveys no right to the licensee to receive the information or code used by the licensor in creating, developing, or implementing the information or the system by which access to the information is made available to the licensee. For purposes of this section, the term "code" means source or object code, schematics and other design material.**

Uniform Law Source: None. First Appeared: 2-2206 (Feb. 1994).
Reporter's Notes:

1. This section adopts the most common result in licensing practice. The license does not extend beyond the information actually made available to the transferee.

2. In software contracts, a license does not convey a right in the transferee to receive source codes or designs except to the extent that this right is expressly created in the contract. Source code, background data, designs and like information are often critically valuable and transfers of rights in such material cannot be lightly implied.

3. This section should be read in tandem with Section 2B- --- providing an interpretation rule that indicates that a license grant covers all rights necessary to achieve the expressly granted rights.

> Example: Computer Systems grants a license in its software to Tuggle Co., making the software available by a copy of the program on a disk. The license provides that Tuggle can "use the program in its accounting system" on a designated computer. This implies the right to use the machine code version of the program and to load it into the designated computer. Under this section, the license does not give Tuggle a right to demand source code for the program.

SECTION 2B-320. DATA RIGHTS IN ORIGINATING PARTY.

(a) If an agreement requires that one party deliver commercial, technical, or scientific data to the other for its use in performing its obligations under the contract or obligates one party to handle or process commercial data, including customer accounts and lists, and the receiving party has reason to know that the data has not been released to the public by the other party:

(1) the data and any summaries or tabulations based on the data remain the property of the party delivering the data or, in the case of commercial data, the party to whose commercial activities the data relate, and may be used by the other party only in a

manner authorized by the agreement; and

(2) the party receiving, processing, or handling the data has an obligation to use reasonable care to hold it in confidence and available to be returned to the delivering party or destroyed according to the terms of the agreement or the instructions of the delivering party.

(b) If technical or scientific data is developed during the performance of the agreement, the following rules apply:

(1) If the data is developed jointly by the parties, rights in the data are held jointly by both parties subject to the obligation of each to handle the data in a manner consistent with protection of the reasonable expectations of the other respecting confidentiality.

(2) In cases not covered by paragraph (1), the data is the property of the party that developed or created the data.

(c) On termination or cancellation of the contract, a party holding data that is the property of the other party must return the data to that party. The party may destroy data if the terms of the contract or the instructions of the other party so provide. The party holding the data must transfer a copy of the data to the each party with a property right in the data.

(d) Breach of an obligation under this section is a breach of the contract.

Uniform Law Source: None. Previously appeared: Section 2-2208 (Feb. 1994); 2-2207 (Prototype)

Selected Issues:

a. Should there be coverage of what rights co-owners of the data have under this section?

b. Should the party in possession of the data of another have a lien on the data to receive payment of fees under the contract?

Reporter's Notes:

1. This section deals only with data, a defined term referring to factual information. In effect, subsection (a) defines a contextual application of the principle in Section 2B-318 which arises when non-personal data are delivered to a party under circumstances indicating that they were not released to the public. The fact that

the data are delivered meets the standard for confidentiality and "ownership" if "the receiving party has reason to know that the data has not been released to the public by the other party".

2. 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 factual data to another in the course of the transaction. The default rule applies to cases involving data that has not been released to the public and that the recipient knows is unlikely to be released. The default rule presumption is that the data 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.

> Example: 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).

3. The contract principle is limited to commercial, technical, or scientific data. It excludes personal information. A significant debate exists about what restrictions should be created in reference to the receipt of personal information and its transfer across borders or use in commercial activities. Sauvant, International Transactions in Services: The Politics of Transborder Data Flows (1986). Since this is a contract statute, it is not appropriate to be involved in that debate. Exclusion of personal information from this section does not indicate a position that restrictions parallel to those outlined here should not be adopted as a basic or default principle in that other context.

4. The section does not deal with secondary use of information obtained in normal business operations not associated with a information contract. Thus, the ability of Master Charge to use as a mailing list any commercial information it obtained from its credit card operations is not dealt with in this section. That acquisition of data did not stem from a information contract. Case law suggests that as to the merchant involved, Master Charge has a right to use its purchase information for its own purposes unless expressly excluded.

5. The obligation to return the data at the end of the contract hinges not only on ownership, but also on the availability of a lien for money owed. See Computer Business Services, Inc. v. West, 627 S.W.2d 759 (Tex. Ct. App. 1981) (no deceptive practice where computerized bookkeeping service simply withheld returning data, but made no assertion about its legal right to do so); LTD Commodities,

Inc. v. Perederij, 699 F.2d 404 (7th Cir. 1983) (While customer may seek a mandated return of the data in context of a lawsuit, release back of the information or relevant software in that setting justifies a requiring that the customer post bond to supplant the valuable possessory lien). Possessory liens may exist under common law where the service provider added value to the property. In Chemical Bank v. Communications Data Servs., Inc., 765 F. Supp. 1401 (D. Iowa) (Supplier of data processing services held a lien pursuant to UCC 9-310). But see Mack Trucks, Inc. v. Performance Assocs. Corp., 381 Pa Super. 173, 553 A.2d 412 (Pa. Super. Ct. 1989) (software developer did not have artisan's lien on personal property delivered to it by customer because the developer did not add value to that property). Some courts not only disallow an implied lien in the data, but impose damages on the service provider who wrongfully retains the data in breach of contract as leverage to settle a contested debt. Magic Valley Radiology Associates v. Professional Business Services, Inc. 119 Idaho 558, 808 P.2d 1303 (Idaho 1991) (medical partnership properly terminated the contract, but the data service provider did not return the billing records as required under the contract; court affirms punitive damages for this action in addition to damages for breach of contract).

6. A possessory lien previously established under this section has not been widely supported. Although case law exists suggesting that such a lien exists in a number of states, it may not be appropriate to develop that concept in this article. The former language read:

(b) A party's obligation to return or destroy data under subsection (a) is subject to the party's right to retain the data:

(1) as security for the performance of any accrued and unpaid monetary obligations under the contract; and

(2) to the extent that commingling required or permitted by the contract makes return or destruction impossible without material harm to the property of that party.

The current draft assumes that the question of whether a lien is appropriate here hinges on other state law.

7. Subsection (b) states a principle regarding data developed during the contract. It does not deal with commercial data (such as customer lists, accounts and the like). The principle used here reflects general copyright law, but deals with a subject matter that is not covered by copyright law principles. The assumption is that joint development creates joint rights. In copyright law, this is the idea of co-authorship. The section does not specify the meaning of joint development, but courts would presumably apply principles developed for similar issues under copyright law. The alternative to joint development is that ownership of data for purposes of the contractual relationship and the contracting parties vests in the party who discovered, compiled or otherwise developed the information. The section excludes commercial data. If company A processes accounts for company B, the data should remain company B's property and the involvement of A does not rise to co-ownership. Some have argued that subsection (b) should be deleted.

E. Electronics.

SECTION 2B-321. ELECTRONIC SECURITY. If performance of an agreement involves a transfer of information in electronic form, communication of an electronic message, or electronic access by the either party to information processing facilities, each party must exercise reasonable care consistent with prevailing industry standards to exclude programs, extraneous

code, viruses, or data that may be reasonably expected to damage or interfere with the use of data, software, systems, or operations of the other party and that are not disclosed to the other party.

Uniform Law Source: None. First Appeared: 2-2225 (Feb. 1994).
Selected Issues:

a. Should the section specify a safe harbor for disclaiming this obligation?

b. Is it appropriate to refer to third party access or should this standard apply only to viruses and the like?

Reporter's Note:

1. In prior drafts, this section was a warranty. It is more appropriately viewed as an ordinary contract obligation where electronic performance or contracting occurs. Of course, the terms of the contract can exclude the obligation

2. This section sets out a basis to apportion liability for so-called viruses that might cause damage in electronic transfers including database and diskette based transactions. The risk of virus and other damaging codes in a transmission or on a diskette is increasingly significant in intangibles contracting. It has not yet resulted in significant reported litigation in a contractual setting, but modern licenses routinely deal with this risk in commercial agreements.

3. The liability principle focuses on reasonable care, rather than on absolute liability for the existence of extraneous harmful code or data. This allocation of loss better accounts for the myriad of risk possibilities that are present in modern systems. In cases where the parties desire a more absolute commitment from the licensor that commitment can be achieved through express contract terms.

SECTION 2B-322. INTERMEDIARIES IN ELECTRONIC MESSAGES

(a) A party who engages an intermediary to transmit, make available for access, or log electronic messages or data electronically, or to perform like services is liable for damages to the other party arising directly from the intermediary's errors or omissions in the performance of such services to the extent that such errors or omissions caused

reasonable reliance on the part of another party.

(b) A party who sends an electronic message through or with the assistance of an intermediary providing transmission or similar services is bound by the terms of the message as

received despite errors in the transmission unless the party receiving the message should have discovered the error by the exercise of reasonable care or the receiving party failed to employ an authentication system agreed to by the parties before such transmission.

Uniform Law Source: UNCITRAL Draft Model Law on EDI. Revised. First appeared: 2-213 (prototype)

Selected Issues:

a. What treatment should be given to unknown or gratuitous intermediaries such as will be involved in transactions occurring through the Internet?

Reporter's Notes:

1. This section deals with one form of the issues caused by an error or mistake in a transaction involving electronic contracting. The basic issue centers on responsibility for error by a third party (intermediary) brought into the transaction. Essentially, the party bringing the intermediary into the deal has responsibility for any errors that the intermediary makes.

2. This section does not deal with the intermediary's liability, leaving that issue to other law. The Committee may wish to consider whether this is appropriate.

3. Current law makes a distinction must be made between mutual and unilateral mistakes. See Restatement (First) of Contracts § 503. As a general common law principle, unilateral mistakes do not absolve compliance with a contract based, in part at least, on the assumption that each party should protect its own position in reference to the handling of errors and the like. This relatively ancient common law principle has been frequently readjusted in modern case law to hold that the unilateral mistake allows an avoidance of the contract if enforcement against the party making the mistake would be oppressive and recision of the contract would impose no substantial hardship on the other party. See 3 Corbin on Contracts § 608. See also Calamari & Perillo, The Law of Contracts § 9-27.

4. This formulation suggests the circumstances under which a mistake by the sender of an offer or an acceptance might avoid its mistaken consequences. Avoidance of those consequences comes most readily in cases where the receiving party had reason to know of the error or that party did not rely to its detriment on the mistaken message. The principle is simple enough. If the mistake caused no harm and was either discovered before reliance occurred or was so egregious that the other party could not in good faith not recognize it as an error, the person making the error should not be liable for it. This element of the doctrine is incorporated here.

5. A relevant consideration deals with whether the mistake was

caused by error of the sender or whether the mistake came in an error caused by the provider of a service that served as an intermediary. As between buyer and seller, in cases involving errors by telegraph companies, the majority approach is that the sender of the message is liable for errors created by the intermediary it chose to communicate the message unless the other party should have known that the message was mistaken. See discussion in Calamari & Perillo, The Law of Contracts § 2-24. See also 1 Williston on Contracts § 94. A minority position exists, holding that no contract exists in such a situation because the sender is not responsible for the actions of an independent contractor. Restatement (Second) of Contracts § 64, Comment b.

6. In Article 4A, in contrast, the UCC defines the intermediary for this purpose as an agent. The fundamental rationale for this approach to the problem comes from the fact that neither the sender nor recipient may have been at fault in creating the problem, but that some loss occurred and must be allocated to one or the other. In such a case, the proper choice is to place the loss on the sender unless the recipient was in fact at fault in not recognizing that an error existed.

7. In computer-based systems, as between the primary parties, there does not appear to be a current common law principle requiring the adoption and compliance with a security system to detect errors or fraud. Arguably, however, the failure to electronically discern an obvious mistake in a transmitted message may cause a court to conclude that the recipient "had reason to know" of the mistake and that its reliance on the verbatim electronic terms was not reasonable or protected. More generally, engaging in transactions requires, as a matter of prudent business conduct, the creation of an effective means to discover and prevent errors and fraud in the transactions.

8. Contractually, the parties can and should deal with both how the risk of error should be allocated and what type of security or other system should be in place as a means to detect and prevent mistake. One fully appropriate contract rule is to define a commercially acceptable security procedure and to then indicate that either party's failure to conform to the procedure shifts loss to that party in compliance with the procedure would have prevented the risk from occurring. This is the result created in UCC Article 4A.

SECTION 2B-323. ELECTRONIC REGULATION OF PERFORMANCE.

(a) Subject to subsections (b) and (c), in a license, the party entitled to enforce a limitation on use may include in the information or the copy thereof electronic or other device that directly restrict use inconsistent with the terms of the agreement if the contract authorizes it to do.

(b) In a mass market license, the contract term required in subsection (a) must be conspicuous.

(c) Express contract authorization is not for the use of passive code or symbols such as serial numbers or the like intended to enable detection of copies made or used by the licensee or

for electronic devices designed to notify the licensor of violations of license provisions without directly preventing this use from occurring.

(d) A party including a device to restrict or monitor use is not liable for any loss caused by operation of the device which merely restricts use consistent with the limits of the agreement. However, if operation of the device precludes use permitted by the agreement, the party including the devices liable for breach of contract.

(e) Unless the affected party manifests assent to a term allowing use, information obtained through a device used to restrict use or to monitor performance shall not be used for any purpose other than to restrict use consistent with the license or to monitor performance for purposes of providing services under an existing contract. Information concerning a party's actual use of the information, the context, or the environment in which use occurs shall not be transferred, made available to, or employed by the other party, except as directly related to enforcement or performance of contractual terms or intellectual property rights. The foregoing limitation does not apply to transactional information obtained in the ordinary course when initiating the transaction or to information regarding use of a system or site or a part thereof owned or controlled by the party monitoring use.

Source: New.

Selected Issues:

a. Is any restriction on the right to control use consistent with contract terms appropriate?

b. What restraints if any are appropriate in the use of information obtained through monitoring devices?

c. Should comments or section indicate what form of notice suffices?

Reporter's Notes:

1. This section does not deal with devices to close down

systems because of breach. It only deals with limitations that are gauged accurately to license terms. If the electronic limitations are excessive, there is a breach of contract. Electronic self help for breach of contract is dealt with in the remedies sections.

2. Subsection (a) authorizes the use of electronic limiting devices in a contract to enforce term and performance limitations. In software, for example, these might entail a calendar or a counter, either of which can be used to monitor time or use. It would also cover devices that monitor for the existence of multiple users. In order for such devices to be used, the licensee must be informed of and at least have an opportunity to object to the inclusion of the device. In mass market licenses, that opportunity must be given through conspicuous contract language.

3. The section focuses on active limiting devices, rather than on methods used to detect if a given copy comes from a specific original. To be a direct limiting device, the electronic method used must has the capability in itself of preventing uses of the information. In a recent case, a software vendor had included in its software code that caused the software to send an e-mail message to the vendor in the event that improper copying was occurring. That device would be a passive device under this section and does not require notice. Requiring notice in such cases would in effect defeat the impact of the antipiracy measure if the licensee chose to alter the code. Under subsection (e), however, the information sent to the licensor can only relate to the impending violation, unless the licensee agreed to the contrary.

4. Subsection (d) indicates that use of such a device to terminate a licensee's use of the information does not make the licensor liable for resulting loss unless the device operates in a manner inconsistent with the terms of the license. This latter event might occur, for example, if there is a one year license, but the automatic device cancels the computer program after only 11 months of use.

5. The provisions of subsection (e) limit the use of information obtained through the inclusion of monitoring devices. This has become a highly controversial current issue in software licensing. The provisions are designed to protect potential privacy interests of the licensee as to the configuration and use of its own systems, while still enabling a licensor to employ automatic means to enhance its ability to perform under the contract.

6. The last portion of subsection (e) clarifies that the restrictions only apply to cases in which a party places devices or monitoring systems in facilities or operated by the party being monitored. There is no intent to restrict the ability of a site owner or operator to monitor the frequency, nature, character or other use of its own resources.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY: AUTHORITY AND NONINFRINGEMENT.

(a) Except with respect to intellectual property infringement claims, the licensor warrants:

(1) that the licensor has authority to make the transfer and will not interfere with the licensee's exercise of rights under the contract; and

(2) that no party holds or will obtain as a result of an act or omission of the licensor any claim or interest that will interfere with the licensee's enjoyment of its rights under the contract.

(b) With respect to intellectual property infringement claims, a licensor who is a merchant in information of the kind warrants that the licensor has no knowledge that the transfer, any goods transferred by the licensor, or any use intended by the licensee and known to the licensor, infringes or will infringe an existing intellectual property right of any third party except as disclosed to or known by the licensee at the time of the transfer. This warranty does not apply to a pure license of a patent.

(c) A licensee who furnishes specifications to a licensor warrants that the licensee has no knowledge that compliance with the specifications as to matters covered by the specifications infringes or will infringe an existing intellectual property right of any third party, but is not liable for losses caused to the licensor arising out of the licensor's choice or method or approach to meet the specifications if more than one alternative existed and at least one of the alternatives would not be infringing.

(d) A licensor of intellectual property rights does not warrant that the intellectual property rights are valid or exclusive except that a licensor providing information for redistribution by the licensee warrants that the intellectual property rights are valid and exclusive.

(e) A warranty under this section is excluded or modified only by specific language or by circumstances giving the licensee reason to know that the licensor does not claim that

competing claims do not exist or that the licensor is purporting to transfer only such rights as it may have. Language in a record is sufficient if it states "There is no warranty of title or noninfringement in this transaction" or words of similar import.

Uniform Law Source: Section 2A-211; Section 2-312. Revised. First appeared: 2-2220 (Feb. 1994)

Selected Issues:

a. Is a no knowledge warranty appropriate and if so, should it be modified to cover "reason to know"?

b. If a no knowledge warranty is not appropriate, should the warranty be an absolute guaranty at all times or limited to the intellectual property claims existing at the time of the transaction?

c. Should the language in (b) relating to uses intended by the licensee be modified to refer to uses expressly permitted or authorized by the contract?

Reporter's Notes:

1. This section follows current law relating to authority, infringement and related issues. It uses Article 2A as a model because Article 2A deals quiet enjoyment and right to continue in use of property over the term of a relationship, rather than merely on the initial delivery. This section changes the Article 2A framework because title and infringement issues in intangibles entail more complexity than for goods. To clarify possible confusion, the next draft of this article will contain a definition of infringement specifically indicating that the term includes misappropriation of trade secrets and other confidential material.

2. Subsection (a) deals with issues other than intellectual property infringement. It has two aspects. First, the licensor represents it has authority to make the transfer. Second, the licensor will not interfere with the licensee's exercise of rights under the contract. This is the essence of the contract. General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175, 181 (1938). See Spindelfabrik Suessen-Schurr v. Schubert & Salzer, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. den. 484 U.S. 1063 (1988). The transfer contains an obligation that the transferor has a right to give that assurance and will not act contrary to it during the license.

3. Subsection (a)(2) states a warranty of quiet enjoyment respecting third party action or rights that might interfere with the licensee's use. It uses as a framework Section 2A-211, adapting that framework to the commercial expectations in intangibles contracts. The warranty is limited to acts caused by or attributable to the licensor. It does not require knowing misconduct, but does require that the problems arise because of action by the licensor.

4. Subsection (b) employs a "no knowledge" warranty for infringement claims. It excludes "pure licenses." In dealing with patents, there is no expectation that the licensor warrants that use of the intangibles will not interfere with or infringe third party rights. Instead, the transfer is viewed as a mere grant of freedom from a lawsuit.

Example 1: Client obtains a copy of a word processing program under license from Developer. Developer in fact created the program by copying existing code from a third party. That third party enforces its infringement claims against Client's copy. Client recovers from Developer.

Example 2: Client obtains a copy of a word processing program under license from Developer. Several months later, an independent third party obtains a patent on the process that the program creates. It sues Client for infringement. The claim does not breach the warranty.

5. The choice between a no knowledge and an absolute liability warranty in reference to infringement requires a balancing of the interests of the licensor and licensee in a situation where infringement claims may arise without direct fault of either party. Both in reference to copyright and patent infringement claims, the complexity of the technology, the diverse sources from which it arises and character of modern infringement claims that do not admit of good faith purchase and do not require knowledge of infringement all create significant risk in the modern commercial environment. The choice here is to place knowing misconduct risk on the licensor, but in cases where neither party had knowledge that an infringement would ensue, to allow loss to stay with the licensee if it is the party sued unless the contract reverses that allocation. No knowledge warranties are common in modern licensing. Additionally, in some cases at least, the article gives a licensee a right to obtain what amount to chain of title information from the licensor, at least with respect to claims of independent contractors. See 2B-315. Note that this is a contract provision, and that it does not alter current intellectual property law which recognizes neither a concept of bona fide purchaser defense to infringement, nor a lack of knowledge defense. Thus, in dealing with the case of a merchant who does not know about the infringement, either the licensee or the licensor may have infringement liability and this warranty will not redistribute the loss. A majority of computer law professionals responding to a survey believed that a mass market license should not be able to disclaim warranties that the licensor has a right to make the license and has no knowledge of an infringement. While the inability to disclaim is inconsistent with the contract freedom base of this article, this section creates warranties consistent with that viewpoint.

6. Subsection (b) extends the warranty to non-infringing uses of the intangibles. Under current law, in Article 2, if <u>use</u> of a machine that has been sold infringes a process patent, there is no breach of the non-infringement warranty since the machine itself is not an infringement. Given knowledge that the infringement would occur, there is no basis to deny recovery to the licensee.

Current law:

7. The idea of title has various connotations. The issues can be broken down into three parts:

<u>public domain risk</u>: Whether enforceable rights exist in the technology that is transferred. In essence, this asks whether there is any property to convey or whether the information and technology is in the public domain.

<u>exclusivity risk:</u> Whether the transferor has the sole right to transfer the technology or whether that right is also held by third parties by way of prior assignment, joint invention or coauthorship.

infringement risk: Whether the transferor can convey the rights defined in the contract in a way that enables the transferee to exercise those rights without infringing third party rights in the technology.

8. The "public domain" risk deals with the affirmation that the subject matter consists of rights controlled by the transferor and not in the public domain. Most contracts deal with this explicitly. If the transferee relies on the rights in creating a product for third parties, this affirmation is the entire deal. Copyright licenses commonly contain a representation that the subject matter is not entirely in the public domain and failure of this implied representation violates a warranty and yields a failure of consideration. M. Nimmer & D. Nimmer, The Law of Copyright § 10.13[A]. The analysis is not clear in patent licenses. The validity of the patent is subject to the fact that subsequent court or administrative actions may invalidate the claim. One can infer that there is a warranty or other obligation that the patent documentation shown to a licensee is real, but there is no warranty that the patent is valid and will remain enforceable. The presence of a public domain warranty is also not clear in licenses to an end user who plans to use the technology internally. The ability to exclude others has a less important role in defining the value to the transferee. Even if aspects of the work had been previously released to the public domain in their entirety, the licensee of software receives value when it acquires its own copy.

9. Current UCC Section 2-312 provides that every sale contains an implied warranty that the seller has "good title" to the property conveyed. The warranty exists unless expressly disclaimed. Case law holds that this does not cover a warranty that use of a machine will not violate a patent held by a third party. Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N.D. Tex. 1986). The warranty applies to the condition of the goods when delivered, not the use of the product.

10. Section 2A-211 speaks not in terms of a warranty of good title, but of implied warranties that (1) the goods are free of claims in the nature of infringement created by act or omission of the lessor that "will interfere with the lessee's enjoyment of its leasehold" and (2) that for lessors who are merchants in the particular type of property, "the goods are delivered free of the rightful claim of any person by way of infringement or the like."

11. The differences between Article 2 and 2A reflect the limited rights and interests involved in a lease as contrasted to a sale. They are applicable to the intellectual property rights distinction in assignments as contrasted to nonexclusive licenses.

12. The second title risk is that a portion of the rights may be vested in another person. Coequal rights exist where coauthors 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 conveyable by the third party coauthor. Depending on the underlying deal, 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.

13. The first draft of this article contained a subsection (e) which applied current law to allow the licensee to cease payments

where a patent or copyright was held invalid. That provision was deleted based on arguments that it is better left to judicial action and that, in many cases, a licensee continues to receive value from technology despite invalidation of the underlying property right.

14. Consistent with its expanded notion of privity, Draft Article 2 provides that the title warranty extends throughout the distribution chain. This section does not adopt a similar proposition for information products. That rule is an aggressive expansion of liability risk based on concepts of deep pocket protections that is not appropriate in the less well formed distribution system characterizing information.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) An express warranty by the licensor is created as follows:

(1) Any affirmation of fact, promise or description of the information made by the licensor to the licensee which relates to the information and becomes part of the basis of the bargain between them creates an express warranty that the information, the intellectual property rights, and any services required under the contract will conform to the affirmation, promise, or description.

(2) Any sample, model, or demonstration that is made part of the basis of the bargain between the licensor and licensee creates an express warranty that the performance of the information will reasonably conform to the performance that the model, sample, or demonstration illustrates, taking into account such differences between the sample, model, or demonstration and the information as it would be used as would be apparent to an ordinary reasonable person in the position of the licensee.

(b) Unless an express warranty specifically indicates to the contrary, an express warranty is limited to a representation about the information at the time of the transfer of rights.

(c) In the case of informational content distributed to the public, an express warranty does not arise with respect to the accuracy or quality of the content unless the licensor or its agent dealt directly with the licensee and made the express warranty to that

licensee.

