UNIFORM COMMERCIAL CODE
ARTICLE 2B
LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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Draft

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With Notes

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NOTES TO THIS DRAFT

With limited exceptions, the January 19, 1997 Draft reflects decisions through the December, 1997 meeting. It is black-lined as to changes that have not appeared in prior drafts except where prior drafts contained suggested language that was not discussed by the Committee.

While the basic substantive content and focus of the Draft remains constant, the January 19, 1997 Draft entails a significant number of changes implementing decisions made and directions given by the Drafting Committee during the November and December meetings and on-going discussions with various observers and other groups. In addition, the January 19 Draft contains materials developed in an attempt to reconcile concepts brought forward from existing Article 2 with the reality that practices in the information industries often deal with a far different practical and legal base. The following brief discussion summarizes some major elements of the new Draft.

1. Definition of Mass Market License.

During the December meeting, the Drafting Committee and observers extensively discussed the definition and application of the concept of "mass market" with respect to this Article. Being a new, relatively innovative concept, much of the discussion focused on identifying the basic theme and structure of how the definition should be approached.

As a result of this discussion, the Committee voted to adopt an approach to defining the idea of a mass market in a structure centering on standard form agreements oriented to transactions directed to the general public. In light of the risk allocation issues involved and new nature of the undertaking, the agreed goal was to focus the definition on relatively small transactions in a retail marketplace. This Draft contains a definition implementing that direction. The definition also expressly incorporates all consumer transactions within the ambit of mass market. This reflects the core principle and fact that, under current law, it is not possible to entirely structure this Article without utilizing general, existing legal concepts pertaining to consumer transactions. For non-consumer transactions (e.g., transactions between two businesses in a retail market), the definition utilizes a combination of a retail, general public reference point with a monetary cap to achieve the intended focus.

The critical issue with reference to the idea of a mass market in this Article goes beyond the definition and deals with how the concept is applied. As discussed in prior memoranda, the two general approaches to using this concept are: 1) treating the marketplace definition as a surrogate for consumer protection and thereby extending some consumer protections to some business transactions, or 2) using the concept primarily as a marketplace identifier which keys into various expectations about the nature of transactions in that market.

The Committee requested the Reporter to prepare a discussion of how the different viewpoints should be developed in this Article. My basic view is that, where the intent is to protect individuals, the Draft should use the traditional, consumer construct, rather than that of the "mass market" which, by definition, includes a wide variety of individuals and businesses. This would focus the mass market concept on marketplace assumptions and expectations, such as transferability.

Based on that assumption and including the Committee's prior vote with reference to warranty disclaimers, the following applications of the two concepts exist in the Draft:

INDIVIDUAL PROTECTION PRINCIPLES:

2B-105 (opt in to Article 2B): consumer, rather than mass market
2B-106 (choice of law by contract limited): consumer, rather than mass market
2B-106 (choice of law in absence of contract term): consumer, rather than mass market

2B-303 (limiting effect of no-oral modification clause): consumer, rather than mass market
2B-304 (limiting modification of continuing contracts): consumer, rather than mass market

MARKET PLACE PRINCIPLES:
2B-308 (notice of some contract terms): mass market, rather than consumer
2B-403 (implied warranty of quality): mass market, rather than consumer
2B-406 (disclaimer of warranty): mass market, rather than consumer*
2B-502 (presumed transferability of license): mass market, rather than consumer
2B-504 (security interest attach without consent): mass market, rather than consumer
2B-601 (perfect tender): mass market, rather than consumer
2B-610 (refusal for imperfect tender): mass market rather than consumer

* previous vote by Drafting Committee that might be reconsidered in light what overall distinctions are made since protection there focuses on protecting an individual, rather than on marketplace questions. This pattern provides a potential base that could be considered in general or at least reviewed as each application of the distinction arises.

2. Concept of Financier.

During the December meeting, the Committee also extensively discussed treatment in Article 2B of security interests and financing lease arrangements. Basic consensus emerged around the approach proposed in the November Draft with reference to creating interests in non-exclusive licenses. That approach enables creation and enforcement in mass market licenses without a licensor's consent, but as to other types of non-exclusive licenses, enables the creation of an interest, but does not allow transfer of the interest by the lender through foreclosure without consent of the licensor. The balance suggested allows creation of a financing interest in a licensee's interests under a contract, but precludes enforcement without consent of the licensor other than by repossession. Remarketing is excluded. This approach received support from all of the affected groups. That approach is refined and implemented in this Draft.

Following discussion of financing issues, a consensus emerged to explore simplification and minimization of the scope of coverage of financing arrangements in this Article while maintaining the core structure. Pursuant to that consensus and to various suggestions, this Draft proposes an integrated concept of "financier" which includes both a security interest and a financing lease. The concept, defined in Section 2B-102, is then applied in the two primary sections dealing with financing arrangements. The first section, 2B-504, basically retains the language and approach of a section proposed for discussion in the November Draft regarding the creation of an financing interest. The second section, 2B-618, contains a limited treatment of the relative relationship between a licensor, a financier, and a licensee (debtor).

The Draft deletes as unnecessary much of the substantive content of the prior Draft regarding finance leases, which was contained in three substantive sections. The core provisions remain constant, however.

3. Treatment of Informational Content Submissions.

As in prior drafts, the December Draft contained a number of provisions derived explicitly from Article 2 relating to tender, inspection, acceptance, rejection and revocation issues modeled on a sale of goods transaction. These rules, which do not exist in the Restatement or general common law jurisprudence, create a number of difficult issues as applied to transactions involving aspects of the information industries not associated with computer software transactions.

This Draft proposes a solution to one aspect of these problems in the development of a concept of "information submissions" applicable to cases involving publishing and contracts where the submission is reviewed by the licensee in terms of aesthetics and market suitability. The insight that underlies this separate treatment is that, in discussing the Article 2 rules as applied to these transactions, the erroneous assumption was that submission of a manuscript is equivalent to tender of delivery of a product. It is not. Rather than calling for immediate acceptance or rejection, such submissions commonly initiate a process of mutual review and revision leading eventually to a final decision to accept or rejected the submission. New Section 2B-602 reflects that reality and takes this scenario entirely outside of the tender-acceptance rules, relying heavily on trade practice and general common law principles to define the interests of the parties.

One consequence of this step is to provide that, in the idea or information submission context, acceptance does not occur unless and until there is an express indication of acceptance (or rejection) by the licensee. This corresponds to practice in this context.

4. Treatment of "Performed on Receipt" Transactions.

A second setting in which Article 2 concepts of tender, inspection etc. create an uneasy fit with practice in information industries arises with respect to a category of transactions in which, by merely viewing information, the licensee receives the essential value of the transaction and by the very nature of the performance, that value cannot be returned. This might involve, for example, a Dun and Bradstreet report on a company, a license of a valuable formula for Coca Cola, a credit report on an individual, or a screening at home of a pay per view motion picture.

To the extent that these transactions involve licenses governed by Article 2B, forcing an Article 2 framework creates a dysfunctional change away from common law principles of accountability, especially with respect to the idea embedded in Article 2 of a right to inspect before payment. Inspection of the information in such cases in effect transfers the value contracted for and the licensee cannot return the value even if it desires to do so.

This Draft in Section 2B-608 proposes an integrated treatment of such types of transactions that exists outside the traditional sale of goods framework. It basically places the transaction under the general rules of 2B-601 and 2B-604 which parallel modern common law, the law currently applicable to such transactions.

5. Creation of More Generic Default Rules.

Since the active involvement of the entertainment and publishing industries has grown in the past several meetings, it has been increasingly apparent that default rules developed with a focus on the software industry were not necessarily applicable to the other information industries. This fact, along with the recommendations of various people that the Draft seek a higher level of generality in reference to default rules, presented a need to reconsider a number of sections that were contained in the November and prior drafts. In the Preface to the November Draft, the Reporter requested advice and guidance on the issue and significant input was received from a number of sources.

This Draft proposes a substantial reduction in the detail of default rules and the number of rules provided. New Section 2B-310, under this proposal, replaces many of the prior rules. Since the Committee had already visited some of the default provisions in prior drafts, core content of some are retained and transferred over to 2B-310. As a general rule, however, the approach suggested aims to reduce the detail of coverage compressing former sections 2B-310 through 2B-318 into three sections.

LICENSES

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PART 1

GENERAL PROVISIONS

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

Uniform Law Source: UCC 2-102.
Reporter's Note:
The scope of Article 2B is 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 a contract for electronic access to a resource containing information, resource for processing information, data system, or other similar facility of a licensor or third party, whether or not performance of the agreement also entails access to information resources delivered to or controlled by the licensee.

(2) “Authenticate” means to sign or to execute or adopt a symbol, including a digital signal and identifier, or to do an act that encrypts a record or an electronic message in whole or in part, with present intent to ~~to~~ establish the authenticity of, or signify a party’s acceptance and adoption of, a record or term that contains the authentication or to which a record containing the authentication refers.

(3) “Cancellation” means an act by either party which ends a contract because of a breach by the other party.

(4) "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result.

(5) "Consequential damages" means compensation for losses of a party resulting from its general or particular requirements and needs which, at the time of contracting, the other party had reason to know would probably result from a breach of contract and which are not unreasonably disproportionate to the risk assumed by the party in breach under the contract and could not have been prevented by the aggrieved party by reasonable measures after breach. The term includes compensation for losses ~~resulting from the breach~~ in the form of lost profit or opportunity, damage to reputation, lost value in confidential information because of wrongful disclosure, damage to information other than the subject matter of the contract, damage to property or information other than the subject matter of the transaction caused by an extraneous program, code, or virus, and injury to person or property proximately resulting from breach of warranty. The term does not include direct or incidental damages.

(6) "Conspicuous" means so displayed or presented that a reasonable person against whom it operates 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 a reasonably configured electronic agent to take it into account or react to it without review of the message by an individual. Except in the case of an electronic agent, a term is conspicuous if it is:

(A) a heading in ~~solid~~ capitals in a record or display;~~ referring to the language in the body or text of the record or display that is not in capitals;~~

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

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

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

~~(E) readily distinguished in another manner.~~

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

[Reporter's Notes: Existing Article 2 does not define "consumer." Article 9 focuses on acquiring property primarily for personal or household uses. European law uses a different approach. It defines "consumer" as someone entering into a contract outside her business or profession.

This draft does not follow revised Article 2 which refers to the time of "delivery" as the point at which intent is measured. The defined term "consumer" triggers restrictions on contracting practice. While in many cases, intent does not change from the time of contract to the time of delivery, when changes occur, a time of delivery focus retroactively changes the contracting rules. The issue is more important in Article 2B than in Article 2 since many contracts in Article 2B are on-going relationships and a delivery concept might provide different characterizations of the same transaction at different points in time.

The Article 9 definition of consumer creates serious interpretation issues when moved over to transactions that are not security interests in several contexts. These problems have been encountered in case law outside Article 9. This Draft clarifies the focus and should be considered by the Article 2 revision process. It deals with a core question. Some personal uses are not within any common conception of consumer use (see, e.g., Howard Hughes using a database to "personally" track his billion dollar investments). Making the distinction between these and other truly consumer uses holds great importance in Article 2B because software and other information can be used "personally" in very traditional business contexts. The exclusions in the definition apply to profit-making, profession, or business use. In the modern economy where individuals can and often do engage in seriously significant commercial enterprises without the overlay of a large corporation, the personal use idea needs to respect and reflect the modern practice, especially in this area. Perhaps we should use the European approach. Failing that, the proposed definition distinguishes between persons using information in profit making and business uses and personal or family uses such as ordinary asset management for an ordinary family. This latter clarification was added in this Draft based on suggestions of consumer representatives.

This issue has been considered in many areas of law that have evolved since the original (1960's?) definition of Article 9 applicable to secured transactions. The issues have proven to be difficult and subject to litigation when allowed to rest on the Article 9 concept, in lending, bankruptcy and other contexts. For example, a number of reported decisions focus on whether or when a purchase of stocks or limited partnership assets for investment purposes would be considered a consumer purchase since it might fall within the general reference to "personal" purposes. See, e.g.~~e.g,~~ Thomas v. Sundance Properties, 726 F.2d 1417 (9th Cir. 1984); In re Manning, 126 B.R. 984 (M. D. Tenn. 1991) (UCC definition "not especially helpful on its face"). Some courts emphasize the difference between acquisition for "consumption (consumer)" and acquisition or use "for profit-making". This approach comes in part from the Truth in Lending Act which uses a definition of consumer debt much like the definition in Article 9 of consumer but additionally contains an express exemption for business transactions. The "profit-making" test has been applied in bankruptcy cases interpreting a Bankruptcy Code provision identical to the standard UCC definition. For example, the Fifth Circuit commented that "[The] test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family or household purposes is whether it was incurred with an eye toward profit." In re Booth, 858 F.2d 1051 (5th Cir. 1988). See also In re Circle Five, Inc., 75 B.R. 686 (Bankr. D. Idaho 1987) ("The farm operation is a business for the production of income. Debt used to produce income is not consumer debt "primarily for a personal, family or household purposes.")]

(8) "Continuous-access contract" means an access contract that, within the time of agreed availability, affords the licensee a right of access at times substantially of its own choosing.

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

(10) "Delivery" means the physical transfer of possession or control, or the communication, of a copy to a licensee or a facility controlled by the licensee or its intermediary.

(11) "Direct [general] damages" means compensation for losses of a party consisting of the difference between the value of the expected performance and the value of the performance received. The term does not include compensation for losses resulting from the aggrieved party's inability to use the results of the expected performance in a commercial or other context, consequential damages, or incidental damages.

Reporter's Note: "Direct [general] damages", "Incidental damages" and "Consequential damages" are defined terms. The Draft defines "direct damages" to provide guidance on the distinction critical to much commercial practice that differentiates among the types of damages for purposes of interpreting disclaimer and other language in contracts. Direct damages are losses associated with a reduction of value or loss of value as to the contracted for performance itself, as contrasted to losses caused by intended uses of the performance or use of the results of the performance. Direct damages are measured in the various damages formulae contained in this Article. A dispute exists on whether this concept should be labeled "direct" or "general" damages. "Direct" is the more common term in commercial discussions. "General" may more accurately reflect the common law rule.

The definition provides guidance in drafting and to clarify terms central to treatment of damages in this Article. The second sentence is added to reject cases that incorporate expected benefits (e.g., consequential damages) within direct damages. Thus, one case held that defects in a system under a contract that disclaimed consequential damages included all the lost benefits that the party expected from the deal (a total far in excess of the purchase price and incorporating what would ordinarily be consequential loss). The query is: if we have software purchased for $1,000 which, if perfect, would give profits of $10,000 and the thing is totally defective, should the "value" of the software be considered to be "$10,000 or $1,000 as "general" damages? The answer here is $1,000. Similarly, if a virus in a program causes a $10,000 loss, but the program otherwise fully performs, should that $10,000 be direct or consequential loss? The draft treats this as consequential loss.

(12) "Electronic agent" means a computer program or similar device designed, selected, or programmed by a party to initiate or respond to electronic messages or performances without review by an individual. The term does not include a common carrier employed or used in that capacity.

(13) "Electronic message" means a record stored, generated, or transmitted for purposes of communication to another party or an electronic agent by electronic, optical, scanner, or similar means. The term includes electronic data interchange, electronic mail, facsimile, telex, telecopying, and similar communications.

(14) "Electronic transaction" means a transaction in which the parties contemplate that a contract will be formed by means of electronic messages in which the messages of one or both parties will not be reviewed by an individual.

(15) "Financier" means a person that pursuant to a security agreement or lease provides a financial accommodation to a licensor or licensee and obtains an interest in the rights in the license of the party to whom the financial accommodation is provided. A person who becomes a licensee and sublicenses or otherwise transfers the license to the financially accommodated party is not a financier unless (i) before the licensor provides the information, the person making the financial accommodation sends and the licensor receives notice of that person's interest and of the intent that the financially accommodated party will be the end user of the information, and (ii) the financially accommodated party agrees or manifests assent to the terms of the license as a condition to the agreement for financial accommodation.

[Reporter's Note: This definition is new. It provides the basis for the proposed, integrated treatment of financing arrangements in this article. The definition covers both security interests and leases that enable or implement a financial accommodation. The second, lengthy paragraph of the definition sets out coverage of what in other contexts are described as finance leases where the lessor, for purposes of financial accommodation, acquired a license which it then leases down to a licensee. Qualifying for finance treatment requires, under this definition, both notice to the licensor and actual agreement or assent by the licensee to the licensee. These requirements protect both the licensor and licensee's interests.]

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

(17) "Incidental damages":

(A) includes compensation for any commercially reasonable charge, expense, and commission incurred after breach by the other party in:

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

(ii) stopping shipment;

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

(iv) reasonable efforts otherwise to mitigate the consequences of breach; and

(v) actions otherwise incidental to the breach;

(B) but do not include consequential or [direct] [general] damages.

(18) "Information" means data, text, images, sounds, computer programs, software, databases, mask works, or the like, or any associated intellectual property rights or other rights in information.

(19) "Informational content" means data, text, images, sounds, or similar information intended to be communicated to a person in the ordinary use of the information.

(20) "Intellectual property rights" includes all rights in information created under laws governing patents, copyrights, trade secrets, trademarks, publicity rights, or any similar law that permits a party independent of contract to control or preclude another party's

use or disclosure of information, whether the law creating the rights is a state law, federal law or the law of another country.

(21) "License" means a contract for transfer of rights in information which expressly conditions, withholds or limits the rights granted, or expressly grants less than all rights in the information, whether or not the contract transfers title to a copy of the information. The term includes an access contract~~, data processing contract,~~ and software contract. The term does not include an assignment or a software contract that transfers ownership of the intellectual property rights in the information~~software~~ or the reservation or creation of a security interest in information or a financial accommodation contract.

[In this article, the distinction between an unrestricted sale of a copy and a license is simple. In an unrestricted sale of a copy, transferee receives ownership of the copy and, if intellectual property rights apply to the information on the copy, may be subject to implicit restrictions on use of the information derived from intellectual property law. In a license, whether ownership of the copy transfers, the transferee is subject to express contract restrictions or receives a contract grant that expressly gives less than all rights.]

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

(23) "License fee" means the price, fee, or royalty payable pursuant to a contract under this article.

(24) "Licensor" means a transferor of rights in a contract under this article, whether or not the contract constitutes a license. The term includes a provider of services in a contract under this article. In an access contract, as between a provider of services and a customer, the provider of services is the licensor, and as between the provider of services and any provider of informational content for the service, the informational content provider is the licensor. If performance of the ~~consideration for~~ 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 it transfers.

(25) “Mass-market license” means a standard form prepared for and used in a retail market for information which is directed to the general public as a whole under substantially the same terms for the same information, if the licensee is an end user and acquired the information in a transaction under terms and in a quantity consistent with an ordinary transaction in the general retail distribution. The term includes consumer contracts. “Mass market license” does not include:

(A) a significant transaction between parties neither or whom is a consumer with respect to that transaction, including:

(i) any transaction in which either the total consideration for the particular item of information or the reasonably expected fees for the first year of an access or similar contract exceeds [$500] [$1,000];

(ii) any license that contemplates concurrent use of software by more than one person acting separately;

(iii) any transaction in which the information is customized or otherwise specially prepared for the licensee; or

(B) a license of the right to publicly perform or publicly display a copyrighted work.; or

[(C) an online or access contract between parties neither or which is a consumer with respect to the particular transaction.]

[The definition of mass market was extensively discussed at the December meeting. The Committee voted to utilize the concept of “general public” as expressed in former Alternative B as the primary model for the revised definition and, as explained by the proponent of the motion, to focus the definition on <u>small</u> retail transactions with a goal of predictability in application, limitation of business risk to manageable levels, and exclusions for various business transactions. This proposed definition achieves those objectives.