(d) It is not necessary to the creation of an express warranty that the licensor use formal words, such as "warrant" or "guarantee", or that the licensor have a specific intention to make a warranty. However, an affirmation merely of the value of the information or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

Uniform Law Source: Section 2A-210. Section 2-313. Minor revisions from current law. Previous: 2-2221 (Feb. 1994)

Reporter's Notes:

1. In the Draft Article 2, treatment of express warranties has been controversial. This draft follows suggestions made, but not voted on, at the NCCUSL meeting that a draft closer to the original Article 2 would be preferable. These comments are especially important here since information products raise different policy questions about the nature and operation of the distribution chain than do goods. Also, retaining, with some modifications, the current Article 2 structure allows this area to draw on the relatively rich body of law existing under current Article 2.

2. This draft retains the "basis of the bargain" language used in current Article 2 and in Article 2A. The section has been modified to reflect three concerns.

a. First, especially in data processing or remote access licenses, and in information services, the traditions of the UCC regarding warranty law are not followed and are often not appropriate. This draft in subsection (c) eliminates any warranty regarding the <u>accuracy of the content</u> of a publicly available information product unless there is specific agreement between the parties.

b. Second, as a matter of practice, demonstration copies and uses are widely used, but their characteristics are not like that of the traditional models and samples used for goods. A demonstration of software operating a 500 item database will yield performance much different from actual use of the software in a 100,000 database. Courts could work their way through such differences, but the draft clarifies that demonstrations are to be viewed from a reasonable person perspective as to the obligations created.

c. Third, warranties are limited to the performance or condition at the time of first performance.

3. As a general rule, express warranties hold that commitments made by one party that become part of the agreement are enforceable representations. This concept transcends sales, leases or licensing law. It is an element of common law, although common law courts often do not describe the commitments involved as being "warranties."

4. In general, the cases dealing with <u>software contracts</u> apply traditional Article 2 express warranty rules. The basis of the bargain language in current Article 2 has not been litigated in

software contracts in any meaningful manner. See, e.g., Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. 1977); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495 (E.D.N.Y. 1984), rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986); Management Sys. Assocs. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985); Consolidated Data Terminal v. Applied Systems Inc., 708 F.2d 385 (9th Cir. 1983) ("the express statements warranting that the Regent 100's would perform at a 19,200 baud rate prevail over the general disclaimer."); Cricket Alley Corp. v. Data Terminal Systems, Inc., 240 Kan. 661, 732 P.2d 719 (Kan. 1987) (court enforced an express warranty that computerized cash registers would communicate with a remote computer; "capability to communicate with plaintiff's Wang computer was the prime consideration in selecting new cash registers.").

5. The applicability of warranty language outside software contracts is more questionable. The Restatement of Contracts does not use warranty law analyses to develop the obligations of the parties, but focuses instead on contractual or promissory obligations. In this Draft, such obligations are spelled out in other portions of the proposed article, much like in the Restatement. In reference to information and entertainment components, the applicability of warranty concepts is unclear. Information products (e.g., the daily newspaper) are seldom held to obligations of accuracy enforced through the liability without fault features of contract law (i.e. does the New York Times actually print "all the news that is fit"?). For products distributed to the general public, First Amendment concerns join with general policy concerns to lead to results that do not impose liability on content errors except in egregious cases or proven fault on the part of the information provider. This Draft does not deal with newspapers, but multimedia and continuous access systems make the line between software and information tenuous. As a result, opting for the policy that seemingly applies to publicly disseminated information products, this section and subsequent sections make clear that there is no warranty liability in reference to content accuracy unless that obligation is truly and expressly undertaken.

SECTION 2B-403. IMPLIED WARRANTY: QUALITY OF COMPUTER PROGRAM.

(a) Except as provided in subsection (b), if a computer program is delivered to a licensee and the licensor is a merchant with respect to programs of this kind, the licensor warrants that the program will perform in substantial conformance with any documentation or specifications provided by the licensor or agreed to by the parties at or before the delivery of the program and that any media on which the program is transferred will be of merchantable quality. However, an affirmation merely of the value of the

information or a statement of opinion or commendation of the information does not create a warranty.

(b) In a mass-market license of a computer program, a licensor who is a merchant with respect to computer programs warrants that the computer program and media are merchantable. To be merchantable, a computer program or media must:

(1) be fit for the ordinary purposes for which it is distributed;

(2) run, within the variations permitted by the agreement, of even kind, quality and quantity, within each unit and among all units involved;

(3) be adequately contained, packaged, and labeled as the agreement or circumstances may require; and

(4) conform to promises or affirmations of fact made on the container or label if any.

(c) The warranties under subsections (a) and (b) do not extend to informational content that is supplied with or that constitutes part of the information.

Uniform Law Source: Section 2-314. Revised. First appeared: 2-2222 (Feb. 1994)

Selected Issues:

a. Is the internal documentation standard appropriate for non-mass market products?

b. Is there a need to distinguish documentation and puffing statements which should not create a warranty?

c. Should (a) extend to non-merchant licensors?

Reporter's Notes:

1. This draft states a preference for the substantial conformance to documentation standard for non-mass market software, rather than the general merchantability standard. That preference is based on extensive commentary received from participants in the industry and from the conclusion that this form of warranty is the one most commonly used in commercial software licenses. The reliance on conformance to documentation reflects the wide range of variations involved in commercial software and the general unworkability of the merchantability concept in that venue because of a lack of clear consensus about the basic, ordinary underpinnings of the various types of software involved.

2. As to mass market products, however, an implied merchantability warranty applies. It differs from the analogous warranty in sales law in that there is no general reference to "pass

without objection in the trade". This is left out because, even among general mass market products, there exists a wide variance in what content and performance is expected from software products. Beyond that, however, the intent is to conform generally to sales law in this mass market environment. This is part of an overall approach that seeks to narrow the divergence in legal concept in cases where there are pronounced similarities between the information product and ordinary goods.

3. This section treats performance warranties. Performance warranties relating to information blend two disparate traditions regarding what obligations are implied. One tradition stems from the UCC and focuses on obligations about the quality of the product. This tradition centers on the <u>result</u> delivered to the transferee: a product that meets ordinary standards of performance. The alternate tradition stems from common law, including case law relating to licenses, services contracts and information contracts. This tradition focuses on the manner in which a contract is performed, the <u>process</u> rather than the result. It assumes that the obligations of the transferor are to perform in a reasonably careful and workmanlike manner unless it expressly agrees to a greater burden. Under current law, these traditions apply or not depending on characterizations about whether a transaction involves <u>goods</u> or not. That distinction is not reliable and does not extend to this article in light of the ability to transfer information electronically without the use of any tangible property to carry the intangibles. This and the next following section seek to define a different basis on which the two different traditions apply.

4. This section applies to "computer programs" "delivered" to the licensee. Delivery does not presume the preexistence of a tangible copy. Rather, it might occur through electronic transmission or through physical delivery.

5. Within the category of products that carry a warranty of ordinary quality (result), a further issue exists about whether the implied warranty in a commercial agreement should be in terms of "merchantability" or of substantial conformance to "documentation." For consumers, merchantability is the standard because in the mass market, the proper reference point for determining fair quality is by reference to other similar products.

6. Most negotiated agreements disclaim merchantability; there are few reported commercial cases involving merchantability. 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.

7. Merchantability measures performance obligations by reference to other like products, while the documentation warranty measures performance by what the licensor says about its product.

Current Law:

8. Current law imposes implied <u>warranties</u> in some licenses and implied <u>obligations</u> in other cases. To understand modern case law, we

must distinguish two types of license. The first is a "pure license" that grants permission from one party to another, allowing the licensee freedom from a lawsuit for use of intangibles the licensor controls. This contract typically contains no relationship other than the promise to not sue and carries no expectation of implied performance warranties. The second is a "commercial" license that consists of additional elements enabling the licensee to use intangibles. Warranty and other performance obligations are greater in a commercial license, but decrease in more a pure license. See, e.g., Berkert v. Petrol Plus of Naugatuck, 216 Conn. 65, 579 A.2d 26 (Conn. 1990).

9. The law on performance obligations ranges across warranty in the U.C.C., common law warranty and negligence rules. The word warranty is not a clear concept. It is better to think in terms of performance obligations, than warranty. The word warranty "illustrates as well as any other the fault of the common law in the ambiguous use of terms." 5 S. Williston, A Treatise on the Law of Contracts § 673 (3d ed. 1961). "To say warranty is to say nothing definite as to legal effect." K. Llewellyn, Cases and Materials on the Law of Sales at 211 (1930). Restatement (Second) of Contracts discusses contracts without mentioning warranties. Restatement (Second) of Torts § 299A states that: "one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade ..." Williston earlier commented that in every services contract there is a promise that the work will be done with reasonable care. Williston, A Treatise on the Law of Contracts § 1012C (3d ed. 1961).

10. Articles 2 and 2A assume the vendor will deliver a product of acceptable quality. An implied warranty of merchantability exists unless disclaimed if the seller (or lessor) is a merchant engaged in selling (or leasing) goods of a particular type. The implied warranty is that the products would pass without objection in the trade under the contract description and are fit for the ordinary purposes to which such goods are used. The product need not be perfect. Breach of warranty turns on separating acceptable flaws from defects that go beyond the ordinary. See Neilson Business Equipment Center, Inc. v. Italo v. Montelone, M.D., 524 A.2d 1172 (Del. 1987).

Common Law

11. Under current law, some software licenses and data processing contracts are treated as contracts for services or as information contracts. See 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"). Most courts reject the position that a licensor or other provider of discretionary services warrants or commits to produce an accurate result in its contract unless it expressly undertakes to do so. See Milau Assoc., Inc. v. North Avenue Devel. Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); Chemical Bank v. Title Services, Inc., 708 F.Supp. 245 (D Minn 1989). Many courts hold that no warranty exists because they equate a warranty to the idea of a warranty of result (or quality product) as exists in sales of goods. See Rosos Litho Supply Corp. v. Hanson, 123 Ill. App.3d 290, 462 N.E.2d 566

(Ill. App. 1984). The majority holds that the licensor commits only that it possesses the skill that it represents itself to have and that it will exercise that skill in a workmanlike and reasonably careful manner. A warranty of result can be created expressly or it may be implied if the contract does not require an exercise of judgment. See Southwestern Bell Telephone Co. v. FDP Corp., 811 S.W.2d 572 (Tex. 1991).

12. A workmanlike effort warranty does not create strict liability. The workmanlike conduct warranty is often indistinguishable from tort law liability for negligence. The Restatement (Second) of Torts § 299A provides: "one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade ..." The rule applies to anyone who undertakes to provide services in a skilled trade such as airline pilot, precision machinist, electrician, carpenter, blacksmith, or plumber. The reasonable care standard does not apply to a contract for goods; it is supplanted by product quality warranties that create a presumption of a warranty of result. See Air Heaters, Inc. v. Johnson Electric, Inc., 23 UCC Rep.Serv. 39, 258 N.W.2d 649 (N.D. 1977); USM Corporation v. Arthur D. Little Sys. Inc., 28 Mass. App. 108, 546 N.E.2d 888 (Mass App 1989).

13. The obligations involve (a) an implicit representation that the service provider has the skill to complete the task and (b) an obligation to apply that skill with reasonable care and diligence. Diversified Graphics, Ltd. v. Groves, 868 F.2d 293 (8th Cir. 1988); Micro Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988). The court in Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) noted: "Those who hold themselves out to the world as possessing skill and qualifications in their respective trades or professions impliedly represent they possess the skill and will exhibit the diligence ordinarily possessed by well informed members of the trade or profession ..."

SECTION 2B-404. IMPLIED WARRANTY: INFORMATION AND SERVICES.

(a) If a licensor provides services, access, data, data processing, or the like, there is a warranty that the licensor warrants that there is no inaccuracy, flaw or other error in the informational content caused by a failure of the licensor to exercise reasonable care and workmanlike effort in its performance in collecting, compiling, transcribing, or transmitting the information.

(b) The warranty under subsection (a) is not breached merely because the licensor's performance does not yield a result consistent with the objectives of the licensee or because

the informational content is not accurate or is incomplete.

(c) The warranty under subsection (a) does not apply where the failure to exercise reasonable care or workmanlike effort causes errors in informational content if:

(1) the licensor made the informational content generally available to the public and the licensee acquired the content in that manner;

(2) the informational content is publicly available in United States Patent and Trademarks Office;

(3) the informational content is merely incidental to a transfer of rights and does not constitute a material portion of the value in the transaction; or

(4) the informational content was prepared or created by a third party and the licensor acting as a conduit makes available the informational content in a form that identifies it as being the work product of the third party, except to the extent the lack of care or workmanlike

effort that caused a loss occurred in the licensor's performance to the informational content. In such cases, however, any liability of the third party under this section is not excluded by the use of a conduit.

Uniform Law Source: Restatement (Second) of Torts § 552. Revised.
First appeared: 2-2223 (Feb. 1994)
Selected Issues:

a. Should a warranty impose absolute liability for information content?

b. Is the exclusion for liability for publicly distributed information content appropriate or should it be limited to publishers?

c. Under subsection (c)(2), should other public records be included?

d. If liability exists, should damages be limited to direct loss or to the cost of the transaction?

Reporter's Notes:

1. This section states the implied warranty with respect to "information" and services. This warranty is intended to apply to transactions in which a court under current law might conclude that the license did not involve a transaction in goods. Another way of stating the warranty would be: "...licensor warrants that there is no inaccuracy, flaw, or other error in the information caused by a failure of the licensor to exercise reasonable care and workmanlike

effort in its performance ....." This is consistent with the Restatement.

2. This warranty derives from case law on services and information contracts. Restatement (Second) of Torts § 552 regarding negligent misrepresentation provides framework against which most modern information contracts are tested in terms of what performance is acceptable. The contract obligation consists of a commitment that the information provided will not be wrong due to a failure by the services provider to exercise reasonable care in the compilation, collection or transmission of the data. 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 and in light of contractual disclaimer).

3. Under subsections (a) and (b) 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).

4. Although the workmanlike performance standard is analogous to a negligence standard, the warranty creates a contract obligation. It is like merchantability in that it measures performance against a standard based on ordinary behavior (or, in the case of merchantability, ordinary products). Courts and parties will refer to external information to gauge the nature of the obligation unless disclaimed. Yet, merchantability refers to an ordinary result, while this warranty refers to an ordinary effort.

5. This is an implied obligation. The parties can agree to a greater or lesser obligation.

6. Subsection (c) lists situations in which the warranty does not arise under current law. Each exception deals with a policy choice that balances the desirability of creating greater assurances of accuracy in the information marketplace against the desirability of avoiding direct or indirect blockage of the free flow of information to the public.

7. Subsection (c)(2) corresponds to modern patent practice.

8. Subsection (c)(4) incorporates 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 may apply to create liability. 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). Subsection (c)(4) clarifies that the licensor is not absolved from its own negligence.

9. The issue of liability 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., -- F.Supp. --, 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.

10. Subsection (c)(1) adopts a policy that prevents liability without fault or on the basis of mere negligence in cases of information provided to the public. This principle needs to be carefully evaluated in reference to information providers that do not merely provide conduits of information, but also provide substantive development. Most of the reported cases that absolve public information providers from liability deal with entities whose primary (often, sole) role involves the publication of data compiled by others. In some cases involving highly technical information products (e.g., air charts), some courts do impose liability on a publisher/ author of the data. One can compare that result, however, to a general refusal to hold newspapers liable for errors in data causing economic loss. The policy proposed here pushes for free flowing information at a potential cost in its accuracy, at least in cases of truly public distribution methods.

11. Of course,tort law plays a role in setting liability standards. The idea of negligent misrepresentation does impose liability in some cases, but modern courts are of many different minds about how far and in what context such liability is appropriate for general publications. Many require proof of a special relationship to establish liability. The current draft Restatement on products liability notes that information is not a product for purposes of the strict liability law.

12. Cases on information providers whose information proves to be inaccurate involve both contract and tort theory. Transactions in information generally do not create liability without fault. For liability, the information provided must be inaccurate or incomplete, but the error must relate to some culpable conduct by the licensor.

13. For data processing and design or consultation work, the basic focus for gauging liability centers on the process, rather than on a guaranty of correct result. For example, in gauging the liability of a computer systems consultant, the court in Diversified Graphics, Ltd. v. Groves, 868 F.2d 293 (8th Cir. 1989) applied a negligence standard, bordering on a malpractice test for determining whether the consultant bore responsibility for the selection of an inadequate system. 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) 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..."

14. A consultant or another who provides information to a client as part of the provider's business and whose negligence causes wrong information to be given to the client may be liable for the lack of care. This liability or performance obligation often stems from tort law. The Restatement (Second) of Torts § 552 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 some states, even between contracting parties, negligent misrepresentation will not apply 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).

15. Under current law, the approach to information contracts often hinges on what characterization a court places on the contract itself. While many cases treat data processing and data services contracts as services agreements, the court in Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992) treated a data processing contract as involving a sale of software modified for the client's data processing needs. See The Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993) (contract providing for over four years of data processing and software development services was a transaction in goods within Article 2 under New Hampshire law.)

16. The court in Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) 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 concluded that concepts of negligent misrepresentation applied to this form of information service. SP suggested that it was merely selling a product, but the court concluded that while "S & P Indexes have been considered salable products, we do not believe that it sheds its character as information used to guide the economic destinies of others."

17. Information products also involve a focus on the extent the information involves public dissemination. Most publicly distributed information products are protected by the First Amendment ad even when this is not directly true, they fall within a general policy concern about not hindering the general free flow of information. Liability for private or limited distribution information does not raise constitutional concerns if the topic does not involve public issues or public figures. See Dun & Bradstreet v. Greenmoss Builders, Inc., 472

U.S. 749 (1985). There is at state law an unwillingness to extend information liability without fault and an even more basic unwillingness to impose liability on persons who disseminate information to a relatively broad public, even if the information is wrong and causes serious harm. 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). Publishers of inaccurate content often have no liability for its errors, while even developers of the content do not have strict, no fault liability.

SECTION 2B-405. IMPLIED WARRANTY OF FITNESS.

(a) If a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the licensee is relying on the expertise of the licensor to develop, design, select, compile, or substantially modify the information to meet the licensee's objectives or purposes, the licensor warrants that it will use reasonable care and workmanlike effort to achieve those objectives or purposes.

(b) In contracts governed by subsection (a), the licensor warrants that the licensor will produce a product of quality and performance suitable for the licensee's particular purposes if:

(1) the contract of the parties so provides; or

(2) from all the circumstances and actions of the parties, it appears that the licensor agreed not to be paid in full for its work unless the information was fit for the purposes to which the licensee intended to put them.

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.
First appeared: 2-2224 (Feb. 1994)
Selected Issues:

a. Is the choice of basic rule, derived from services contract law, appropriate or should the article presume correct completion of the licensee's intended result?

b. Under subsection (b), if there is a failure to achieve the licensee's intended result, should damages be limited to nonpayment?

c. Is there a better standard to shift the focus of the contract than that set out in subsection (b)?

Reporter's Notes:

1. This section deals with development and design contracts. Design contracts involving software are a setting in which litigation is common over whether the contract involves goods or services under current law. This choice determines the implied obligations.

2. Courts differ on when special design projects yield a

services or information contract or a contract involving goods (albeit specially designed). The choice is often less related to the character of the transaction than to the comfort of the court with the UCC which are accessed only if a transaction is a sale of goods. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 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).

3. Development contracts are covered by this chapter without regard to classification of the contract as one involving services of goods.

4. Under current law, the distinction between goods and services affects the applicability of the implied warranty of fitness. Services contracts involving custom design do not call into play a warranty that the result of the services fits the licensee's purposes. This is because the focus of such contracts in law is on the process of performance, rather than the outcome. See Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); 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 viewed as inconsistent with the nature of the contract. Fitness of outcome can be contracted for only as an express warranty. In contrast, custom contracts treated as sales of goods may create implied warranties of fitness pursuant to UCC 2-315 if the vendor's expertise is relied on by the vendee. See USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 108, 546 N.E.2d 888 (1989).

5. This section balances two results. The default rule in subsection (a) follows the traditions of services contracts. Most development contracts contain disclaimers of the implied fitness warranty, replacing that implied obligation with warranties about results expected in the contract. This section does not affect express warranties of fitness.

6. A warranty of fitness exists in two cases spelled out in subsection (b). The first merely states that an express warranty can transform the licensor's obligation into one that commits to produce a particular result for the licensee. Subsection (b)(2) sets out a new approach to determining when or whether the implied commitment to a particular result is appropriate. The goal is to state a reference point for courts that focuses on the reality of the transaction, rather than on the pseudo distinction between goods and services. The proposed reference asks whether, from all the circumstances, it appears that the licensor agreed to not be paid in full unless the software was fit for the intended purpose.

SECTION 2B-406. EXCLUSION OR MODIFICATION OF WARRANTIES.

(a) Words or conduct relevant to the creation of an express warranty and words or

conduct tending to negate or limit the warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301, words negating or limiting a contract are inoperative to the extent that such a construction is unreasonable.

(b) To exclude or modify an implied warranty arising under Section 2B-403 or 2B-404, the language must be in a record, conspicuous, and mention "merchantability", "reasonable care", or similar terms. Language that mentions either "merchantability" or "reasonable care" is sufficient as to both warranties.

(c) To exclude or modify a warranty of fitness, the exclusion must be in a record and be conspicuous. Language excluding all implied warranties of fitness is sufficient if it states "There is no warranty that the subject matter of this transaction will be fit for any particular purpose of the transferee" or words of similar effect.

(d) All implied warranties are excluded by the expression "as is", "with all faults", or other language that in common understanding or under the circumstance calls the licensee's attention to the exclusion of warranties and clearly indicates that there is no implied warranty.

(e) If the licensee before entering into the contract examined and tested the information or an adequate sample or model thereof as fully as desired, or has refused to examine the information, there is no implied warranty with regard to defects or errors that an examination should in the circumstance have revealed.

(f) An implied warranty may be excluded or modified by course of dealing, course of performance, or usage of trade.

(g) If a contract requires ongoing performance or a series of performances by the licensor, language of exclusion that complies with this section is effective with respect to all performance that occurs after the licensee manifests to the language of exclusion.

Uniform Law Source: Section 2A-214. Revised. First appeared: 2-2226 (Feb. 1994)

Reporter's Notes:

1. At the July, 1995 NCCUSL meeting, a sense of the house motion was passed to eliminate the distinctions between consumer and commercial protection present in Article 2. This section implements that vote.

2. The Sales Committee in October, 1995 discarded the rule that a warranty disclaimer must be in a record and conspicuous. The Committee voted to require conspicuousness only in cases involving standard forms. This vote was taken with an explicit exception for consumer transactions which will be reviewed by a separate subcommittee. The change leaves a serious concern about mass market transactions, some of which are not in fact documented by records. If the record requirement is dropped, the section might provide:

(b) If the language of exclusion is contained in a standard form record, the language must be conspicuous and conform to the following rules:

(1) To exclude or modify an implied warranty arising under ----- the language must be in a record, mention "merchantability", "reasonable care", or similar terms, and be conspicuous. Language that mentions either "merchantability" or "reasonable care" is sufficient to both warranties.

(2) To exclude or modify a warranty of fitness or system integration, the exclusion must be in a record and be conspicuous. Language excluding all implied warranties of fitness or system integration is sufficient if it states "There is no warranty that the subject matter of this transaction will be fit for any particular purpose of the transferee except as specifically provided for in the contract of the parties" or words of similar effect.

(3) All implied warranties are excluded by the expression "as is", "with all faults", or other language that in common understanding or under the circumstance calls the licensee's attention to the exclusion of warranties and clearly indicates that there is no implied warranty.

(c) Language of exclusion contained in a record other than a standard form need not comply with the provisions of subsection (b), but language that does so comply is adequate to exclude the warranties.

SECTION 2B-407. MODIFICATION OF SUBJECT MATTER. Modification of a computer program by the licensee voids any warranties, express or implied, regarding the performance of the program unless the licensor previously agreed that the modification would not void the warranty or the modification involved use in the intended ordinary course of operation of capacities existing in the program. A modification occurs if a licensee alters or adds code to the computer program.

Uniform Law Source: None. First appeared: 2-2227 (Feb. 1994)

Reporter's Notes:

1. This method of losing warranty protection applies only to warranties related to the performance or results of the software. The basis for the provision lies in the fact that software systems are complex and that changes may cause unanticipated and uncertain results.

2. 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 refers to modifications intending to cover 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.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES. Warranties, whether express or implied, must be construed as consistent with each other and as cumulative. However, if that construction would be unreasonable, the intent of the parties determines which warranty prevails. In ascertaining that intent, the following rules apply:

(1) Exact or technical specifications prevail over an inconsistent sample, model, demonstration, or general language of description.

(2) A sample, model, or demonstration prevails over inconsistent general language of description.

(3) An express warranty prevails over inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

Source: 2-2228 (Licenses, September); 2-2409 (prototype)
Reporter's Note: The policies expressed in Section 2-317 apply to the intangibles context without change.

SECTION 2B-409. THIRD PARTY BENEFICIARIES OF WARRANTIES.

(a) A warranty made to or for the benefit of a licensee extends to persons for whose benefit the licensor intends to supply the information directly or indirectly and who use the information in a transaction or application in which the licensor intends the information to be used.

(b) For purposes of this section a licensor is deemed to have intended to supply the information to any natural person who is in the family or household of the licensee if it was reasonable to expect that this person may rightfully use the copy of the information

delivered to the licensee.

(c) An exclusion, modification, or limitation of the warranty or of rights and remedies, which is effective against the licensee is also effective against any beneficiary under this section.

Uniform Law Source: Section 2-317; Section 2A-215. Slight changes.
First appeared: 2-2228 (Feb. 1994).
Selected Issues:

a. Should this article adopt a broader perspective creating quasi-tort liability or simply deal with intended contract beneficiaries?

b. Should there be a specific ability to exclude intent to supply the information to any person other than the license?

Reporter's Note:

1. This draft adopts a third party beneficiary concept. It does not deal with the scope of tort liability under other law. For a discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994). Subsection (b) modifies beneficiary concepts to include the family of a licensee regardless of intent in reference to the licensor.

2. Unlike in goods, the willingness of courts to avoid privity restrictions and impose third party liability through tort or contract theory has been extremely limited in information products. The Draft Restatement on products liability recognizes this, noting that information is not a product for purposes of that law. While there may be a shift to include embedded software in traditional products this article does not deal with embedded products. The section states basic contract law.

3. Restatement (Second) of Torts § 552 establishes a limited third party liability structure for persons who provide information to guide others in business decisions. It states, in relevant part:

> (1) One who, in the course 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 upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) ... the liability stated in Subsection (1) is limited to loss suffered
>
> (a) 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
>
> (b) 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 a number of states, no liability arises under this theory of action unless there is a "special relationship" between the information provider and the injured party.

4. In reference to third party liability various other standards that could be applied, but 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) (adopts Restatement test in dealing with auditor liability; "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. The receipt of such notice justifies imposition of auditor liability for conduct that is merely negligent."). 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.

5. 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. See also Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817, 824 (3rd Cir. 1951).

6. In Berkert v. Petrol Plus of Naugatuck, 216 Conn. 65, 579 A.2d 26 (Conn. 1990), for example, a GM trademark license for transmission fluid required licensee to produce product that met performance tests, but did not control ingredients. The court held that warranties only exist for a seller of goods; absent more than passive involvement, GM was not a seller. The court rejected common law warranty and tort: "[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...."

7. In Porter v. LSB Industries, Inc., 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993) a holder of a trademark on a lathe could not be held liable either in strict products liability or negligence for injuries suffered by a lathe operator, premised solely on its status as trademark holder. Products liability cannot be imposed on a party that is outside the manufacturing, selling, or distribution chain. See also 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).

8. In Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W.D. Pa. 1991) (16 UCC Rep. Serv.2d 38) the defendant provided designs, technical advice and drawings along with a license to operate a process for converting solid zinc into zinc dust. Operation of the plant caused the death of an employee, leading to a lawsuit against the licensor on various bases, including a breach of warranty claim. The court rejected this claim, characterizing the transaction as a contract for services (as compared to goods) and holding that no "warranty" exists in such contracts.

9. 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 properly 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).

10. Where the subject matter of the contract involves information, constitutional considerations and general considerations of policy often limit liability at least in respect of the liability of the publisher (as compared to the author). See Winter v. G.P. Putnam's Sons 1991 WESTLAW 124588 (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.

PART 5

TRANSFER OF LICENSES

SECTION 2B-501. TITLE.

(a) Transfer of title to or possession of a copy of information does not transfer ownership of the intellectual property rights in the information.

(b) Regardless of title, a licensee's right to possession or control of any copy of information depends on its compliance with the information contract.

(c) Title to any copy of information delivered to the licensee is determined by the contract. In the absence of contractual provisions, title to a copy of information passes when the copy is delivered to the licensee.

(d) A reservation in the licensor of title to a copy of information reserves title in the original copy and in any copies made by the licensee from the copy in which title is reserved.

(e) If a licensee receives ownership, control, or possession of a copy of information from the owner of intellectual property rights or an authorized person, the licensee receives all rights in, and is subject to all the duties regarding the copy that are provided for in the

contract. In

addition, a licensee who becomes an owner of the copy has all of the rights of an owner of a copy under applicable federal law.

(f) If the parties agree that ownership of intellectual property rights will pass from the licensor to the licensee under the contract and the contract does not specify when ownership vests in the licensee, ownership vests when the information has been so far completed or identified to the contract as to be distinguishable in fact from other similar property even if it has not been fully completed and the transfer of rights or any required delivery has not yet occurred. The licensee may not exercise ownership rights until it pays for the rights transferred according to the terms of the contract.

Uniform Law Source: Section 2-401; section 2A-302. Revised. Previous: 2-2301 (Feb. 1994).

Reporter's Notes:

1. Subsection (a) distinguishes title to the tangible property from title to the information intellectual property rights. This parallels the Copyright Act. Title to goods does not convey title to the information contained on the goods.

2. Subsection (b) states an important premise. The right to use and retain a copy of information depends on the terms of the license and not on the label one applies to handling underlying media. The media here is not the message, but the conduit. The license and the conditional nature of the transaction it creates dominate. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (Copyright licenses transferred only limited rights for exhibition or distribution of films for limited purpose and limited time did not constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license does not create a first sale; second less clear agreement creates jury issue on this question).

3. Subsection (c) provides that title to goods that are a copy of the information passes on delivery to the licensee. However, that rule is subject to variation by contract. A reservation of title in a license agreement is effective to reserve title. This compares to Article 2 which provides that a reservation of title in a sale is not effective, except to create a security interest. The difference is that the transaction referenced here is a license and centers on the information, rather than ownership of the goods. Reservation of title to the media is an important element coordinating license practice with federal first sales concepts which may limit what rights can be retained against the licensee.

4. This article should consider whether an electronic transfer of a copy constitutes a sale of that copy for purposes of state law. The alternative would hold that the copy created electronically is, in

effect, owned by the licensor even though it possessed by the licensee and there are no contract provisions stating that title is reserved. A recent White Paper report on copyright in the information age would agree with this latter result.

5. Subsection (e) restates first sale concepts and implied license rights. Under current intellectual property law, title to a copy can be important under federal copyright and patent law. Certain property rights held by the owner of the copyright (or patent) are eliminated by a first sale of a copy of the work or the patented invention. These property rights are eliminated only as to that copy. 17 U.S.C. § 109. A similar shift of property rights occurs when a copy of a computer program is sold. 17 U.S.C. § 117. The owner of the copy can exercise some rights with respect to that copy that would otherwise violate the copyright. Those rights are limited and do not abrogate the entire copyright. A first sale requires that the transfer pass title. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977). Similarly, the section 117 rights apply only to the "owner" of a copy. See, e.g., Midway Mfg Inc. v. Arctic Int'l, Inc., 704 F.2d 1009 (7th Cir. 1983); Hubco Data Products Corp. v. Management Assistance, Inc., 219 U.S.P.Q. 450 (D. Idaho 1983). See also R. Nimmer, The Law of Computer Technology ¶ 1.18[1]. This section does not affect property law concepts, but states a premise relevant to the extent that contract principles apply. Contract law principles are not affected by determinations of whether or not title was transferred in the copy of a program or other intangible.

6. Current case law does not define whether a contract supersedes or can exclude the rights that a first sale would create for the owner of a copy. In part this is because the agreement of the parties in itself not only establishes license terms, but also determines whether or not a sale occurs. The better view is that a valid contract can condition property rights. Subsection (e) states as a default rule the premise that the copy owner's rights are those granted in the agreement and any rights created under the applicable federal law unless otherwise agreed thus allowing for the possibility that contrary agreement may convey away those federal property rights, but not mandating that this be the case.

7. In Vault Corp. v. Quaid Software, Ltd., 847 F.2d 255 (5th Cir. 1988) the Fifth Circuit invalidated on preemption grounds a state statute that authorized specific license terms in conflict with the rights created by Section 117. The lower court had held that, without the validating statute, the contract itself would have been an unenforceable contract of adhesion under applicable state law. See Foresight Resources Corp. v. Pfortmiller, 719 F. Supp. 1006 (D. Kan. 1989) (dicta suggesting that where there was a sale of a copy, rights under section 117 cannot be eliminated by contract). In Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992) the Federal Circuit concluded that a contract limiting the buyer's use of a patented item to a single use was enforceable as a matter of contract law regardless of whether a "sale" occurred.

8. Subsection (f) deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a particular copy). In some cases, federal law requires a writing to make this ownership transfer and the provisions of subsection (d) would obviously be subject to that over-riding limitation. The subsection resolves the problem

addressed in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) where the 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 sufficient completion that allows one to separate out the transferred property from other property of the transferor. This deals with the rule applied in In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) which disallowed a transfer of title in software where the "new" program and code could not be separately identified from the old or pre-existing program or code. Subjection (d), since it deals with intellectual property rights, is subject to contrary federal law in reference to rights created under patent and copyright statutes.

SECTION 2B-502. ASSIGNMENT OR TRANSFER OF PARTY'S INTEREST.

(a) A licensee's rights under a nonexclusive license may not be assigned or otherwise transferred voluntarily or involuntarily, by sale, attachment, levy, or other judicial process unless:

(1) the contract with the party who holds or controls the intellectual property rights in the information expressly permits the assignment or other transfer;

(2) the party who holds or controls intellectual property rights in the information consents to the transfer;

(3) the transfer is part of a transfer of all or substantially all of the assets of the licensee to one transferee and the transferee assumes all of the duties, obligations, and limitations of the license; or

(4) the license was a mass-market license, the licensee owned the copy of the information, and the licensee transfers that copy and all other copies made by it pursuant to the license or applicable intellectual property law to its transferee.

(b) A licensor's rights under a contract may be assigned unless:

(1) the assignment transfers rights in information provided on a nonexclusive basis to the licensor by the licensee or owned by the licensee and the conditions of subsection (a) are not met; or

(2) the assignment would materially change the duty of the licensee, materially increase the burden or risk imposed on the licensee, disclose or threaten to disclose trade secrets or confidential information of the licensee without its authorization, or materially impair the

licensee's chance of obtaining return performance.

(c) A transfer by either party of the right to receive payment from the other is not prohibited by this section unless there is a delegation of a material performance of the party making the transfer.

(d) In cases not governed by subsection (a), (b), or (c), a party's rights may be assigned unless the assignment would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose or threaten to disclose trade secrets or confidential information of the other party without its authorization, or materially impair the other party's chance of obtaining return performance.

Uniform Law Source: Section 2A-303. Revised. First appeared: 2-2303 (Feb. 1994)

Reporter's Notes:

1. The provisions of subsection (a) 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. Comments need to clarify that assignment here means a complete transfer of rights under the agreement as that term is understood in intellectual property law, rather than the conditional assignment concept common in Article 9 financing.

2. Subsection (a) adopts current law which holds that a licensee cannot assign its rights in a nonexclusive license. For patents and copyrights, this represents federal policy. See 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 limited 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).

3. Most of the exceptions in subsection (a) illustrate cases in which a transfer is permitted under current law. Subsection (a)(4) deals with the rights of an owner of a copy of a computer program under copyright law 17 U.S.C. § 117 (1988). The copy owner may transfer its copy so long as it does not retain other copies made pursuant to section 117. A substantial majority of computer law professionals responding to a survey supported the transferability of mass market licensed products. Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995).

4. Subsection (a)(3) creates a new rule that was suggested by a broad majority of persons who commented on the February 1994 Draft. It creates a presumption (subject to contract terms that preclude it) that a transfer of substantially all of the assets of the licensee is a setting in which the licensee rights can be transferred without

consent of the licensor. This has become a major issue in modern merger practice and the proposed language provides a commercially sustainable solution that enhances the ability of parties to engage in commercial contracts that affect license rights.

5. Rights created under an exclusive license or under an assignment of intangibles are generally subject to subsequent conveyance unless there is a material relationship between the individual party and the value of the contract to the other party. See In re Sentry Data, Inc., 87 B.R. 943 (Bankr. ND Ill. 1988) (test for a nonassignable contract turns on whether there is a special reliance, special relationship or fiduciary relationship at the core of the contract. An exclusive license to market software did not create such a relationship since performance did not depend on special action by the licensee. This exclusive license apparently did not involve any obligation to protect trade secrets, but merely an obligation to market a product.

6. Under subsection (b), licensor rights are assignable under standards applicable to contracts generally except in cases where the licensor holds rights in or possession of intangibles of the licensee (e.g., cases where the licensee delivers data to the licensor for processing). This latter case in effect treats the "licensee" as a "licensor" for intangibles it provided to the licensor.

7. Subsection (d) states the basic rules relating to transfers not governed by other subsections (e.g., sales of information, exclusive licenses, assignments). This hinges the ability to assign rights on whether or not the transfer works a material change relevant to the other parties' position. The subsection stems from Section 2-210(2) which provides: "Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party or increase materially the burden or risk imposed [on the other party] or impair materially his chance of obtaining return performance." The subsection specifically refers to threats to confidential information and trade secrets as a basis to deny transferability in order to remove any doubt that the other party's interest in its confidential material predominates over the right to make a transfer.

8. Subsection (c) enacts a rule from Article 9. This permits transfer of the right to receive payment unless that transfer also makes a material change in the relationship of the parties. The goal is to permit financing arrangements in reference to payment streams with or without prior contractual authorization. Section 9-311 provides: "The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." Section 9-318(4) provides: "A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or requires the account debtor's consent to such assignment or security interest."

SECTION 2B-503. SECURITY INTEREST.

(a) The grant or enforcement of a security interest in a licensee's interest under a nonexclusive license is ineffective unless a transfer of the licensee's interest would be effective under Section 2B-502(a) or (c).

(b) The grant or enforcement of a security interest in a licensor's interest under an contract or in its ownership interest in the information governed by the contract is effective except to the extent that:

(1) it creates a delegation of a material performance of the licensor; or

(2) the transfer extends to information in which the licensee has intellectual property rights.

(c) To the extent a security interest is precluded by subsection (a) or (b), the grant or enforcement of a security interest is effective if the party not involved in creating the security interest consents to the creation of the security interest.

Uniform Law Source: Section 2A-303. Revised. First appeared: 2-2303 (Feb. 1994).

a. Should there be a distinction between creation of a security interest and enforcement as to priority and validity?

b. Should the provisions on security interests and the like reflect the optimal approach that should be created if federal law would change to reflect this, or should they be drafted to reflect the best approach given currently existing federal law?

Reporter' Notes:

1. Subsection (a) states the premise that a security interest in a licensee's rights is not effective unless a transfer of those rights would be effective. This limits security interests in rights other than the right to receive money under a contract. It also allows transfer if the licensor consents in the agreement or otherwise.

2. Current UCC Section 2A-303 contains lengthy provisions on transfer which in effect apply an expanded version of the policy in Section 9-311 that all "rights" are subject to transfer and that a contract provision holding otherwise is ineffective against third parties. Section 2A-303 deals with a situation in which one presumes a right to transfer and proposes standards for the enforcement (or non-enforcement) of contract provisions that restrict transfer. The goal apparently was to make for the broadest range of transferability possible (especially in reference to security interests) without impinging substantively valid considerations about performance on the part of either party to the contract.

3. Subsection (b) deals with transfer of a licensor's rights. Here, there is no federal policy prohibiting transfer. The rule

adopted is that the transfer is effective unless is would materially affect the licensee by creating a delegation of material performance or by transferring rights which affect intangibles of the licensee. The pre-existing licensee's rights are preserved under the section dealing with priority in such cases.

SECTION 2B-504. DELEGATION OF PERFORMANCE; SUBLICENSE. **A party may delegate or sublicense its performance under a contract unless the other party to the contract has a substantial interest in having the original promisor perform or directly control the performance required by the contract, or the contract prohibits delegation or sublicense.**

Uniform Law Source: Section 2-210; Section 2A-303. Revised. Previous: 2-2303 (Feb. 1994) .

Reporter's Notes:

This Section deals with delegation of performance (as contrasted to assignment of rights). It follows the principles of current UCC Section 2-210(1) which permits delegation of performance unless the contract provides otherwise or the other party has a substantial interest in having the promisor perform. Delegation does not absolve the party making the delegation of its obligations under the original contract.

SECTION 2B-505. EFFECT OF ASSIGNMENT OR DELEGATION. **Unless the transfer is merely for security, acceptance of an assignment, delegation or sublicense of rights**

created under a contract constitutes a promise by the transferee to perform the duties of the party whose interest is being conveyed. The promise is enforceable by the party making the conveyance or by the other party to the information contract. Unless the other party to the information contract agrees, the assignment, delegation, or sublicense of the interest of a party to a contract does not relieve that party of any duty to pay or perform or any liability for breach.

Source: Section 2-2306 (Licenses, September); 2-2504 (prototype).

Reporter's Note:

This section implements a policy in current Article 2. 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.

SECTION 2B-506. CONTRACTUAL RESTRICTIONS ON TRANSFER. Contractual restrictions or prohibitions on transfer of an interest in a contract or of a licensor's ownership or intellectual property rights in the information that is the subject of a license are enforceable except as follows:

(1) If the licensee becomes the owner of a copy of the information, a term in a mass-market license which prohibits the transfer of the copy and all rights in that copy is not enforceable to the extent that the prohibited transfer is allowed under applicable federal intellectual property law relating to the rights of an owner of a copy after a first sale.

(2) A term that prohibits a party's assignment of an account, prohibits creation of a security interest in a general intangible for money due, or requires the other party's consent to such an assignment or security interest is not enforceable.

(3) A term that prohibits creation or enforcement of a security interest in an interest of a party under a contract or in the licensor's residual interest in the information is not enforceable unless the creation or enforcement of the security interest would:

(i) result in a delegation of material performance of either party in violation of the contract;

(ii) be prevented under Section 2B-503 if the term were not present; or

(iii) transfer an interest in information in which the other party to the contract holds intellectual property rights.

(4) Breach of a provision that prohibits voluntary or involuntary transfer of an interest of a party under a contract or that makes the transfer a breach gives rise to the remedies for breach and a transfer made in breach of the term is ineffective.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8). Revised. First appeared: 2-2305 (Feb. 1994).

Selected Issues:

a. Should the invalidation provisions of subsection (4) apply to other transactions in this part of the article?

Reporter's Note:

1. Subsection (1) is changed from prior drafts based on comments from ABA reviewers that a more blanket prohibition on anti-assignment clauses would violate concepts of freedom of contract and would prevent the evolution of electronic and other contracting practices. As drafted, subsection (1) applies to cases involving the first sale in the mass market.

2. Article 2A limits transfer restrictions in order to enhance the ability to use leases and leased property for financing. The Drafting Committee should review that policy for our agreements. As a general matter, however, the desirability of restricting in a commercial contract statute the enforceability of contract terms in arm's-length bargaining is unclear unless cogent reasons exist to do so or to believe that the agreements do not reflect truly bargained for positions. There is no evidence on this issue in respect of information contracts.

3. A prior Draft presented two options. Option 1 stated a position in favor of freedom to contract. It retained the policy in Article 9 regarding the right of parties to transfer interests in their right to receive money under a contract. Option 2 brought together provisions of Article 2A-303 which deal with limitations placed on the enforceability of contract restrictions on the transfer of rights and interests in an intangibles contract. This Draft opts for the freedom of contract provided in original option 1.

4. Current UCC Section 9-318(4) provides: "A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or requires the account debtor's consent to such assignment or security interest."

5. Subsection (3) limits the impact of provisions that restrict creation of a security interest to cases where that restriction would be otherwise prevented or would affect the party allowing the interest to occur and was without its consent.

6. Subsection (4) as revised rejects the Article 9 premise that transfers made in violation of a prohibition on transfer are nevertheless effective. That rule stems from a basic presumption that transfers of goods should be free and unencumbered, while in dealing with information, intellectual property and confidentiality concerns often yield the opposite, baseline presumption. The rule as drafted more closely corresponds to current case law.

SECTION 2B-507. PRIORITY OF TRANSFERS BY LICENSOR.

(a) A licensor's transfer of its ownership in the information or intellectual property rights associated with the information, other than by the creation or enforcement

of a security interest, whether voluntary or involuntary, is subject to a nonexclusive license if the nonexclusive license:

(1) is represented by a record signed by the licensor and executed prior to the transfer of ownership;

(2) involved a transfer of rights accomplished by delivery of a copy to the licensee and the transfer of rights was completed prior to the transfer of ownership; or

(3) was a mass-market license in the ordinary course of the business to a licensee and was made without knowledge of the transfer of ownership.

(b) A security interest created by the licensor or a transfer of ownership made through the enforcement of such security interest in the information or in copies of the information has priority over any nonexclusive license unless the nonexclusive license:

(1) involved a transfer of rights completed prior to the time that the security interest was perfected;

(2) was authorized by the secured party; or

(3) involved a transfer of rights in the ordinary course of the licensor's business.

(c) For purposes of this section a transfer, including the creation of a security interest, for which federal law requires registration or other recordation to attain priority against other transfers of ownership does not occur until the registration or recordation occurs.

Uniform Law Source: Sections 2-402; 2A-304. Revised. First appeared: 2-2306.

Selected Issue:

a. Should there be a distinction between creation of a security interest and enforcement as to priority and validity?

Reporter' Notes:

1. This section deals with an area that involves an interaction of federal and state law as well as a question of allocating treatment of state law issues among the various articles of the U.C.C. 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.

2. 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.

3. 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.

4. 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 possession of 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.

5. Even if this position is not correct, the priority rules developed here would be applicable to all intangibles other than copyrights, leaving a wide variety of important situations to be addressed here.

6. The policy of Copyright Act § 205(f) in reference to unwritten licenses protects the person who acquires a copyright against the risk that other parties will fraudulently claim to have obtained nonexclusive rights in the copyrighted work. This is a typical statute of frauds rule. Subsections (a)(1) and (a)(2) deal with the same type of issue and carry the federal policy forward to situations in which the risk of fraud is present. They condition the licensee's priority on the presence of a signed writing or on delivery of a copy of the intangibles to the licensee. Subsection (a)(3) expands on this to protect interests created in the ordinary course of mass market transactions. It is not appropriate to expect a small business or a consumer purchaser of a copy of Word Perfect to check registration records or obtain consent from a transferee of the Word Perfect copyright. While licensing law generally does not employ concepts of ordinary course protection, that protection is clearly appropriate in reference to mass market transactions.

7. Subsection (b) carves out treatment for security interests. Modern case law does not completely answer whether security interests are "transfers" of ownership under federal law to require registration in federal systems for priority against other transferee. Nimmer & Krauthaus, Secured Financing and Information Property Rights, 2 High Tech. L.J. 195 (1988). The answer apparently differs for patent and copyright law. See City Bank & Trust Co. v. Otto Fabric, Inc., 83 B.R. 780 (D. Kan. 1988); In re Transportation Design & Technology, Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985); In re Peregrine Entertainment, Ltd. 116 B.R. 194 (C.D. Cal. 1990). This section treats creation of a security interest as a transfer of ownership but this position does not affect whether under applicable federal law a security interest would be similarly defined.

8. 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. As this is written, a number of competing proposals are being considered in Congress to alter current federal law on security interests and registration rules.

9. This section does not deal with priority among transferees of transactions that federal law treats as transfers of ownership (i.e. the relative position of an exclusive licensee and an assignee). In copyright and patent law, federal law provides a registration system and priority rules governing exclusive licenses and assignments (described as transfers of ownership in the patent or copyright itself). These are being reviewed by various groups at this time.

10. The Drafting Committee should decide whether to address the non-federal law topics or to leave them to general common law. Common law is virtually non-existent on this issue and, therefore, entirely unclear. If the Drafting Committee decides to address conflicting positions of two transfers of ownership in non-federal intangibles, it should not mirror federal law. Federal law entails a registration and a relation-back grace period. These are inconsistent with modern commercial law.

11. For purposes of discussing this issue, the following alternative provisions may be an appropriate basis for discussion:

[Discussion Option 1]

(b) Unless otherwise required by applicable federal law, exclusive licenses and other transfers of ownership in intangibles made voluntarily or involuntarily by the licensor rank in priority in order of the time the transfer occurred, except that a subsequent transfer of rights takes priority over an earlier transfer if the subsequent transfer occurred in the ordinary course of the transferor's business.

[Discussion Option 2]

(b) Unless otherwise required by applicable federal law, exclusive licenses and other transfers or ownership in intangibles made voluntarily or involuntarily by the licensor rank in priority in order of the time at which the transfer of rights occurred.

SECTION 2B-508. PRIORITY OF TRANSFERS BY LICENSEE.

(a) In cases subject to sections 2B-502, 503, 504, or 506, a creditor or transferee of a licensee acquires no interest in information, copies of that information, or any other rights held by a licensee pursuant to a information contract, by judicial process, contract or otherwise, unless the conditions of those sections for an effective transfer are met.

(b) A creditor or other transferee of the licensee who obtains an interest in information, copies or other rights held by the licensee pursuant to a information contract takes that interest subject to a license or other information contract and to the rights of the licensor if the transfer of rights occurred before the creditor or other transferee acquired its interest.

(c) Subject to subsection (d), a licensee who acquires a copy of information from a party who is a merchant dealing in property of that kind to whom copies were transferred

by a remote licensor, obtains all of its transferor's rights in the copy. It takes its interest free of the contract between the other remote licensor and the licensee's transferor if the licensee acquired the copy in the ordinary course of its transferor's business, in good faith and for value.

(d) A licensee under subsection (c) is subject to the intellectual property rights of the remote licensor, the terms of any contract with that licensor to which it assents, and any terms of the contract between the licensor and the merchant of which the licensee had notice within a reasonable time often beginning to use the information.