The definition contemplates a retail marketplace where information is made available in pre-packaged form under generally similar terms. The marketplace is such that the distribution is oriented to the general public as a whole, including consumers. This captures most of what one regards as a true retail setting, such as transactions that occur in modern department stores or the like.

The definition also contains a comprehensive inclusion of consumer contracts. As discussed at the last meeting, this cannot be achieved through any method other than specific utilization of the term "consumer." More generally, as discussed in the introductory notes, it will be important for the Committee to differentiate cases where marketplace protections or assumptions are desired as compared to consumer protection assumptions.

In reference to business (non-consumer) transactions, Article 2B will be the first UCC article to extend consumer-like protections to business deals in any form and the first to tailor at least some contract default assumptions based on that concept. As discussed in December, the goal is to do this in a limited manner, reflecting the innovative nature of the concept, while confining the risk created by focusing on small transactions for information oriented toward the broad general public.

The definition excludes any "significant" non-consumer transaction. That general principle is further elaborated by the explicit exclusions noted in (B). The dollar limit here plays an important role in establishing predictability. The $500 item exceeds the current average cost of retail software. The $1,000 figure far exceeds that average. The dollar amounts thus aim for predictability, while covering virtually all true retail transactions. Unlike in the Draft considered at the annual meeting, consumer transactions are not subject to the dollar limitation, but are handled separately. The basic theme suggests that, especially to the extent that the concept applies to establish consumer-like protections for business transactions or to create assumptions that may be contrary to ordinary expectations in business to business transactions, a dollar limitation establishes a predictable planning basis that cannot otherwise be established

The other business transaction exceptions essentially identify situations involving site licenses, typical performance licenses (e.g., ASCAP, Broadcast Music) and situations where the licensor provides customization of the product, rather than transferring it essentially of the shelf

This Draft applies to dealing with the extent to which on-line (Internet) transactions fall within the idea of mass market transactions. All consumer transactions on Internet fall within that definition and a vast number of consumer transactions occur on Internet. It is especially important however, with this new media, to not regulate business transactions before practices have evolved. One possible approach is to exclude from the definition of mass market any online transaction not involving a consumer. This would give the online industry room for expansion and growth not subject to unintentional regulations, while still preserving consumer protections in that environment. The bracketed language in (C) suggests that approach.

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

(27) "Nonexclusive license" means a license in which the licensor or other person authorized to make a transfer or license is not prohibited from licensing the same information or rights therein to other licensees. The term includes a consignment of copies.

(28) "Published informational content" means informational content prepared for distribution or distributed in substantially the same form to all licensees and not provided as customized advice tailored for ~~the particularized situation of~~ the particular licensee by an individual acting on behalf of the licensor using judgment and expertise. This term does not include informational content provided within a special relationship of reliance between the provider and the transferee.

(29) "Receipt" means taking delivery of a copy or information. An electronic record is received when it enters an information processing system in a form capable of being processed by that system and the recipient uses or has designated that system for the purpose of receiving such records or information.

(30) "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.

(31~~2~~) "Sale" means the passing of title to a copy of information for a fee.

(32) "Scope" of a license means those terms of a license that define the subject matter licensed, the rights granted, the territory or location in which the grant applies, the term of the license, and the uses granted.

Reporter's Note: This definition is new and patterned after suggestions from the entertainment industry. It contemplates dealing with certain critical terms in a license that should be integral in determining assent and in gauging the effect of forms. The scope provisions of a license essentially deal with what the subject matter of the transaction entails and are central to the use, application, and protection of intellectual property rights in the particular information.

(33) "Software" means a computer program and any data, program description, media, or supporting documentation provided by a licensor as part of the transaction.

(34) "Software contract" means an contract to transfer rights in software, including a contract to develop software as a work for hire, whether or not the software exists at

the time of contracting, is to be developed, or whether the contract provides for transfer of ownership of or conditional rights in copies of the software or for services to develop, support, or use it.

(35) "Standard form" means a record consisting of multiple contractual terms prepared by one party for general and repetitive use which is used in a transaction without negotiation of, or changes in, the substantial majority of the standard terms. Negotiation or customization of price, quantity, method of payment, standard options, or time or method of delivery does not preclude a record from being a standard form.

(36) "Standard term" means a term prepared in advance for general and repetitive use by one party and used in a standard form.

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

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

(39) "Transfer of rights" means a grant of a contractual right or privilege as between the parties for the transferee to have access to, modify, disclose, distribute, purchase, lease, copy, use, process, display, perform, or otherwise take action with respect to information, coupled with any actions necessary to enable the transferee to exercise that right or privilege.

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

Committee Votes:

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

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

3. Voted to adopt a definition of "mass market license" that utilizes a reference to a market involving the general public and that centers on small retail transactions including most consumers and excluding special primarily business transactions.

Reporter's Notes:

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

2. Authenticate. This article replaces the traditional idea of "signature" or "signed " with a term that incorporates modern electronic systems, including **all** forms of encryption or digital symbol systems. Substantive rules on proof of authentication are in Section 2B-[114]. Basically, the fact of authentication can be proved in any manner including proof of a process that necessarily resulted in authentication. Use of an "attribution procedure" agreed to by the parties per se establishes that a symbol or act constitutes an authentication.

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

3. Computer program. This definition parallels the Copyright Act.

4. Consequential damages. This article follows existing Article 2. Personal injury and property damage are a form of consequential damages; all other requirements being met. Beyond that specification, this article also resolves some issues that are not clear in current law and that involve important issues for parties involved in contract negotiation. The basic premise of consequential loss is that it is attributable to a breaching party only if some level of foreseeability can be proven. More importantly, contracts deal with exclusion or inclusion of consequential loss in practice and that negotiation process should be supported by a delineation, insofar as possible, of what falls into this category and what does not. The illustrations suggested in this article cover many relevant situations providing clarity for negotiation. The theme here is that consequential losses go outside the principle that the performance itself was less in quality than was agreed to by the parties.

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

5. Conspicuous. This definition follows existing law and adds new concepts to deal with electronic systems. The edits contained in this draft remove language not associated with electronic and online transactions that was not directly taken from existing law in UCC 1-201(10). Current law contains three explicit safe harbors for making a clause conspicuous and these have been part of modern law for over fifty years. They serve a critical role in planning transactions and drafting documents. As a general rule, under current law, a draft that conforms to a "safe harbor" provision in the UCC for conspicuous is held to be conspicuous as a matter of law. In fact, the trend of cases holds that failure to conform to a safe harbor may invalidate any claims to being conspicuous.

"Conspicuous" in a message received by an electronic agent refers to the ability to act on the term; that is, the term must be in a form that can be processed and understood by the computer. It need not be otherwise separated out in the machine situation. If an electronic message (e.g., E-Mail) is used and a human reaction is intended, the other provisions of this definition apply. The electronic message suffices if it is designed to invoke such a response from a "reasonably configured" electronic agent, a concept that will be spelled out in the commentary to indicate that it intends an analogous construct that parallels the reasonable man standard used for the general concept of conspicuous.

Revisions of Article 2 currently advocate abolition of the safe harbor concepts in current law. The rationale apparently is to ensure a debated issue and general scrutiny of contract terms in any case where law requires a conspicuous term. Arguably, that is an invitation to litigation. This Draft retains existing law on this point. The idea of conspicuous language is a concept that blends both a function of notice to the party receiving the contract and certainty to the party preparing and using it. It is equally important to ensure that, to the extent reasonably possible, the recipient of a record receives notice of the contents, and that the party who reasonably desires to rely on the terms of the record can do so. Taking out all safe harbor language eliminates the second objective and may also jeopardize the first.

Under Section 2B-115(c), whether a term is conspicuous or not is a question of law, as is true under current law.

6. Consumer: See discussion appended to the definition.

7. Continuous access: This concept applies to literally continuous access contracts and, for example, to cases where a contract calls for availability during afternoons only and does not allow for access whenever the licensee desires outside that time period.

8. Copy: Edit intended to avoid confusion with defined term "record" and to use language that has common meaning in the Copyright Act, corresponding this statute to case law developing in that field about when a copy occurs. Cases there hold that a copy does not require permanence, but cannot be purely transitory, such as an image on a screen. Courts hold that moving information into a computer memory constitutes making a copy of that information.

9. Court: This definition extends the power to make choices, such as on conscionability, to officers of non-judicial forums.

10. Direct damages: see discussion in text.

11. Electronic Agent: 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. The term plays an important role in shaping responsibilities and how parties comply with various conditions, such as an obligation to make terms conspicuous. Courts may ultimately conclude that an electronic agent is equivalent in all respects to a human agent, but this Draft does not go so far, making specific provisions relating to electronic agents when needed. In this respect, the Draft is consistent with Article 4A as well as with modern practice. The accountability of a party for actions of a computer program may hinge on different issues than accountability for a human agent.

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

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

13. Electronic Transaction: This definition has been edited to clarify its focus on transactions in which one or both parties is represented by a machine (electronic agent), rather than a human being.

13a. Financier: This definition replaces the definition of "finance lease" and encompasses both security interest providers and lease financing. It provides the lynch pin for developing a compressed and cohesive treatment of financing interests in this article without going into excessive detail. The affirmative definition in the first sentence is intended to cover both types of modern financing. The exclusion under the second sentence deals with a circumstance that is unique to some forms of finance leasing: the case in which the license is given to the financier and then transferred down to the financed party (licensee). This transaction will often violate the terms of transferability in a license. In this case, to qualify for coverage under the financier language, the party must give notice to the licensor of and financier status depends on making the financial accommodation conditional on the licensee's assent to the license terms. This protects both the licensor and the licensee.

14. Good Faith: The definition extends the duty of good faith fair dealing to consumers, rather than alternatives that restricted the concept to honesty alone or that would limit the broader concept to merchants only. Non-merchant duty of fair dealing would, in the context of this article, probably encompasses uses of information, such as computer programs, that may not violate express terms, but represent unfair dealing.

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

16. Intellectual Property Rights: The definition is to be inclusive and capable of responding to new developments in national and international law, such as possible non-copyright database protections. With each area of law referenced here, the relevant law itself defines what rights are and are not covered. Whether this affects contract limitations pertaining to the information has been debated, but subject to misuse and other regulatory concepts that go beyond this statute, the general approach in courts is that a property right need not exist in order to have an enforceable contractual limitation.

17. License: The linchpin of this definition lies in the conditional or limited nature of the contract rights. At least some conditions must be express, rather than implied. Some have suggested that fully "implied licenses" should be included. These arise, for example, where a court concludes that, to make the transaction a reasonable one in light of the parties' expectations, some rights or limitations not made express should be inferred (e.g., where intent was to transfer ownership, an implied license may be inferred if the ownership transfer was ineffective). Many such transactions are within this Article, including any transaction where some rights are implied in any otherwise conditional transaction. We do not include implied in law licenses such as occur under first sale rules in copyright relating to the sale of a copy of a book. As noted by the Federal Circuit Court of Appeals, a sale can be made conditional on intellectual property rights (e.g., patent in that case) and, similarly, while a sale of a copy transfers some copyright rights under federal law, the licensor retains control of a great deal of the copyright law's exclusive rights even as to that copy. A license deals with control of rights of use and the like with reference to the information, while title to the goods deals simply with that - title to the goods.

18**. Licensor and Licensee: These are generic terms.** Changes in the text to clarify that these terms are used not only in reference to "licenses" but in reference to other contracts covered by the Article (e.g., a development contract in which the licensee obtains ownership of the copyright in the software). In the definition of licensor, several specific illustrations are used to avoid confusion in cases where more than one party transfers information, that is, where the parties exchange information or performance.

19. Mass-Market License: This is a key term, What we are trying to capture is the difference between a mass market and non-mass market transactions even though in both settings, standard forms are routinely used, not negotiated and relied on for reasons of economy. (an example of a non-mass market transaction would be a transaction between Xerox and IBM for a group of Xerox copiers governed by a standard form that Xerox will not negotiate). The problem comes in defining a mass-market as compared to any other market.

This Draft contains a definition that implements the Committee's decision to focus the concept on small retail transactions in a manner that provides optimal predictability. The definition hinges on a deal made in a retail marketplace involving information that is directed to the general public as a whole. To avoid concerns about consumer coverage, the definition expressly incorporates all consumer contracts. To avoid or minimize the creation of high risk aspects in the coverage of business transactions, a dollar cap is placed on those transactions reflecting modern mass market pricing practices.

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

21. Sale: With respect to information, a distinction is made between title to the copy and title to the information. Title to information essentially means that the transfer is free of any restrictions, express or implied, on the use, reproduction or modification of the information.

22. Standard form: The coordinating committee recommended that Article 2 conform to Article 2B on this definition. Nevertheless, the Article 2 committee apparently concluded that standard forms do not exist and deleted the use of this concept. Subsequently, ALI Council recommended that this decision be reversed. The reference in this definition is to forms (e.g., groupings of standard terms) whose use in modern commerce is not only widespread, but virtually ubiquitous. The idea is not that a record containing language previously use in other deals falls within the term, but that a record prepared for repeated use is a form whose legal significance is judged accordingly.

SECTION 2B-103. SCOPE OF THE ARTICLE.

(a) This article applies to licenses of information and software contracts whether or not 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, and even if the expected development, discovery, compilation, or transformation does not in fact occur. The article also applies to any agreement related to a license or software contract in which a party is to provide support, maintain, or modify information.

(b) Except as otherwise provided in subsections (c) and (d), if another article of this [Act] applies to a transaction, this article does not apply to the part of the transaction governed by the other article.

(c) If a transaction involves both information and goods, this article applies to the information and to the copies of the information, its packaging, and documentation, but Article 2 or 2A governs standards of performance of the goods other than the copies, packaging, or documentation pertaining to the information. If a transaction includes information covered by this article and services outside this article, or elements excluded from this article under subsection (d)(1) and (2), this article applies to the information, copies of the information, its packaging and documentation. A transaction excluded from this article under subsection (d)(3) is governed by Article 2 or 2A.

(d) This article does not apply to:

(1) a contract of employment of an individual who is not an independent contractor, a contract for performance of entertainment services by an individual or group, or a

contract for performance of services by a member of a regulated profession with respect to services commonly associated with regulated aspects of that profession;

(2) a license of a trademark, trade name, or trade dress, or of a patent and know-how related to the patent to the extent the license does not pertain to computer software or to an access contract or database contract; or

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

Committee Votes:

a. Committee voted 10-3 to reject a proposal to limit the scope of the article to "coded", "digital", "electronic" or similar concept.

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

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

Selected Issues:

a. Should authors' contracts in the publishing industry be excluded?

b. Should the section deal specifically with coverage or exclusion of online "chat room" arrangements with celebrities?

Reporter's Notes:

[This section has been edited for clarity with no changes of substance from prior drafts. The Article focuses on licenses (except as excluded) and on software contracts. By the terms of the definition of "license", that coverage extends only to contracts that expressly condition rights in the information. Sales of books and newspapers are not covered. The issue regarding upstream author's or other contract should be considered only in relation to the proposed sections on submission of informational content and related issues proposed in this Draft.]

1. This article deals with transactions involving the copyright industries. These industries play a major role in the modern information age. The article does not cover all contracts in these industries, but focuses on licenses and emphasizes transactions in those industries whose current or future direction deals with digital products. Thus, the article does not deal with sales of books, newspapers or traditional print media sold over the counter since, except for transactions involving computer software, the scope of the article is limited to licenses. Article 2B-102 defines a license as a transaction involving a transfer of rights in information that expressly conditions or limits the rights conveyed. Implied conditions, which are present because of copyright law, in any sale of a copyrighted product, are not in themselves adequate to fall within the scope of the article.

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

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

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

4. Subsection (b) discusses interface issues. For transactions governed within the trio of UCC transactional articles (2, 2A and 2B), the primary rule applies each to its particular subject matter. This is the "gravamen of the action" test followed in some states under Article 2 in making distinctions between transactions in goods and transactions in services. It rejects the "predominant purpose" test for this issue. The primary exception occurs in reference to software embedded as discussed in (d)(3). Subsection (b) allocates coverage for mixed transactions where the non-covered aspects are not goods. In all cases, this Article covers the information issues within its scope, while other law governs for other aspects of the transaction. No predominant purpose test is intended even with reference to transactions part of which fall entirely outside the UCC.

5. Based on a suggestion from the floor of the annual meeting, comments will make it clear that manuals delivered in connection with software are covered under Article 2B.

6. The exclusion in subsection (d)(1) deals with employment contracts and services agreements related to entertainment (e.g., actor, musical group performance, producer, etc.). In the excluded cases, personal services contracts involve different default provisions than here. The motion picture and publishing industries have suggested that the Committee consider exclusion of talent and author contracts generally (e.g., the upstream portion of the industry). This subsection also excludes professional services to avoid confusion between and the regulatory standards of regulated professions. The exclusion only pertains to regulated services and not to other contracts or services (e.g., law firm web site where legal advice is not given is treated the same as any other web site).

7. Subsection (d)(2) excludes patent and some other pure intellectual property licenses. The rationale for exclusion lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that are not contemplated by this draft. The article concentrates on a more focused area of commerce. In practice, however, one can anticipate that courts will apply by analogy aspects of this Article to other fields of licensing. The comments will discuss the role of application by analogy of this Article in context of the history of reasoning by analogy in other contexts. See, e.g., the discussion of applying Article 2A to leases of other personal property.

8. Subsection (d)(3) excludes computer programs such as airplane navigation or operation software, software that operates automobile brake systems, and the like. It may not be possible to draw a bright line on when or whether such programs should be placed under the aegis of Article 2 or Article 2B. Comments will clarify the intended scope by examples from case law and other sources.

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

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

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

(2) a law of this State regulating purchase or license~~s~~ of rights in motion pictures by exhibitors; or

(3) a consumer protection law of this State.~~;~~

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

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

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

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

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

Sources: Section 9-104(1)(a); 2A-104(1)
Cross Reference: 2-104 (revision draft)
Committee Votes:
a. The Committee voted 11-1 to approve the section subject to further review of (b)(4). (September, 1996)
Coordination Meeting: Coordinating Committee recommended that Article 2 conform to 2B-104(b).
Reporter's Notes:
[Subsection (b)(4) was amended to delete the reference to "negotiation".]

1. Subsection (b) deals with the balance between the modernization themes developed in Article 2B relating to electronic contracting and existing law regulating of contract law in consumer or similar restrictions. The balance must preserve important policies and diversity (thus, the principle of general non-reversal) of these laws, but should extend the effectiveness of innovations in electronic contracting. The approach here sets out a presumption that the other law controls, but identifies aspects of other law where it is appropriate to reverse that presumption as to particular rules based on a legislative judgment that the electronic contract provisions of this Article are appropriate state policy. Digital signature laws adopted in Washington, Utah, and as proposed in other states, adopt a similar reconciliation approach, defining acts that comply with their requirements broadly to comply with writing, signature and similar requirements in **all state laws.** This Draft is more limited in impact, narrowing the changes to center on manageable and identified parameters of existing law without attempting to alter the entire world of signatures, assent and the like.