Uniform Law Source: Section 2A-305; section 2-402. Revised. First appeared: 2-2306 (Feb. 1994). Also Section 2-2309 (Licenses, September); 2-2507 (prototype)

Reporter's Notes:

1. As a general principle, a license does not create vested rights and is not generally susceptible to freely be transferred on in the stream of commerce. This principle is implemented in paragraph (a) with respect to unsecured or similar creditors who seek to obtain an interest in the intangibles by judicial process. This section holds that the judicial lien creditor does not obtain an interest in intangibles that are held through an nonexclusive license unless the license or the circumstances fulfill the conditions for transferability spelled out elsewhere. One consequence of this premise, which is the current law applicable to nonexclusive licenses, is that the licensee's rights in a patent or copyright license are not property of a bankruptcy estate under normal conditions. See In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W.D. Tenn. 1987).

2. Subsection (c) derives from Section 2A-305(1) and deals with voluntary transferees (e.g., buyers, secured creditors, sublicensees). In general, the transferee is subject to the terms of the license contract. The transferee receives all of the licensee's rights in the intangibles as well as any rights that the licensee had power to transfer. This language derives from Article 2A-305. The purpose of this language is to indicate that the transferee "obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel ...." In most intangibles transactions, these equitable theories are not available in fact because of the nature of intangibles contracting. As in Article 2A, the transferee only receives licensed rights. The licensee cannot transfer ownership even to a good faith purchaser. See Section 2A-305, comment ("[This section] is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser under Section 2-403(1).").

3. As drafted, the dominant rule is that a nonexclusive license is ordinarily not transferable. Arguably, this would cut off equitable arguments creating the appearance of a right to make a

transfer in cases where the underlying license is in the nontransferable category.

4. The idea of entrustment, which plays a major role in dealing with goods, has a lesser role in intangibles 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. Subsection (c) recognizes limited situations in which the licensee has an ability to transfer rights onward to an ordinary course transferee regardless of the terms of the original license. This is limited to cases where the licensee has copies of the intangibles and transfers them to a third party. The subsection makes clear that the eventual transferee takes free of the license, but is still subject to the intellectual property rights of the licensor. Intellectual property law does not recognize a concept of buyer in the ordinary course. It does, however, allow for a concept of "first sale" which gives the owner of a copy various rights to use that copy. This provision essentially allows a merchant to transfer that right to ordinary course buyers.

5. Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). The court granted a preliminary injunction against a retailer that it obtained from third parties. It argued first 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 rejected this argument, concluding 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 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."

PART 6

PERFORMANCE

A. General Rules.

SECTION 2B-601. OBLIGATIONS; SUBSTANTIAL PERFORMANCE

(a) The parties to a transaction are obligated to perform in accordance with the terms of the contract and this article.

(b) A party's duty to perform, other than with respect to restrictions related to the scope, manner, method, location of use, or disclosure of information, is contingent on the other party's substantial performance of its obligations under the contract that precede in time the particular performance of the first party.

(c) Nonmaterial breach by one party of its obligations, duties, or restrictions does not in itself justify the other party to refuse to perform its obligations under the contract or to cancel the contract, but entitles the aggrieved party to the appropriate remedies described in this article.

Uniform Law Source: Restatement (Second) Contracts § 237; Section 2A-523(2). Substantially revised. First appeared: Sections 2-2212, 2213 (Feb. 1994)

Reporter's Notes:

1. This section introduces a theme of substantial performance (or material breach) applicable to the tender of rights. It replaces the Article 2 idea of perfect tender with a more flexible standard that is routinely applicable under common law and the CISG.

2. The definitions of Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach is defined in Section 2B-109 and is discussed in the Reporter's Notes to that Section. The definition of material breach in this article largely adopts the definition in the Restatement (Second) of Contracts § 241, adding some specificity related to the commercial context with which this article deals. This article rejects the less fully explored language used in Article 2A (and some limited 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.

3. 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 in situations where performance involves multiple and ongoing activity, fully complete and perfect performance cannot be the expected norm. This is especially true in reference to information contracts. Software often contains "bugs" or imperfections. Information services performance often entails 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.

4. The operation of substantial performance concepts varies in large part on the terms of the contract. The concept is based on the common law belief that it is better to preserve a contract relationship in the face of minor problems and that allowing one party to cancel the contract for small defects may result in unwarranted forfeiture against the defaulting party and unfair opportunism on the part of the supposedly injured party. Materiality relates to the injured party's perspective and to the value that it expected from the agreement. In cases where the contract expressly holds that a particular aspect of a tender or transfer of rights is material, that contract provision governs in defining the materiality of the breach.

5. There are many reasons to adopt substantial performance in this article. This standard currently applies to contracts, including licenses, not governed by Article 2 sales law. Also substantial performance concepts are well-suited to licensing contracts. Licenses involve ongoing relationships and the flexibility engendered by substantial performance concepts is an appropriate baseline for deriving contract and other principles of the relationship. An ongoing relationship often produces minor breaches or slightly tardy performance. Until these affect the substance and value of the contract relationship, they should not justify terminating the entire contract. For these less severe, minor defaults, the injured party has a right to damages, but cannot cancel the contract. Applying that same concept to tenders of rights within the relationship creates a continuity of law and performance standards that reflects commercial practice in fact.

6. The ABA Software Task Force recommended that the perfect tender rule be abolished with respect to software contracts because of the complexity of the software product and the fact that minor flaws ("bugs") are common in virtually all software. The perfect tender rule is not well suited to this technology.

7. The CISG provides that the buyer can "avoid" a contract for the sale of goods unless there was a "fundamental breach." "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. This approach was not adopted, but is more closely akin to the idea of "substantial performance" than to the notion of "perfect tender".

8. The idea of substantial performance is the common law position for transactions not involving goods. The Restatement 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." Restatement (Second) of Contracts § 237.

9. The idea of substantial performance does not allow a party to deviate from express and important contract terms. Thus, a contract that specifically requires timely performance and states the time when performance is due does not admit of a deviation from this date on the basis of "substantial performance." Treating substantial performance as sufficient is to prevent forfeiture and unreasonable demands in a contract where the parties have not communicated the need

for strict compliance with express contract provisions. It does not require a party to accept and fully pay for something other than what it contracted to receive.

10. The PEB report on Article 2 suggested that repeal of the perfect tender rule be examined by the Drafting Committee as that rule applies to transactions in goods. The current position of the Sales Drafting Committee retains the perfect tender rule.

11. The substantial performance standard currently applies to intangibles and software contracts outside of Article 2 sales law. Use of substantial performance terminology avoids a discontinuity between this article and common law.

12. 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 computers and software, a court expressly applied a substantial performance test to a UCC sales transaction. See <u>D.P. Technology Corp. v. Sherwood Tool, Inc.</u>, 751 F Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven economic loss).

13. The substantial performance rule does <u>not</u> hold that substantial (but imperfect) performance of a contract is not a breach. To the contrary, substantial (but imperfect) performance is a breach of contract. The significance of the concept 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.

> Example: Party A grants a license to Party B for remote access to A's software and data processing systems. After the initial transfer of rights that starts up the transaction, there is a two hour period in which Party B cannot obtain access to the system because of telephone line problems. Unless this two hour problem is a material breach, B cannot use the two hour loss of access to cancel its contract but it can obtain compensation in damages for lost service.

Example: Party A contracts to develop custom software for B's inventory systems. The initial system omits a feature that was contracted for by party B. If this is a material breach, B can reject the tender of the software system and need not pay for any of the work. If the defect is not material, B must pay for the system, but receives damages for the lost value resulting from the omitted feature.

14. Substantial performance as a standard tends to draw the transaction to a completion in which the party who receives substantially what it contracted for pay for that value. Current Article 2 uses this standard for when a party can revoke acceptance and for when it can reject a delivery as part of an installment contract. Article 2A uses substantial performance for when a party can cancel a lease because of breach by the other party. Article 2 and Article 2A use "perfect tender" only in the case of a single (non-installment) lot delivery.

15. Even when it applies, the idea that the standard is "perfect" tender is misleading because whether a tendered performance conforms to the contract is judged in terms of ordinary industry standards, trade use, course of dealing and the like, the sum and essence of which is to inject a substantial amount of flexibility in what quality of performance is mandated. See, e.g., Family Drug Store of New Iberia, Inc. v. Gulf States Computer Services, Inc., 563 So.2d 1324 (La App. 1990) (no actionable defects in a software system despite complaints by the buyer that the system was cumbersome and difficult to operate; "[the] plaintiff's measured the effectiveness of a $2,500 system against the results which might have been achieved by $10,000 or $15,000 systems which were rejected because of their relatively high cost); Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364, 370 (E.D. Mich. 1977) ("[Not] every mechanical failure in a new and complex machine [constitutes] a breach of warranty."); Photo Copy, Inc. v. Software, Inc., 510 So.2d 1337 (La. Ct. App. 1987) (although some elements of software are functional, rejection of accounts and inventory program where program could not perform cross reference function since this function was the "principal motive or cause" for purchase of the system.); Computer Corp. v. Wolsteins Projector House, Inc., 57 B.R. 155 (Bankr. ED Pa. 1986) (computer said to be Apple-compatible does not fail the contract description simply because it cannot accommodate all software that can operate on Apple systems, but some analysis of the degree of compatibility is required).

16. In Article 2 and Article 2A, the idea of substantial performance is incorporated in language which requires that a defect or default substantially impair the value of the performance to the injured party. This draft uses a broader definition that parallels common law.

SECTION 2B-602. QUALITY OF PERFORMANCE. **If the quality of the performance required of a party under the contract is not fixed by or determinable from the express terms of the contract or this article, the party shall render performance of a quality that is reasonable and not less than average under the circumstances.**

Uniform Law Source: UNIDROIT Art. 5.6 Revised. Previous: 2-402 (prototype).

Reporter's Note:

This section states the underlying premise about what performance is required if not contract provision and no section of this article deal with the relevant standard of performance. The measure adopted parallels both common law and international custom: if there is not a reason in contract or in statute to adopt a different term, the relevant gap filling assumption refers to reasonable and average, rather than perfect, performance. See discussion in notes to section 2B-601.

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SECTION 2B-603. TRANSFER AT A SINGLE TIME. **If all of one party's performance can be rendered in a commercially reasonable manner at one time, the performance is due at one time, and payment or other reciprocal performance is due only on tender of full performance.**

Uniform Law Source: Section 2-307. Restatement (Second) of Contracts § 233. Revised. Previously appeared: 2-2214 (Feb. 1994)

Reporter's Notes:

The section adopts an approach found in both § 2-307 and common law as described in the Restatement (Second) with reference to the relationship between performance and payment in cases where performance can be rendered at a single time. It adds the qualification that the ability to so perform must be gauged against standards of commercial reasonableness. The section does not affect the treatment of contracts calling for delivery of systems in modular form or for contracts that extend performance out over time, such as in data processing arrangements. In each of these cases, the performance of the one party cannot be completed at one time.

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SECTION 2B-604. WHEN PAYMENT DUE.

(a) If either party has the right to make or demand performance in part or over a period of time, payment, if it can be apportioned, may be demanded for each part performance accepted by the party obliged to pay.

(b) If the payment cannot be apportioned or if the agreement or the circumstances indicate that payment may not be demanded for part performance, payment is due only on full performance.

Uniform Law Source: Restatement (Second) Contracts; Section 2-310. Revised.

Reporter's Notes:

1. This section measures the obligation to pay for performance, reflecting that a variety of commercially different contexts might be encountered. The greater diversity here than in the sales article stems from the fact that this article assumes that something more is involved in the prototype transaction than a mere delivery with reciprocal payment. In situations where continuing performance is involved, apportioned obligations to pay are relevant.

2. The presumption, as in the Restatement, is that the paying party should have a right to have acceptable performance before the obligation to pay arises. The Drafting Committee might consider whether, in light of normal commercial practice, some obligation to make periodic payments should be presumed in a contract involving performance over a period of time in order to share the risk between the parties.

SECTION 2B-605. LICENSOR'S PERFORMANCE OF CONTRACT.

(a) If a information contract requires ongoing performance by the licensor:

(1) the licensor's duty to perform, other than with respect to confidentiality and nondisclosure, is conditional on substantial performance by the licensee of its obligations under the license including compliance by the licensee with any restrictions on the scope, manner, method, or location or other limitations on the exercise of rights in the information; and

(2) the licensor shall perform in a manner that conforms to the terms of the contract or, in the absence of terms, in a workmanlike and timely manner consistent with standards of the applicable trade or industry.

(b) If a licensee breaches its obligations including by failure to comply with any restrictions on use of the information, the licensor may suspend its performance, other than with respect to confidentiality and nondisclosure obligations, and demand assurance of future performance pursuant to Section 2B-622 or exercise its rights on breach. The licensor may cancel the contract if the licensee's breach constitutes a material breach and has not been cured, or if the contract so provides.

(c) Cancellation is not effective until the licensor sends notice of it to the licensee.

(d) Nonmaterial breach by the licensee of its obligations, duties, or restrictions

under the contract does not in itself justify the licensor to refuse to perform its further obligations under the contract or to cancel the contract but entitles the licensor to resort to the appropriate remedies under this article or the contract.

Uniform Law Source: Restatement (Second) of Contracts § 237. Substantially revised. First appeared: Section 2-2413 (Feb. 1994)

Selected Issues:

a. In this and other sections, does a reference to workmanlike conduct add relevant obligations beyond those obtained by reference to standards of the industry?

b. How should this section (and the next) coordinate with provisions on tender, acceptance and refusal of performance?

Reporter's Notes:

1. This and the next following sections set out basic default rules regarding performance of a contract. The model treats the performance of the parties as being mutually conditional on the substantial performance of the other party. This section and Section 2B-606 set out generally applicable rules. Other sections dealing with specific types of contract or with the treatment of tender and acceptance of particular performance supplement these with more specific provisions that enhance and amplify the general rules, but displace them only if there is a conflict.

2. The model stems from the Restatement which states this proposition in the following terms: "[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." Restatement (Second) of Contracts § 237. The standards for materiality or substantial performance are mentioned in the Restatement and incorporated in this draft. Included in those standards is the basic premise that a breach is material if the contract provides that this is true.

3. The licensor's continuing performance obligations are conditioned on there being no uncured breach by the licensee. A subsequent section discusses the idea of cure in continuing performance obligations. This section and its relationship with other parts of the draft will require substantial discussion and further refinement. The basic structure derives from common law assumptions about ongoing contracts and brings those assumptions to specific focus in reference to intangibles contracts.

4. Most licenses provide at least some definition of under what conditions either the licensee or the licensor can exercise a right to terminate (or cancel) and what procedures must be followed to enforce that right (e.g., notice to the other party). In respect to both issues, the terms of the agreements vary widely. The most common events allowing cancellation by the licensor are failure by the licensee to make required payments or to stay within the limits of the license grant. Given clear contract language, equal bargaining power and steps to enforce the contract in compliance with the contract, such provisions can be enforced according to their terms.

5. Often, a contract requires prior notice or grants the

breaching party a right to cure. Subsection (c) establishes the default rule that notice is required, but can be dispensed by agreement in cases where cancellation is based on performance problems. Even if the right to notice were not the rule, cancellation and suspension provisions are subject to principles of estoppel, waiver and similar remedies to prevent unfair forfeiture where the non-breaching party accepts noncomplying performance by the other party and then abruptly reverses that pattern.

6. Many licenses provide for cancellation in the event of "material breach" by the licensee. A license unlike a sale of goods entails an ongoing obligation by the licensee. Breach of contract does not necessarily end the license without such language or in the absence of a material default. The concept that cancellation requires a material breach is also found in general contract law. The rationale is that an ongoing relationship often produces minor breaches and that, until these affect the substance and value of the relationship, they should not justify terminating the entire contract. For breaches that are less severe, the injured party has a right to damages, but cannot cancel the contract.

7. What constitutes a material breach can be defined by contract. Without that definition, the standards are not clear. Nonpayment of royalty or other financial obligations often constitutes a material default. Compare Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) (failure to pay all royalties under the contract did not constitute a material breach). In personal property leasing, Article 2A remedy provisions were drafted to expressly incorporate a version of material breach defined in that context as a "default [that] substantially impairs the value of the lease to the lessor [or lessee]." UCC § 2A-523(2)(a). Such a breach may justify cancellation of a lease contract. Other (nonmaterial) breaches, however, give the injured party a right to recover for "the loss resulting in the ordinary course of events from the ... default as determined in any reasonable manner, together with incidental damages, less expenses save in consequence" of the default. UCC § 2A-523(2).

8. The measure of materiality relates to the value that the injured party expected from the agreement. See Fantasy, Inc. v. Fogerty, 984 F.2d 1524 (9th Cir. 1993); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) (under New York law, "a breach of a contract 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."). It incorporates questions about the motivation of the breaching party. A series of minor defaults or slower than optimal performance 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 renegotiation, aspects of the deal that are otherwise important to it. See Compuware Corp. v. J.R. Blank & Associates, Inc., 1990 WL 208,604 (not reported in F.Supp) (N.D. Ill. 1990) (Cancellation of license possible in the event of material breach; materiality should be judged by factors including the extent to which the injured party is denied an anticipated benefit, the extent to which compensation in damages is available, bad faith issues involved in explaining the breach, and the

relative hardship imposed by continuing the contract as contrasted to allowing cancellation.); Lucasarts Entertainment Co. v. Humongous Entertainment Co., 815 F. Supp. 332 (N.D. Cal. 1993) (In case involving contract right to use a game-development software system, court notes that California law defines a "material breach" as a total failure of consideration. This transaction involved consideration beyond royalties, because a major consideration was that the former employee would provide support and upgrades for the software. Thus, breach of the price restriction "does not amount to a material failure of consideration." Even if the breach were material, under California law, rescission can occur only if the rescinding party returns to the other party everything of value it received under the contract. "[T]o effect a rescission a party to the contract must promptly upon discovery of facts which entitle him to rescind ... (a) give notice ... and (b) restore to the other party everything of value which he has received from him under the contract. Lucasarts continued to receive service and support and upgrades under the contract. Thus, no rescission was possible.).

SECTION 2B-606. LICENSEE'S PERFORMANCE OF CONTRACT.

(a) If a information contract restricts the scope, confidentiality, manner, method, location, or other aspects of the exercise of rights in the information or requires other ongoing performance by the licensee, including periodic payments, the licensee's right to exercise the rights transferred is contingent on its substantial performance of its obligations.

(b) A licensee's duty to perform obligations, other than those related to the scope, confidentiality, manner, method, or location of use or the disclosure of information, is contingent on the licensor's substantial performance of its obligations under the contract that precede the licensee's obligations.

(c) If a licensor breaches a contract, the licensee may cancel the contract if the breach constitutes a material breach and has not been cured or if the contract so provides.

(d) Cancellation is not effective until the licensee sends notice to the licensor.

(e) Except as otherwise provided in the contract, nonmaterial breach by a licensor does not in itself justify the licensee to refuse to perform under the contract or to cancel the contract but entitles the licensee to resort to the appropriate remedies under this article or

the contract.

Uniform Law Source: Restatement (Second) of Contracts § 237. Revised.
Previously appeared: Section 2-2412 (Feb. 1994)
Selected Issue:

a. How should this section coordinate with provisions on tender, acceptance and refusal of performance?

Reporter's Notes:

1. This section sets out rules for the licensee's obligations. The framework flows from the premise used in the preceding section: performance obligations of the parties are mutually conditional on performance by the other party. This adapts the Restatement and general contract law to the context where there are continuing obligations.

2. Subsection (a) makes clear that the default position is that the licensee's rights under the contract are conditional on performance of its duties and compliance with contractual restrictions on use. This language sets out the basis or conditions of performance. The remedy for a failure of the other party to perform is linked to the issue of whether that nonperformance constitutes a material breach.

3. Subsection (b) has two effects. The first is to establish the basic premise that the licensee's obligations to perform are conditional on the licensor's performance of preceding obligations. Second, the subsection carves out restrictions on use and disclosure of information. A licensor's breach does not absolve the licensee of its obligations to comply with these restrictions which are fundamental to the intellectual property rights of the licensor and with preserving its value in the information.

4. This section sets out basic duties or conditions of performance. It is supplemented by later sections dealing with particular types of contract, with payment obligations and with tender and acceptance of performance. These sections amplify and augment the default rules here, but do not displace them unless there is a clear conflict of terms.

B. Tender of Performance; Acceptance.

SECTION 2B-608. TENDER OF PERFORMANCE; EFFECT.

(a) A tender of performance occurs when a party completes the performance or, with manifested present ability to do so, offers to complete the performance.

(b) A tender of performance that substantially conforms to the contract entitles the party making the tender to acceptance of that performance.

(c) If payment is due and demanded at or before the time of performance, payment

by the party receiving the performance is a condition to the other party's obligation to complete its performance.

(d) A party must pay or render other performance required by the contract according to the contract terms for any performance it accepts. Acceptance with knowledge of a defect in that performance obligates the accepting party to pay or to perform in response to that performance,

but acceptance does not waive any other remedy except the right to cancel or to revoke acceptance on account of the defect.

Uniform Law Source: Section 2-507. Substantially revised.
Reporter's Notes:

1. This section is modeled after article 2 provisions, but broadened to reflect the diversity of acts encountered in contracts dealing with information. In broadening this to "performance", rather than tender of delivery, the Draft uses some concepts from the Restatement (Second) of Contracts.

2. The performance referred to here covers any performance that might occur in a contract or related contracts covered by this article. The model set up in each case is that the tender (which may in fact be performance) triggers the obligation to accept. In cases where payment is due on tender (see sections talking about the time of payment), then tender of payment should precede actual rendition of the performance. In cases where no payment or other performance by the other party is specifically linked to the particular performance, tender transforms into a duty to perform.

3. Tender of substantially conforming performance initiates a right to have the performance accepted and acceptance, in turn, triggers the obligation to pay. Here, however, the timing of payment may not coincide with acceptance. What arises, rather, is an obligation to pay for the accepted performance according to the contract.

SECTION 2B-608. TENDER OF RIGHTS; HOW MADE. If the tendered performance consists of a transfer of rights, the following rules apply:

(1) A licensor shall tender first but has no duty to complete the performance until the licensee tenders any initial payment or other performance required under the contract.

(2) If a contract requires physical delivery of a copy of the information, tender requires that the licensor put and hold the copy at the licensee's disposal at the location to

which delivery is required by the contract, and give the licensee notification reasonably necessary to enable the licensee to take possession or control of the copy. The manner of, time, and place for tender are determined by the contract, but tender must be at a reasonable hour, and the copy must be kept available for a period reasonably necessary to enable the licensee to take possession or control.

(3) If the contract requires electronic communication of a copy of the information or the transfer is in an access contract, tender requires that the licensor make the communication or the electronic resource containing the information available to the licensee and, unless the licensee knows of its availability, notify the licensee that the communication or resource is available.

(4) In cases governed by paragraph (3), the manner of, time, and place for tender are determined by the contract, but:

(i) the resource or communication must be held available in a form and for a period reasonably sufficient to allow the licensee to obtain access to the electronic facility; and

(ii) the licensor must provide the licensee with information on how to obtain the means to complete the initial access or transmission, including any access codes, on completion by the licensee of any acts required under the contract.

Uniform Law Source: Section 2-503(1); Restatement (Second) of Contracts § 238. Substantially revised. Previous: 2-2401.

Reporter's Notes:

1. This section is a specific application of the rules in section 2B-608. The provisions focus on a particular performance: tender of a transfer of rights. The rationale for a section on this subject stems from the recurring importance of the transfer of rights and a desire to provide guidance on that aspect of a common licensing transaction.

2. Subsection 1 parallels rules developed in reference to the sale of goods, except that it links the obligation of the licensee to tender payment to the terms of the contract as supplemented by this article. Basically, when focused on the transfer of rights, the sequence is initiated by the licensor making a transfer of rights, presently available followed by any initial, required payment or

performance.

3. Subsections (2) and (3) deal with how a tender of rights is made. Where the information is made available to the licensee through delivery of a tangible copy, the copy must be made available to the licensee and notice given. There must be an opportunity for the licensee to take control of the copy. Note that this corresponds to provisions on delivery obligations and on transfer of rights which do not require delivery to the licensee's location -- unless the contract so provides.

4. Electronic transfers are covered in subsection (3).

SECTION 2B-609. TENDER OF PAYMENT.

(a) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the other party demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(b) If an agreement requires payment in whole or in part before inspection, nonconformity in the tender does not excuse the licensee from so making payment unless:

(1) the nonconformity appears without inspection and would justify refusal pursuant to Section 2B-612;

(2) despite tender of required documents, the circumstances would justify an injunction against honor under Section 5-114; or

(3) the information is being developed pursuant to the agreement , the licensor materially fails to comply with its performance obligations, including timing for completion of the information or any material part thereof, and the licensee has substantially performed its prior obligations.

(c) Payment pursuant to subsection (a) does not constitute an acceptance or impair the licensee's right to inspect or any of the licensee's other remedies.

Uniform Law Source: Section 2-511(1)(3). Substantially revised.
Previously appeared: 2-2403 (Feb. 1994).
Reporter's Notes:

1. These provisions are based on language in article 2.

2. Subsection (a) merely outlines how payment must be tendered. Arguably, the proposition stated there is sufficiently obvious that the subsection could be deleted in this new code. It stems from the

Article 2 focus on filling gaps left by indeterminate terms.