2. The goal is to facilitate electronic commerce and to implement concepts concerning electronic trade. Article 2B expands the idea of a writing and a signature to include, respectively, a record and an authentication. Conspicuous is defined to deal with electronic contexts and expanded by an enhanced concept of manifestation of assent. In these respects, electronic concepts that were not at issue when existing consumer law developed, require adjustments appropriate to promote uniformity and certainty in commerce that is truly national in nature, while preserving the intent of the regulations. There is no effort to alter content terms, such as whether a disclaimer can be made, what language must be used, and like issues. **The Coordination Committee recommended that Article 2 conform to Article 2B in this respect. After review, the Article 1 revision may elect to move this into revised Article 1 if the same principle should apply in all other articles.**

3. Subsection (a) reflects the diversity of statutory and common law regulation of aspects of law relating to information assets. This article centers on contractual arrangements and does not generally affect property rights. It does not disturb regulations that compel disclosure or other rights of access to the materials. This Article leaves undisturbed the law relating to privacy and personality rights. While these rights may be the subject of a license within this article, the underlying property right is not affected. For example, a state may hold that individuals have rights to control use of data concerning them. A licensee of a database of addresses would have to deal with the fact that each individual may be the required licensor. This article would not affect those rights, but deals with contract terms and remedies. While privacy and public access laws are especially relevant for the increasing commercial use of information, this article deals with contract law, not property rights and, thus, leaves to these other contexts the development of appropriate rules on information as property. As recommended by a bar association group, the comments to this section will contain illustrations suggesting the type of statutes referred to in subsection (a)(1). Given the functions of subsection (a), the draft should perhaps include in comments of text a reference to professional regulations in a transaction involving a lawyer or medical professional within this Article. Subsection (a)(2) intends to exclude preemption of the various state laws that regulate so-called blind bidding and other practices specifically relevant to the motion picture industry. As with consumer legislation, these statutes were developed through extensive discussion and policy making and they should not be disrupted or affected by Article 2B.

4. The Article is also subject to preemptive federal law. Federal intellectual property law contains some contract rules, but does not generally preempt state contract law. Instead, licensing law has traditionally been largely relegated to state law. When this is not true, of course, federal law controls. This draft does not refer to the preemptive effect of federal law for reasons of style, since the principle of preemption is clear.

5. This section was amended to reflect comments of consumer groups to make clear that as to consumer law, the preservation of rules covers both statutory and case law. This brings Article 2B into conformity with existing Article 2A and draft Article 2. Comments to Article 2A set the framework for interpreting the scope of this section and will provide a basis for comments to this subsection.

6. Discussion in September, 1996, raised issues about (b)(4) and reference to rules related to a requirement of negotiation. This draft deletes the reference in (b)(4) to negotiation. To the extent that a requirement of negotiation entails a mandate that a party actually dicker over a term with there being an actual and direct exchange and alteration of positions, the concept of manifesting assent does not meet this. No one has presented the Committee with an analysis of in what states or what contexts that requirement exists or what underlying policies the requirement, when adopted by a state, serves. Clearly, negotiation cannot exist in Internet transactions, if it requires individualized discussion of a term with the option to alter the term being present in fact. The Committee should invite research on this point from interested parties.

7. In final form, the structure of Article 2B must reflect some state's constitutional and other laws that preclude general revision without specific authorization, of laws outside the particular enactment. This can be achieved through a legislative note.

SECTION 2B-105. APPLICATION TO OTHER TRANSACTIONS. Parties to a transaction not governed by this article by agreement may elect to have all or part of this article apply to the transaction if the agreement is in a record that is not ~~other than~~ a consumer contract~~license~~. The agreement is effective to the extent that it covers issues resolvable by agreement.

Sources: None.
Coordination Meeting: Article 2 should conform to Article 2B approach; should be considered for possible inclusion in Article 1.
Selected Issue:
a. Should the section be adopted?
Reporter's Notes:
1. This Section makes explicit an approach generally accepted as existing in current law based on the theory of party autonomy. A contractual election to apply this article is analogous to a choice of law term selecting the law of a particular state. By agreement, parties can determine, for example, that the warranty rules of this article are more appropriate in a contract involving services than are common law or Article 2 warranties. If there are no fundamental policy barriers precluding use of these rules, the choice of law made by contract governs.
2. This Article exempts out from the idea of contract control consumer contracts dealing with this issue. That exclusion assumes that consumers are not likely to understand or have access to understanding the differences in law, but in most states under current law, a similar theory does not apply in cases where a consumer contract makes a choice of law unless fundamental policies of the state are circumvented by the choice. The draft suggests that the limitation on law selection be limited to a consumer, rather than extended to business licensees under a mass market characterization. Restrictions of this type, if appropriate for consumers, are not typically expanded to business parties; little rationale exists to apply this limitation in a case where the licensee may be a business of larger size and sophistication than the licensor where no similar limitation exists in any state in reference to business transactions involving any other type of transferee.

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

Alternative A

(a) A choice of law term in a contract is enforceable.

Alternative B

(a) A choice of law term in a contract is enforceable. However, in a consumer contract~~license~~, a choice of law term that selects the law of a jurisdiction other than the jurisdiction whose law would apply in the absence of the term is enforceable only if the pertinent contract rule could have been resolved by the parties' agreement or ~~to the extent that~~ giving effect to the term would not deny the consumer ~~the benefit of~~ fundamental protections available ~~to it~~ under the otherwise applicable law.

(b) If a contract does not have an enforceable choice of law term, the following rules apply:

(1) In an access or other online contract or a contract providing for delivery of a copy by electronic communication, the contract is governed by the law of the jurisdiction in which the licensor is located when the transfer of rights occurred or was to have occurred.

(2) In a consumer contract not governed by subsection (b)(1) in which the contract requires delivery of a physical copy to the consumer, the contract is governed by the law of the jurisdiction in which the copy is located when the licensee receives physical possession of the copy or, in the event of non delivery, the jurisdiction in which receipt was to have occurred.

(3) In all other cases, the contract is governed by the law of the state [with the most significant relationship to the contract] [where the licensor is located].

(c) If the jurisdiction whose law applies as determined under subsection (b)(2) is outside the United States, subsection (b)(2) applies only if the laws of that jurisdiction provide substantially similar protections and rights to the party not located in that jurisdiction as are provided under this article. Otherwise, the rights and duties of the parties are governed by:

(1) the law of the jurisdiction in the United States or in the country in which the licensor does business and has the most substantial connection with the transaction; or

(2) if no such jurisdiction exists, the law of the jurisdiction in the United States in which the licensee is located.

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

Uniform Law Source: Restatement (Second) of Conflicts ' 188;Section 1-105; Section 9-103.

Coordination Meeting: These issues are unique to Article 2B.

Selected Issues:

1. Is validation of choice of law agreements desirable in that it is consistent with modern common law and an important element of certainty in on-line contracts?

2. Should the section be adopted?

Reporter's Notes:

1. There are two questions addressed in this section. The first deals with enforceability of contract provisions choosing the applicable law for a contract and the second deals with choice of law in the absence of a contract term dealing with the question.

Choice of law clauses are routine in commercial licenses. They select what state's law applies. This section adopts a strong, contract choice position in reference to choice of law. Law outside this statute might restrict the ability of commercial parties to choose their law if the choice infringes fundamental policy of the forum state, but virtually none of the cases discussing this deal with anything other than a consumer case. In the few states where more expansive case law or regulations exist, of course, the limitations they create apply since they are typically grounded in consumer protection rules which are not affected on this issue by the terms of this article.

Subsection (a) validates choice of law agreements. That rule states a crucial policy choice in a context in modern information transactions occur in cyberspace, rather than in fixed environments. Because many transactions in this field are not easily related to tangible locations, the ability to fix an appropriate choice of law provides an important contract drafting premise. The Committee in January, 1996 expressed strong support for this premise and, indeed, it reflects the clear trend of modern law. The rule enhances certainty of contract on choice of law rules in Article 2B under the principle of freedom of contract.

Alternative A makes the clause enforceable, subject, implicitly, to concepts of unfair surprise, conscionability, duress, and other general law theories. Except in Article 2A and cases of consumer regulatory statutes, no current uniform law in the U.S. precludes enforcement of contract choice of law on issues that a contract could control. Neither the Restatement, current Article 1 or Article 2, nor revised Article 2 place special restrictions on choice of law. Alternative A was supported by a committee of the New York City Bar Association and others in commercial practice. It conforms to the commercial law concept that contract relationships govern. It provides an important base for the information infrastructure and Internet trade. In online contracting, the ability to control what law applies has especially great significance. An alternative rule would impinge on that base.

Alternative B makes a limited incursion on freedom of contract, precluding denial of fundamental protections by agreement in consumer licensees. The draft focuses on consumer, rather than mass market transactions. That is typically the maximums scope actually applied to such limitations. More generally, the protection if granted here is based on the nature of the party, rather than on the marketplace involved. In this Draft, the language of the exception was rewritten to more closely correspond to the Restatement (Second) of contracts. In working through when to apply consumer or mass market concepts for a particular issue, that factor provides one clear point of guidance and suggests here and in subsection (b) that the pertinent choice involves a focus on consumer, rather than mass market transactions.

2. The Restatement allows choice of law terms to govern in any case (including consumer contract) where the issue could be resolved by contract. In addition, even if contract rules might not otherwise govern, under the Restatement, the contract choice is presumed to be valid, subject to limited exceptions. Restatement (Second) of Conflict of Laws ' 187 (may be invalid if not resolvable by contract and either there was no "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue."

3. Article 1-105 allows a choice of law clause to govern in any case where the chosen state has a "reasonable relationship" to the transaction. This rule is more restrictive than the Restatement and the other law of most states not restricted by existing Section 1-105. It reflects a body of law that existed when the UCC was adopted five decades ago, but that has little merit in modern electronic transactions and does not fit with modern scholarship about choice of law as reflected in the Restatement (Second) and elsewhere. That rule is anomalous applied to transactions involving general commercial behavior. Article 2A provides a more limited rule for consumer leases, restricting the choice of law to the jurisdiction in which the lessee resides on or within thirty days after the contract becomes enforceable. ' 2A-106. That rule is inappropriate for the intangible property involved in the subject matter

of this article. It would create a situation in which an on-line provider would be subject to the law in all fifty states and unable to resolve this even by contract. That would be true even if no discernible consumer protection interest justified the contractual choice limitation. The residence rule does not exist under Article 2, Article 1 or the Restatement. As a consumer protection, it assumes that the domicile is more protective than any other state law. As a matter of logic, that **cannot** be true in all cases. In an information marketplace and especially in cyberspace transactions, the residence rule harms the consumer as often at it helps her. It clearly frustrates internet law goals of providing uniformity and being able to control the number of divergent laws with which a contract must comply.

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

4. The second issue involves choice of law in the **absence of contract terms** and is covered in subsection (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain for different terms if they so choose. Under general law, choice of law principles are often driven by litigation concerns and refer to questions about "reasonable relationship", "most substantial contacts", and "governmental interest." In the online environment, this does not support commercial development and creates substantial uncertainty.

5. The most important rule stated in subsection (1) is contained in (b)(!). It deals with modern electronic transactional environments and creates a presumptive choice of law based on the location of the licensor. This concept has been extensively discussed in reference to on-line environments. In cases where an on-line vendor automatically is providing direct marketing to the entire world through the internet, any other formulation would in effect require the vendor to comply with the law of fifty states and 168 countries since it will often not be clear where the information is being sent. Some states or countries mandate such compliance through local laws, such as for example, recent amendments to California warranty law applicable to the sale of goods. By opting for a more stable, identifiable source of underlying law is an important step toward facilitating electronic commerce in digital products. As described in this section, the licensor's location refers to its chief executive office (as in Article 9), rather than the location of the computer that contains or provides the information.

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

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

8. This Restatement theme is by no means the universally or even primarily accepted principle of choice of law concepts. A number of states continue to use principles from the Restatement (First) and from theories evolved by a large number of academic authors. One text describes the situation as follows: "[C]hoice-of-law theory today is in considerable disarray - and has been for some time. [It] is marked by eclecticism and even eccentricity.

No consensus exists among scholars…. [Like] revolutionaries who can unite only to eliminate the existing government, they cannot agree on the establishment of a new one. The disarray in the courts may be worse. Four or five theories are in vogue among the various states, with many decisions using - openly or covertly - more than one theory.” William Richman & William Reynolds, Understanding Conflict of Laws 241 (2d ed. 1992). The wide-ranging disarray approaches argues for providing guidance in this contractual environment for contract drafting and planning in cyberspace.

9. Common law cases generally enforce contractual choice of law, especially in transactions involving intangibles. See Finch v. Hughes Aircraft Co., 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985) (patent license); Medtronic Inc. v. Janss, 729 F.2d 1395 (11th Cir. 1984); Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products, 229 U.S.P.Q. 335 (D. Md. 1985); Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co., 986 F.2d 607 (1st Cir. 1993). The major exception occurs where the choice contradicts the basic policy of the state that would otherwise have its law apply, but reported cases outside of consumer or other regulated contracts often go relatively far to avoid finding such fundamental policies. Shipley Co., Inc. v. Clark, 728 F. Supp. 818, 826 (D. Mass. 1990) (non-compete choice enforced since it violates no fundamental policy).

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

SECTION 2B-107. CHOICE OF FORUM. An exclusive judicial, arbitration, or other dispute resolution forum may be chosen by the parties, but in a consumer contract~~license~~ [that does not involve an access contract or other online transaction], the choice of a ~~[~~judicial~~]~~ forum is not enforceable if the chosen jurisdiction would not otherwise have jurisdiction over the licensee and the choice [unfairly disadvantage] the consumer~~licensee~~. A forum chosen in a term of an agreement is not exclusive unless the agreement expressly so provides.

Uniform Law Source: Section 2A-106. Substantially revised.
Coordination Meeting: This issue is covered only in Article 2B.
Selected Issue:

1. Should restrictions on forum selection be limited to consumer contracts in light of a modern pattern in U.S. law enforcing forum selection in most contracts, including standard form agreements?

Reporter’s Notes:

1. This section deals solely with choice of an **exclusive** forum. It does not cover contract terms that merely permit litigation to be brought in a designated jurisdiction, but do not require that this occur. The trend of modern case law generally enforces choice of forum clauses, even if contained in unread standard form contracts, so long as enforcement does not unreasonably disadvantage a party. In Bremen v. Zapata Offshore Co., 407 U.S. 1, 10 (1972), for example, the Supreme Court noted that choice of forum clauses in contracts are “prima facie valid.” This case law does not generally differentiate between standard form and nonstandard, negotiated contracts. However, in both contexts, constitutional concerns about fairness and notice may provide a limiting role. Thus, 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. Similarly, some courts hold such clauses to be unenforceable where they impinge on concepts of fundamental unfairness. See Perkins v. CCH

Computax, Inc., 106 N.C. App. 210, 415 S.E.2d 755 (1992); Lauro Lines v. Chasser, 490 U.S. 495 (1989); Sterling Forest Assocs., Ltd. v. Barnett-Range Corp., 840 F.2d 249 (4th Cir. 1988).

2. The importance of allowing enforceable choice provisions in information transactions in cyberspace contexts was highlighted recently by a series of cases involving jurisdictional questions presented in internet and on-line environments. See, e.g., CompuServe v. Patterson, 89 F.3d 927 (6th Cir. 1996). (allowing jurisdiction of Texas provider in Ohio because of contract contacts with Ohio on-line provider).

3. This section focuses protective language on "consumers" rather than on mass market transactions. The primary purpose of the exception created here is to protect the individual, not to deal with a market place or transactional issue. This is especially important as information commerce goes more and more online. If online transactions in the internet are generally equated to mass market transactions, using that broader term here would seriously affect the ability of providers in that environment to control their risk in world wide distribution. Even then, the section creates consumer protections that are not necessarily available under current law in all states. The Supreme Court has enforced a choice of forum in a form contract involving a cruise line even though the choice effectively denied the consumer the ability to defend the contract and the choice was contained in a non-negotiated form and not presented to the consumer until after the tickets had been purchased. See Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991). The Supreme Court's comments in that context have relevance to Internet contracting:

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

The bracketed language about online transactions raises the question of whether the policy stated in Cruise Lines should be applied to the online environment.

4. 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 contracts.

5 A number of comments have been received questioning what meaning attaches to the term "unfairly disadvantage." The intent it to track modern law on when choice of forum clauses are invalidated. Following further research, the term will be adjusted, if necessary, to reflect the language most commonly used in reported case law. Comments will spell out the factors, which tend to require extreme inconvenience to the affected party.

6. Comments to this section will make it clear that the section does not deal with arbitration or other alternative dispute resolution clauses. The law regarding that field is characterized by substantial federal preemption and specific, existing state law rules that should not be disturbed here.

SECTION 2B-108. BREACH OF CONTRACT.–

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

(b) A breach of contract is material if the contact so provides. In the absence of express contractual terms, a breach is material if the circumstances, including the language of the agreement, expectations of the parties, reasonable expectations of ordinary parties in a similar contractual arrangement, and character of the breach, indicate that the breach caused or may cause substantial harm to the interests of the aggrieved party including imposing costs that significantly exceed the contract value, ~~that~~ the injured party will be substantially deprived of the benefit it reasonably expected under the contract, or ~~that~~ the breach meets the conditions of subsection (c) or (d).

(c) A breach of contract is material if it involves:

(1) an uncured failure to perform in conformance with and substantially in the time required by express performance standards or specifications;

(2) wrongful ~~knowing or negligent~~ disclosure or use of confidential information of an aggrieved party not authorized by the license;

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

(4) an uncured [substantial] failure to pay a license fee when due which is not justified by a bona fide dispute about whether payment is due; or

(5) a failure of performance under a contract term that requires performance to be to the subjective satisfaction of the party receiving that performance.~~.~~

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

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

Uniform Law Source: Restatement (Second) Contracts ' 241.
Coordination Meeting: Article 2 and 2A to conform to Article 2B.
Selected Issues:

1. Should breach of an express contract condition constitute a per se material breach?

2. Should the section be approved?

Reporter's Notes:

[Modified to reflect the effect of subjective to the satisfaction of a party clauses. Given the Committee's adoption of the Article 2 standard for mass market transactions, the definition of material breach has only limited relevance to consumer licensees. Significant discussion has focused on what specificity should be given to the definition of material breach and what degree of flexibility should be allowed for courts in making judgments. In discussing this, the Committee should recall the impact (outside the mass market) of the distinction. If a breach is defined as material, the other party can cancel the contract and make no payments at all, while if it is not material, the injured party receives damages reflecting the degree of loss, but must otherwise perform. As a result, one description of the idea of material breach in common law is that it is designed to avoid and prevent unwarranted forfeitures. Thus, a rule which defines and imperfect compliance with a due date for delivery as material, a one day delay in delivery allows cancellation and entire non-payment by the other party for any work; the developer in effect forfeits its contract because of a one day delay.]

1. This Article distinguishes between ordinary (insubstantial) breaches and material breach. Subsection (a) defines the general idea of breach. The definition of breach is intended to be inclusive. Breach occurs whenever either party acts or fails to act in a manner required by the contract. Encompassed within this term are failures to make timely performance, breach of warranty, late delivery, repudiation, non-delivery, and exceeding contractual limitations, etc. What is and is not a breach is determined by the language of the contract and, in the absence of contractual terms, by the provisions of this Article.

2. Subsection (b) defines the concept of material breach, subsection (c) gives a non-exclusive list of some types of breach that are considered material. In this Draft, "material breach" parallels the idea of substantial performance; the two phrases are interchangeable. This is achieved through definitions in Section 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."

3. As the language of (b) indicates, the materiality concept engages a combination of factors, generally oriented toward determining the degree of significance of the breach in context of the actual relationship of the parties. The factors listed in subsection (b) are not exclusive and courts should be free to draw on common law cases as well as their own view of the entirety of the circumstances in light of the purpose of distinguishing between material and non-material breach. The concept incorporates questions about the motivation of the breaching party. A series of minor breaches may constitute a material breach where the motivation for this conduct involves a bad faith effort to reduce the value of the deal to the other party or to force that party into a position from which it will be forced to relinquish either the entire deal or, through re-negotiation, aspects of the deal that are otherwise important to it.

4. Material breach and substantial performance rules currently apply to transactions not governed by the Article 2 (and Article 2A). See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) (license to reproduce photographs); 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"; this was met where there was an accounting failure and failure to complete colorization of movies); Compuware Corp. v. J.R. Blank & Associates, Inc., 1990 WL 208,604 (N.D. Ill. 1990) (Termination justified only if there had been a material breach but that no such breach was proven. 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.).

5. The idea of distinguishing between a material and a non-material breach stems from common law and courts routinely apply that concept throughout contract law, except with respect to some sales of goods and some leases of goods. The basic theme of materiality lies in the fact that, while both parties are entitled to the full measure of contract performance for which they bargained, some breaches are sufficiently immaterial in context that they do not justify forfeiture of the entire bargain as a remedy. For example, in context, a one day delay in making a payment may or may not be material. A reasonable failure to fully meet advertised performance expectations of handling 10,000 files may not be material where the licensee's needs never exceeded 4,000. And the system actually handles 9,999. Numerous other illustrations exist in both the literature and the case law.

6. The concept of materiality does not affect whether a party has a remedy, but merely what remedies are available. 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. The material breach concept rests on the common law belief that it is better to preserve a contract relationship in the face of minor performance problems and the related belief that allowing one party to cancel the contract for minor defects

may cause unwarranted forfeiture and unfair opportunism. Materiality relates to the injured party's perspective and to the value that it expected from performance. Faced with only a nonmaterial breach, the injured party can recover for 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. This Article carries the distinction throughout and with respect to both parties to a contract, except that a different standard applies to mass market transactions involving a refusal of a single delivery of software where the Article follows existing Article 2 and, rather than inquiring whether the breach is material, in that case asks merely whether the product conformed to the contract.

7. One cannot define materiality in absolute, black and white terms, any more than one can define concepts such as negligence, reasonable care, merchantability, or the like in absolute terms. The concept is contextual in character. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements of definition: the express contract terms and the extent to which the breach causes significant harm to the aggrieved party, either in terms of loss or a failure of reasonable expectations under the contract. 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). Courts use various language in describing the idea.

8. The use of materiality here parallels modern developments in international law. Modern international laws tend to use the term “fundamental breach” to describe the same concept as is covered under the idea of material breach. The Convention on the International Sale of Goods (CISG) states: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: “A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance.” UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern law in requiring so-called “perfect tender”, but do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a standard is virtually unanimous. 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.

7. Because of the flexible and contextual nature of the problem, some situations arise in commercial practice where somewhat more precise guidance is desirable for the parties. One source of greater precision lies in the contract itself. Subsection (b) acknowledges the right of parties to agree to the remedy caused by certain types of breaches and makes the express contractual terms binding. Beyond that, subsection (c) lists several situations in which, under the statute, materiality under the general standard is not subject to factual debate. These are selected with an effort to identify commercially relevant standards in which, absent coverage here, there would be potential disputes in a court setting.

8. Subsection (c)(1) reflects an important issues: failure to comply with express performance criteria. The section treats express contractual conditions as parallel to common law notions of express conditions, breach of which permits cancellation or otherwise excuses non-performance by the injured party. This solves a problem for licensees in cases where the contract requires software to meet particular performance standards. Failure to do so constitutes a material breach. The subsection does not precisely deal with design errors or situations in which potentially serious harm is caused by a breach, leaving those situations (which are many and varied) to the general standard of subsection (b). What constitutes an express performance standard varies depending on the nature of the agreement, but the concept clearly includes situations in which the licensee or the licensor propose and the parties agree to detailed specifications of performance for the completed product.

Illustration 1. The licensee provides specifications that the parties accept as part of the contract for development of a new word processing program. The standards require a dictionary with no less than 5 million words. The actual dictionary has 4.99 million. The developer fails to meet the standard within the agreed period of time. The failure to meet the express standards constitutes a breach which, under the current draft of subsection (c)(1) is by definition material regardless of whether it pertains to actual needs of the licensee. The licensee need make no payments for any of the work and can simply refuse the product.

Illustration 2. A contract requires delivery of a database program. The contract involves a mass market transaction. The database program meets its own specifications, but because of faulty design, substantially fails to in a manner comparable to other similar type programs. Whether there is a breach hinges on what express (description) warranties exist and what implied warranty and whether the design and performance fall outside of these. If there is a breach, materiality hinges on whether the defect causes substantial harm to the licensee's interests under subsection (b).

Illustration 3. In Illustration 1, the software meets all specifications, but is delivered one day after the scheduled completion date. This raises a question of whether a brief time delay should be treated as material without looking at the entire context. A similar question arises with late payment of fees. One view holds that the delay itself is material, even if the context indicates that no harm was caused to the other party. The other view holds that timing may be material, but that a contextual analysis should apply before allowing one party to forfeit its entire rights under the contract.

The Committee should also consider whether and how **timing** of performance should be dealt with. The 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.

9. Subsection (c)(3) was modified to reflect the proposed deletion of the section of the Article dealing with confidentiality. It provides that wrongful use of disclosure of confidential or trade secret material is per se material. The word wrongful, of course, allows for the fact that in many cases (especially sales of software copies) reverse engineering and discovery and use of the resulting information is not wrongful under existing case law.

10. In subsection (c)(4), the Committee should address whether this Article should correspond to Article 2A (expressly) and Article 9 (at least by implication), both of which provide that any failure to pay (substantial or not) that is neither waived nor cured is in effect a material breach justifying cancellation and repossession. No immediate reason appears why licenses and leasing law should not be identical on this point.

SECTION 2B-109. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court finds as a matter of law that a contract or any term thereof 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 term, or so limit the application of an unconscionable term as to avoid the unconscionable result.

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

Uniform Law Source: Section 2-302; 2A-108. Revised.
Coordination Meeting: Article 2B to consider Article 2 formulation that introduces the idea of "inducement" of contract. Article 2A applies that concept to consumer contracts only.
Votes:

1. In debate on Article 2 at the 1996 Annual Meeting, a motion to delete the inducement language was defeated.

2. At the same meeting, a motion to delete the requirement that unconscionable is a matter of law for the court was defeated.

3. Although there was discussion of the point, no motion was made to limit the Article 2 provision to consumers.

Reporter's Note:

This draft generally follows original Article 2. Draft Article 2 contains language regarding unconscionable inducement of a contract. At the Coordinating Committee session, the consensus was that, unless the Article 2B Drafting Committee reversed its position, Article 2B would not be required to adopt the inducement language unless directed to do so by vote of the Conference. The inducement concept does not exist in current law in any context other than in Article 2A. In Article 2A, the inducement concept is expressly limited to consumer leases and does not apply to mass market or other commercial contracts. The argument for extending the scope of any inducement language beyond consumer contracts is not clear. In this article, many of the situations where inducement may be an issue are dealt with by the new concepts of manifesting assent, opportunity to review and statutory creation of a right to exclude surprising terms.

SECTION 2B-110. ATTRIBUTION PROCEDURE.

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

(b) The commercial reasonableness of an attribution procedure is a question of law to be determined by the court in light of the purposes of the procedure and the commercial circumstances at the time of the agreement, including the nature of the transaction, sophistication of the parties, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, cost of alternative procedures, and procedures in general use for similar types of transactions. An attribution procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, key escrow, or similar security devices that are reasonable under the circumstances.

~~(c) Except as otherwise provided in Sections 2B-111 and 2B-102(--), if a loss occurs because a party complies with a procedure that was not commercially reasonable, the party that proposed or required use of the procedure bears the loss unless it disclosed the nature of the risk to the other party or offered commercially reasonable alternatives that the party rejected.~~

Uniform Law Source: Article 4A-201; 202.
Coordination Meeting: Article 2 and 2A to conform to eventual Article 2B formulation.
Selected Issues:

1. Should an attribution procedure be effective only if commercially reasonable?

Reporter's Note:
[Subsection (a) requires either agreement or adoption by both parties. Thus, for example, a procedure of which one party is not aware, but which is routinely used internally by the other would not qualify as an attribution procedure. The comments will make that clear. In (b), the concept of commercially reasonable procedure must also take into account ideas of cost relatively to value of transactions such as the comments to 4A-203, cmt. 4 suggest. This is implicit in the idea of commercial reasonableness, but could be added to the text if appropriate language can be developed. Subsection (c) has been moved to section 2B-111 with no substantive change intended. That subjection supports the rule suggested in (a) by indicating that a procedure adopted at the insistence of a party that proves to be commercially unreasonable places the loss that results on the party insisting on the procedure.]

1. An attribution procedure is relevant to much more than merely signature requirements in that it also applies to questions of attributing performance to a particular party. An attribution procedure has significance in this draft in respect to questions of attribution (see next section) and authentication. In effect, if an attribution procedure is established and followed, an enhanced level of legal reliability is attributed to the message or performance. In signature requirements, following an attribution procedure results in a signature as a matter of law. In other contexts, if there is a question of who sent the message or performance, compliance with an attribution procedure makes the alleged originator of the message attributable as a matter of law. On the other hand, failure to use an authentication procedure does not indicate that there is no signature or that the purported sender is not responsible for the message or performance. It merely places attribution issues under the general attribution sections.

2. Against this background of enhanced legal force, a question arises about whether, in a non-mass market context, we should eliminate the requirement of commercial reasonableness. That requirement was adapted from current Article 4A and provides a potential buffer for over-reaching and for protecting parties who do not necessarily have co-equal knowledge of technology. Viewed as used here as an enhanced assurance of reliability, the requirement of commercial reasonableness serves to encourage the development of reasonable attribution procedures. This section regulates the procedures as in Article 4A. The requirement of commercial reasonableness is an important safety valve for consumer and other users of these systems. Consider the following:

Illustration 1: General Motors sets up a procedure in its contract with franchisees that requires merely that a message contain the franchisee's E-mail address as an identifier. A bad guy uses that system and causes loss of $100,000 in the name of the franchisee. If the contract controls, the franchisee is liable for the loss unless the procedure is commercially unreasonable. It would most likely be unreasonable in this case.

3. The provisions relating to how to gauge reasonableness are adapted from suggestions of a member of the committee. In subsection (c), the edits are designed to clarify the effect of non-compliance with the reasonableness standard (the parties are placed under the other attribution and signature rules) and to allow for notice of the risk to avoid liability.

SECTION 2B-111. ATTRIBUTION OF ELECTRONIC RECORD, MESSAGE, OR PERFORMANCE; ELECTRONIC AGENT.

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

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

(2) the receiving party, in good faith and in compliance with an attribution procedure or an established course of dealing between the parties~~;~~, concluded that it was sent by the other party; or

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

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

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

(C) the receiving party reasonably relied to its detriment on the apparent source of the message or performance.

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

(1) The receiving party has the burden of proving reasonable reliance, and the

alleged sender has the burden of proving reasonable care~~ and access source~~.

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

(c) In a transaction subject to subsection (a)(1), if an electronic message was transmitted pursuant to an attribution procedure for the detection of error and the message contained an error:

(1) if the sender or its agent complied with the attribution procedure and the error would have been detected had the receiving party also complied with the attribution procedures, the sender is not bound by the message if the error pertains to a material element of the message, except that

(2) if the sender would not be bound under subsection (c)(1), but receives notice that the message was received and acted upon by the receiving party and the notice describes the content of the message, the sender has a duty of reasonable care to discover and report the error to the receiving party and, in the event of a failure to exercise reasonable care, the sender is liable for any direct losses incurred by the other party that would have been prevented by the sender's exercise of reasonable care and could not have reasonably been prevented by the exercise of reasonable care by the receiving party.

(d) Except as provided in subsection (a)(1) and (c), if a loss occurs because a party complies with a procedure that was not commercially reasonable, the party that proposed or required use of the procedure bears the loss unless it disclosed the nature of the risk to the other party or offered commercially reasonable alternatives that the party rejected. The party's liability under this section is limited to losses that could not have reasonably been prevented by the exercise of reasonable care on its part.

(e~~c~~) An authentication made by an electronic agent constitutes the authentication of a party if the party designed, programmed, or selected the electronic agent for the purpose of achieving results of that type.

Uniform Law Source: Article 4A-202; 4A-205; UNCITRAL Model Law on EDI.
Coordination: Article 2 and 2A to conform to Article 2B.
Committee Votes:

1. Alternative requiring reasonable care standard in (a)(3) selected by consensus.

Selected Issues:

1. Should this section deal with the case where a message (e.g., offer or acceptance) actually sent by a party contains an error, or should that be left to general common law concepts?

Reporter's Notes:
[Subsection (d) was moved to this section from 2B-110 as a result of suggestions made at the ALI Consultative meeting. A new subsection (c) is proposed to deal in a limited fashion with liability for errors in messages. That subsection is based on Article 4A-205.]

1. This section states risk allocation rules pertinent to the potentially anonymous nature of electronic commerce regarding information assets and applicable to both the creation of an enforceable relationship and acceptance of or reliance on performance. The goal is to balance interests in making electronic commerce possible in an open environment (as contrasted to the relatively closed structures of funds transfer and EDI transactions), while reasonably apportioning risk. It should be noted here that the risk allocation rules do not apply to handling of funds, bank accounts, or other transactional subject matter that falls outside of the scope of Article 2B.

2. Subsection (a) describes three circumstances under which one party is held to be bound by a message. Subsection (a)(1) relies on general agency rules, but also adds the idea of an electronic agent. "Electronic agent" is a defined term, covering a computer program programmed to respond or initiate without human review and selected by the party for that purpose. Some observers have commented that this definition needs to be made more flexible to accommodate developments in technology. The general approach, however, 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. Having selected and opted to rely on an electronic device or system, the party becomes responsible for its actions. The idea of an electronic agent does not exist under current law, but has importance in the context of electronic contracting for information because of the increasing use of preprogrammed software to acquire and conclude agreements for information assets. The principle here is that the individual or company who created and set out the program undertakes responsibility for its conduct. That result could be reached by common law courts under agency theory, but the goal is to eliminate uncertainty on this point. This treatment parallels that adopted in the UNCITRAL Model Law. Article 13 provides that as between the parties, a message is deemed that of the originator if sent "by an information system program by or on behalf of the originator to operate automatically." That Model Act also separately lists attribution principles including that the party sent the message and that it was sent by an authorized agent.

3. Subsection (a)(2) focuses on agreed 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 party 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. As defined, "attribution procedure" deals with a procedure adopted by the parties to verify source or detect errors. In earlier versions of this section, the substantive treatment here was limited to the verification or attribution of source issue. Bracketed language in this draft generally follows Article 4A in reference to error detection in messages (not contract performance), leaving to common law the treatment of other situations under general law of mistake.

4. 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 reasonably relied. Thus,

for example, if the nature of the message or performance clearly indicates or gives reason to doubt the source, reliance that causes harm may not be protected, but where the reliance is reasonable, the receiving party has a protected right under this article. The Drafting Committee previously discussed whether liability under (a)(iii) should exist without proof of negligence or any other fault. This needs to be evaluated in terms of drawing a balance between the interests of senders and the reliance interests of recipients of messages. In other contexts, it has been argued that use of a new system can be encouraged by liability limitations. The draft principle was modeled on provisions of the UNCITRAL Model Law. The UNCITRAL Model Law originally provided that as between the parties, the recipient is entitled to treat the message as that of the originator if the parties applied a procedure agreed to for this purpose **or** the message "resulted from the actions of a person whose relationship with the originator enabled that person to gain access to a method used by the originator to identify the data message as its own." Apparently, this latter provision was deleted in the final draft.

5. Under other law, in cases where the electronic process involves transactions between large businesses and 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. 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. Often, the transaction will be between two individuals. Also, in many cases, the transactions will occur in a public network, not owned, operated or controlled by a single operator. Also, unlike in cases involving electronic funds transfers (which are dealt with under federal law), 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. Here, one may be inclined to look to communications law and the allocation of risk there. In reference to telephone systems, the proprietor of a system (telephone) is responsible for all calls using that number, even if produced by a hacker engaged in entirely illegal and unauthorized access. The loss allocation there, of course, is between the owner of the system and the system operator. This Article adopts an intermediate position, keyed to use of attribution systems and reasonable care.

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

6. Subsection (d) provides for allocation of loss caused by the situation in which one party insists on a procedure for attribution, but that procedure is not commercial reasonable. The section presumes that the loss for use of such procedure falls on the party insisting on its adoption. As drafted, the loss encompasses expectation, rather than merely reliance issues.

> **Illustration 1:** Jones insists that, in dealing with its software vendor, the vendor electronically ship software whenever it receives an E-Mail request using Jones' name. An impostor places an order for software with a $1,000 retail price. The vendor ships. Jones would be responsible for the $1,000 loss if the procedure it required were commercially unreasonable.

An alternative to this result would be to limit the loss to reliance damages which, here, might be restricted to the actual out of pocket loss (e.g., cost of the copy).

The bracketed language in (d) sets out one way of limiting this liability risk. Reasonable care would be judged, of course, in light of the existence of the procedure itself. However, if a party has knowledge of the problem or reason to know, it cannot impose loss on the other party indefinitely. The language here should be coordinated with Article 4A.

SECTION 2B-112. MANIFESTING ASSENT.

(a) A party or electronic agent manifests assent to a record or term if, after having an opportunity to review the record or term under Section 2B-113, it:

(1) authenticates a record or term, or engages in other affirmative conduct that the record conspicuously provides or the circumstances clearly indicate will constitute acceptance of the record or term; and

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

(b) Merely retaining ~~The mere retention of~~ information or a record without objection is not manifestation of assent.

(c) If assent to a particular term in addition to assent to a record is required, conduct of a party or an electronic agent does not manifest assent to that term unless there was an opportunity to review the term and the authentication or conduct manifesting assent relates specifically to the term.

(d) Manifestation of assent may be proved in any manner, including by a showing that a procedure existed by which a party must of necessity have engaged in conduct that manifests assent to the contract or the term in order to proceed further in the use or processing of the information.

Uniform Law Sources: Restatement (Second) of Contracts ' 211.
Coordination Meeting: Article 2 to conform to Article 2B.
Selected Issues:

1. Should the section be approved as drafted?

Reporter's Notes:

1. The concept of manifesting assent is used throughout this article as a means of identifying when a party assents to terms of the record and to particular terms of the record. The phrase "manifesting assent" is used in the Restatement (Second) and in the UNIDROIT Principles as defining the basis on which a party is held to be bound to the terms of a standard form contract and , indeed, to any form of a record. Similar themes are found in various judicial rulings. See, e.g.,, Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991) (cruise line ticket containing contract terms). While used in those contexts, the concept is not clearly defined in any functional manner. Sections 2B-112 and 113 create a procedural background for when manifestation of assent occurs that provides protection against inadvertent and unknowing assent.

2. A critical step in understanding this section and the term it sets out is to draw a distinction between this concept and the idea of offer and acceptance creating a binding contract. While manifesting assent may often be equivalent to accepting an offer, the idea of acceptance is broader and need not fall within the procedural detail depicted here. **The concept of manifesting assent is, instead, designed to provide procedural protections to**

ensure fairness in the use of standard forms. The basic thrust of the term is that objective manifestations of assent bind a party to a term or to a record.

2. Two fundamental steps are required for manifestation of assent under this article. First, there must be an affirmative act. A signature, of course, manifests assent to a record; initials attached to a particular clause manifest assent to that clause. So too, in the electronic world would an affirmative act of clicking on a displayed button in response to an on-screen description that this act constitutes acceptance of a particular term or an entire contract. The idea of assent does not in modern commerce require a formalized event, although notorization or other formalities certainly qualify. Neither does assent require proof that the party actually read the terms to which it assents. In this article, however, the second element of assent does require that the assent **come after** a party had an opportunity to review the record or term. "Opportunity to review" is a defined term in this article. It requires that the term or record be called to the party's attention before the actions occur. The terms need not all be in a single record, so long as the location creates an opportunity to review and the requirement of explicit consent are met. Thus, for example, a hyper-link reference to a license actually contained in a different record would, all other conditions being met, satisfy the concept.