3. Payment may occur before inspection in a large number of circumstances in the ongoing relationships that arise in licensing. The provisions of subsection (b) circumvent the obligation to pay first in narrowly drawn circumstances. Subsection (b)(3) is new and tailored to information relationships. It deals with the most common prepayment transaction: custom development contracts. The default rule in that context allows the licensee to avoid making prepayments in the face of material breach by the licensor. This is consistent with subsection (a)(1) which voids the prepayment obligation when the defect is patent. Terminating pre-payment obligations for breach is consistent with Restatement (Second) of Contracts § 237 which 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 allows the licensee to forego prepayments in a development contract if the licensor is in material breach and the licensee has previously performed it obligations. The situation here, in effect, authorizes withholding payments to a underperforming developer as a means of reducing loss or encouraging better performance.

4. This section needs to be read in connection with section 2B-611 which creates a right to inspect in cases where performance by the other party requires delivery of a copy of all or part of the information or related subject matter.

SECTION 2B-610. LICENSEE'S RIGHT TO INSPECT. If performance requires delivery of a copy of information, the following rules apply:

(1) Subject to paragraphs (3) and (4), a licensee has a right before payment or acceptance to inspect the information and any goods involved at a reasonable place and time and in any reasonable manner in order to determine conformance to the contract.

(2) Expenses of inspection must be borne by the party receiving the copy, but reasonable expenses may be recovered from the other party if the performance does not substantially conform to the contract and is refused.

(3) If the procedures for the delivery of the copy or for payment agreed on by the parties are inconsistent with an opportunity to inspect before making payment, the licensee does not have a right to inspect.

(4) A licensee's right to inspect is subject to the licensor's interest in confidentiality. If commercially reasonable inspection would jeopardize confidentiality or

would provide the licensee with the value of the information before payment, there is no right of inspection unless the parties expressly so agree.

(5) A place, method of inspection, or performance standard for inspection fixed by the parties is presumed exclusive. If compliance becomes impossible, inspection is as provided in this section unless the place, method, or standard fixed was clearly intended as an indispensable condition the failure of which avoids the contract.

Uniform Law Source: Section 2-513; CISG art. 58(3). Substantially revised. Previously appeared: 2-2405.

Reporter's Notes:

1. This section limits the right to inspect to cases where the transaction entails delivery of a copy to the licensee. Inspection and acceptance testing is important in commercial software and other contracting, but the diversity of the relationships and the subject matter affect the relevance of inspections prior to payment. Often, as a commercial matter, no such right exists because of the context which requires at least partial prepayment (e.g., software development contract) or in which most of the performance of the licensor will occur after the tender of rights is accepted and the initial payment made (e.g., database access contract). There are many contracts where the right to inspect is not pertinent. This would be true, for example, in a pure license. The patent information is contained in a public record and the transaction is effectively completed when the contract is executed by the parties. The licensee will often have long before analyzed the public record information and there is no further inspection.

2. Subsection (1) modifies section 2-513(1). What inspection is reasonable varies greatly and it would be non-productive to attempt to catalogue all of the varieties in a statutory provision. One important distinction between software and goods, noted in a report of the ABA Task Force on Software Contracts is that software performs in many different states shaped by the demands placed on it, making inspection or testing performance very different than in reference to goods.

3. Subsection (2) allocates the cost of inspection. In the case where the information substantially conforms to the contract, thus requiring acceptance, costs are borne by the inspecting party. A recovery of costs is allowed if the inspection leads to a justifiable refusal of the tendered performance. The section limits the recovery of expenses to "reasonable" expenses.

4. Subsection (3) rewrites original § 2-513(3) to accommodate the diverse contexts in which procedures agreed on by the parties may obviate a right to inspect. The Article 2 section refers to COD terms and transactions calling for payment against documents. The language in this draft is a modified version of CISG art. 58(3) which provides: "[a] buyer is not bound to pay the price until he has an opportunity to examine the goods, unless the procedures for delivery or payment agreed upon by the parties are inconsistent with his having such an

opportunity."

5. Subsection (4) draws a balance between the inspection right and the fact that intangible values can be lost by merely allowing an inspection. The two cases be covered are where the information contains trade secrets that would be revealed or information which, once disclosed, cannot be recovered if the licensee elects to not purchase.

SECTION 2B-611. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to [section on cure], if a tender of performance fails to substantially conform to the contract or if the tendering party's prior performance constitutes a material breach, the party to whom performance is tendered may:

(1) refuse the entire performance;

(2) accept the entire performance; or

(3) accept any commercial unit of the performance and refuse the rest.

(b) Refusal must be within a reasonable time after the tender. It is ineffective unless the party refusing the performance seasonably notifies the other party of the refusal.

(c) If the contract specifies a time during which the licensee may examine the performance or exercise rights in the information before accepting or refusing, a failure to refuse the performance within that time constitutes acceptance unless the time period was manifestly unreasonable under the commercial circumstances known to the parties at the time of the contract.

Uniform Law Source: Combines § 2-601, 2-602, 2A-509. Substantially revised. Previously appeared: 2-2406.

Reporter's Notes:

1. This section deals with refusal of any type of performance. The word "refuse" is used in lieu of the Article 2 term "reject" because the intent here 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.

2. 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.

3. The section follows the theme of substantial performance (or material breach) discussed earlier. This substitutes for the Article 2 idea of perfect tender with a more flexible standard applicable under common law and the CISG. In this draft, the definitions of Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach definition here largely adopts the definition in the Restatement (Second) of Contracts § 241. It does not employ the less fully explored language of Article 2A which refers to a breach that "substantially impairs" the value of a contract to the injured party. Yet, a material breach is one that significantly damages the injured party's receipt of the value it expected from the contract.

4. The choice between acceptance and rejection is reduced in importance with respect to a system that hinges rights on substantial performance rather than on perfect tender. Under current law in sales of goods, the act of "acceptance" converts the position of the licensee (buyer) from being able to avoid paying the contract price for minor defects to being forced to pay the contract price unless a latent defect substantially impairs the product.

5. Subsection (c) provides guidance on a common method parties use to control the timing of acceptance or rejection via use of a reasonable, specified time. The reference to "manifestly unreasonable" as a gauge for the validity of the contractual standard stems from section 9-501.

SECTION 2B-612. DUTIES FOLLOWING RIGHTFUL REFUSAL.

(a) After refusal of a transfer of rights, any use or exercise of rights by a licensee with respect to the information, or any action the natural consequence of which would be to substantially reduce the value of the information to the licensor, is wrongful as against the licensor and constitutes a breach of contract.

(b) If a licensee before refusal of a transfer of rights has taken physical possession of copies or documentation relating to the information or has made additional copies, the licensee must return all copies and documentation to the licensor or to hold them with reasonable care at the licensor's disposition for a reasonable time sufficient for the licensor to remove them. In this case, the following additional rules apply:

(1) If the licensee elects to hold the documentation or copies for the licensor's disposition, the licensee shall follow any reasonable instructions received by the licensee from the

licensor with respect to the foregoing. Instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

(2) If the licensor does not give instructions within a reasonable time after notification of the refusal, the licensee may store the documentation and copies for the licensor's account or ship them to the licensor with a right to reimbursement for reasonable costs of storage, shipment, and handling.

(c) A licensee has no further obligations with regard to the information or related copies and documentation rightfully refused but remains bound by any restrictions on confidentiality, disclosure, or use which would have been enforceable had the tender not been refused.

(d) In complying with this section, a licensee is held only to a standard of care that is reasonable in the circumstances and good faith. Good-faith conduct under this section does not constitute acceptance or conversion and shall not be the basis of an action for damages.

Uniform Law Source: Section 2-602(2), 2-603, 2-604. Substantially revised. Previously appeared: 2-2408 (Feb. 1994).

Reporter's Notes:

1. Article 2A states: "the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's ... disposition for a reasonable time after the lessee's seasonable notification of rejection." § 2A-512(1)(a).

2. Both Article 2 and Article 2A contain separate provisions regarding the obligations of a merchant buyer (lessee) relating to the handling of rejected goods. This seems to relate primarily to the handling of perishable property and other cases where a need to sell may arise to avoid loss to the seller, such as where the buyer and the seller are in remote locations. That problem does not arise in dealing with information.

3. 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.

4. Under subsection (a), after rejection, exercise of any rights in the information by the licensee is wrongful as a matter of contract law, whether or not it is also wrongful under applicable intellectual property law. This clarifies the policy in current 2-602 regarding the exercise of ownership rights in rejected goods.

5. Subsections (b) through (d) generally follow the approach developed in UCC Article 2. A licensor's rights with respect to a performance wrongfully refused are governed by Part 7.

SECTION 2B-613. WHAT CONSTITUTES ACCEPTANCE.

(a) Acceptance of a performance that does not involve delivery of a copy occurs when the party receiving the performance obtains the value or access to the value of the performance and, without objection by it, retains the value or access beyond a reasonable time to refuse the performance.

(b) Acceptance of a performance that involves delivery of a copy of information occurs after a party has a reasonable opportunity to inspect the information and any related goods or documentation and the party:

(1) signifies or acts with respect to the information in a manner that signifies to the licensor that the information and the manner of transfer conform to the contract or that the licensee will take or retain them despite their nonconformity;

(2) fails effectively to refuse under the terms of the contract or of Section 2B-612; or

(3) whether or not the party had a reasonable opportunity to inspect, acts in a manner that makes compliance with the licensee's duties on refusal impossible because of commingling or because by use the information the licensee has received substantial value from the transfer.

(c) Acceptance of a part of any commercial unit is acceptance of the entire unit.

(d) If the contract requires a transfer of rights in stages with respect to

portions of the information, or with respect to its performance capacity, this section applies separately to each stage or capacity. Subject to subsection (b), acceptance of any stage or capacity is conditional until completion of the transfer of rights in the completed information or the full capacity required under the contract.

Uniform Law Source: Section 2A-515. Revised. Previously appeared: 2-2410 (Feb. 1994).

Reporter's Notes:

1. There are differences in language and content between Article 2A and Article 2 dealing with acceptance and what constitutes acceptance. Article 2A does not refer to acts inconsistent with the seller's ownership because the arrangement of separate possession and ownership in a lease makes that ownership rule irrelevant. Current revised Article 2 and Article 2A also differ regarding whether action with respect to the goods is sufficient to signify acceptance. This draft follows Article 2A with modifications.

2. Subsection (b)(3) focuses on two circumstances that may be significant in information and that differ from cases in goods. In both cases, the key fact is that it would be inequitable or impossible to refuse of the transfer or of the data or information. Recall that the obligation of a rejecting licensee is to return or to keep the information available for return to the licensor.

a. Commingling does not refer only to placing the information into a common mass from which it is 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 information is integrated into a database or knowledge base that it cannot be separated from. Commingling precludes the licensee's performance of its obligation to return rejected property.

b. The second situation involves use or exploitation by the licensee. For example, the licensee might receive a right to use a computer mailing list and actually do so before attempting to reject because the list is deficient in some substantial way. The proper treatment of reallocating damages in that case is through standards relating to the effect of acceptance and to recovery for defects in accepted information.

3. 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-614. REVOCATION OF ACCEPTANCE.

(a) A licensee may revoke acceptance of a performance that constitutes a material

breach of the contract if the party accepted it:

(1) on the reasonable assumption that the nonconformity would be cured and it has not been seasonably cured; or

(2) during a period of continuing efforts at adjustment and cure and the nonconformity was not 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 of acceptance is not effective until the revoking party sends notice to the other party of it and is barred if:

(1) it does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) it does not occur before any substantial change in condition or identifiability of the information not caused by the nonconformity; or

(3) the party attempting to revoke acceptance received substantial value with respect to the performance which value cannot be returned.

(c) A party who revokes acceptance:

(1) 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 performance; and

(2) is not obligated to pay the contract price for the performance as to which revocation occurred.

(d) If a licensee revokes acceptance of some but not all commercial units and if the commercial units in which the licensor does not exercise its right to revoke are not generally licensed by the licensor separately or under the terms and conditions

contained in the contract between the licensor and the revoking licensee, the licensor may require the licensee to choose to revoke acceptance of all of the units or of none.

Uniform Law Source: Section 2A-516; 2-607. Revised. Previously appeared: 2-2412 (Feb. 1994) .

Selected Issues:

a. Should (b) be modified to clarify that continuing efforts to cure affect what constitutes a reasonable time to revoke?

b. Is revocation an appropriate concept for performance other than delivery of copies?

Reporter's Notes:

1. This section splits acceptance and liability issues and also makes changes for custom contracts. It moves provisions on a licensor's liability over to the licensee to the part dealing with remedies. Revised Article 2 differs from original Article 2 and Article 2A on issues covered by this section.

2. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. Often, of course, other performance will have already occurred. 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.

3. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general remedies sections. 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 simple question is whether or not the licensee is obligated for the contract price, less a right to damages for breach by the licensor.

4. There has been substantial litigation in Article 2 on questions of 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. <u>National Cash Register Co. v. Adell Indus., Inc.</u>, 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."); <u>Integrated Title Data Systems v. Dulaney</u>, 800 S.W.2d 336 (Tex. App. 1990); <u>Eaton Corp. v. Magnovox Co.</u>, 581 F.Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may constitute a waiver); <u>St Louis Home Insulators v. Burroughs Corp.</u>, 793 F.2d 954 (8th Cir. 1986) (limitations bar); <u>The Drier Co. v. Unitronix Corp.</u>, 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); <u>Computerized Radiological Service v. Syntex</u>, 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).

5. 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, (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms, and (iii) the licensee cannot reject the transfer or cancel the contract based on any nonconformity.

6. Subsection(d) is new. It deals with cases where modules or stages are presented for separate acceptance or where components of a software system could be viewed as arguably separate.

7. Subsection (c) adopts the position in a number of states that revocation is conditional on return of the value that the licensee received from the information. This is a common law rule of fairness and avoiding unjust enrichment. It is not often relevant in dealing with goods since the primary value in such deals typically involves continued use of the goods themselves. That is not be true for information. The subsection bar, revocation if the party received substantial value which cannot be returned.

C. Special Types of Contracts.

SECTION 2B-615. CONTINUOUS ACCESS CONTRACTS.

(a) In a continuous access contract, access must be available at times and in a manner consistent with:

(1) express terms in the contract; or

(2) to the extent not dealt with by the terms of the contract, in a commercially reasonable and workmanlike manner in light of ordinary standards of the trade and industry for the particular type of contract.

(b) Intermittent or occasional failures to have access available do not constitute a breach if they are consistent with

(1) industry standards;

(2) the express terms of the contract; or

(3) reasonable needs for maintenance, scheduled downtime, or reasonable periods of equipment or system failure, or events beyond the licensor's reasonable control.

(c) If a licensor defaults on its obligation to make access available and the default is a material breach as to the entire contract, the licensee may cancel the contract if the breach has not been cured or if the contract so provides.

(d) Cancellation is not effective until the licensee sends notice of it.

(e) Nonmaterial breach by the licensor does not in itself justify a licensee's refusal to perform or a cancellation of the contract, but entitles the licensee to resort to the appropriate remedies described in Section 2B-718.

Uniform Law Source: None. Previously appeared: 2-2416.

Reporter's Notes:

1. This section applies to a "continuous access" transactions. Continuous access contracts constitute a particular and important application of an ongoing relationship that involves tailored application of the general principles and default rules spelled out in an earlier section. "Continuous access" contracts are defined in § 2B-102.

2. The transaction here is not only that the transferee receives the functionality or the information made available by the transfer of rights, 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.

3. 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.

4. Included in this section would be contracts involving outsourcing processing of business information, licenses to access and use computer systems and software in remote facilities, online services, and database access contracts. Under current law, these contracts are ordinarily services or information contracts. The fault

based warranties noted in the warranty sections would apply to the continuous access contract insofar as one deals with the content or processing of the information.

5. The contract obligation deals with making and keeping the system available. 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, for example, 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.

6. This section focuses the right to cancel a transaction on one aspect of the nature of the relationship itself: accessibility. The transaction here is not only that the transferee receives the functionality or the information made available by the transfer of rights, 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.

7. In continuous access contracts, the transferee may receive substantial value before or in spite of problems in the overall transaction. The remedies in cases of breach 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-616. CORRECTION AND UPDATE CONTRACTS.

(a) If a licensor agrees to correct errors in information, or provide similar services, the following rules apply:

(1) If the agreement covers a limited time and is in lieu of a warranty created in this article, the licensor undertakes that its performance will complete a transfer that conforms to the agreement.

(2) In cases not governed by paragraph (1), the licensor shall perform at a time and place and with a quality consistent with:

(i) the terms of the agreement; and

(ii) to the extent not dealt with by the terms of the agreement, in a

commercially reasonable and workmanlike manner in light of ordinary standards of the trade and industry for the particular type of agreement, but a licensor providing the services does not thereby guaranty that its services will correct all defects or errors unless expressly so provided in the agreement.

(b) If a licensor agrees to provide updates or new versions of information, the following rules apply:

(1) The licensor shall make the new versions or upgrades available at a time and place and with a quality consistent with:

(i) the terms of the agreement; and

(ii) to the extent not dealt with by the terms of the agreement, in a commercially reasonable and workmanlike manner in light of ordinary standards of the trade and industry for the particular type of agreement.

(2) The licensor does not agree to make available new versions or upgrades that it has not yet made available to the public or relevant customer base and owes no obligation to make new versions or upgrades available to the public at any particular time.

(3) New versions or upgrades provided pursuant to an agreement must conform to the same standards of quality as applicable to the information involved in the initial transfer unless the licensor indicates that such compliance is not intended and the licensee accepts a lesser performance.

(c) In the case of a breach, Sections 2B-605 and 2B-606 apply with respect to cancellation of the contract and the aggrieved party's remedy for breach.

(d) Breach entitles the other party to the remedies provided in this article and in the agreement with respect to the correction or update contract. It does not entitle the licensee to cancel the contract concerning the information unless the breach results in a material breach of that contract.

Uniform Law Source: None. First appeared: 2-2419 (Feb. 1994).
Reporter's Notes:

1. This section should be read in connection with the licensor's and licensee's general obligations in a contract and the conditions under which breach of those obligations justify cancellation of the contract.

2. The section distinguishes between obligations to correct errors and obligations to provide updates. A licensor has no obligation to provide the licensee with updates or enhancements. It may have an obligation to make an effort to correct errors in cases where a licensee accepted a transfer of rights because the nonconformity was not material and did not justify refusal. See Section 2B-621. In modern practice, contracts to provide updates, generally described as maintenance contracts, are a valuable source of revenue for software providers. The reference to error corrections covers contracts where, for example, a software 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, we are dealing more with new products when we are referring to generally available upgrades or new versions.

3. Subsection (a)(1) reflects a core distinction. In some cases, the replacement or correction agreement substitutes for a warranty and should be treated as creating a commitment to achieve the result that the parties originally contemplated in the intangibles contract to begin with.

4. Subsection (a)(2) treats the contractual obligation to make corrections in a manner consistent with information contracts. The ordinariness standard for measuring baseline performance obligations refers to workmanlike performance and commercially reasonable behavior. The cases on services contracts provide guidance on how courts should approach the standard in reference to correcting errors in the information itself.

5. Subsections (c) and (d) establish the basic relationship between the upgrade contract and the underlying intangibles contract. In subsection (c), breach and cancellation of the repair contract for its own performance problems is treated by reference to general standards. In subsection (d), a breach by a party to the intangibles contract may, if material, justify cancellation of both the repair contract and the intangibles contract relationship.

SECTION 2B-617. SUPPORT CONTRACTS.

(a) A licensor is not required to provide support or instruction for the licensee's use of information or licensed access after the transfer of rights.

(b) If a licensor agrees to provide support to the licensee, the licensor shall make the support available at a time and place and with a quality consistent with:

(1) the terms of the agreement; and

(2) to the extent not dealt with by the terms of the agreement, in a

commercially reasonable and workmanlike manner in light of ordinary standards of the trade and industry for the particular type of agreement.

(c) In the case of a breach of a support obligation, Sections 2B-605 and 2B-606 apply with respect to cancellation of the support contract and the aggrieved party's right to a remedy for breach of that contract.

(d) A licensor's breach of a support obligation does not entitle the licensee to cancel the contract concerning the information unless the breach causes in a material breach of that contract.

Uniform Law Source: Restatement (Second) of Torts § 299A. Revised.
First appeared: 2-2417 (Feb. 1994).
Reporter's Notes:

1. Subsection (a) states that, as a general principle, after completing the original transfer of rights, the licensor does not undertake a support obligation to assist the licensee in effectively using the licensed information. In practice, of course, most information suppliers do in fact provide post transfer support.

2. This section should be read in connection with the treatment of a licensor's and licensee's general obligations in a contract and the conditions under which breach of those obligations justify cancellation of the contract.

3. An agreement to provide support of advice need not be separate from the information contract itself. It may either be a component of that agreement or a related contract. This reflects modern practice in reference to software and related intangibles.

4. Support, advice and information, for purposes of this section, imply an obligation of assistance in an advisory role, rather than a commitment to make adjustments or to provide updates or related materials.

5. Subsection (b) provides a default rule regarding the time, place and quality of the services that is subject to contrary agreement. The standard reflects a theme of "ordinariness" or "commercial reasonableness" that provides default performance rule throughout the chapter (e.g., warranty of merchantability, warranty or workmanlike conduct). 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 mass market services or by express terms of a contract.

6. Subsections (c) and (d) deal with the relationship between the support contract and the information contract itself. The support agreement potentially serves as an entirely separate agreement

which can be enforced and for which remedies are available independent of the information agreement. On the other hand, in some cases, a failure to support produces a material breach of the information agreement, entitling cancellation of that contract. Just when this may or may not happen, of course, depends on the facts and cannot be predicted in general terms.

SECTION 2B-618. CONSIGNMENTS

(a) If a copy of information is delivered to a merchant who deals in products of that kind under a name other than the name of the person making delivery for the purpose of sale or relicense, the person receiving delivery of the copy is a nonexclusive licensee unless the circumstances indicate that the receiving party obtained ownership of the relevant intellectual property rights.

(b) The rights of creditors of the person receiving delivery for resale or relicense are governed by the sections of this article on the rights of creditors in a licensee's interest in information.

Uniform Law Source: Section 2-321. Substantially revised.
Selected Issue:
a. Should there be specific treatment of the ownership and rights to encumber proceeds from the sale of consigned property?
Reporter's Notes:
1. Consignments are important transactional devices in the information industry since licensing entails retention of significant rights by the software manufacturer despite transfer of copies to a third party for distribution. In Article 2, consignment issues provide a difficult problem of balancing sales and secured financing issues regarding third party rights, filing, priority and the like. Similar issues arise here.
2. This subsection characterizes a consignment as equivalent to a license. Indeed, many information products are routinely distributed through distribution licenses. See Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). Under the provisions of this article relating to the transfer of nonexclusive license rights, a nonexclusive licensee cannot convey its rights under a license without the licensor's consent; this means that the creditors of a licensee (nonexclusive) do not obtain an interest in the licensee's rights.
3. In Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994) the court granted a preliminary injunction against a retailer that was selling Microsoft products, but could not demonstrate that it had obtained those products from a third party authorized to sell the products to it. The defendant in Harmony

was distributing product that it obtained from third parties. It 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 sale from an authorized party. The court rejected this argument, concluding that there is no concept of good faith purchaser under copyright law. The buyer cannot obtain any greater rights than the seller had. If 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, it purported to sell product as a stand alone. This 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."

4. The section does not deal with handling priority to and control of proceeds of resale or relicense. One commentator argues the terms along the following lines are appropriate: "To the extent that the proceeds of resale or relicense are payable to and owned by the party receiving possession, as between a creditor of that person and the licensor, the right to such proceeds are governed by Article 9, including the provisions of Article 9 dealing with filing. However, to the extent that the proceeds are payable to or owned by the licensor and are segregated from other proceeds, a creditor of the party receiving possession of the copies may obtain an interest in those proceeds only according to the terms of this article regarding transfer of rights by a nonexclusive licensee."

SECTION 2B-619. SYSTEM INTEGRATION CONTRACTS.

(a) If the agreement requires that the licensor provide a single or integrated system consisting of components provided by more than one supplier and the circumstances indicate that the licensee is relying on the expertise of the licensor to select or develop the system, the units selected or developed if delivered in proper condition must function together as a system substantially consistent with the goals of the licensee known by or communicated to the licensor.

(b) In cases governed by subsection (a), acceptance by a licensee of performance with respect to delivery or installation of part of a system is conditional on completion of

the system consistent with subsection (a).

Uniform Law Source: None.
Reporter's Note:

This section needs further development. The intent is to distinguish cases in which the obligation is that each element of a system functions well separately and situations where the items are perfect, but do not work together as a system. Earlier drafts of this article included this language within warranty sections. It is thought that the obligation is more in the nature of a contractual obligation.

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D. Performance Problems, Cure.

SECTION 2B-620. CURE OF BREACH.

(a) A party in breach may, at its own expense, cure a breach if that party:

(1) without undue delay gives notice to the other party of its intent to cure;

(2) cure is appropriate in the circumstances;

(3) the injured party has no legitimate interest in refusing cure; and

(4) the party in breach effects cure promptly, prior to cancellation by the other party, and within any contractual time period for cure of a breach.

(b) Other than in a mass market license, if a licensor receives timely notice of a specified nonconformity and demand from a licensee who accepted a performance because a nonconformity was not material and did not allow refusal of the performance or revocation of acceptance, the licensor must promptly and in good faith make an effort to cure. Failure to make this effort constitutes a breach of the contract unless the cost of the effort would be disproportionate to the effect of the nonconformity on the licensee.

(c) A breach that has been cured may not be used as a basis to cancel a contract.

(d) A cure occurs only if the party in breach:

(1) fully performs the contract obligation that was in breach;

(2) fully compensates, or provides adequate assurance that it will promptly compensate, the injured party; and

(3) provides adequate assurance of future performance.