> **Illustration 1:** In a registration file, the New York Times on-line system provides: "Please read the terms of the license. Click here to read the License. If you agree to the terms of the license, indicate your agreement by clicking the "I agree" button. If you do not agree to the terms of the License, click on the "I decline" button." The underlined reference to the License is a so-called hypertext link which, if choice, displays the terms of the license.

I Agree	I Decline

> In this sequence, a party who assents to the license by indicating "I agree" is bound by the license terms.

4. The section provides for a distinction between assent to the record and, when required by other provisions of this article, assent to particular terms. Edits were made at the suggestion of a member of the style committee suggesting that the phrase "record or term" need not be repeated throughout the section. The basic point is that assent to a record involves meeting the procedures generally with respect to the record, while assent to a particular term, if such is needed, occurs only if the actions relate to that particular term. One action, however, may relate both to the record and particular terms if the terms if the record conspicuously so provides:

> **Illustration 2:** In a paper shrink wrap license, the license provides:
>
> OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR AGREEMENT TO THE LICENSE.
>
> WE CALL YOUR ATTENTION SPECIFICALLY TO: **Contract Term No. 5, Precluding Use at Home,** and **No. 16, Imposing a $100 Annual Help line Fee if You Choose to Use the Help Line**.

In this case, and others where manifestation of assent to a term occurs, manifesting assent in this article is an enhanced form of conspicuousness in that it requires an affirmative act w2ith respect to a clause or term.

5. Based on comments of several commissioners, the comments will make clear that the act is satisfied if the party has actual notice of the terms, the terms are actually part of the basis of the bargain between the parties, or other methods are used to call attention to the term and the party accepts it. Manifestation of assent is not the only manner in which the parties define the terms and limits of their deal. For example, clear indications that the product has specific characteristics and limitations become part of a bargain even if there is no specific, formal manifestation of assent, simply because they in effect define the bargain itself. A party can license a database of intellectual property attorneys to an end user and rely on the fact that the product need only contain intellectual property attorneys as a basic term of the deal without obtaining a manifestation of assent in formal terms to that aspect of the deal. The nature of the product would, in that case, presumably be the essential feature of the deal itself.

> **Illustration 3:** A copyrighted software package states, in large and clear letters: "THIS PRODUCT IS LICENSED FOR CONSUMER USE ONLY." It does not go on to specify that opening the product or using it accepts this term. The circumstances here clearly indicate that the product is licensed solely for consumer use. The terms should be effective as an inherent part of the agreement, not requiring additional,

pro forma language or conduct.

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

7. manifesting assent hinges on there being an opportunity to review the contract or term; the record must be called to the party's attention before assent is obtained. This would exclude devices to create or modify a contract designed to misled or conceal, rather than to obtain true assent. For example, a notation on the back of a check stating elaborate license terms and sent to the cashier's office of a company would not create terms when the check is cashed. The cashier lacks authority and the terms have not been called to the attention of the company.

. SECTION 2B-113. OPPORTUNITY TO REVIEW.

(a) A party or electronic agent has an opportunity to review a record or 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 record or term:

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

(2) before a 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) Except for a proposal to modify a contract, if a record is available for review only after initial use of information, a party has an opportunity to review the record only if it has a right to a refund of the license fees paid by discontinuing use and returning all copies. In the case of multiple products transferred for a single, bundled price, (i) if the rejected license is from the supplier of the bundled product, the refund must be for the entire bundled price on return of the entire bundled product, unless the licensee agrees to accept a reasonable allocation of the portion of the total price to the licensee attributable to the rejected license in light of the price paid by the licensee for the bundled product, and (ii) if the rejected license is from another licensor, the refund must be for a reasonable allocation attributable to that license.

Uniform Law Source: None
Coordination Meeting: Article 2 to conform to Article 2B.
Selected Issues:

1. Should the section be approved as drafted?

Reporter's Notes:

1. The concept of an opportunity to review corresponds to the idea of manifesting assent. 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. Under this section, the opportunity to review can come at the time of the initial acquisition or at time associated with the **initial** use of the information. If the latter, then there must be a refund opportunity if the terms are rejected. This refund right is not clearly a condition to enforceability of standard terms in the modern marketplace, but provides an important protection and balancing point for the transferee. See Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997).

> **Illustration 1.** Sam acquires a copy of the latest James Bond movie from Blockbuster on a three day rental agreement. When Same places the copy on screen, a statement appears that the copy is for home and personal use only, and not for display to an audience for a fee. Looking around the room at his paying customers, Sam would be bound as a matter of contract by this limitation if he had a right to return the copy for a refund. Under current law, the restriction may also be effective as a matter of direct copyright law.
>
> 3. In subsection (b) the prefatory language is intended to make clear that the ideas of refund associated with the opportunity to review are not intended to alter ordinary law relating to the modification of an agreement in which the parties are already performing, but are only directed to the initial stages of contract formation. Thus, in substantive sections involving contract modification, for example, the additional of standard form terms to an existing contract would be dealt with under general contract law concepts about acceptance or adoption of those terms which, in the UCC, can occur without additional consideration.

4. This section does not create an obligation to make a refund, but rather it preconditions the creation of terms of a direct contract between the licensor and the licensee. The failure to provide a refund is not a breach of contract, but results in a failure of the terms to become part of the bargain. Under Section 2B-615, a retailer is required to refund the price paid if an end user declines the publisher's license. That right to a refund, if and when it occurs, fulfills the refund option stated here.

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

> **Illustration 2.** Producer transfers a copy of a copyrighted musical work to User, subject to the terms of a license that restricts use of the work to home use only. The license is established after the delivery of the copy through use of a shrink wrap package. User has a right to either assent to the license or obtain a refund of the fee. It assents. User later transfers the copy to Jones. Jones need not have any refund right. If Jones uses the music in a commercial context, the license is breached and Producer has contract recourse against User. Producer may also have a copyright claim against Jones for use (performance) that was not authorized. Producer has a contract claim against Jones only if Jones took an assignment of the license or if Jones assented to a license directly from Producer.

6. The additional language of subsection (b) deals with the options available in cases of bundled products. The obligation to refund and return is as to the entire bundled package unless the licensee agrees to an allocation of the price based on the proportionality of cost measured by the vendor's cost for the product bundle or the rejected licensor did not supply the entire bundle. Thus, if the particular software being refused was attributable

for 5% of the total cost of the bundled products for the vendor, the refund must be of 5% of the price of the bundle to the licensee. The bundled products here can include both goods and information products, but the principle remains the same. Based on comments by a licensee attorney, several consumer advocates, and others, this draft deletes a subtraction in the refund for "value received." We are dealing here with an up-front contract creation and deductions would seldom be merited in most cases in any event.

. **SECTION 2B-114. PROOF OF AUTHENTICATION.** A record or message is authenticated as a matter of law if the symbol executed or adopted by a party complies with an attribution procedure agreed to or adopted by the parties. Otherwise, authentication may be proven in any manner, including by showing that a procedure existed by which a party necessarily must have executed or adopted a symbol in order to proceed further in the use or processing of the information.

Reporter's Note:

1. This section derives from language formerly contained in the definition of "authenticate" or "sign". It was moved here for stylistic purposes. The intention is that an agreed attribution procedure, if followed, removes factual questions about whether an authentication (signature) occurred. This happens, of course, only if the procedure was commercially reasonable. The second concept in this section allows proof of an authentication in any manner, but specifically allows proof gauged by showing that a process exists that required this result in order to proceed further. This responds to on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

2. This section, as with the concept of attribution procedure generally, is entirely neutral as to the nature of the systems adopted for these purposes. Current law in some states keys so-called "digital signatures" to the use of specific types of encryption technology. That is inappropriate in a general law such as being developed here. Fingerprint, voice recognition, encryption and other technologies as they evolve are equally acceptable.

SECTION 2B-115. EFFECT OF AGREEMENT.

(a) ~~Except as otherwise provided in Section 1-103 and this article, t~~The effect of any provision of this article may be varied by agreement of the parties, but except as expressly provided in this article or Article 1 of this Act, the agreement may not vary:

(1) the obligation of good faith;

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

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

(4) the limits in Section 2B-712 (waiver of self-help protections);

(5) the unenforceable terms described in Section 2B-503(b) (contractual transfer restrictions);

(6) the limitations on excluding notice in Section 2B-629(d);

(7) the limitation stated in Section 2B-626(e) (excuse by unexpected events);

(8) the restrictions on modification stated in Section 2B-708 (statute of limitations); or

[other provisions to be added]

(b) The absence of a phrase such as "unless otherwise agreed" in a section of this article does not by itself preclude the parties from varying the provision by agreement.

(c) Unless this article requires a term to be conspicuous, or that there be manifest assent to the term, fulfillment of the requirement is not a prerequisite to enforceability of the term. Whether a term is conspicuous is a question of law.

Uniform Law Source: None.
Coordination Meeting: Recommends deletion of the Section in Article 2 and 2B.
Selected Issue:

1. Should the section be deleted other than the reference to conspicuous terms?

Reporter's Notes:

1. This section implements the basic policy that all of the provisions of this Article are subject to contrary agreement with the exception of listed sections or rules that are not subject to contractual modification. It deals with an important issue created by virtue of the drafting approach applied here. As a general rule, sections in Article 2B (and Article 2) are drafted in apparently mandatory terms as rules of law. This drafting approach, however, is subject to the over-riding principle, described in subsection (a), that all of the terms of the article can be altered by agreement. The difficulty rests in the fact that this general principle is, itself, subject to important limitations. The difficulty thus created is how to provide guidance to persons drafting or planning a transaction who are not aware of all of the nuances of when or whether a particular statutory term can be varied and, indeed, even what one means by varying the statutory terms by agreement.

2. As drafted, the section reverses decisions such as Suburban Trust and Savings Bank v. The University of Delaware, 910 F. Supp. 1009 (D. Del. 1995) which applied its view of the "plain meaning" of an Article 9 provision and held that the specific terms of Article 9 rule supersede the general terms of UCC ' 1-102 (permitting contractual variation of statutory rules).

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

4. Subsection (c) contains a rule moved from the definitions section based on style standards. The rule that conspicuousness is determined as a matter of law reflect current law under Article 2. Its continuation was supported on the floor at the Annual Meeting of the Conference. The standard reflects the mixed fact and policy characteristics of the idea of conspicuous terms. In this Draft, conspicuousness remains an important standard, but its significance is reduced somewhat by requirements of manifestation of assent to specific terms.

PART 2

FORMATION

SECTION 2B-201. FORMAL REQUIREMENTS.

(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 which enforcement is sought or to which the party manifested assent sufficient to indicate that a contract has been made between the parties and describing the subject matter.~~ and scope.~~ Any description of the subject matter~~ and scope~~, whether or not it is specific, satisfies this subsection if it reasonably identifies what is described.~~:~~

(b) A contract enforceable under this section is not made unenforceable merely because it is not capable of being performed within one year after its making.

(c) A grant or limitation dealing with the topics ~~subject matter~~ of Section 2B-310(a)(b) or (c)~~;~~ or Section 2B-502 ~~2B-311, 2B-312, or 2B-316~~ may not vary the terms of those sections except by a record authenticated by a party against which enforcement of the contractual term is sought.

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

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

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

(2) the agreement involves a release or waiver of intellectual property rights pertaining to a work, image, or act and derivatives thereof;

(3~~2~~) to the extent that ~~the licensor or~~ a person authorized by the holder of intellectual property rights transferred copies of the information or access materials~~codes~~ to the licensee; or

(4~~3~~) to the extent that performance has been rendered by one party and accepted by the other party.

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

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

Coordination Committee: Differences in Article 2B subject matter support different treatment than in Article 2.

Votes:

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

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

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

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

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

Selected Issues:

1. Are the substantive terms generally appropriate?

2. Should there be an exception for contracts requiring performance of services that will cover less than one year?

Reporter's Notes:

[New subsection (e)(2) was added to correspond the statute of frauds rule to practices in motion picture and other visual entertainment industries where releases (a form of a license) are often obtained without an authenticated record.]

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

There has been essentially no support outside academic contexts, for full repeal of the statute of frauds in reference to information transactions covered by this article. The reasons for this involve a number of concerns, but relate primarily to questions about the intangible nature of the subject matter and the ease of copying as diminishing the reliability of other indicia of agreement to circumvent fraudulent claims. The Drafting Committee voted to adopt a statute of frauds rules with a relative large dollar cut-off. The dollar figure adopted is intended to position the statute as being applicable only in relatively large transactions and to leave out most (all?) mass market and small deals in this area. In context of the larger transactions, the degree of risk is sufficiently large that retention of a statutory safeguard is relevant.

2. Having opted for a statute of frauds, a decision should be made about 1) what minimum content is required for a record under the statutes, and 2) what exceptions exist for that rule. This draft opts for a limited subject matter requirement. There are several reasons for this. Chief among these is that, unlike in reference to transactions in goods, questions about quantity are not a chief consideration in reference to intangibles. Rather, as suggested by entertainment industry representatives, the major focus of a license deals with questions about the scope of the license. As defined in 2B-102, scope refers to five aspects of the contract: subject matter, rights granted, location, duration and the uses allowed. One could argue for a statute that requires all five elements to be covered in a record, but practices in all of the industries that are covered by this article does not routinely support such a position. The subject matter (or work covered) was selected as a reasonable compromise.

3. This section does not require that a record, once made, must be retained and presented to a court in order to enforce the contract. As in current law, the key is to establish that a record was made with the relevant terms. One can establish the prior existence of the record by showing that a procedure exists by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity. In electronic environments, the definition of "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information must be in this form. Significant litigation has occurred in copyright law on this question. The cases there do not impose a minimum time period; a "copy" occurs when information is placed in a different part of memory in a computer than the one in which it was stored. Copyright law, on the other hand, does distinguish a copy and a ephemeral manifestation of information. Presumably, an ephemeral copy is not a record in this Article.

4.. Subsection (c) carries forward a limitation contained in all prior drafts of this section, but modified on the assumption that the Drafting Committee will opt for the proposed reduction in the detail of default rules pertaining to use and scope issues. The basic principle is that, in intangibles contracting, use questions relating to scope are significant and that some basic principles should not be altered except by a record doing so. The reference to 2B-310 incorporates the primary rules being retained in this draft: single user, no right to modifications, and implied right to uses necessary to expressly granted uses. These three facets of the default rule provisions include both licensor and licensee protections.

5. Subsection (d) contains of number of exceptions to the statute of frauds rule. The $20,000 limit was chosen by the Drafting Committee in order to exclude coverage the large number of small value transactions that do not require formalities. Focusing on dollar amount may be too narrow here, and we might consider a "value" standard instead. Subsection (d)(2) reflects entertainment industry practice.

6. Subsection (f) makes clear that trading partner or similar agreements are enforceable to alter the statute of frauds issue. The parties can clearly agree to conduct their further business without there being a need for additional, authenticated writings. . Consistent with current Article 2, a partial performance exception has been added.

6. The common law statute of frauds is actually contained in statutes in at least 47 states. Restatement (Second) of Contracts ch. 5, Statutory Note, at 282 (1979). State law rules differ. In the final version of this draft, legislative notes must cover the partial revision/ repeal of existing statute of frauds rules. Article 2A adopted a statute of frauds for leases based in part on the 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. 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). 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.

9. The statute overrides the common law statute of frauds for contracts not to be performed within one year. The **Committee should consider whether this is appropriate in all cases in light of contemporary practices.**

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 and an action of an electronic agent which recognizes the existence of a contract.

(b) If the parties ~~so~~ intended an agreement, an agreement sufficient to constitute a contract may be found, even if the time that the agreement was made cannot be determined, one or more terms are left open or to be agreed upon, one party reserves the right to modify terms, or the standard forms of the parties contain varying terms, but if records exchanged by the parties disagree on the scope of the license, an agreement exists only if from all the circumstances it appears that an agreement existed as to scope.

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

Uniform Law Source: Section 2-204, modifies (b).
Coordination Meeting: Article 2 to conform in style to Article 2B.
Committee Votes:

1. Committee voted unanimously to adopt the section in principle. (September, 1996) [Language was added to make clear the importance of scope on the creation of a contract in this field and to coordinate this section with the treatment of conflicting standard forms where the licensor's form controls as to scope. This controlling effect presumes an actual agreement and this section clarifies that no agreement exists if there is no mutual assent as to the central feature of the contract.]

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 a time is not stated, the offer is irrevocable for a reasonable time, not exceeding 90 days. A term of assurance in a standard form supplied by the offeree is ineffective unless the offeror manifests assent to the term.

Uniform Law Source: Section 2A-205; Section 2-205.
Coordination Meeting: Article 2 to conform to Article 2B and use manifest assent in lieu of requiring conspicuous term.
Committee Actions:

1. **Committee unanimously to approve this in principle. (September, 1996)**
2. **Agreed to use 90 days as a standard in lieu of three months. (September, 1996)**

SECTION 2B-204. RELEASES. A release or waiver of intellectual property rights in whole or in part is effective without consideration if it is effective under other law, or is ~~it is~~ contained in a record authenticated by the party giving the release or waiver and identifying the rights released or waived.

Reporter's Note:

1. This section relates to practices important in the entertainment and multimedia industries involving acquisitions of rights clearances relating to properties used in new works. The release or waiver here does not relate to claims based on breach of contract, but refers to releases of intellectual property and similar rights. In effect, a release is a license since it is in the nature of a limited grant of a right to use a person's image or work. As drafted, the section clarifies existing law concerning the enforceability of releases in fully executed form.

2. This section states the affirmative rule that release of rights in a certain form is enforceable, but does not disturb existing law with respect to enforceability in other settings. Thus, for example, it does not address the question of whether a release obtained by conspicuous posting and conduct acquiescing in that posted release is adequate.

> **Illustration 1:** Film Co. is engaged in filming street scenes in New York City for inclusion in its newest video game. As is common practice, it posts conspicuous signs on the sidewalk informing people that the filming is occurring and indicating that, if they are filmed, their voluntary participation constitutes a release of intellectual property rights in the use of the film (e.g., rights of publicity). The effectiveness of this release is not governed by this Section, but as clarified in the text, this section does not preclude enforceability under other law.

The Committee should consider whether this latter situation should be dealt with under a concept of manifesting assent.

3. An situation analogous to Illustration 1 arises in on-line relationships. For example:

> **Illustration 2:** Wilson Goods operates a website. The first page of the site states that the user can download and use a copy of the text of the Wilson art work by printing it. Wilson charges for access to the website, but not for downloading. Is the release or grant effective?

In this context, there would be two analyses that would yield an enforceable waiver or grant of a right here. One could conclude that the term giving the right to download was part of the access contract, even though there was no procedure for manifesting assent to the term. Alternatively, under this section, the release or waiver of the intellectual property right to control the making of copies is enforceable if the website could be construed as an authenticated record or other law supports enforceability (e.g., estoppel).

SECTION 2B-205. OFFER AND ACCEPTANCE.

(a) Subject to Section 2B-202 and 2B-206(a), unless otherwise unambiguously indicated by the language or the circumstances, 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 in a standard form containing standard terms that vary from the terms of the offer.

(b) 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.

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

(d) Language which states that a party does not intend to be bound unless the other party agrees to the terms in a record or as otherwise proposed is enforceable if the conduct of the party proposing the terms is consistent with the stated conditions.