(e) Failure to timely perform all assurances provided in reference to a cure constitutes a breach that cannot subsequently be cured.

(f) Actions that do not put the aggrieved party in as good of a position as if full performance occurred, or that are part of a repeated pattern of breach and cure, do not constitute a cure.

Uniform Law Source: Sections 2-508; 2A-513; 11 USC 365; Restatement (Second) of Contracts § 237. Revised. First appeared: 2-2407, 2420 (Feb. 1994)

Selected Issue:

a. Should there be a right to cure after the expiration of the time for performance?

b. Should cure rights related to nonmaterial breach be spelled out?

c. Should the ability to cure continue after a performance has been rejected if there is no cancellation of the entire contract?

Reporter's Notes:

1. This section brings together cure principles applicable both the transfers of rights and to all other performance. 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 contract law. This section implements that concept. The language in subsection (a) is new. It is adapted from the UNIDROIT Principles, article 7.1.4 based on a suggestion by Professor Richard Hyland. This draft, however, alters the UNIDROIT model by terminating the ability to cure if cancellation occurred prior to cure or if the contractual time period specified for cure is exceeded. The draft does not contemplate that the injured party has any obligation to delay reacting to a material breach by cancellation in order to permit cure (or an effort to cure). The interests of the injured party in such cases are predominant.

2. 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. This section spells out some standards for determining the timing and character of the actions that constitute a cure.

3. Subsection (d) indicates that cure consists of complete contract performance coupled with necessary compensation and assurances of future performance. As to the latter aspects, the provisions of this Draft are taken from Section 365 of the Bankruptcy Code and is intended to spell out a requirement that the breaching party's actions fully alleviate adverse consequences from the breach including any uncertainties caused about future performance.

4. This draft differs from Article 2. There is no absolute right to cure a material breach in this article. The reason for the difference lies in the fact that rightful refusal, revocation or cancellation requires "material breach" in this article, while the

sales provisions require only a minor breach for rejection. If the breach is material and the injured party desires to cancel the contract, subsection (a) limits the right to cure consistent with the injured party's ability to cancel the agreement. In such cases, the injured party's interests are dominant. A different case exists for nonmaterial breaches, cure of which are not subject to prior cancellation because rejection or cancellation is not permitted. Nonmaterial breaches are subject to contractual time limits and to the overall condition that the cure be prompt.

5. Article 2A provides, in addition to a right to cure before expiration of the time for performance, that: "If a lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender it he seasonably notifies the lessee." This does not seem to apply to performance governed by the substantial impairment test.

6. Cure sets a framework in which achievement of the reasonable expectations of the parties is enhanced and a sale arrangement held together conditioned on performance of the contract terms by the parties. One goal is to hold together the contract while giving play to and a framework for productive correction and adjustment of the first delivery of the goods. One author suggests that this function of cure has been substantially taken over by the replacement and repair warranties in most industries. John Sebert, Jr., Rejection, Revocation, and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals, 84 Nw. U. L. Rev. 375 (1990).

7. Limiting the ability to reject for minor defects was a goal of the UCC in these provisions. In current law, the combination of cure, acceptance and related standards creates substantial litigation about when an acceptance or rejection has occurred and whether efforts to correct malfunctions in software constitute an acceptable effort to cure a defective tender.

8. Subsection (c) defines the effect of a cure. It prevents cancellation of the contract based on the breach. Cure does not prevent the injured party from recovery under other remedies provisions of this chapter.

9. Subsection (b) imposes an obligation of good faith effort to cure in cases of minor defects (nonmaterial). This is to protect the licensee against adverse effects of the material breach standard. The licensor, however, need not extend huge efforts to correct minor problems and, if an effort to cure would be disproportionate to the value lost to the licensee, failure to make the effort or to continue it does not constitute a breach.

SECTION 2B-621. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. If reasonable grounds for insecurity arise with respect to the performance of either party, the other may demand in a record

adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance for which the agreed return has not already been received.

(b) The reasonableness of grounds for insecurity and the adequacy of the assurance offered is determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand, failure to provide within a reasonable time, not exceeding 30 days, assurance of due performance which is adequate under the circumstances of the particular case is a repudiation of the contract.

Uniform Law Source: 2-608. Follows current draft Article 2.

Selected Issue:

a. Should the section require that demand be made in a record?

Reporter's Notes:

Adequate assurance concepts are important in the context of an article dealing with ongoing relationships. The language here follows current drafts of Article 2. It will be adjusted to the language of Article 2A.

SECTION 2B-622. ANTICIPATORY REPUDIATION. If either party to a contract states to the other that it will not or cannot make a performance still due under the contract or, by voluntary affirmative conduct, makes a future performance by it impossible or apparently impossible and the loss of the performance will substantially impair the value of the contract to the other, the aggrieved party may suspend its own performance or proceed in accordance with Section 2B-711 or 2B-718 and:

(1) await performance by the repudiating party for a commercially reasonable time; or

(2) resort to any remedy for breach, even if the repudiating party has been notified that the aggrieved party would await the repudiating party's performance and the

aggrieved party has urged retraction.

Uniform Law Source: 2-609. Follows Article 2.
Reporter's Note:

1. Anticipatory repudiation concepts are important in the context of an article dealing with ongoing relationships. The language here follows current drafts of Article 2.

2. Comments at the NCCUSL meeting dealing with Article 2 questioned whether "impossible" is the correct standard in reference to payment obligations. Also questioned was to what extent this draft changes prior law in Article 2 such that return to original language of Article 2 is appropriate. In a subsequent draft of this article, the language here will be compared to that in existing Article 2 and Article 2A with more specific proposals to be made.

SECTION 2B-623. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) A repudiating party may retract a repudiation until its next performance is due unless the aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform. However, a retraction must include any assurance justifiably demanded under Section 2B-622.

(c) Retraction reinstates a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay caused by the repudiation.

Uniform Law Source: Section 2-6-110. Follows current draft Article 2.
Reporter's Note:

Anticipatory repudiation concepts are important in the context of an article dealing with ongoing relationships. The language here follows current drafts of Article 2. In a subsequent draft of this article, the language here will be compared to that in existing Article 2 and Article 2A with more specific proposals to be made.

E. Loss and Impossibility.

SECTION 2B-624. 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 of the information. If the contract does not

contemplate that the licensee take possession of a copy, risk of loss passes to the licensee when it obtains control of the copy.

(b) If a contract requires or authorizes a licensor to ship a copy 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 tendered and 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 so as to enable the licensee to take delivery.

(3) If a tender of delivery of a copy or a shipping document fails to conform to this article or to the contract, the risk of loss remains on the licensee until cure or acceptance.

(c) If a copy is to be delivered electronically or the licensee is provided with access to an information processing facility containing the information, risk of loss passes to the licensee on its receipt of a copy of the information.

(d) If a copy is held by a bailee to be delivered without being moved, the risk of loss passes to the licensee:

(1) on the licensee's receipt of a negotiable document of title covering the copy;

(2) on acknowledgment by the bailee to the licensee of the licensee's right to possession of the copy; or

(3) after the licensee's receipt of a nonnegotiable document of title or record directing delivery.

Uniform Law Source: Section 2-509
Reporter's Note:

1. Risk of loss concepts developed for goods are difficult to apply to information because the reduced significance of physical manifestations of the property means that allocating risk cannot depend on the treatment of physical items.

2. While, in many cases, there is no risk of loss element present in a information contract, there are situations where the risk of loss is potentially as significant as it is in the case of transactions in goods. 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).

3. 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 buyer-seller environment, however, the transfers of control or the like may go in either direction. Basically, the proposition is that the risk passes to the party who has taken possession of copies or control of the intangibles themselves.

4. Subsection (c) adapts current section 2-509.

5. The Committee should consider whether this section deals well with risk of loss in remote access or on-line systems. The variations there need to be considered (e.g., outsourcing contract, data processing contract, online service). Included is the fact that risk of loss goes in both directions in some information contracts.

SECTION 2B-625. CASUALTY TO IDENTIFIED PROPERTY. If a contract requires information identified when the contract is made or to be developed during the contract and the information suffers casualty without the fault of either party before the risk of loss passes from the party originally in control of the information, the following rules apply:

(1) The party in control of the information shall promptly notify the other party of the nature and extent of the loss.

(2) If the loss is total, the contract is avoided.

(3) If the loss is partial or the copies or the information no longer conforms to the contract, the other party may nevertheless demand inspection and may either treat the contract as avoided or accept the information with due allowance from the contract price for the nonconformity but without further right against the other party.

Uniform Law Source: Section 2-613. Revised. Previous: 2-2422 (Feb. 1994)
Reporter's Note:
1. The section is modified to deal with the two-directional nature of the information contracts (e.g., there may be casualty to information held by the licensee and essential to the contract). 2. The section applies only if information necessary for the contract is destroyed before the transfer of rights occurred. Thus, in a custom development contract, destruction of the code and data being used by the developer through no fault of either party and before the transfer of rights occurs, eliminates the contract obligation except as to nondisclosure of proprietary information if no backup copies exist.

3. This draft deletes provisions dealing with the impact of situations where third parties (e.g., communications providers) are essential to the contract and, through fault of the service provider, performance is prevented or hindered. The former language, which was not widely supported, stated:

(b) If the contract requires a third party to make or assist in the transfer or performance, the licensor must exercise reasonable care in selecting the third party. If the licensor fails to exercise reasonable care, failures in the performance of the third party it selects are attributable to the licensor for purposes of this section.

(c) If either the licensor or the licensee suffers loss as a result of a third party's failure to exercise reasonable care in making or assisting the transfer or performance, the loss is recoverable against the third party to the extent that the loss was a reasonably foreseeable consequence of the failure and is not disclaimed or prohibited by applicable contract or law.

SECTION 2B-626. INVALIDITY OF INTELLECTUAL PROPERTY. If a contract requires intellectual property rights in information identified when the contract is made or to be developed during the contract and the intellectual property rights are declared invalid by a court of appropriate jurisdiction, the following rules apply:

(1) The party in control of the intellectual property rights shall promptly notify the other party of the nature and extent of the loss.

(2) The contract is avoided, but the other party may either treat the contract as avoided or continue performance with due allowance from the license fee for the lost intellectual property rights.

Uniform Law Source: None.
Reporter's Notes:
1. This applies casualty law to intellectual property rights and their invalidation.

SECTION 2B-627. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Delay in performance or nonperformance by either party is not a breach of a 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.

(b) A party claiming excuse under subsection (a) must seasonably notify the other party that there will be nonperformance or delay. If the claimed excuse affects only a part of the capacity to perform of the party claiming excuse, the following rules apply:

(1) The party claiming excuse must allocate performance among its customers and may do so in any manner that is fair and reasonable and notify the licensee of the estimated quota made available.

(2) The party may at its option include regular customers not then under contract as well as its own requirements for further manufacture.

(c) If a party receives notification of nonperformance, a delay or an allocation justified under subsection (a) and the nonperformance, delay, or allocation would be a material breach if not justified by this section, the party receiving the notification 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) In exercising its rights under (c), the party must give notice to the other party. If the party that is able to exercise a right under (c) fails to terminate or modify the contract within a reasonable time not exceeding 30 days after receiving notice under subsection (a),

the contract lapses with respect to any performance affected.

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616. Revised.
Reporter's Note:

1. This section combines the sales sections on excuse and procedure on claiming excuse. It deletes a provision in the latter section that made the injured party's options under the Code not subject to waiver or modification by agreement. This latter rule is inconsistent with the emphasis in this article on contractual freedom.

F. Termination.

SECTION 2B-628. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Subject to subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged, but any right based on breach or performance before termination survives.

(b) A party in possession or control of information, materials, or copies of information of the other party , must return all materials and copies or hold them for disposal upon instructions of the other party upon termination. If the information was subject to restrictions on its use or disclosure, continued exercise of rights in the information by the party in possession or control following termination is a breach of contract and wrongful as against the other party unless that use is pursuant to contractual provisions that survive termination or that were designated as irrevocable in the contract.

(c) The following survive termination of a contract:

(1) a right based on prior breach or performance;

(2) a limitation on the scope, manner, method, or location of the exercise of rights in the information;

(3) an obligation of confidentiality, nondisclosure, or noncompetition;

(4) an obligation to return or dispose of data, confidential information, material, copies, or the like to the other party, which obligation must be promptly performed;

(5) a choice of law or forum including an obligation to arbitrate or otherwise resolve contract disputes through means of alternative dispute resolution procedures;

(6) any remedy for breach of the whole contract or any unperformed balance; and

(7) any right, remedy, or obligation stated as surviving in the contract.

Uniform Law Source: Section 2A-505(2); Section 2-106(3). Revised.
First appeared: 2-2218 (Feb. 1994)

Reporter's Notes:

1. This draft adds a presumption that obligations of confidentiality and the like survive termination. This is a common drafting approach in contracts that involve confidential material. It is an important element of information contracting. Of course, the survival of these obligations hinges on the fact that the contract created the obligations to begin with.

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SECTION 2B-629. TERMINATION; NOTICE.

(a) A party may not terminate a contract, except on the happening of an agreed event, unless the other party receives reasonable notification of the termination.

(b) An agreement dispensing with notification is invalid if its operation would be unconscionable. However, a contract term specifying standards on the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)(Revised Article 2). Previous: 2-2217 (Feb. 1994).

Reporter's Notes:

1. Termination is ending a contract other than for breach. This section does not require notification to terminate based on an event expressly noted in the contract (e.g., end of the contract term) unless the contract so provides.

2. The last portion of (b) derives from Article 9-501 and sets out a standard for measuring the validity of contract provisions relating to time, place and method of termination notice. As applied in Article 9, that standard creates substantial room for effective exercise of contract freedom.

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SECTION 2B-630. ELECTRONIC TERMINATION.

(a) On expiration of a contract term, each party is entitled to the relief provided in subsection (c). In addition, in an access contract, the licensor may discontinue access without prior notice to the licensee.

(b) If it gives prior notice to the other party in the contract or otherwise, a party may include in information electronic means to enforce the rights stated in subsection (c) on the expiration of the license term and apply that electronic means at the end of the license term without judicial process.

(c) A party in possession or control of information, materials, or copies of information of the other party , must return all materials and copies or hold them for disposal upon instructions of the other party upon termination. If the information was subject to restrictions on its use or disclosure, continued exercise of rights in the information by the party in possession or control following termination is a breach of contract and wrongful as against the other party unless that use is pursuant to contractual provisions that survive cancellation or that were designated as irrevocable in the contract.

(d) On termination at expiration of a contract term, each party is entitled by judicial process to prevent the other party's exercise of rights in or use of or other information provided by one party to the other, and to repossess property transferred pursuant to the contract. To the extent necessary to enforce this right a court may order that the party:

(1) to take possession of any tangible objects containing the subject matter of the contract, any information delivered to the other party, and any information related thereto;

(2) to, without removal, render unusable the information or the capability to exercise rights therein;

(3) to destroy any record, data, or files containing the information under the

control or in the possession of the other party;

(4) to obtain injunctive relief against any continued use or purported exercise of rights in the information; and

(5) if the contract so provides, to require the licensee to assemble all materials containing the information and make them available to the licensor at a place designated by the licensor or to destroy electronic and other records or files containing the information.

(e) Electronic termination is not wrongful if consistent with the expiration of the contract term. Electronic termination prior to expiration of the contract is a breach, unless the termination occurs under circumstances allowing cancellation by the terminating party.

Uniform Law Source: New. Adapts electronic rights to termination situation.

Selected Issues:

a. Should the notification requirement exist in cases where the electronic means simply enforces contractual obligations, including terms?

b. How should the section handle the case where software expires on a given date unless a renewal code is given by the licensor?

Reporter's Note:

1. This draft deals with the important issue of how enforcement of termination rights should occur. The assumption here is that, if the termination ends the contract consistent with fixed contract terms (as compared to alleged breach), electronic termination is appropriate given that notice of the capability was given.

2. Termination differs from cancellation. Cancellation applies to ending a contract for breach. Subsection (d) is not intended to blur the distinction, but to protect a party from loss through mislabeling its conduct. There are greater procedural and substantive safeguards in electronic cancellation.

3. This section should be read in connection with section 2B-323 dealing with electronic monitoring and restricting use.

4. Subsection (a) states the unexceptional principle that the expiration of the contract term justifies immediate termination without notice. The most important aspects of the remainder of the section are those that allow the licensor to include and then use electronic means to enforce such termination of rights. This would include, for example, a calendar or a counter that monitor and the end the utility of the use of a software program after a given number of days or utilizations, whichever constitutes the definition of the applicable contract term.

PART 7

REMEDIES

A. In General

SECTION 2B-701. REMEDIES IN GENERAL.

(a) Remedies must be liberally administered with the purpose of placing the aggrieved party in as good a position as if the other party had fully performed.

(b) Except as provided in a contract term liquidating damages for breach, an aggrieved party may not recover for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid loss resulting from the breach. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(c) Except as provided in a contract term, rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury. A court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

(d) If a party breaches and the breach is material as to the entire contract, that party may exercise all remedies made available under this article or the contract subject to the conditions and limitations applicable to the remedy. If the breach is material only as to a particular performance, the remedies must be exercised only as to that performance except that, if a remedy cannot reasonably be applied to a particular performance, that remedy is not available. If the party so elects, the party may recover under any combination of the remedies for material breach and the remedies for nonmaterial breach under Section 2B-702.

(e) If a party is in breach, the party seeking enforcement has the rights and remedies as provided in this article, the contract , and may enforce the rights and remedies available

to it under other law.

Uniform Law Source: Section 2A-523. Revised. First appeared: 2-2516 (Feb. 1994).
Selected Issue:

a. Should there be a distinction between material breach of the entire contract and material breach with respect to a particular performance

b. Should a codification of commercial practice presume consequential damages are not available unless agreed? This question is also pertinent to the other damage sections.

c. If consequential damages are not eliminated as a default rule for all cases, should they be eliminated for transactions involving information content (data, sounds, images and the like)?
Reporter's Note:

Uniform Law Source: 2-701. Revised. Previously appeared: Section 2-2502 (Licenses).
Reporter's Note:

1. The exclusion for liquidated damages is based on discussion on the floor at the NCCUSL meeting and a desire to coordinate this principle with other remedies sections of this article.

2. This Section provides general standards for the administration of remedies. Subsection (b) states the principle of mitigation, referring to this as a duty to take measures reasonable to avoid loss. This is implicit in current law and explicit in the Restatement.

3. Subsection (c) provides that the remedies in this article are cumulative and there is no concept of election of remedies. This is fundamental in the UCC and expressed in Section 2A-501(4) as to leases. Section 1-106(1) provides that "remedies ... shall be liberally 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 cap is appropriate for contract-related remedies.

4. Subsection (c) also gives the court a 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. This is an important safeguard in this Draft because the other remedies provisions give the injured party (rather than a court) broad discretion in electing what form of damages computations it desires to pursue. On the other hand, it is appropriate to limit the judicial scrutiny and right to overturn a remedy award to cases of substantially greater awards. This restriction reduces the extent to which judicial overview will be an issue in cases and implements a policy that the injured party can choose its remedy within broad limits consistent with the general remedies policy.

5. Subsection (d) outlines general principles regarding the treatment of material breaches and the remedies available to the aggrieved party. The approach makes a distinction between breach of the entire contract and breach of a single performance. This parallels breach of performance in Article 2A. A material breach of

the entire contract entitles the injured party to all of the remedies available under this article or the contract , subject only to the conditions as being applicable to the particular remedy itself. In principle all of the remedies of this article and the contract are also available for a material breach of a single performance. However, depending on the type of breach involved, a particular remedy may be inappropriate for a specific performance. Subsection (d) provides that in such cases, the remedy is not available. The last sentence of subsection (d) follows the principle that remedies are cumulative and allows the party affected by a material breach to choose remedies for material breach, remedies for nonmaterial breach, or any combination thereof.

6. Subsection (e) clarifies that an injured party may have rights under other law. In discussing remedies one must consider not only contract law, but also remedies under intellectual property law. This is true because, at least in some cases, a breach of a license agreement by the licensee if coupled with continued use of the intangibles by the licensee or use outside the scope of the license infringes the underlying intangible property rights of the transferor. In practice, contract damages pertaining to licenses are often not sought because a licensor relies on the property right and infringement claim, rather than on contract law for recovery. 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).

7. The remedies differ depending on whether the party's breach is a material breach or not. As a general rule, remedies applicable to nonmaterial breach do not contemplate an ending the contract, but enable the party to calculate its loss from the breach in any appropriate manner and to recover while continuing performance.

8. In cases of material breach, a further distinction exists between material breach that affects the entire contract and material breach that affects only the single performance. The former allows action to end the contract as a whole, while a breach that is material only as to a single performance allows refusal of that performance, but not cancellation.

> Example: Bear Corp. obtains access to the Dow Financial database for an annual fee plus charges for each use. On March 1 and 2, the database is not available at a time that Bear would have liked to obtain investment information. Assume that this is a breach of the continuous access contract. The breach is material as to the performance, but whether it is material as to the entire contract depends on a broader analysis. At minimum, Bear can recoup the lost value from the breach.

SECTION 2B-702. REMEDIES FOR NONMATERIAL BREACH. **If a party breaches and the breach is not material, the party may:**

(1) recover any unpaid license fees and royalties for any performance accepted;

(2) recover the loss resulting in the ordinary course from the breach as determined in any reasonable manner, together with incidental damages and consequential damages, less expenses saved as a result of the breach; and

(3) exercise any rights or remedies provided in the contract.

Uniform Law Source: Section 2A-523(2).

Selected Issues:

a. Should a codification of commercial practice presume consequential damages are not available unless agreed? This question is also pertinent to the other damage sections.

b. If consequential damages are not eliminated as a default rule for all cases, should they be eliminated for transactions involving information content (data, sounds, images and the like)?

Reporter's Note:

1. This section states a general measure of damages for the case of a nonmaterial breach. Because of the variety of circumstances that might be involved the measure of damages is left open and general.

2. This section draws together material from Section 2B-718 and 2B-711 in the former draft. It reflects a restructuring of the remedies provisions without substantive change.

3. By virtue of the provisions of section 701(d) which allows a person injured by a material breach to opt to use the general remedies measure of this section, this section supplies a basic remedies principle for the various types of miscellaneous breaches that may occur and are not governed by the more specific sections of this article. This same principle was previously stated in section 2B-707 of the December, 1995 draft.

SECTION 2B-703. DAMAGE TO INFORMATION. In a license, in addition to any other damages permitted by this article or the contract, on breach by one party, an aggrieved party who has a property right or interest in the information may recover an amount that will compensate it for any loss of or damage to the party's interest in the information that was reasonably foreseeable and caused by the breach, as measured in any

reasonable manner.

Uniform Law Source: Uniform Law Source: 2A-532. Appeared as: 2-2507 (Sep. 1994).

Selected Issue:

a. Are damages under this section consequential or direct damages?

Reporter's Note:

1. This section does not create the property or other interest. It covers damage by the either party to any information property rights of the other to the extent those interests exist under other applicable law. It covers not mere infringement, but actual and permanent damage to the value of the information. This might occur, for example, if the one party reveals otherwise confidential information, thus lessening its value. If may also apply to cases where a party destroys information entrusted to it for processing, although the applicability of the section hinges on whether the entrusting party held a property interest after delivery and measures damages in light of whether that party had backup copies protecting against loss.This section recognizes that the may parties retain an interest in the information not measured by the price or terms of the contract, but which may be affected by the conduct of the licensee and that in some cases the licensee has an interest in intellectual property that can be affected by actions of the licensor.

2. The damages here are similar to a "residual interest" under Article 2A. The loss is in the nature of a direct loss, rather than consequential damages. There is no restriction on this recovery in terms of materiality of the default or the general contract standard that the injured party should receive no more than is needed to place it in as good of a position as full performance would have placed that party. Yet, the basic principle is similar. In an intangibles contract, the licensor has a right to expect that the conduct of the licensee will not injure its property rights, if any. A default which damages those rights infringes those expectations and is also a default under contract law, of the licensor.

3. The measure of damages is unspecified because the range of possible intrusions is too wide to permit any meaningful standard. The effect of this section is to give the licensor an option to pursue damages for infringement or loss to the intellectual property rights either as a contract law matter, or as a matter of intellectual property law so long as no double recovery results.

SECTION 2B-704. CANCELLATION; EFFECT.

(a) If a party breaches a contract, the aggrieved party may cancel the contract if the breach is a material breach of the entire contract and has not been cured or if the contract so provides.

(b) Cancellation is not effective until the canceling party sends notice of

cancellation to the other party. In cases governed by subsection (a), if the licensor so elects, the licensor may recover under any combination of subsections (a) and (b).

(c) A party in possession or control of information, materials, or copies of information of the other party , must return all materials and copies or hold them for disposal upon instructions of the other party upon cancellation. If the information was subject to restrictions on its use or disclosure, continued exercise of rights in the information by the party in possession or control following cancellation is a breach of contract and wrongful as against the other party unless that use is pursuant to contractual provisions that survive cancellation or that were designated as irrevocable in the contract.

(d) Subject to subsection (e), all obligations that are executory at the time of cancellation on both sides are discharged.

(e) The following survive cancellation of a contract:

(1) a right based on prior breach or performance;

(2) a limitation on the scope, manner, method, or location of the exercise of rights in the information;

(3) an obligation of confidentiality, nondisclosure, or noncompetition;

(4) an obligation to return or dispose of data, confidential information, material, copies, or the like to the other party, which obligation must be promptly performed;

(5) a choice of law or forum including an obligation to arbitrate or otherwise resolve contract disputes through means of alternative dispute resolution procedures;

(6) any remedy for breach of the whole contract or any unperformed balance; and

(7) any right, remedy, or obligation stated as surviving in the contract.

(f) Unless a contrary intent clearly appears, expressions of "cancellation" or "rescission" of the contract or similar terms may 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. First appeared: 2-2504 (Feb. 1994)

Reporter's Notes:

1. This section outlines the remedy of cancellation for either party. Cancellation means putting an end to the contract for breach. This section makes clear that 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. Various other sections contain language about when and under what conditions a cancellation is appropriate.

2. In an ongoing relationship, the remedy of cancellation is important to the injured party. Cancellation stems from a material performance problem. Of course, the mere fact that a material breach occurred does not <u>require</u> the injured party to cancel. It may continue to perform and collect damages under other remedial provisions.

3. No attempt is made to outline the circumstances in which a breach of contract is material as to the entire contract. 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).

4. Some commentators suggested that the reference to a breach of the entire contract could be clarified by using the Article 2 and Article 2A reference to breaches that substantially impair the value of the entire contract. However, the concept of general harm and of seriousness of the breach are incorporated in the definition of material breach in this Draft and are broader that the terms suggested. Also, there is no case law interpreting the concept of "substantial impairment" in this setting, while material breach is a common law term.

5. Subsection (c) incorporates by reference the various obligations of continued confidentiality, return of information, and the like that are associated with the end of a contract, either by peaceful means or as a result of a material default. It may eventually be better to spell out those issues here.

6. Either cancellation and termination end the contract. The end of the contract, however, affects only executory obligations, leaving in place any existing claims or the like. This section makes that clear and also spells out the survival of restrictions on the use of information (if any such restrictions existed) and on location and other restrictions on the exercise of rights in the intangibles reflects licensing practice. It is made explicit in this draft to avoid any uncertainty about whether these obligations are executory. Of course, the parties can contract for a different result, but this will seldom be their intention.

7. This section requires that notice be sent to the other

party. This standard does not require receipt of the notice. There are two issues here that should be addressed. The first is whether any notification is needed. The initial proposals assumes that there is such a requirement for this level of action in part because of the serious consequences involved to the other party. Use of intangibles after cancellation may be an infringement of the intellectual property rights of the other party. The second issue deals with whether sending or receipt of notice is necessary. The choice here opts for a standard focused on sending notice as a way of reducing the burden on the injured party.

8. Subsection (e) spells out various aspects of the relationship that survive cancellation. The most important changes in this context are the express references to handling data and confidentiality issues. It will seldom be the case that the parties intend these obligations to end at the point of cancellation or termination.

SECTION 2B-705. SPECIFIC PERFORMANCE.

(a) On request of a party other than with respect to a personal services contract, a court may grant specific performance to an aggrieved party:

(1) if specific performance is possible and if the parties have expressly agreed to that remedy in their contract; or

(2) if the subject matter of the performance that was not rendered by the breaching party is unique and can be transferred to the aggrieved party.

(b) A decree for specific performance may include any terms and conditions as to price, damages, or other relief that the court considers just but must provide adequate safeguards

consistent with the terms of the contract for the confidential information and intellectual property of the party ordered to perform.

(c) A party has a right to recover information which was to be transferred to and owned by that party if, after reasonable efforts, the party is unable to effect cover for that property or the circumstances indicate that an effort to obtain cover would be unavailing and the information exists in a form capable of being transferred.

Uniform Law Source: 2A-521. Section 2-716. Revised. First appeared: 2-2512 (Feb. 1994).

Reporter's Notes:

1. Article 2 contains a right to obtain specific performance of the contract "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 court have shown in connection with specific performance of contracts of sale." UCC § 2-716, comment 1. There are few reported cases ordering specific performance in a sale of goods transactions. 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.

2. Article 2A has a similar specific performance section. Section 2A-521.

3. 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.

4. 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.

5. There is non-uniform case law dealing 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:

"[The] following circumstances are significant:

(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. In common law, despite the often unique character of the intangibles, the off-setting respect for a licensor's property and confidentiality interests often preclude specific performance in the form of allowing the licensee continued use of the property. One is likely to find courts ruling that a monetary damage award suits the circumstances, unless the licensee's need for continued access is compelling. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985); Johnson & Johnson Orthopaedics, Inc. v. Minnesota Mining & Manufacturing Co., 715 F. Supp. 110 (D. Del. 1989).

7. Subsection (b) 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 or require personal services of the party. Subsection (b) specifies that

confidentiality and intellectual property interests must be adequately dealt with in any specific performance award. Article 2A merely allows the court to order conditions that it deems just. This standard is inappropriate for cases involving information assets.

8. Subsection (c) adapts language from current Article 2 and Article 2A. It applies only in cases where the contract calls for a transfer of the intangibles, not mere rights in the intangibles. This would occur, for example, in cases of custom software development with respect to developed, but not yet delivered software that will be owned by the transferee.

SECTION 2B-706. CONTRACTUAL MODIFICATION OF REMEDY.

(a) Subject to subsections (b) and (c):

(1) An agreement may provide for remedies in addition to or in substitution for those provided in this article, or the agreement may limit or alter the measure of damages recoverable under this article, including limiting a licensee's remedies to:

(i) return of all copies of the information and refund of the portion of the license fee that exceeds the value already obtained by the licensee from its use or receipt of the information; or

(ii) repair and replacement of copies of the information by the licensor.

(2) Resort to a modified or limited remedy is optional, but a remedy or remedies expressly described as be exclusive are the sole remedy.

(b) Subject to subsection (c), if the performance of the breaching party in providing the agreed remedy fails to give the other party an adequate remedy consistent with the terms of the contract:

(1) to the extent that the agreed remedy has failed, the aggrieved party has remedies as provided in this article; and

(2) a licensee may revoke acceptance and obtain from the licensor either a refund of the portion of the license fee paid less the value received by the licensee that

exceeds the value already obtained by the licensee.

(c) Failure of the agreed remedy or unconscionability does not affect the enforceability of separate terms that liquidate, limit, or exclude consequential or incidental damages unless the consequential damages limitations are expressly made subject to the performance of the other remedy.

(d) Consequential or incidental damages may be limited or excluded by agreement unless the limitation or exclusion is unconscionable. A limitation or exclusion of consequential or incidental damages for commercial loss is presumed to be conscionable.

Uniform Law Source: Section 2-719 (revised). Alternative B to subsection (b)(2) is from 2-2503 (Licenses, September). Previously appeared: 2-2503 (Feb. 1994).

Selected Issues:

a. Should any failure of a basic remedy invalidate the consequential damages claim?

b. Should "timely" refund be defined per se as an adequate remedy?

c. Is the presumption in subsection (d) appropriate since it is limited to commercial loss?

d. Should the presumption in reference to limited remedies be reversed?

Reporter's Notes:

1. This section applies the general principle of freedom of contract to remedies.

2. In subsection (a)(1), the refund remedy is expressly made subject to value the licensee already received. Unlike in reference to goods, simply obtaining access to or use of information can produce significant value for the licensee and a remedy that does not take this into account risks creating a windfall for the licensee.

3. Subsection (a)(2) uses language from the proposed revision of Section 2-719. It states the presumption that contract remedies are in addition to other remedies provided for in this article unless the agreement expressly indicates that the contract remedies are exclusive.

4. Subsection (b) clarifies language used in Article 2 and in the Draft Article 2 which provide that the options presented arise if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential purpose". This was suggested by several comments from the floor of the NCCUSL meeting in July. Further clarification of the intent may be desirable.

5. Subsection (d) validates limitations on damages. In this draft, both the licensor and the licensee are entitled in appropriate cases to recover for consequential loss. The last sentence of subsection comes from the proposed revision of Section 2-719. Article 2A language is different. Section 2A-503(3) provides: "limitation,

alteration, or exclusion of damages where the loss is commercial is not prima facie unconscionable."

6. This Draft eliminates a presumption that exclusion of loss for personal injury in consumer cases is unconscionable. As discussed in notes to another section, case law holds that in cases involving information products, reliance on inaccurate information does not cause liability even in the case of personal injury to the relying party except in unusual aces or cases of software incorporated into more general products. As this indicates, sales law concepts of product liability for personal injury are not generally present in reference to and other information. Because it is not widely present, an assumption that limitation of such loss is wrongful is not appropriate.

7. Subsection (c) deals with a topic that has produced inconsistent results in modern litigation. It concerns whether a failure of a limited remedy causes a failure of a limit or exclusion of consequential damages. The Draft adopts a contract choice option.

SECTION 2B-707. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach by either party may be liquidated, but only in an amount that is reasonable in the light of the then anticipated loss caused by the breach. If a liquidated damages term is unenforceable, the aggrieved party has remedies as provided in this article or in the contract.

(b) If a party justifiably withholds or stops performance, the other party is entitled to restitution of the amount by which the sum of payments it made exceeds the amount to which the party withholding performance is entitled under terms liquidating damages in accordance with subsection (a).

(c) A party's right to restitution under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under the provisions of this article other than subsection (a) and the amount or value of any benefits received by the party claiming restitution directly or indirectly by reason of the contract.

Uniform Law Source: 2-718. Revised. First appeared: 2-509 (prototype).

Selected Issue:

a. Is a standard gauged by the difficulty of proving the ultimate damages be allowed or required?

b. Should the contractual limit be subject to any review?

Reporter's Note:

1. This amends Article 2 in subsection (a) to focus on the reasonableness of the amount. The alternative under present law allows consideration of either this standard or the difficulty of proof.

2. 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. Certainly, a court should not revisit the deal after the fact and disallow a choice made because it later appeared to disadvantage one party.

SECTION 2B-708. STATUTE OF LIMITATIONS.

(a) An action for breach must be commenced within four years after the cause of action accrued. By contract, the parties may reduce the period of limitations to not less than one year from the date that the cause of action accrues.

(b) Except as provided in subsections (c) and (d), a cause of action for breach, including a breach of warranty, accrues when the act or omission on which the breach is based occurs or

should have occurred, regardless of the aggrieved party's lack of knowledge of the breach. Breach of warranty occurs when the transfer of rights occurs. If a warranty extends to future conduct, the breach of warranty occurs no later than the date for the expiration of the warranty.

(c) A cause of action for breach of the warranty of noninfringement or for a breach involving disclosure of confidential information accrues when the act or omission on which the breach is based is or should have been discovered by the aggrieved party.

(d) This section does not alter the law on tolling of the statute of limitations and does not apply to a cause of action that accrued before this article took effect.

Uniform Law Source: Section 2A-506; 2-725. Revised. First appeared: 2-2505 (Feb. 1994).

Reporter's Note:

1. This section combines a discovery rule with a rule that the cause of action accrues when the breach occurs. The later rule applies in most cases involving performance in similar causes of

action for such breaches a discovery rule coupled with the fact that many licenses are for extended periods would create indefinite and long term liability exposure. This is particularly true in the case of software where some defects do not become manifest until particular circumstances arise in the use of a product. On the other hand, the discovery rule applies in cases of warranties related to infringement of intellectual property rights to correspond this statute with other law, especially the Uniform Trade Secrets Act.

2. This section follows Article 2A and Article 2 regarding a four year limit for the contract action and the other provisions of the statute except for subsection (b).

3. Article 2A adopts a "discovery" rule for when a cause of action accrues. Article 2 adopts a time of transfer rule for when the cause of action arises, except in cases where warranty expressly 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.

4. For claims dealing with information disclosed during an intangibles contract, current state law limitations periods depend in part on whether the claim is treated as contractual or as arising in tort. In both contexts, case law and statutes differ in defining when the cause of action accrues.

5. In Intermedics, Inc. v. Ventritex, Inc., No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) the court applied California law to reject the idea that a misappropriation claim entails a continuing tort. In addition, it held that the cause of action for contract breach related to the misappropriation would likewise not entail a continuing breach, at least not in this case. Essentially, the limitations period on both claims accrued at the same time.

6. In Computer Associates International, Inc. v. Altai, Inc., -- S.W.2d --, (Tex. 1994) the court concluded that Texas law would not apply a "discovery rule" to delay tolling of a statute of limitations in reference to a trade secret misappropriation claim. A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

7. This section alters the "future performance" exception from current Article 2. The basic decision is whether a breach occurs when the actions that relate to it did or should have occurred, or whether a discovery rule applies. It also deletes the reference to secondary actions that in Article 2 receive addition time to be brought if a first law suit is terminated.

B. Licensor Remedies

SECTION 2B-709. LICENSOR'S DAMAGES FOR BREACH.

(a) On a material breach by a licensee, the licensor may recover as damages for the particular breach or performance or, if appropriate, as to the entire contract, the

following:

(1) Accrued and unpaid license fees and royalties, the present value of the total license fees and royalties for the then remaining contract term, less the present value of costs and expenses saved as a result of the licensee's breach. The date for determining present value and the sum of accrued license fees and royalties is the following: (i) the date of default if the licensee never received a transfer of rights, ii) the date the licensee no longer has possession or the ability to use the information in the case where the licensor cancels and discontinues the right to possession or use, or (iii) the date of entry of the judgment if the licensee's rights were not canceled or discontinued by the licensor as a result of the breach. In addition, the licensor may recover the present value of any incidental or consequential damages as of the date of entry of the judgment.

(2) The present value of the profit, including reasonable overhead, that the licensor would have made from full performance by the licensee, plus the present value of any incidental and consequential damages all determined as of the date of entry of the judgment.

(3) Accrued and unpaid license fees or royalties as of the date of entry of the judgment for performances accepted by the licensee but not paid.

(b) The damages computed under subsection (a) must be reduced by due allowance for the proceeds of any substitute transaction involving the information which was obtained because the transaction was made possible by the licensee's breach.

(c) To the extent necessary to obtain a full recovery a licensor may use any combination of the measure of damages provided in subsection (a).

Uniform Law Source: Section 2A-528; Section 2-708. Revised. First appeared: 2-2521 (Feb. 1994).
Also: Section 2-2520 (Licenses, September); 2-2615 (prototype)
Reporter's Notes:

1. This section gives the licensor a right to elect damages recovery under any of three measures. The section has been

substantially revised. The revisions are modeled after the damages provisions in Article 2A, but adapted to information assets where possession and use are not necessarily similar in importance to a lease. In connection with these revisions, former section 2B-717 was deleted and replaced by the above. The remedial options in this section should be read in conjunction with the general damages measure stated in section 2B-7--- which by the terms of that section is available in any appropriate combination with this section.

2. The first alternative involves a formula accounting for unpaid license fees (measured at present value) minus costs saved as a result of the breach. Different dates for determining present value and accrued fees are employed to reflect the different position of the parties relating to the information. The second alternative involves a lost profit standard. This option is limited by the terms of Section 1-106(1) and Section 2B-702 that the purpose of the damages remedy is to put the injured party in the same position as full performance would have done and cannot put the licensor in a position substantially greater than it would have been in had there been full performance of the contract. It is also limited by the fact that the election exists only in cases of material breach or where the contract so provides. The third alternative states the obvious option of collecting unpaid fees for performance rendered.

3. Licensor damages remedies are formulated in a manner that differs greatly 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 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 contract remedy standard. That approach to damages reflects 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 license fee and lost profit of the licensor. This is consistent with common law approaches in similar cases.

4. Subsection (a) makes the election between these two remedies at the option of the licensor. It also allows the licensor a recovery for consequential damages in appropriate cases. In reference to both measures of damages, the court is instructed to give due credit to the licensee for any substitute transactions made possible by the breach. In many cases, no credit is merited because the loss of one transaction does not fairly create an ability to conduct the other (e.g., breach of an access contract does not typically enable the creation of a second contract; both could exist without additional resource commitment by the licensor). Yet, in some cases there may be a replacement deal which, in light of basic mitigation principles, should be considered in reducing damages.

Other Law:

5. 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. Section 504 of the

Copyright Act provides: "[An] infringer of copyright is liable for ... the copyright owner's actual damages and any additional profits of the infringer ... that are attributable to the infringement and are not taken into account in computing the actual damages...."

6. Loss is measured in terms of wasted advantage, lost profit or the like. Actual loss to the copyright owner is measured by reduced market value of its work plus ancillary costs due to the infringement. Alternatively, loss to the owner can be recovered measured by loss of potential customers. 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.")

7. Infringement of a patent entitles the patent holder to damages under 35 U.S.C. § 284 which provides:

> Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court. When the damages are not found by a jury, the court shall assess them. In either event the court may increase the damages up to three times the amount found or assessed.

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. See 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) (infringer's profits may be evidence tending to prove amount of patentee's damages or relevant in calculation of a reasonable royalty, infringer's profits are not themselves recoverable without regard to the extent of the patentee's actual damages); Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959). See Paul Janicke, Contemporary issues in Patent Damages, 42 Am. U. L. Rev. 691 (1993).

8. Trade secret law is grounded in state law relating to the creation and enforcement of confidential relationships relating to information that has value to a commercial enterprise. There are two sources of trade secret law: the Restatement (First) of Torts § 757 and the Uniform Trade Secrets Act (UTSA). While the Restatement has dominated this field, the majority of all states have now adopted the UTSA.

9. 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).

10. 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."

11. There is a dual focus that combines a concern for the loss caused to the trade secret owner and a concern about not allowing the wrongdoer to retain the fruits of its misbehavior. The UTSA expressly allows recovery of both unless that would yield a double recovery for the owner of the secret. It is less clear that the cases in fact directly adopt this approach or the somewhat less clear formulation of the same principle in the Restatement. Cases under the Restatement are highly sensitive to individual facts and engage in what one court described as a "flexible and imaginative approach to the problem of damages." University Computing Co. v. Lykes-Youngstown Corp., 504 F.2d 518, 538 (5th Cir. 1974). The "general law as to the proper measure of damages in a trade secret case is far from uniform." Telex Corp. v. International Business Machines Corp., 510 F.2d 894, 931 (10th Cir. 1975).

12. The distinction between lost value and wrongdoer gain permeates the case law, albeit with divergent results. The Fourth Circuit stated the point: "There are two basic methods for assessing damages for misappropriation for trade secrets: one, the damages sustained by the victim (the traditional common law remedy), and the other, the profits earned by the wrongdoer by use of the misappropriated material (an equitable remedy which treats the wrongdoer as trustee ex maleficio for the victim for the wrongdoer's gains from his wrongdoing). ... Ordinarily a plaintiff may recover either, but not both, because to allow both would permit double recovery." Sperry-Rand Corp. v. A-T-O, Inc., 447 F.2d 1387, 1392 (4th Cir. 1971).

13. In Article 2 gauges monetary damages for the seller based on the contract sale price placed in juxtaposition to the actual or hypothetical marketplace for the item. This creates a number of uncertainties applied to intangibles where the item has less relevance and far less value than the rights conveyed since the item, if any, merely constitutes a format for delivery. If the buyer's breach consists of a failure to pay for goods that it accepted, the seller's recovery consists of an action for the remaining price along with any incidental damages associated with the breach of contract. UCC § 2-709(1)(a).

14. Article 2A does not presume that the lessor will or should be required to dispose of the goods after breach as a means of fixing its right to recover. Section 2A-527(1) allows the lessor to dispose of the goods as a means to set the damages, but does not require it. Overall, the assumption is that, in a lease, ownership remains in the lessor and the lessor has a right to deal with its property in whatever manner it sees fit.

15. Outside of the UCC, contract "damages are ordinarily based on the injured party's expectation interest and are intended to given him the benefit of his bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he

would have been in had the contract been performed." Restatement (Second) of Contracts § 347, comment a. The Restatement 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.

This uses language like that in UCC Article 2 (e.g., incidental and consequential loss), but the common law does not distinguish between buyer and seller, client and service provider or the like. In contrast, UCC Article 2 grants a right to consequential damages to the buyer, but it does not do so for sellers (e.g., licensor). Common law does not make this distinction.

16. The common law focuses on loss to the injured party, rather than gain obtained by the other party. In licenses, the clarity of the distinction is often blurred or simply not attended to by the courts. A more holistic and less structurally exact analysis occurs; the goal is to provide complete and correct compensatory recovery. The basic structure is that the injured party should be made whole and placed in a position that reflects roughly where it would be if the contract were performed. See Cherne Industrial Inc. v. Grounds & Associates, Inc., 278 N.W.2d 81 (Minn. 1979) (affirmed an award of damages based on a percentage of the defendant's profits flowing from its breach of an employment contract); Harris Market Research v. Marshall Marketing & Communications, Inc., 948 F.2d 1518 (10th Cir. 1991) (sublicense fees charged to third parties were relevant under a contract breach claim involving a lawsuit by a licensor of computer software used to provide services to third parties against its licensee); Bandag, Inc. v. Gerrard Tire Co., Inc., 704 F.2d 1578 (Fed. Cir. 1983) (license fee represents a proper measure of damages for patent infringement, but that this can be true only if the infringer's acts of infringement were commensurate with the acts contemplated under the license for which the fee was established); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (licensee breached contract under which it licensed performance rights for movies by failing to make appropriate payments; applying general contract law principles, the court awarded the full contract price to the licensor without deduction of overhead).

17. The Restatement uses a licensing illustration in describing its general damages approach:

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

Restatement (Second) of Contracts § 347, illustration 1. See also United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) (premature publication breached the contract entitling the licensor to lost profits caused by the early publication).

18. In Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) a patent license prohibited the licensee from manufacturing or selling any other products which included any designs or features of the licensed product after the license terminated. The license dealt with variable resistance exercise equipment. This contract provision was breached when the licensee did in fact incorporated features and designs into others of its products. There was no patent infringement. Under contract theory, the court concluded that:

> [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.

SECTION 2B-710. LICENSOR'S RIGHT TO COMPLETE. On material breach by a licensee, the licensor may in the exercise of reasonable commercial judgment for the purposes of

avoiding loss and of effective realization, either complete and wholly identify the information to the contract or cease work on the information. In either case, the licensor may recover damages or enforce other remedies.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised. First appeared: 2-2517 (Feb. 1994)

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.

2. 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.

3. This section does not use language in both 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 linked to transactions in goods.

4. As a general matter, identifying and completing the intangibles will be an inappropriate rule for intangibles. 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. It is to that notion that the option to complete goods generally pertains.

5. This draft applies the right to complete the intangibles to the circumstance in which it is most likely to occur: contracts involving development or compilation. In such cases, intangibles may not have a general market. The option to complete often will be commercially sensible unless the licensor anticipates collateral benefits from the continued development (e.g., the creation of program subroutines that are useful in other projects; development of technical expertise in the context). It remains important to allow the transferor, in a regulated or monitored manner, to act to reduce net overall loss from the default by the transferee.

6. If the transferor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails.

SECTION 2B-711. LICENSOR'S RIGHT TO PREVENT USE.

(a) On a breach of a license by the licensee that is material as to the entire contract, the licensor may by judicial process prevent the licensee's continued exercise of rights in the information and repossess any copies of the information and any materials transferred by it to the

licensee pursuant to the contract. Subject to subsection (b), to the extent necessary to enforce this right a court may enjoin continued exercise of rights in the information by the licensee and may order that the licensor:

(1) take possession of any copies of the information or other material related thereto;

(2) without removal, render unusable any copies of the information;

(3) destroy any copy of the information or other information related thereto under the control or in the possession of the licensee or to which the licensee has access; and

(4) if the contract so provides, require the licensee to assemble all copies of the information and other information relating thereto and make them available to the licensor at a place designated by the licensor which is reasonably convenient to both parties.

(b) The remedies in subsection (a) are not available if the information prior to breach and in the ordinary course of performance under the license was so altered or commingled as to no longer be reasonably separable or identifiable from other property or information of the licensee to the extent the remedy cannot be administered without undue harm to the licensee's information or property.

Uniform Law Source: Section 2A-525; Section 9-503. Revised. First appeared: 2-2518 (Feb. 1994).

Reporter's Notes:

1. This section defines the right of a licensor to use judicial process to prevent further use of information after material breach by the licensee. The right stated here exists only to the extent that the remedy can be administered without undue damage to the information or property of the licensee due to commingling in the ordinary course of performance under the license. The remedy entails a combination of an injunction and destruction or return of tangible copies of the information. Self help issues are in the next section. A right to discontinue a continuous access license is covered in a different section.

2. The section has been substantially modified based on discussion at the Drafting Committee meeting in Jaunary, 1996. Most importantly, the section is specifically limited in application to licenses. The remedies discus here are inappropriate in cases where information is sold to a licensee unless a security interest is retained under Article 9. Additionally, this draft clarifies that the limitation on the remedy stemming from commingling deals with cases where commingling creates a situation in which copies of licensed information cannot be removed or disabled without damage to property or information. As noted in the prior draft, lost profits and the like are not property for this purpose although, if a licensor acts wrongfully, they may serve as an appropriate measure of damages.

3. A right to prevent use is appropriate in a license because the contract restricts use of the information. The right to enforce this does not depend on there being a property interest in the subject matter, but that interest would augment the contractual right. In effect, the right to enforce a discontinuation of use also stems from contractual principles of specific performance. The restrictive license provisions carry with them the implication that a material breach ends the right to use as created by contract. Also, if there are intellectual property rights associated with the material, the remedies most often available in those property law areas give the licensor a right to retake and prevent continued use in the event of infringement. This draft limits the repossession right in two ways. First, the section only applies to licenses. Second, the rights cannot be implemented to the extent they would yield undue harm to property of the licensee.