(e) In an electronic transaction:

(1) a contract is formed by the interaction of two electronic agents if the interaction results in both agents engaging in further actions that signify a contract such as by engaging in performance, ordering or instructing performance, or making a record of the

existence of a contract;

(2) a contract is formed by the interaction of an individual and an electronic agent if the individual has reason to know that it is dealing with an electronic agent and performs actions the individual should know will cause the agent to perform or to permit further use, or that are clearly indicated as constituting acceptance regardless of other contemporaneous expressions the individual to which the agent cannot react; and

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

Uniform Law Source: Section 2A-206; Section 2-206.
Coordination Meeting: Article 2 to conform to Article 2B except for subject matter differences.
Committee Vote:

1. Approved in principle, subject to coordination with electronic transactions. (September, 1996)

Reporter's Notes:
[Since the Committee last reviewed the section, the treatment of action of an electronic agent in former subsection (c) was modified; deleting that subsection here and adding a new subsection to deal with under what circumstances interaction between an individual and a machine leads to a contract where, for example, the individual enters extraneous material that the machine cannot perceive, but the machine continues on to complete the "acts" that "signify" acceptance. That issue is divided into the question of whether a contract exists and what the terms of the contract contain. Basically, where the individual interacts with an electronic agent, it cannot alter the contract terms outside the options that the electronic agent can perceive and react to according to its programming unless the party breaks off the interaction and reaches a person who can deal with the different terms. Unlike with respect to human agents, the program cannot exercise independent discretion.]

1. Revisions of Article 2 and this draft separate the issue of whether an **agreement** exists from the issue of what **terms** govern that agreement. This Section allows formation of a contract through a wide variety of means, including the exchange of conflicting standard forms if the parties behave as if a contract exists. The material in subsection (a) through (c) are generally consistent with current law.

2. This general approach leaves open the question of what is the effect of a truly conditional offer. Subsection (d) states that terms of condition are enforceable if the party's behavior is consistent with those terms, insofar as the issue concerns whether the parties have a contract. Subsection (d) coordinates with current law and with the battle of forms treatment in 2B-309. The approach validates conditional offers in both contexts if the conditioning language is followed with actual behavior sustaining its conditionality. Thus, if a party ships pursuant to an allegedly conditional form and its behaviors manifests the existence of a contract, a contract exists despite the language of condition. If, however, a party conditions its form and refuses to ship until the conditions are accepted, that conditioning language and activity preclude the formation of a contract. Section 2B-309 allows the terms of a form to govern over a conflicting form where the conditioning language is coupled with an actual refusal to perform unless the conditional terms were accepted or the parties execute an authenticated record containing the terms. In either case, the condition is actual and enforceable. In all other cases, the conditioning language is ignored or the terms cancel out.

3. Committee discussion in September highlighted the fact that the draft section did not deal adequately with the question of whether a contract was created in cases where there is no interaction between humans. The new subsection (e) deals with two contexts that a relevant in the electronic world: 1) interaction between a human and an electronic agent, and 2) an interaction between two electronic agents without human intervention. In both situations, electronic methodology is in quite widespread use, but there are latent questions of under what circumstances is agreement inferred from electronic behavior and of to what terms an electronic agent can effectively agree. The following illustrations, although not within Article 2B scope, illustrates one aspect of the issue:

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

Under (b), there is a contract. The verbal addition or condition is ineffective, so long as Ray knowingly acted in an interaction with a machine. Stating conditions clearly outside the capability of the electronic agent to make a reaction does not eliminate the agreement reached by taking the steps needed to initiate the shipment. Similarly, the verbal terms should be ineffective to alter the agreement since the Tootie system could not respond to the verbal condition.

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

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

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

SECTION 2B-206. ELECTRONIC TRANSACTIONS AND MESSAGES: CONTRACT FORMATION.

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

(1) the response is received if the response consists of furnishing the requested information or notice of access to the information and the originating message did not prohibit that form of response; or

(2) the sender of the originating message receives an electronic message signifying acceptance.

(b) In an electronic transaction, a contract is formed although no individual representing either party was aware of or reviewed the initial message, response, reply, information, or action signifying acceptance.

(c) Subject to Section 2B-207, a~~A~~n electronic message is effective when received, even if no individual is aware of its receipt.

Uniform Law Source: Section 2A-206; Section 2-206.
Coordination Meeting: Article 2 to conform to Article 2B.
Committee Vote:

1. Approved in principle, subject to clarifications and possible integration into other sections.

Reporter's Notes:

1. In September, discussions of the Committee supported an expansion of the definition of electronic message and a focusing of subsection (a) on the timing of contract formation. Subsection (a) deals solely with timing of a contract when electronic messages are used to complete the transaction. It rejects the mail box rule, and times acceptance or effectiveness of a message to when the message is received. As in other sections, questions of attribution of the messages also apply. These are resolved under the section on attribution. If, for example, the "response" purports to be from ABC Corp., but is not, a contract exists as to ABC only if the message can be attributed to it under rules of agency, attribution procedures, or the other attribution concepts contained in this Article or in common law.

2. The principal application of this section lies in the growing realm of electronic commerce. A principal contribution is in subsection (b) and (c) 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 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. The principle stated here, however, needs further development and coordination with the various other affected sections.

SECTION 2B-207. ACKNOWLEDGMENT OF ELECTRONIC MESSAGE

(a) If the originator of an electronic message requests or has agreed with the addressee of the message that receipt of the message be acknowledged:

(1) If the originator indicated in the message or otherwise that the message was conditional on receipt of an acknowledgment, the message does not bind the originator~~sender~~ until acknowledgment is received.

(2) If the originator requested acknowledgment but did not state that the message was conditional on acknowledgment and acknowledgment has not been received within an reasonable time after the message was sent, the originator may give notice to the addressee that it has not received acknowledgment and either retract the message or specify a further reasonable time within which acknowledgment must be received or the message will be treated as of no binding effect. If acknowledgment is not received within that additional time, the originator may treat the message as of no binding effect.

(3) If the originator requested acknowledgment and ~~terms of the message~~ specified a time for receipt of acknowledgment, the originator may exercise the options in subsection (a)(2) if receipt does not occur within that time.

(b) If the originator timely receives acknowledgment of receipt, that acknowledgment creates a presumption that the message was received by the addressee but does not in itself imply that the content of the message sent corresponds to the content of the message received.

SELECTED ISSUE:

1. Should the section be deleted?

COMMITTEE VOTE:

1. Motion to delete rejected 5-6.

REPORTER'S NOTE:

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

PART 3

CONSTRUCTION

[A. General]

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

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

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

Uniform Law Source: Section 2A-202; Section 2-202.
Coordination Meeting: Article 2 to drop subsection (b) regarding contest of merger clause; Article 2B to conform to remaining Article 2 language; alternatives to be considered.
Committee Votes:

1. The Committee voted 11-0 to adopt a motion to strike provisions suggesting presumptions in reference to merger clauses and, in effect, return to the Article 2 rule under current law, but not the proposed revision.

Reporter's Notes:

1. This Draft generally corresponds to current Article 2 and rejects changes suggested in Draft Article 2 that refer to a hearing and appear to weaken the effect of merger clauses in commercial and other contracts. The Coordination Committee recommended that Article 2 delete a provision in its draft dealing with procedures and criteria for challenging the effectiveness of a merger clause. That recommendation was announced to the floor of the annual meeting before discussion of this section in Article 2. The Article 2 Drafting Committee apparently voted to the contrary. The Article 2B Drafting Committee declined to include that provision in this draft.

2. UNIDROIT Principles of International Commercial Contract Law provide that a: "contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing." Art. 2.17.

3. The current draft of Article 2 contains a subsection (b) that both invites court hearing on the intent of the parties and creates a presumption that the merger clause states the intent. That presumption is expressly not applicable in a consumer contract. The apparent intent is that the merger clause in a consumer agreement under revised Article 2 has no impact on the question of the integrated character of the agreement. The strength of the presumption in other cases is not clear.

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

(a) If an agreement involves repetitive performances by either party with knowledge of the nature of the performance and opportunity for objection to it by the other party, a course of performance accepted or acquiesced in without objection is relevant in determining the meaning of the agreement.

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

(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; and

(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.
Coordination Meeting: Coordinating Committee recommended that Article 2 and 2A conform to Article 2B; consider removing section to Article 1.
Committee Vote:
1. The Committee voted unanimously to adopt this section. (September, 1996)

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract is binding without consideration.

(b) A contract that contains a term that excludes modification or rescission except by a record authenticated by the party to be bound may not otherwise be modified or rescinded. However, in a consumer license, a term requiring an authenticated record for modification is not enforceable unless the consumer manifests assent to the term.

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

Uniform Law Source: Section 2A-208; Section 2-209.
Coordination Meeting: Article 2 to delete first sentence relating to modification by waiver. Article 2B will not conform to remainder of Article 2 section.
Selected Issue:
1. Should the default rule be that a contract contained in a record can only be modified in a record?
Committee Vote:
1. The Committee voted 12-1 to approve the section and the use of manifest assent.
Reporter's Notes:

[Use of the reference to consumer here is appropriate. Under current article 2, no modification clauses between merchants are expressly made enforceable, while the protective terms in Article 2 (current) trigger only if a merchant provides a form with the clause to a consumer. The objective of the protection is not to reflect a marketplace consideration, but to provide protection for a particular type of licensee.]

1. Subsection (d) was moved into a general section on waiver of breaches. Subsection (b) contains a modification designed to bring this section into parallel with current law. Article 2 and Article 2A require no oral modification terms to be signed by the consumer; section was added here in the form of manifestation of assent, rather than signature.

2. This draft deletes bracketed language that had been added in response to the suggestion of a licensee attorney for consideration by the Committee. The language in former (a) stated: "Other than in a consumer license, an agreement expressed in a record cannot be modified except by a modification in a record." In commercial contexts, written modifications may be the expected norm in all of the industries covered by Article 2B.

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of an agreement involving repetitive performances apply to all later performances of the parties, their agents, or their designees unless modified pursuant to this article, even if the terms are not subsequently displayed or otherwise brought to the attention of the parties or electronic agents in the context of the later performance.

(b) If a ~~A~~ term in ~~that provides that~~ a contract involving repetitive performances provides that the contract may be modified as to future performances by compliance with a described contractual procedure, a ~~is enforceable. A~~ modification made in good faith pursuant to that procedure is effective if:

(1) compliance with the procedure notifies the other party of the change a reasonable time before the change becomes effective; and

(2) in a consumer contract, the procedure permits the consumer to withdraw from the contract if the terms are unacceptable.

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

UNIFORM LAW SOURCE: None

COORDINATING MEETING: Either leave in Article 2B alone, or move to Article 1 for general application.

Selected Issue:

1. How should the section deal with modification of continuing terms in light of on-line practices of posting changes in terms of service?

Reporter's Notes:

1. This section was extensively discussed at the meeting in October. Subsection (a) deals with a simple principle that causes confusion in on=going contracts. It states the unremarkable principle that contract terms, if enforceable, cover all forms of contractual performance. In the language of the section, they are continuing in nature and need not be repeated on each use of a system.

2. Subsection (b) addresses a common practice in online or other continuing service contracts in which changes in service conditions occur by posting on the service from time to time. This language requires that the procedure be in the contract, followed, and that the circumstances be such that the procedure gives reasonable notice to the other party of the change. What constitutes reasonable notification varies depending on the circumstances. What is required here is notification. A procedure for the posting of changes in an accessible location of which the other party is aware is reasonable. In consumer contracts, a further protection involves the requirement that the consumer be allowed to withdraw from the contract (e.g., terminate it) if it disagrees with the changed terms or simply does not desire to continue in light of them. Withdrawal is without penalty, but the consumer must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due).

SECTION 2B-305. OPEN TERMS.

(a) An agreement otherwise sufficiently definite to be a contract is enforceable even if 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 agreement requires performance that is reasonable in light of the commercial circumstances.

(c) If a term of an agreement is to be specified by a party:

(1) Specification must be made in good faith.

(2) An agreement that provides that the performance of one party be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party whose satisfaction must be met. However, the agreement requires performance to the subjective satisfaction of the other party~~that satisfies the other party in fact~~:

(i) to the extent the agreement requires the party to provide informational content to be evaluated in reference to its aesthetics, marketability, appeal, suitability to taste, or similar characteristics; or

(ii) if the agreement expressly provides that the performance is to be judged in the "sole discretion" of the party or words of similar import.

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

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

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

(d) If a term is to be fixed by agreement and the parties intend not to be bound unless the term is fixed or agreed to, a contract is not formed if the term is not fixed or agreed to. In that case, each party shall return or, with the consent of the other party, destroy all copies of information and other materials already received or, if unable to do so, pay the to the other party the amount by which it received a benefit from the information that cannot be returned or destroyed. The licensor shall return any portion of the license fee paid on account for which performance has not been received and retained by the licensee. The parties remain bound with respect to any agreed to confidentiality or similar obligations.

Uniform Law Source: Section 2-305; Section 2-311. Revised.
Coordinating Meeting: Articles to avoid substantive differences where not merited by subject matter and commercial practice; different frameworks to be retained.
Selected Issue:

1. Is the treatment of contracts in publishing, entertainment and other similar venues appropriate?

2. Should the section be approved in principle?

Reporter's Notes:

1. Subsection (c)(2) has been reorganized based on suggestions at the Drafting Committee meeting. The general rule refers to a reasonable person standard, but the two exceptions create an important standard in reference to entertainment and publishing aspects of the industry. The provision on information context has been clarified to refer to judgments referencing aesthetics, market appeal and the like.

In contracts calling for performance that is to the satisfaction of one party, the two different approaches to this issue reflect entirely different traditions and case law background in the industries affected by Article 2B and differences in the qualitative standards that are appropriate to the commercial relationships. The factor that distinguishes these industries is that many of the information products that they obtain entail judgments about aesthetics and marketplace shifts, leaving it important that the judgment of the licensee be unfettered by overview in terms of reasonable man standards. The converse rule is more appropriate as a default rule in cases involving the development of computer programs and the like. The comments to this section will outline the type of language that can be used to shift the default rule in both cases (e.g., "Acceptable in the licensee's sole discretion.").

2. The Restatement ' 228 provides that it "prefers" a reasonable man approach if the context permits of the creation of objective standards for determining satisfaction. This, very imprecise, standard is not adequate to information content industries. Indeed, the Restatement cites an entertainment industry example as one in which no reasonable standard of satisfaction is possible.

3. Subsection (d) deals with situations in which the parties agreement contains an element requiring further **agreement** to a term. This is not equivalent to a conditional offer since, in this context, the term remains open and is set for subsequent agreement. The section derives from 2-305. It has been revised based on Committee discussion in several respects. The relevant policy is that, in the case of a failed agreement, the parties must be placed into the same position as that would have been without the tentative steps toward agreement having occurred and that no party should retain a benefit for which it has not paid.

4. Unlike in Article 2, subsection (d) permits destruction of copies of the information and other materials in lieu of returning them. In the context of goods, return of the tangible items is essential to place the parties back into the position that they were before the tentative agreement. In reference to information, in most cases at least, the party having transferred the information retains copies of it. The option of destroying the copies is made subject to the consent of the other party to cover the unusual case in which recovery of the information by the original transferor would be difficult or costly.

5. Subsection (d) is also revised to clarify the test for measuring value in the case where return or destruction is not possible. Article 2-305 refers to "value" received. The language here is more precise, and instructs the parties and a court, if appropriate, to examine the benefit received by the party unable to destroy the information. Note that, this issue covers not only licensees, but also licensors in the common transaction where information is delivered for processing. The requirement to pay for the benefit retained is not a right that can be exercised if the party simply desires to retain the information. It is a measure of value in the event that return or destruction is not possible.

6. Sentence 3 of subsection (d) has been modified to focus on the return of the license fee less any amounts due for performance received and retained. This is an essential facet of placing the parties back into their original position and also reflects common law ideas of recoupment.

> **Illustration 1:** EDP provides outsourcing for clients. It reaches a tentative agreement with Beltway Construction to handle all of its accounts, but the agreement is subject to final agreement on confidentiality terms. Beltway delivers information to EDP and EDP begins work while negotiation continues. The annual fee for services is $120,000. Beltway performs for two months, but then the agreement fails. EDP must return or, if Beltway consents, destroy the information it received. It must return the $120,000 license fee, but can deduct for the two months of performance.

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

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

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

Uniform Statutory Source: Section 2-306.
Coordination Meeting: Article 2 should try to conform to Article 2B in substance.
Committee Vote:
1. Voted unanimously to approve the section in principle, but to consider changes in the idea of best efforts, either in definition or by shifting to a "reasonable commercial efforts" standard.
Selected Issue:
1. Should the section be approved as redrafted?
2. Should subsection (b) be deleted because of diverging practices in the various industries?
Reporter's Notes:
1. Licenses do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. A prime characteristic of information as a subject matter of a transaction lies in the fact that the intangibles are subject to reproduction and use in relatively unlimited numbers; the goods on which they may be copied are often the least significant aspect of a commercial deal. Rather than supply needs or sell output, the typical approach would be to license the commercial user to use the information subject to an obligation to pay royalties based on the volume or other measurable quantity figure.
2. Subsection (b) has been redrafted to cover the various, different bodies of case law that pertain to exclusive dealing relationships in reference to information. Unlike in the case of goods as dealt with in Article 2, the typical case here does not necessarily entail the creation and delivery of copies (products) for resale by the other party. The prior draft relied on existing Article 2 and on case law dealing with pure patent licensing, to create a best efforts default rule. That rule, however, is not presently the law in the other fields governed by this Article and, in any event, uses a standard that has been difficult if not impossible to define with any degree of reliability. The standard established here is more consistent with publishing and similar industries and allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. Forms]

SECTION 2B-307. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in subsection (c) and Sections 2B-308 and 2B-309, a party adopts the terms of a record, including a standard form, if the party agrees to or manifests assent to the record before or ~~within a reasonable time after beginning to use the information or commencing performance~~ in connection with the initial use of or access to the information. If agreement or assent to a record does not occur by that time, but the parties commence performance or use the information with the expectation that their agreement will be later represented in whole or in part by a record that the party has not yet had an opportunity to review or that has not yet been completed, a party adopts the terms of the later record if the party agrees to or manifests assent to that record.

(b) A term adopted under subsection (a) becomes part of the contract without regard to the knowledge or understanding of the individual term by the party assenting to the record and whether or not the party read the record.

(c) A term of a record which is unenforceable for failure to satisfy a requirement of another provision of this article, such as a provision that expressly requires use of conspicuous language or manifested assent to the term, is not part of the contract.

Uniform Law Sources: Restatement (Second) of Contracts 211.
Coordination Meeting: Concept should be applicable in all three articles; Article 2 to conform to Article 2B definitions of standard form and standard terms.
Committee Votes:

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

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

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

Selected Issue:

1. Should the section be returned to the more limited focus on "standard form" records?

Reporter's Notes:
[This was redrafted to cover all types of records and to recognize that contracting practice in this broader field cannot be bound to relatively limited concepts of manifesting assent.]

1. This section originated in the effort, begun in the combined Article 2 project, and carried forward here, to deal with enforceability of standard forms, a topic that the UCC did not previously deal with, except in the limited case of conflicting forms. The approach basically balances two positions. The first, reflected in this section, firms up the enforceability in commercial deals of the writing. This confirms an important aspect of commercial contract law. The principle, already followed in the vast majority of modern commercial case law, flows from the belief that in the absence of fraud, unconscionable or similar wrongful conduct, commercial parties are bound the writings to which they assent or sign, without being generally able to later claim surprise or a failure to read the language presented to them. The other premise is that, in consumer transactions, enhanced protections can be creating by **rejecting** the idea that a party is bound by the entire form to which it assents, and adopting the terms of the Restatement (Second) of Contracts 211, which creates a limited basis to argue that a term in a record to which the party assents may have been so surprising that it should not be enforced unless called to that person's attention. The Restatement rule is seldom applied in commercial contracts and has been adopted fewer than ten states even in other (consumer) agreements. Other states use concepts of fraud, unconscionability, bad faith and similar devices to police, in a very limited way and in **serious cases of abuse**, the terms of contracts assented to by parties.