4. The repossession remedy arises only if there is a material breach affecting the entire contract.

5. Under current law, unless the seller retains a security

interest as part of the transaction, Article 2 provides few rights for the seller against product delivered to the buyer. There is no general right to repossess or to prevent the buyer's continued use and possession of the goods regardless of whether or not the buyer fails pay the agreed price. Although Article 2 generally de-emphasizes the issue of who holds title and when title to the property passes to the buyer, a sale is a transaction in which title and, typically, all other interests of the vendor in a particular item are transferred to the buyer. The seller's rights against the buyer are in the nature of a general chose in action, essentially, a right to recover damages for nonperformance of contract terms by the buyer. Indeed, Article 2 provides that any effort to reserve "title" in the goods after delivery to the buyer creates no more than a security interest in the property. Enforcing that security interest is governed by Article 9.

6. In some circumstances, Article 2 provides the seller with rights against the property, but these are typically cases in which no delivery has occurred or where there are elements of fraud. Thus, a seller may by timely action stop delivery of goods in transit if it discovers the buyer to be insolvent or if the buyer repudiates. Similarly, the seller has a limited right to reclaim the goods from the buyer if the buyer received the goods on credit while insolvent and the seller acts within applicable time limits. "Successful reclamation of goods excludes all other remedies with respect to them."

7. Article 2A contains a right in the lessor to repossess leased property after default. This stems from the retained title or residual property interest of the lessor in the lease transaction. The right to repossession is patterned after Article 9. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The lessor also has a right to repossess by taking action in court. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC § 2A-525, Comment 3, citing Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. den., 402 U.S. 909 (1971). Article 2A provides:

> After a default by the lessee ... the lessor has the right to take possession of the goods. ... Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises. ... The lessor may proceed under [this section] without judicial process if it can be done without breach of the peace or the lessor may proceed by action.

UCC § 2A-525. The right to take possession in a lease, although patterned after Article 9, serves a different purpose. Retaking is not a first step in realizing against the property to recover an unpaid debt. It is an exercise of the lessor's property rights in the goods and a means to deny the lessee the continued benefits that it had been granted under the contract that it has breached. In this sense, then, both retaking physical possession and the alternative of disabling the property from use serve the same purpose: they enforce the dominant interest of the lessor in the use and benefit from the goods.

8. The Copyright Act contains remedies that effect a form of

repossession right and the right to enjoin future infringement. Section 502 authorizes a court to grant temporary or permanent injunctions "on such terms as it may deem reasonable to prevent or restrain infringement of a copyright." 17 U.S.C. § 502. Standards for injunctive relief include showing that irreparable harm is threatened and that there is a likelihood of success on the merits, standards identical to ordinary preliminary injunction relief. In ordinary cases irreparable harm may be presumed where the plaintiff has made out a prima facie case of infringement. See Educational Testing Service v. Katzman, 793 F.2d 533, 544 (3rd Cir. 1986); Apple Computer Inc. v. Franklin Computer Corp., 714 F.2d 1240, 1254 (3rd Cir. 1983), cert. dism, 464 US 1033 (1984).

9. Even more directly parallel to the idea of repossession is the right under contract law to have infringing items impounded. Section 503 provides:

> (a) At any time while an action under this title is pending, the court may order the impounding, on such terms as it may deem reasonable, of all copies ... claimed to have been made or used in violation of the copyright owner's exclusive rights, and of all plates, molds, matrices, masters, tapes, film negatives, or other articles by means of which such copies or phonorecords may be reproduced.

(b) As part of a final judgment or decree, the court may order the destruction or other reasonable disposition of all copies ... found to have been made or used in violation of the copyright owner's exclusive rights, and of all plates, molds, matrices, masters, tapes, film negatives, or other articles by means of which such copies or phonorecords may be reproduced.

Impoundment is a prejudgment remedy. Destruction of infringing copies and the devices involved in making the copies is a post judgment remedy.

10. Section 283 of the Patent Act provides:

> The ... courts having jurisdiction of cases under this title may grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable.

35 U.S.C. § 283. Injunctive relief is common in patent infringement and is generally awarded based on considerations that parallel those for other cases involving injunctive remedies. Although there is some contrary earlier case law, the modern view holds that preliminary injunctive relief is available under standards applicable generally to any type of case seeking such relief. See Roper Corp. v. Litton Systems, Inc., 757 F.2d 1266, 1269 (Fed. Cir. 1985). For preliminary relief, the validity of the claimed patent is an issue. See H.H. Robertson Co. v. United Steel Deck, Inc., 820 F.2d 384 (Fed. Cir. 1987). Given a showing of validity and that the defendant's acts infringe, as a general rule "irreparable harm" sufficient to trigger the injunction is presumed and this presumption controls most, but not all cases. Permanent injunctions are also provided for under the Patent Act. "It is the general rule that an injunction will issue when infringement has been adjudged absent a sound reason for denying it." See Richardson v. Suzuki Motor Co., 868 F.2d 1226, 1247 (Fed. Cir.), cert. den. 110 S.Ct. 154 (1989); Smith Int'l Inc. v. Hughes

Tool Co., 718 F.2d 1573, 1581 (Fed. Cir.), cert. den. 464 U.S. 996 (1983).

11. A trade secret violation often yields injunctive relief designed to enforce the confidentiality of the subject matter and the preclude the defendant's continued use of the intangibles. The UTSA § 2(a) provides:

> Actual or threatened misappropriation may be enjoined. Upon application to the court, an injunction shall be terminated when the trade secret has ceased to exist, but the injunction may be continued for an additional period of time in order to eliminate commercial advantage that otherwise would be derived from the misappropriation.

Subsection (c) further states that: "In appropriate circumstances, affirmative acts to protect a trade secret may be compelled by court order." This recognizes that remedies for past harm do not fully protect the property rights of the trade secret owner. There exists an interest in preventing future use of the intangibles. The availability of an injunction and other "affirmative acts" can be viewed as a form of repossession of the property that is held by the wrongdoer. With intangibles, retaking tangible items may enhance repossession and be a critical aspect of the licensor's relief, but preventing future use of intangibles may require more than an injunction. Here, as in reference to copyright case, we see a combination of concern about tangible embodiments of the secret or other intangible and removing those from the infringer's hand coupled with a right to injunctive prohibitions on use of the intangibles themselves.

12. The Restatement recognizes the importance of preventing future use. It states that in addition to damages:

> [The secret owner] may ... be granted an injunction against future harm by disclosure or adverse use [or] have the physical things embodying the secret, such as designs, patterns and so forth, surrendered by the wrongdoer for destruction. Moreover, he may have two or more of these remedies in the same action ....

Restatement (First) of Torts § 757 (1939). The theory combines injunctive remedy with attention to destroying physical embodiments of the intangible property. For cases arising under a quasi contract theory, the Restatement of Restitution similarly provides for an injunction against future use. Restatement of Restitution § 136, 554 (1937) ("[A trade secret owner] is entitled to a redress enjoining [the wrongdoer] from continuing to use the trade secret and requiring him to account for the profits which he has made by its use.").

13. UTSA provides for termination of the injunction if the property becomes public domain. UTSA Section 2(b) provides that if a court determines that an injunction prohibiting future use would be unreasonable, it can condition an injunction on payment of a reasonable royalty. The conditions under which this might occur are not clear, but one such circumstance would be where the intangibles and their use are no longer clearly severable from other commercial actions and information used or taken by the defendant.

14. As a basic principle, specific performance and injunctive relief are available for breach of license contracts in appropriate cases. The issue most frequently arises in reference to contract

actions involving trade secret protection where the unique nature of the property and the need to prevent actions that would destroy secrecy are the clearest arguments for mandatory judgments. Thus, one court commented:

> The jurisdiction in equity to interfere by injunction to prevent such a breach of contract or trust when the injury to the discoverer or his assigns would be irreparable and the remedy at law inadequate is so well established that the citation of authority would be trite.

American Dirigold Corp. v. Dirigold Metals Corp., 125 F.2d 446, 452 (6th Cir. 1942).

SECTION 2B-712. LICENSOR'S SELF-HELP.

(a) A licensor may proceed under Section 2B-711 without judicial process only if there is a breach that is material as to the entire contract without regard to contractual terms defining material breach and only if proceeding without judicial process can be done without a breach of the peace, without foreseeable risk of injury to persons, and without substantial damage to or destruction of information or property of the licensee.

(b) The limitations on a licensor's right to act without judicial process may not be waived by the licensee prior to default.

(c) A licensor may not include in the subject matter of a license means to enforce its rights under subsection (a) unless a conspicuous term of the license expressly provides that it may do so. Even if a conspicuous term authorizes the licensor to include a means to enforce it rights, the following apply:

(1) The licensor's use of electronic remedies to prevent further use of the information is subject to the limitations in subsection (a) and section 2B-711(b). Exercise of the means to prevent further use in circumstances in which the licensee has not committed a material breach constitutes a breach by the licensor.

(2) If the licensor's use of the means to prevent further use of the information damages property or information of the licensee, the licensee is entitled to recover as damages for the destruction or damage of the property any resulting loss in the

ordinary course as measured in any manner that is reasonable accounting for the difficulty or ease of restoring or recreating any information that was damaged.

Uniform Law Source: Section 9-503. Revised. First appeared: 2-2518 (Feb. 1994).

Selected Issues:

a. Should self-help repossession be barred?

b. Is prior notice in the contract sufficient to protect the licensee?

Also: Section 2-2518 (Licenses, September); 2-2613 (prototype)

Reporter's Note:

1. This section is substantially revised based on discussions of the Drafting Committee. The intent of the revisions is to clarify the conditions that limit the self help remedy and to introduce a sense of proportionality in the determination of when self-help is available. The remedy applies only in the case of a license. Proportionality is introduced by providing in subsection (a) that self-help (electronic or otherwise can occur only if there is a breach that would be material as to the entire contract independent of what definition of materiality exists in the contract. Thus, under the definition of material breach applicable in the absence of contract terms, there must be a breach by the licensee that substantially threatens or reduces the value of the contract to the licensor. If a licensor acts to use self help and the licensee's breach is not material, the licensor breaches the contract and is exposed to all contract remedies.

2. This proportionality concept is substantially different from the provisions of Article 9 where self help hinges solely on default and the absence of a breach of the peace. A policy consideration exists about whether this greater precondition is justified and whether it will simply result in self help occurring through the creation of an Article 9 interest as an adjunct of a license.

3. Considered together with the prior section, self help remedies are limited in the following manner: a) nonelectronic self-help can occur only if the information is not commingled so as to make damage to the licensee's information or property inevitable, only if there is no breach of the peace or foreseeable risk of injury to persons, and only if there is no substantial damage to the licensee's information or property (irrespective of commingling); b) electronic self-help can occur only if the foregoing conditions are met and then only if authorized by a conspicuous contract term, furthermore, even if the preconditions are appropriate the licensor is liable for damages caused to the information or property of the licensee.

4. The type of damage or risk of damage that bars self help refers to damage to persons, property or information. This standard does not hinge on mere loss of business profitability. A policy decision must be made about whether a further restriction to actual physical damage is appropriate. The ABA Task Force has recommended that the damage limitation be restricted to damage to tangible property.

5. This is a controversial section. Criticism comes in two directions. One group believes that any self-help remedy is excessive and inappropriate in a license because of the commercial interests at stake. Another group criticized the form draft of this section as constraining the licensor's right to act too closely. A recent survey reported a substantial majority of computer law professionals (87%) as supporting the inclusion of disabling devices to enforce software restrictions even in shrink wrap licenses if the software is conspicuously labeled as having such element included. Michael Rustad, Elaine Martel, Scott McAuliffe, <u>An Empirical Analysis of Software Licensing Law and Practice</u>, 10 Computer L. Ass'n Bull. -- (1995).

6. The self-help option here is closely constrained and limited. The intent is to give the licensor a potentially important remedy, but to minimize the extent to which the remedy can be used as an unfair club against the licensee when a dispute exists about the adequacy of performance. The section seeks a balanced midpoint for applying this remedy.

7. The position taken as to electronic self-help essentially requires disclosure of electronic remedial devices implanted in software and compliance with the contextual restrictions on self help generally. In <u>American Computer Trust Leasing v. Jack Farewell Implement Co.</u>, 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 <u>Farewell</u> 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."

8. Article 2A contains an express right held by the lessor to repossess leased property after default. This stems from the retained title or residual property interest of the lessor in the lease transaction. The right to repossession is patterned after Article 9. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The lessor also has a right to repossess by taking action in court. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC § 2A-525, Comment 3, citing <u>Clark Equip. Co. v. Armstrong Equip. Co.</u>, 431 F.2d 54 (5th Cir. 1970), cert. den., 402 U.S. 909 (1971). Article 2A provides:

> **After a default by the lessee ... the lessor has the right to take possession of the goods. ... Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises. ... The lessor may proceed under [this section] without judicial process if it can be done without breach of the peace or the lessor may proceed by action.**

UCC § 2A-525.

SECTION 2B-713. LICENSOR'S RIGHT TO DISCONTINUE. In the event of a

material breach, the licensor may:

(1) refuse to complete the transfer of rights or copies;

(2) discontinue access by the licensee in an on-line or a continuous access license; or

(3) instruct any third party engaged in assisting the transfer of rights or performance of the contract to discontinue its performance.

Uniform Law Source: Section 2A-525(1);. Sections 2A-526; 2-705. First appeared: 2-2519 (Feb. 1994). Also: Section 2-2519 (Licenses, September); 2-2614 (prototype).

Reporter's Notes:

1. This section deals with the right of the licensor to stop performance under several significant circumstances. This is not a right to retake transfers already made, but merely to stop performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit and to act in response to insolvency by the licensee. This derives in part from Section 2A-525(1). As redrafted, this section 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.

2. Licenses are governed by bankruptcy law in reference to rights in the event of insolvency. See 11 U.S.C. § 365. Those rights over-ride the ability to stop performance in the event of insolvency if that right is not exercised before the licensee files a bankruptcy petition.

C. Licensee Remedies

SECTION 2B-714. LICENSEE'S DAMAGES.

(a) On a material breach by a licensor, the licensee may recover as damages for the particular breach or performance or, if appropriate, as to the entire contract, either:

(1) the present value, as of the date of breach, of the market value of any performance not provided, minus the present value as of the same date of the license fees for such performance. In the case of damages for the entire contract, both amounts are to

be computed for the remaining contract term plus any extensions available as of right. In addition, the licensee may recover the present value of incidental and consequential damages resulting from the breach as of the date of entry of the judgment; or

(2) If a licensee accepts performance from the licensor and gives timely notice of any defect in the performance, the measure of damages is the present value, at the time and place of performance, of the difference between the value of the performance accepted, and the value if
there had been no defect, not to exceed the contract price, together with present value of the incidental and consequential damages as of the date of entry of the judgment.

(b) The amount of damages calculated under subsection (a) must be:

(1) reduced by any expenses and costs saved by the licensee as a result of the licensor's breach; and

(2) if further performance is not anticipated under the contract:

(i) reduced by any unpaid license fees that relate to performance by the licensor the value of which has been received by the licensee; and

(ii) increased by the amount of any license fees already paid that relate to performance by the licensor the value of which has not been received by the licensee.

(c) Market value is determined as of the place for performance. In determining market value, due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contract terms, performance, and information that were similar in terms, quality, and character to the information or performance with respect to which a default occurred.

(d) To the extent necessary to obtain a full recovery a licensee may use any combination of the measure of damages provided in subsection (a).

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2). Revised. First appeared: 2-2507, 2508 (Feb. 1994).
Reporter's Notes:

1. 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. This Draft makes the choice of remedy broader and eliminates the hierarchy set out in current Article 2. The remedial options in this section should be read in conjunction with the general damages measure stated in section 2B-716(b) which by the terms of that section is available in any appropriate combination with this section.

2. There is no specific provision dealing with a remedy based on "cover." This remedy is removed as a major element of this Draft because, in dealing with intangibles that are, by their nature, often distinct or unique, the options of "cover" is seldom viable and always uncertain of application. In this Draft, alternative transactions are to be given "due weight" in determining market value under subsection (c), but a failure to effect an alternative transaction does not bar recovery.

3. This section gives the licensee a choice between computing damages based on a contrast between contract value and market value or based on the difference in value promised as contrasted to performances actually delivered

4. Given a court's general overview to prevent excessive damages, there is no reason to make one option preferred over the other. Also, unlike in goods, the type of breach involved here is more varied; greater flexibility is needed.

5. Article 2A (and Article 2) focus remedies on the handling of goods, their delivery or non-delivery. This draft is more extensive because of the nature of the contracts that are covered by this article. The focus on goods is inappropriate. The language is drafted to clarify that the applicable damages measure can be used for various types of situations (e.g., the transfer, the performance, or the entire contract).

6. 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.

7. Courts have applied 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

8. The computation outlined in subsection (a)(2) relates to performance that has been accepted. For "accepted" goods under Article 2, the damages formula is in Section 2-714, consisting 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.

9. An issue exists about whether recovery should be limited to the contract price or simply to the value of the intangibles a warranted. This draft caps damages by the contract price, leaving any further loss to fall within the area of consequential damages. 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 often equals the purchase price, but it need not be so limited. Thus, the court in Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3rd Cir. 1980), allowed a value measure that encompassed the value that the buyer would have obtained from a perfect computer system with specific capabilities, even in excess of the contracted for price. This is an inappropriate application of this framework in lieu of the use of consequential damages.

SECTION 2B-715. LICENSEE'S RIGHT OF RECOUPMENT. If a licensor is in breach, the licensee, after notifying the licensor of its intention to do so, may deduct all or any part of the damages resulting from breach from any part of the license fee still due under the same contract.

Uniform Law Source: Section 2-717. Revised. First appeared: 2-2510

(Feb. 1994). Also: Section 2-2511 (Licenses, September); 2-2606 (prototype).
Reporter's Note:
This language is in both Article 2 and Article 2A. It recognizes that the injured party can employ self-help by diminishing the amount that it pays under the contract.

SECTION 2B-716. LICENSEE'S RIGHT TO CONTINUE USE. **On breach by the licensor, the licensee may continue to exercise rights under the contract. If the licensee elects to continue to exercise rights, the following rules apply:**

(1) The licensee is bound by all of the terms and conditions of the contract, including restrictions as to use, disclosure, noncompetition, and any obligations to make license fee or royalty payments.

(2) The licensee may pursue remedies with respect to accepted transfers or performance, including the right to recoupment.

(3) The licensor's rights and remedies in the event of breach remain in effect as if the licensor had not been in breach.

Source: First appeared: 2-2515 (Feb. 1994). Also: Section 2-2514 (Licenses,Sept); 2-2609 (prototype).
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.

SECTION 2B-717. LICENSOR LIABILITY OVER.

(a) If a licensee is sued by a third party and the licensor is answerable over for breach of warranty or other obligation other than for infringement, the licensee may give the licensor notice of the litigation. If the licensee gives the licensor a notice that states that the licensor may come in and defend and that if the licensor notified does not do so the licensor will be bound in any action against the licensor by the licensee by any

determination of law or fact common to the two litigations, the licensor is so bound unless the licensor after seasonable receipt of the notice comes in and defends.

(b) If a licensee receives notice of litigation against it for infringement or the like in reference to the information or the licensee's exercise of rights therein, the following rules apply:

(1) The licensee shall notify the licensor in a seasonable manner or be barred from any remedy or recovery from or against the licensor for liability established by the litigation.

(2) The licensor may demand in writing that the licensee turn over control of the litigation including settlement if the licensor is answerable over to the licensee for the claim or if the information contract is a nonexclusive license. If the demand states that the licensor agrees to bear all the expenses and to satisfy any adverse judgment or settlement and the licensor provides reasonable assurance of its capability to do so, the licensee is barred from any remedy over against the licensor except for costs already incurred and the licensor may seek control of the action by appropriate legal remedies unless the licensee after seasonable receipt of the demand turns over control. A licensor who takes over control under this subsection must act in good faith and with reasonable care to protect the licensee's interests in the litigation and in any settlement.

Uniform Law Source: Section 2A-516; 2-607. Revised.
Reporter's Note:

This section gives the licensor a right to control the infringement defense in any case where it is answerable over to the licensee or where the license is nonexclusive. It does not create a right to have a remedy against the licensor, but merely deals with cases in which such right exists. In the situation of a nonexclusive license, the licensor's interest in preserving the integrity of its proprietary rights is dominant over the interest of the licensee. Giving the licensor the right to step in such cases after having provided appropriate financial safeguards for the licensee is appropriate in such cases.

NOTES ON THE FEBRUARY 1, 1996 DRAFT

Substantial changes have been made in this Draft based on discussions at the Drafting Committee meeting in January, 1996 and input from software end user groups, representatives of the publishing industry, members of the New York City Bar Association, members of the California Bar Association commercial law committee, and the Software subcommittee of the American Bar Association.

While substantially improved, this remains a draft "in process," and no final decisions on any provisions have been taken by this Drafting Committee or the sponsoring organizations.

The reader is referred to the Preface contained in the December, 1995 draft for an overview of the structure and drafting approach of this draft. That discussion is not repeated here. The purpose of this note is to provide guidance to the major changes made in the Draft

Scope

The December Draft focused on transactions in digital information. That term was used to attempt to capture the convergence that is occurring in the electronic information industries. Virtually unanimous commentary, however, suggested that a concentration on a single, current technology was not appropriate. The likelihood is that new technologies for processing information will continue to evolve and to do so rapidly. Because of this, this Draft abandons the digital limitation.

This step leaves open a difficult question of defining scope. Both during the Drafting Committee meeting and at later sessions with some of the groups noted above, there was relatively strong support for a scope definition covering all transactions in information (regardless of technology), with an approach of carving out transactional contexts that, as the substantive terms of the Article evolve, appear to be inappropriate. Much more limited support existed for seeking a new, technology based qualifier for the scope definition.

This Draft applies to all transactions in information subject to exclusions outlined in Section 2B-103. That choice was made for drafting purposes because it allows the Drafting Committee to consider the broadest range of input available and to ask questions about appropriate substantive default rules looking at an entire range of transactions that have strong similarities. For example, in considering the appropriate default rule for factual or other content errors in the case of on-line databases, the Committee can squarely consider why (if at all) that default rule should be different from that used with reference to ordinary newspapers and magazines (increasingly being distributed in both paper and digital form). The Draft presumes that the rule should not be different and that the time-tested rules applicable to generally distributed new and entertainment products as to their content should carry over to the on-line context.

The Draft continues to use a licensing paradigm for many of its provisions, but also includes transactions in which copies of information products are sold, in the same manner that original Article 2 covered transactions in goods viewing them primarily from a perspective based on sales. To ensure that the distinctions are observed when appropriate, the definition of a "license" has been narrowed to cases where an express contractual limitation on use, copying, or the like exists.

Electronic Contracting

There was extensive discussion of electronic contracting issues at the Drafting Committee January meeting. The thrust of the discussions generally supported the approach taken in the prior Draft and that approach remains largely unchanged. There are several important modifications, however, that are critical to understanding this Draft.

The first is that it has been made clear that, in order to be bound by actions of one's computer in arranging or performing a contract, the party must have programmed or had programmed for it a system that is capable of and intended to achieve those results. The key step in clarifying this comes in the definition of "electronic agent" which has been extracted from prior definitions in the December 1995 Draft and delineates a computer program designed, selected, or programmed to be able to act independent of immediate personal review by the party. The actions of such an "agent" are those that may bind the party.

The second change is to highlight the question of "attribution." In the electronic venues in which the Article will have its greatest effect, attribution questions are key. As drafted here, all of the questions of assent, electronic performance, offer and the like hinge on being electronic actions that can be attributed to the particular party. Hence, the definition of attribution is a critical risk allocation step. As in other parts of the article, actual agreements control. Absent that, Section 2B-113 plays a critical role. That section was modified to clarify language in the prior draft. It now sets out two clear rules (actual agency, presumed agency because of compliance with an agreed procedure) and list three options for a third rule that would allocate loss when a third party intervenes and causes the message to be sent. All of the options assume that a pure hacker cannot bind anyone and that the loss will lie with the one defrauded by the hacker. Beyond that, however, it suggests some situations in which a different result may be appropriate in the interests of enhancing the reliability of the internet and similar contracting systems. One should also review the definition of "attribution procedure" new to this Draft, and adapted from Article 4A.

Remedies

Two major changes have been made in the remedies provisions.

The first was a substantial reorganization and clarification of general remedies (damages) rules based on a review of the sections in light of the scope of the article. The damages rules have been reduced in number and clarified. They will be discussed at the March meeting of the Drafting Committee.

This Draft raises, but does not adopt the position strongly argued by various sources that the default rule in reference to damages should exclude consequential damages unless agreed to be the parties. Arguably, this would be correspond to modern commercial practice where consequential damages are often disclaimed in negotiated deals. As indicated in the Preface to prior drafts of this article, a goal of drafting must be to reflect, rather than regulate commercial practice. Additionally, a perhaps less globally, an exclusion of consequential damages for publicly distributed electronic or other information would seem to be highly appropriate given the low cost, potentially high risk, nature of the commodity being dealt with. By analogy to other recently adopted UCC articles, a default rule that requires affirmative agreement to create liability for consequential loss would be appropriate for on-line systems and similar nonelectronic general information products. A limited step in that direction is in the section on terms of electronic transactions.

The second major change involves an effort to clarify the balance sought with reference to a licensor's right to prevent continued use of its product after a material breach. The goal is to more closely condition the right on there being a proportionate right or loss. That is, to ensure that no significant rights are entailed of damage to person or property and that the remedy exists only in the event of a true material breach.