2. As drafted, this section applies the principle of enforceability to all commercial records. This takes on a far bigger issue than dealing with standard forms. Whether this is appropriate should be considered.

3. This section deals with “single record” cases and does not apply to mass market licenses. Within those limitations, under subsection (a), a party is bound by a record if it agrees to the record or if it manifests assent to the record. Given the definition of manifesting assent, this gives three ways of establishing that a record is binding: “agreement” to the form, authentication (signing) of the form, and manifestation of assent (to the form). Whether these cover all ways of being bound to the terms of a writing remains to be considered. It is important, however, to recognize the this section (and 2B-308 and 309) do not address whether a contract exists. If there is no contract under other provisions of this Article, the sections are not applicable. What is addressed here is, given an agreement, what are the relevant terms.

4. Subsection (a) rejects the idea that a contract and all of its terms must be formed at a single point in time. Case law uniformly adopts a more fluid conception of the process of contracting, where parties define the agreement over a period of time that is not unending, but is not constrained to an instantaneous “closing” in most cases. As a consequence, terms can be created by agreement or assent after beginning performance. Thus, in the entertainment industry and in many development contracts, contract terms are developed and drafted **while** performance occurs, not before performance begins. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section expressly accommodates that process, following modern case law and practice. See, e.g., Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991); Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997).

5. Given the presumption that performance begins in expectation of documentation, assent to a record developed by the parties can come in many different ways. The most restrictive here deals with “manifested assent.” This concept adopts procedural safeguards allowing the party bound by the standard form an opportunity to review terms and to reject the contract if the terms are not acceptable. The two safeguards are in the concept of "opportunity to review" (see 2B-114) and "manifests assent" (see 2B-113). Both terms are defined in this article. Under these definitions, a party cannot manifest assent to a form or a provision of a form unless it has had an opportunity to review that form before being asked to react. Except in contract modifications, an opportunity to review does not occur unless the party has a right to return the subject matter, refuse the contract, and obtain a refund of fees already paid (if any). The second theme involves signing the record (authentication). Historically, this has been sufficient to show assent. Third, there is the possibility of “agreement to the record.” This is more subjective and deals with the entire context. A party in a context covered by this section would generally prefer to construct its transaction to fall within the either of the other provisions.

6.` If a record is adopted under this section, the party adopting the record cannot argue that it did not read the contract language or any particular clause. This is standard law in contract law decisions. If you have the opportunity to read and refuse it or do not take advantage of that opportunity, your failure to read the language does not disadvantage the other party.

SECTION 2B-308. MASS-MARKET LICENSES.

(a) Except as otherwise provided in this section and Section 2B-309, a party adopts the terms of a mass-market license if the party agrees or manifests assent to the mass market license before or in connection with the initial use of or access to the information. ~~before or within a reasonable time after beginning to use the information or commencing performance.~~

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

However, except as otherwise provided in this section, a term does not become part of the contract if the term creates an obligation or imposes a limitation which:

(1) the party proposing the form should know would cause an ordinary and reasonable person acquiring this type of information and receiving the form to refuse the license if that party knew that the license contained the particular term; or

(2) conflicts with the previously negotiated terms of agreement~~ of the parties relating to the transaction~~.

(c) A term excluded under subsection (b) is~~becomes~~ part of the contract if the party that did not prepare the form manifests assent to the term or if, under the circumstances, the ~~presence of the~~ limitation or obligation ~~contained~~ in the term was clearly disclosed to the party before it agreed or manifested assent to the mass market license.

(d) A term of a mass market license which is unenforceable for failure to satisfy a requirement of another provision of this article, such as a provision that expressly requires use of conspicuous language or manifested assent to the term, is not part of the contract.

(e) A ~~The terms of a~~ mass-market license must be interpreted whenever reasonable as treating in a similar fashion all parties situated similarly without regard to their knowledge or understanding of the terms of the record.

(f) A term that states a limitation ~~on reproduction, distribution, modification, public performance, or other exclusive rights in the information~~ that would be placed on the party ~~assenting to the license~~ by copyright or patent law in the absence of the term does not come within ~~the provisions of~~ subsection (b)(1).

Uniform Law Source: Restatement (Second) of Contracts ' 211.
Coordination Meeting: Difference in practice and focus justify substantive differences.
Votes:

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

2. The Drafting Committee adopted by a vote of 10-1 a motion to delete the reference to terms consistent with "customary industry practice."

3. The Drafting Committee adopted by a vote of 12-0 a motion to delete a safe harbor for terms giving no less rights than under a first sale.

4. The Drafting Committee voted 12-0 to support in principle in (b) that focuses on the perspective of the party proposing the form.

Selected Issues:

a. Should a term that restates limits placed under copyright and patent law be excluded from being a refusal term as suggested in subsection (f)?

Reporter's Notes:

1. This section applies general contract theory to mass market transactions, creating what will be, in most states, an expansion of protections for consumers and businesses who make contracts in the "mass market." The section adopts and expands on the principles of the Restatement (Second) of Contracts ' 211. Since the Restatement test has been adopted in only a minority of all states, this expands **licensee** protection as contrasted to **current** law.

2. This section focuses on single-form cases. In that situation, while some contrary case law exists, modern case law generally affirms the enforceability of forms coupled with transactions in mass market settings. In Article 2B, this section is most commonly associated with so-called "shrink wrap" licenses, but its scope of application goes beyond this and covers many on-line contracts (at least insofar as these contracts fall within the operative definition of mass market license). **With respect to single form, shrink wrap cases, while the cases split, in situations dealing with single form settings involving shrink wrap licenses, no appellate case law rejects the contract-based enforceability of the forms and recent cases generally support it.** See Hill v. Gateway 2000, Inc., 1997 WL 2809 (7th Cir. 1997); ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). Compare Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th 1988) (applying a preemption analysis to statute validating a particular term **after** the lower court held otherwise the contract was invalid as a contract of adhesion).

Case law is less clear in the conflicting forms setting, where, as in Section 2B-309 of this article, the presence of differing terms in forms creates questions about assent to either form. See Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir.1991); Arizona Retail Systems, Inc. v. Software Link Inc., 831 F. Supp. 759 (Ariz. 1993). These cases do not contest the underlying enforceability of forms, but deal with the reality of conflicting terms. See Douglas G. Baird & Robert Weisberg, Rules, Standards, and the Battle of the Forms: A Reassessment of ' 2-207, 68 Va. L.Rev. 1217, 1227-31 (1982).

3. Subsection (a) follows the treatment of records generally in Section 2B-307 and allows a form to govern if agreed to at the outset or agreed or assented to within a reasonable time after the initial use of the information in cases where there was reasonable basis to expect that a record would be used to document part of the transaction. This bars entirely surprising forms (a result that may or may not apply under current law), but enables the creation of contracts in this market over a period of time, rather than at a single instant. The more important provisions are in subsection (b). This section was amended in this draft to limit the applicability of the form as part of the agreement to cases where assent to the form comes at or before initial stages of use of the information. As described in 2B-307, the basic principle holds that contracts may be formed over a period of time, rather than only at a specific point in time.

4. Subsection (b) adopts the Restatement. The major difference between this subsection and Restatement 211(3) is that, in light of the mass market context, this Draft focuses on the perspective of the party proposing the form with respect to an **ordinary** user of the information, while the Restatement refers to the perception of the party proposing the form as to the reactions of the **recipient**, assuming a one-to-one transaction. In the mass market, that would be unrealistic. Both rules, however, focus on the perspective of the party proposing the form, a focus approved by the Drafting Committee. By disallowing so-called "refusal terms" this treatment allows a mass market licensee to argue that some terms of the form were not made clear to it and that, had they known of the terms, they would refuse the license. To buttress this right, subsection (c) allows the proposing party to call the terms to the licensee's attention explicitly and, thereby, eliminate the argument of surprising, refusal terms. See

Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass'n Bull. -- (1995) (65% of surveyed computer law professions believed that shrink wrap licenses should be generally enforceable).

5. In contrast, proposed revisions of Article 2 focus on consumers, rather than mass market transactions, and go beyond any existing U.S. law, adopting a refusal term perspective centered on the consumer's perspective, a test used only in the UNIDROIT rules and currently adopted in no U.S. jurisdiction. A motion to delete that provision was defeated based in part on the representation by the Committee in Article 2 that the Article 2 consumer test was an "objective" standard.

Illustration 1: Assume that party A accesses the front "page" of party B's online 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." 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.

Illustration 2: ABC Industries agrees with Software Co. to acquire a $800 word processing program. The oral agreement contemplates that the program contains a spell checker. It does not contain reference to warranties. When the package is opened and placed into a computer, the first screens state: "This software is subject to a license agreement. To review the agreement, click [here]. If you agree to be bound by the license agreement, click below on the icon stating your agreement. If you do not agree, click on the icon stating your nonagreement and return this product and all copies you have. We will give you a full refund. " Assume that by clicking to review the agreement, the entire license is available on screen. Also assume that the licensee cannot proceed to load the software without indicating its agreement. Does this license generally define the agreement if the licensee clicks acceptance. Yes. The licensee had an opportunity to review before taking steps defined as assent. The opportunity to review includes, as it must, a chance to read the license, an opportunity to decline it, and a right to a refund if the licensee declines. By clicking acceptance, it assents to the form. The fact that there was a prior agreement is not material since the license did not contradict negotiated terms.

Illustration 3: In the foregoing illustration, assume that the license contains a term that provides that the software does not have a spell checker and that licensee shall not make backup copies of the program. Assume that a reasonable licensor would know that an ordinary and reasonable licensee would refuse the license if he knew it prohibited the backup copy, and note that the first clause contradicts the express agreement of the parties. Does either license term govern the relationship of the parties? Answer is no. The terms are excluded by this section unless there is manifest assent to the terms. Note that if the illustration were changed to cover the sale of a Nintendo game, a product for which backup copies are not made and defective games are simply replaced by the manufacturer, Nintendo would not need to obtain manifest assent to the "no backup" term because it reasonably would know that an ordinary, reasonable licensee of a Nintendo game would not refuse the contract for inability to make a backup.

Basically, if a party desires to use terms in its mass market forms that it should know would typically cause refusal of the license and does not wish to risk their unenforceability, that licensor must structure the transaction to obtain manifest assent by the licensee to the particular term. Under the definitions used here, that requires that the term be called to the licensee's attention and assent obtained by signing or an action specifically related to that term and with the assurance that, if he declines, the licensee can return the information product for a refund. 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 a bizarre term, the only safe procedure you can adopt entails one in which that term is brought to the licensee's attention and assented to by the licensee.

6. Subsection (e) contains a directive regarding interpretation of the standard forms. The subsection intends to incorporate the provisions of the Restatement and reflects a fair estimation of how courts should approach standard contracts in a mass market context.

7. Subsection (f) suggests an exception urged by several commissioners at the September Meeting. It indicates that a term stating limits under existing federal law are not refusal terms and do not fall within the provisions of subsection (b)(1). The section does not validate specific terms or go outside the scope of what rights the licensor would have under copyright and patent (including any limitations on those rights under federal law or policy). In specific, the intent is not to cover questions about contract clauses pertaining to reverse engineering. It deals, instead, with contract terms that implement directly the copyright owners exclusive rights in the contract and that, therefore, preclude application of what in some cases in this draft are default rules that may be outside the requirements and limits of those intellectual property rights.

SECTION 2B-309. CONFLICTING TERMS.

(a) If the parties to an agreement made pursuant to Section 2B-205 exchange standard forms that purport to contain terms of the agreement and the forms contain varying standard terms, the following rules apply:

(1) If a party proposes a standard form containing language which states that the party does not intend to be bound unless the other party agrees to the terms in its form and the conduct of the party proposing the conditional form is consistent with the stated conditions, the terms of that form govern if the other party by ~~its~~ language or conduct agrees to the form.

(2) In all other cases, terms on which the forms agree become part of the contract, but the varying standard terms are not part of the contract unless the party claiming inclusion establishes that the other party manifested assent to the varying term or the records of both parties agree in substance with respect to the term.

(b) Subject to subsections (c~~d~~) and (d~~e~~), in cases governed by subsection (a)(2), the terms of the contract are:

(1) terms actually agreed to by the parties;

(2) terms of the licensor's record governing the scope of the license;

(3~~2~~) terms included under subsection (a)(2); and

(4~~3~~) supplementary terms under this article.

(c) In the case of a conflict between terms included under ~~the provisions of~~ subsection (b): ~~;~~ terms under subsection (b)(1) govern as to all other terms; ~~and t~~terms included under subsection (b)(2) govern terms under subsection (b)(3) or (b)(4); and terms under (b)(3) govern terms under (b)(4).

(d) ~~The terms of the contract under subsection (a)(2) include the terms of the licensor's record relating to the scope and character of the license to the extent that the terms do not conflict with the negotiated terms of the agreement.~~

~~(e)~~ Contractual terms contained in a record authenticated by the party to be bound supersede the inclusion or exclusion of terms under subsections (a) or (b).

Uniform Law Source: Section 2-207. Substantially revised.
Coordination meeting: Approaches in all three articles differ. Due to differences in practice and subject matter, reconciliation is not likely.
Committee Votes:

1. By consensus agreed to strike or rewrite former subsection (c) (now subsection (b)(2)), intending to deal more effectively with defining terms that are basic to defining the product and, thus, not subject to the knock out rule.

Reporter's Note:
[The provisions of subsection (b)(2) deal with an important issue in the copyright industries where the treatment of the scope of the license in essence defines the product licensed (e.g., public performance of X movie in the city of Houston). Additionally, it is only the licensor who is aware of what can be granted (e.g., it holds rights to a screen play only for use in television). Those terms should not be altered by a conflicting form. If express terms in forms conflict on scope, the case should be resolved under 2B-202 or 205 dealing with formation of a contract Disagreement on scope of the license indicates a lack of agreement on what is being purchased. In this section, terms of a form that conflict with a negotiated agreement on scope do not control; the licensor's terms only control as against other non-negotiated terms.]

1. This section deals with a limited, but significant problem. It does not purport to provide a general rule of interpretation where records exchanged by the parties do not fully agree. It deals, instead, with the case of two or more conflicting forms, the problem with which current 2-207 deals. See ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996). The battle of forms setting deals with a situation where the parties have generally decided to exchange forms, but undertake a contract regardless of whether the forms agree. Where this is true, the section states simply that, if the parties did not undertake to negotiate or actually to limit their conduct to cases were the form in fact governs, law will not retroactively create a transaction in which the standard form terms have greater significance for either party. In that setting, the section applies a "knock-out" rule, reverting the parties to the supplementary principles of this Act. As the Third Circuit Court of Appeals noted:

> The insight behind the rejection of the last shot rule [in Article 2] is that it would be unfair to bind [a party to the standard terms of the other party] when neither party cared sufficiently to establish expressly the terms of their agreement, simply because [one party] sent the last form.

2. This section deals, however, with three cases where a pure knock-out rule would be inappropriate. The first involves a case (subsection (a)(1) where one party, by conduct **and** by its form, conditions its acquiescence to a contract on the other party's assent to its forms. Although a naked exchange of forms should give neither party general priority, conditional offers or acceptance must be recognized, even if made via a standard form. By linking the form with the behavior involved in the conditional form terms, as required in subsection (a)(1), a party undertakes expressly to take the transaction outside the scope of the battle of forms by actually conditioning its participation in the contract on agreement to the terms of the form. Often, when this occurs, there will be no agreement between the parties unless the other party agrees to the conditional offer or response. See 2B-202.

3. A second situation that takes the case out of the knock-out rule occurs when the parties execute and authenticated writing that records their agreement. This authentication (signature) supersedes forms under subsection (d). The authenticated record can come before or after the exchange of forms. The basic theme, however, is that an executed agreement better indicates intent and throws the case outside the knock out rule. Consistent with this section, however, courts can and should use general concepts of contract interpretation to discern the meaning of the contract.

4. The third situation occurs when the forms disagree about the scope of the license. Scope issues affect the basic definition of what property is licensed by the licensor. The mere fact that one form disagrees with the licensor's form on issues of scope cannot be held to throw the case back on general default rules. A vendor who provides a consumer version of software cannot be forced to have given an unlimited, license in the software for development and other use under a consumer license fee simply because a competing form stated terms different than the consumer restriction. In cases where forms disagree on such basic points, the true issue is whether a contract exists (that is, was there an agreement). If so, the licensor's form controls on the scope issue. A knock-out rule would expose intellectual property to the vagaries of conflicting forms.

The nature of information product contracting creates significant questions about whether a knock out rule should be applicable to scope since the contract actually defines what property (rights) are transferred. Should a party be able to eliminate a single CPU restriction that is central to the definition and pricing of the particular software, for example, by including in its standard order forms terms that require a right to use the software on multiple CPU knowing that the business of the provider will not ordinarily allow it to review the language in each form? Unlike warranty and similar terms, scope terms define what product is being sold (e.g., multi-user or single user license). The pure knock out rule may not be appropriate in the multi-element world of software and information licensing. Subsection (b)(2) adopts an approach suggested by a commissioner during discussion and later supported by members of the entertainment industry concerned about scope provisions. The approach provides that the licensor's provisions as to scope of the license control despite conflicting standard terms unless the licensor's scope provisions conflict with a contrary negotiated agreement. Scope refers to terms restricting field of use, duration and similar terms that in effect define the nature of the information product being licensed.

> **Illustration 1.** Vendor offers two versions of its copyrighted directory and commentary relating to restaurants. One is a license for personal, consumer use only and is offered at a price of $50.00. The second, containing essentially the same data and software is licensed for commercial use, including the right to make commentary available in commercial publications. It is priced at $10,000. Licensee sends a standard form which contains the provision that the software must be available for **all** uses, including commercial use. It includes a $100 check and orders one copy of the restaurant software. Vendor ships, using a standard form limiting use to **consumer** purposes. T vendor's scope limitation controls since there was no contrary, negotiated term. Under a knock out rule, the default rule applies, which allows any use.

5. The scope of this section has been an issue in terms of whether it should deal with all records that are exchanged or be limited to standard form records. A prior draft covered all records "that purport to contain the terms of an agreement." During Committee discussions, it became apparent that this expansion potentially affected all negotiated and non-negotiated contracts in which the parties exchange any written material. That is too large of a scope for a limited purpose rule. The knock-out rule here is appropriate for an exchange of forms, but not with reference to interpretation of writings of various types, such as letters, partial lists of clauses and the like. This draft leaves treatment of those complex situations to ordinary contract interpretation rules which in general have not proven to be a problem in modern litigation. Extension of this section to non-standard records would undermine the two prior sections in any case where, for example, a letter or an E-Mail was used to request a contractual relationships. The intent in this Draft is to focus solely on the most common and highly disputed topic (the battle of forms) and to leave undisturbed the highly important decisions reached by the Committee in sections 2B-307 and 308.

6. The sole question here deals with what are the terms of the contract in the battle of forms. The creation of the contract comes under 2B-202 and 205.

Illustration 2: In response to a standard order form from DuPont, Developer ships software subject to a form. The two forms disagree on warranty terms. Under this rule, both warranty terms drop out. If Developer sends an E-mail or a letter objecting to the warranty terms, but goes ahead and ships without obtaining assent from DuPont to any change, determining what terms govern the contract poses a difficult, but ordinary contract interpretation issue inquiring into the intent of the parties, rather than an automatic knock-out rule. If Developer states its refusal to ship unless DuPont agrees to its warranty terms **and**, in fact refuses to do so until DuPont agrees, the provisions of (a)(1) apply. If Developer sends a form conditioning shipment on acceptance of its terms, but nevertheless ships, subsection (a)(2) governs; the conflicting terms drop out.

7. In cases of two conflicting records, this section controls over the prior two sections on standard forms and mass market licenses which deal with cases involving only one standard form. It adopts a knock-out rule. Varying or conflicting terms are excluded unless a party manifests assent to a particular **term**. A party does not manifest assent by mere silence or retention of a record. Assent requires an affirmative act that reflects agreement to terms that the party had an opportunity to review and reject.

Illustration 3: Licensor and licensee exchange standard forms relating to an acquisition of software. The terms conflict with respect to warranty. The conflicting terms drop out. The licensee does not obtain its term (full warranties) unless the other party assents to that term. Suppose that the Licensee form states that, by shipping this package, you consent to all of my terms and specifically to term 12 on warranties. Does shipping the package assent to the term? No. The conduct does not relate to that term. The licensee would have to require initials on the term, telephone assent to the term, or other act clearly connected to the fact that the licensor knew of and assented to the term itself.

Illustration 4. Same facts, except that licensor desires to obtain its warranty terms. Its license provides that "by opening this package you assent to all the terms of my license." Does this conduct assent to the warranty disclaimer? No. Again, the conduct must relate to the particular term. For example, the license might contain a screen that appears at the outset of the first use of the program and provides that the licensee click on an icon indicating assent to the license and a second icon indicating assent to the warranty term.

[C. Interpretation]

SECTION 2B-310. INTERPRETATION OF GRANT.

(a) Subject to Sections 2B-312 and 2B-501 and except as otherwise provided in this section, a license grants rights under all rights expressly described and all rights within the licensor's control during the duration of the license that are necessary to use the rights expressly granted in the ordinary course in the manner anticipated by the parties at the time of the agreement. A license grant contains an implied limitation that the licensee will not exceed the granted scope. Use of the information in a manner that was not expressly granted or expressly withheld, exceeds this implied limitation if the use was not necessary to the granted uses and would not otherwise be legally permitted in the absence of the implied limitation.

(b) A license grant dealing with digital information which does not specify the number of simultaneous users permitted grants a right for use by one party at any one time, but if the license authorizes display or performance, it permits participation in or viewing by any number of persons, but only a single performance or display at any one time.

(c) Neither the licensor nor the licensee is entitled to: (i) any rights in improvements or modifications made by the other party after the transfer of rights, or (ii) receive source code, object code, schematics, master copy, or other design material, or other information used by the other in creating, developing, or implementing the information. A licensor's agreement to provide updates or new versions requires that the licensor provide only such updates or new versions that are developed by the licensor from time to time and made generally available unless the agreement expressly requires that the licensor develop and provide new versions or updates in a timely manner.

(d) In interpreting grant language, the following rules apply:

(1) A grant without qualification of "all possible rights and media" in information , or a grant in similar terms, covers all rights then existing or created by law in the future, and all uses, media, modes of transmission, and methods of distribution under such rights in technologies or applications then existing or developed in the future. A grant of "all possible rights" covers all rights then existing or created by law in the future. A grant of "all possible media" covers use in all media, modes of transmission and methods of distribution under technologies or applications then existing or developed in the future.

(2) In a contract between merchants that is not a retail transaction, a "quitclaim" of rights or a grant in similar terms is a transfer of rights without warranties as infringement or ~~to~~ the rights actually possessed and ~~or~~ transferred by the grantor.

Reporter's Notes:

1. This section proposes a significant reduction and focusing of the various default rules that were contained in prior drafts. As drafted, the section would replace the following sections of the December, 1996 Draft: 2B-310, 311, 312, 313, 315, and 316. Much of the former material is not carried forward to the new section. A variety of sources, including licensee representatives and external commentators, as well as members of the Drafting Committee expressed concern about excessive detail in the draft. Also, as new industries have entered active discussions in the development of the Draft, it became clear that many of the default provisions contained in earlier versions would not be appropriate across the various affected industries. This section and the various deletions suggested in this Draft reflect and effort to move the draft on these issues to a higher level of generalization and provide important rules applicable across the information industries.

2. The first sentence in subsection (a) covers a classic form of implied license dealing with rights necessary to achieve the purposes of the grant and with rights that may not have been expressly granted. For example, a license to use a film clip in a CD ROM product impliedly conveys the right to crop or modify the size of the clip to fit the media unless that is expressly excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to make modified versions of that software. This subsection stems from former 2B-310(d) and 2B-311(b). The implied license relates to rights transferred and to materials provided to the party; it does not require a transfer of additional materials (such as source code), unless that transfer was agreed to by the parties.

4. The second and third sentences in subsection (a) deal with an interpretation issue that is highly important as information transactions become more and more common outside areas of the profession expert in reference to intellectual property law. The issue was discussed extensively at an earlier meeting with instructions to recast the substance of the approach. See former 2B-312(b). This was done here. Unless dealt with here, the issue creates a potential trap for unwary draftsmen. Under current law, it is clear that uses of licensed information outside the express scope of a license are breaches of contract if the scope is defined in terms of "this use only" or otherwise expressly precludes the use. Where the word "only" does not appear, the cases are less clear and some limited case law would suggest that the omission of the word in formal grant language vitiates the contract claim. The concept of implied lesser use rights is not universally followed in licensing law and some federal policy appears to holds that the proper interpretation is that any use not expressly granted is withheld. Subsection (b) adopts the converse, more commercial perspective as a way of avoiding unexpected and undesired results.

Under the second and third sentences of (a), an affirmative grant of less than all rights impliedly excludes other uses that exceed the scope. The implied limitation, however, is not as strong as would be an express limitation. The implied limitation does not preclude acts that are **necessary** to achieve the uses contemplated in the express grant. Additionally, the implied limitation is not exceeded if the use would have been permitted by law in the absence of the implied limitation. The reference here is to any source of law and would include actions that constitute **fair use** in the absence of the **implied** limitation. Thus, a consumer (personal) use of a commercial license might be permitted if it would be a fair use (if it does not adversely impact the market for the work) and was not expressly precluded by the contract. Similarly, in some cases, a reverse engineering use is permitted in general law. The implied limitation does not alter these results. However, if a grant is for use in one location but did not use the magic word "only" and the licensee uses the motion picture copy to make and distribute multiple copies for sale to home uses, that activity would violate the copyright (as a non-fair use) and breach the contract. The position that no implied limits are present creates a trap for the unwary licensor in that it contradicts normal contract interpretation ideals of viewing a contract in light of its commercial purpose. A grant to use software in Peoria seems to imply the lack of a contract right to do so in Detroit. That is the view taken here.

> **Illustration 1:** Disney licenses to Acme Theater the right "to show the movie Snow White during a six month period in Kansas." Acme, enamored with the musical score of the movie, digitally separates the music into a separate copy and uses it during that six month period in the Acme lobby. This infringes the copyright. Whether it breaches the contract depends on whether the grant creates an implied limitation that precludes other uses of the work and derivative copies. Under section (b), the implied limitation exists unless the use was a fair use without that limitation or was necessary to the primary grant. Neither condition is met here. The fact that Disney forgot to add the word "only" to its grant language does not create a different result than would be explicit in the presence of that language.

Illustration 2: Licensor grants the "right to use its software in motion pictures." The licensee uses the software to develop and distribute an animated movie. Later, it uses the software to develop and distribute a television series. Assume that a television program is not within the idea of a motion picture. When sued for breach, if the rule is that uses outside the grant are not breaches of contract, the grant terms are inadequate to give the licensor rights in this case. If there is an implied limitation as proposed here, the issue is whether television use "exceeds" the grant. It should, under an appropriate test.

Illustration 3: Same as illustration 2, except that the license grant states that it grants "the right to use its software solely in motion pictures." Under this framework, use in television violates and express condition of the license and is a breach. Whether such difference in result should flow from the addition or omission of the word "solely" is at issue. Requiring that word may be a trap for less well-counseled parties.

Illustration 4: Same as illustration 2, except that the license provides in addition to the grant that "all uses not expressly granted are expressly reserved to the licensor." This is the same as Illustration 3.

Illustration 5. EXL licenses software to Dangerfield. The license is silent regarding reverse engineering and consumer use, but expressly gives Dangerfield the right to use the software in the 1000 person network Dangerfield operates for its employees. Dangerfield reverse engineers the software to discover its interface with Digital Computer systems for purposes of making a new system. Also, a Dangerfield employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is clearly authorized since it would be a fair use if the implied limitation were not present. The reverse engineering would also most likely be authorized under case law allowing reverse engineering if necessary to discover interoperablity requirements.

4. Subsection (b) states the presumption that, for copyrighted or patented material, an agreement that does not enable a greater number of copies or uses generally restricts the licensee to a single simultaneous use. This is consistent with a basic principle that allows retention by a copyright owner of rights not expressly granted. While many commercial licenses involve site or multiple user licenses, this pattern entails an express or implicit agreement that would, in any event, over-ride the default rule provided here, which like other default rules is expressly subject to the contrary agreement of the parties. The second sentence of (a), however, recognizes that contracts for or involving display or performance rights center on the simultaneous number of performances, rather than on the number of users. Thus, for example, a transfer of a Nintendo computer game does not allow the making and simultaneous copying of multiple copies, but does implicitly allow involvement by more than one person in reference to the performance. The second sentence of (a) does not deal with the issue of whether a "public performance" is presumed. Most likely, that would not be the case unless expressly granted.

5. The first clause of subsection (c) comes from prior 2B-311(d) which the Committee approved. The second clause comes from prior 2B-316 which was also previously approved. The basic principle is that no right to subsequent modifications made by the other party is presumed., nor is access to typically confidential material. Arrangements for improvements and source codes or designs constitute a separate valuable part of the relationship handled by express contract terms, rather than presumed away from their owner by the simple fact of creating a contract.

Illustration 6: Word Company licenses B to use Word's robotics software. The license is a four-year contract. Three months after the license is granted, Word develops an improved version of the software. Party B has no right to receive rights in this improved version unless the agreement expressly so provides.

Illustration 7: In the Word license, two years after the license is established, Party B's software engineers discover several modifications that greatly enhance its performance. Word is not entitled to rights in these modifications unless the license expressly so provides. However, the modifications may create a derivative work under copyright law and a question also exists about whether the license granted the right to make such a derivative work.

The second sentence of subsection (c) is from former 2B-613 and provides a standard interpretation of an update agreement.

6. Subsection (d) stems from original 2B-310 and provides guidance for dealing with two recurring problems: (1) whether a license grants rights only in existing media or methods of use of an intangible or whether it extends to future uses, and (2) how, in a commercial context, parties can transfer information without giving assurances about rights. On the first issue, the draft adopts the majority approach found in a large number of recent cases. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a fact sensitive interpretation issue. But the intent of the parties may not be ascertainable. In such cases, use of language that implies a broad scope for the grant without qualification should be sufficient to cover any and all future uses. This is subject to the other default rules in this chapter, including for example, the premise that the licensee does not receive any rights in enhancements made by the licensor unless the contract expressly so provides.

~~SECTION 2B-311. IMPROVEMENTS AND ENHANCEMENTS.~~ [deletion proposed; subsection (d) carried into new 2B-310, subsection (b) carried into 310 under more general language]

~~(a) A continuous access contract grants rights of access over the duration of the license to the information as modified from time to time. An agreement other than a continuous access contract grants rights in information as it exists at the time of the grant.~~

~~(b) In the case of a license, a licensee may make modifications enabled by the ordinary use of the information or necessary to the licensee's use as authorized by the agreement.~~

~~(c) In the case of an unrestricted transfer of information, a licensee may make any modifications consistent with the intellectual property rights of 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.~~

~~SECTION 2B-312. RESTRICTIONS ON LOCATION AND USE.~~ [deletion proposed;; rewritten (b) carried into proposed 2B-310]

~~(a) If an agreement does not specify the location, the number of uses, or the purposes for which the licensee may use information, the licensee may use the information any number of times for any purpose and in any location that does not infringe any intellectual property right not granted in the agreement.~~

~~(b) In a license, a grant contains an implied limitation that the licensee will not exceed the rights, location, and uses granted, but permits any lesser use. A use exceeds an implied limitation if the use itself as compared to any uses of ideas or facts obtained through such use results in a more significant impact on the value of the retained intellectual property rights of the licensor than does the granted use.~~

~~(c) If a license expressly or impliedly limits location, number of uses, or purposes, exceeding the limits in the license is a breach of contract.~~

~~**Committee Votes:**~~

~~**1. The Committee voted 2-9 to reject a motion to delete subsection (b). (September, 1996)**~~

~~**2. Consensus that (b) should be rewritten.**~~

~~SECTION 2B-313. RESTRICTIONS ON USERS.~~ [deletion proposed]

~~(a) If a license expressly limits the persons permitted to use information, use by a person other than a designated person is a breach of contract.~~

~~(b) Subject to Section 2B-504, a license that does not limit the persons to which use of information is restricted other than by identifying the licensee allows use by any person authorized by the licensee. A person using the information pursuant to authorization is bound by the terms of the license pertaining to use, disclosure, and related restrictions, but does not undertake responsibility for payments or other transfers to the licensor unless that undertaking is express.~~

SECTION 2B-311. DURATION OF CONTRACT. If an agreement does not specify its duration, the following rules apply:

(1) If the agreement involves a sale of a copy or the payment of a license fee in a liquidated amount determined at the outset of the contract and the contract does not require

recurrent or successive performances over the indefinite term, the contractual rights of the licensee are perpetual, subject to cancellation for breach of contract by either party. ~~In all other cases, the duration of the contract is a reasonable time.~~

(2) In all other cases, the duration of the contract is a reasonable time. If the contract is a license of a patent or a copyright, the reasonable time is the term of validity of the copyright or patent.~~However,~~

(3) I~~i~~f the agreement provides for successive performances over an indefinite term, the agreement may be terminated at will by either party ~~during that period~~ on reasonable notice to the other party.

Uniform Law Source: Section 2-309(1)(2).
Coordination Meeting: Differences in transactions justify differences in approach.
Committee Votes:
1. The Committee voted to approve this section in principle.
Reporter's Note:

1. This section was edited to conform to style changes in Article 2-306 which refers to contracts calling for successive performances and to adopt suggestions considered and supported at the Drafting Committee meeting that a perpetual license be assumed in the case of a paid up license.

2. Subsection (a)(3) restates and limits the rule in Article 2 and 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 assumes a contract of indefinite duration.

3. Based on discussion at the Committee meeting and recommendations from a licensee representative, the default provision of subsection (1) was modified to apply a presumption of a perpetual license in all cases in which a single fee is involved. This rule applies whether or not the fee is paid in installments and corresponds to licensing practice in general, especially in the context of patent licenses.

4. Comment to explain that amount is liquidated even if it is a floating interest rate. Recognize that perpetual is subject to limits in terms of the length of copyright or patent protection. Also, comment regarding reasonable time on the web relating to low cost sites.

~~SECTION 2B-315. CONFIDENTIALITY IN GENERAL.~~ [deletion proposed; former (d) moved to remedies section]

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

~~(b) A term of a license which creates conditions of confidentiality or nondisclosure is not~~

~~enforceable if it imposes or continues those conditions on information that is or becomes generally known to the public other than through an act of the party on which duties of confidentiality and nondisclosure are imposed. If a combination of items of information, some of which may be generally known to the public, is not generally known, the combination is not generally known to the public for purposes of this section.~~

~~(c) If conditions of confidentiality or nondisclosure exist, the party on which the conditions are imposed may not disclose the confidential information, except pursuant to an order of a court of competent jurisdiction or a valid subpoena, and shall exercise reasonable care to maintain confidentiality, including giving notice to the other party of its receipt of a court order or subpoena 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 party in breach as a result of the breach. A remedy under the agreement or under this article for breach of confidentiality is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.~~

~~SECTION 2B-316. NO RIGHT TO UNDERLYING INFORMATION OR CODE.~~

[moved to new 2B-310] ~~An agreement does not convey a right to the licensee to receive the source code, object code, schematics, master copy, or other design material, or other information 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.~~

~~**Uniform Law Source:** None~~
~~**Coordinating Meeting:** Unique to Article 2B.~~
~~**Committee Votes:**~~
~~**1.** Voted unanimously to approve the section in principle.~~

SECTION 2B-312~~7~~. INFORMATION RIGHTS IN ORIGINATING PARTY.

(a) If an agreement requires one party to deliver commercial, technical, or scientific information 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 information is confidential, the following rules apply:

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

(2) The party receiving, processing, or handling the information shall use reasonable care to hold the information in confidence and make it available to be destroyed or returned to the delivering party according to the agreement or instructions of the delivering party.

(b) If technical or scientific information is developed during the performance of the agreement, to the extent that federal intellectual property law does not control, the following rules apply:

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

(2) If the information is developed by one of the parties, the information is the property of that party.

(c) The rules in this section do not apply to transactional data.

Uniform Law Source: None.

Coordinating Meeting: Unique to Article 2B.
Committee Votes:

1. Voted unanimously to approve the section in principle.

Reporter's Note:
[The section has been amended to remove the reference to "data", the definition of which was deleted in this Draft and to cover information generally. The scope of the section remains focused, however, on cases in which information is delivered and required for performance of obligations owed to the other party (e.g., data processing, out-sourcing).]

Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person about whose business the commercial data relates maintains ownership of the data. This deals with an important issue in modern commerce relating to cases in which one party transfers data to another in the course of the transaction. The default rule applies to cases involving information that has not been released to the public and that the recipient knows is unlikely to be released. The default presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee. In effect, the circumstances themselves establish a presumption of retained ownership.

> **Illustration 1:** Staten Hospital contracts to have Computer Company provide a computer program and data processing for Staten's records relating to treatment and billing services. Staten data are transferred electronically to Computer and processed in Computer's system. This section provides that Staten remains the owner of its data. Data held by Computer are owned by Staten because the records are not released to the public. There is an obligation to return the data at the end of the contract.

See <u>Hospital Computer Sys., Inc. v. Staten Island Hosp.</u>, 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).

The comments will point out that the remedies for any breach of this section is a breach of contract and that ordinary contract remedies apply. New subsection (c) is intended to indicate that the section applies to situations involving out-sourcing, data processing and similar contracts for handling information, and does not state a data protection right.

[E. Electronics]

SECTION 2B-313~~8~~. ELECTRONIC VIRUSES.

(a) Unless the circumstances clearly indicate that no duty of care could be expected, a party must exercise reasonable care to ensure that, when it completes a particular electronic performance or message, that performance or electronic message does not contain an undisclosed virus that may be reasonably expected to damage or interfere with the use of data, software, systems, or operations of the other party.

(b) The obligation described in subsection (a) is satisfied if:

(1) the party exercised reasonable care in fact; or

(2) except with respect to a mass market license involving physical delivery of a

copy of information, language in a contract stating that no action was taken to ensure exclusion of a virus or that a clear risk exists that viruses have not been excluded.

(c) A party is not liable under this section if the virus was introduced by a third party after the party completed its performance or if the other party failed to exercise reasonable care to prevent or avoid loss.

(d) In determining whether reasonable care has been exercised, the court shall consider the nature of the party, type and value of the transaction, consideration exchanged, the circumstances of the transaction, language on packaging or in a display, and general standards of practice prevailing among persons of similar type for similar transactions at the time of the performance or message.

(e) A party's obligations with respect to the existence of a virus is measured under this section and the express terms of the contract and not under implied warranty.

UNIFORM LAW SOURCE: None.
COORDINATION: Unique to Article 2B.
SELECTED ISSUES:

1. Is reasonable care an appropriate standard?
2. Should a comparative fault concept be created or should a contributory negligence theme be followed?

COMMITTEE VOTES:

1. Voted to delete former (e) disclaimer 10-0.
2. Consensus that across the board disclaimer is not appropriate.
3. Motion to delete former (b)(2) allowing obligation to be satisfied by language and circumstances giving reason to know of risk, rejected: 5-6.

REPORTER'S NOTES:
[This section was extensively discussed in November, 1996. The changes reflect that debate and the votes taken there. The two core issues were: 1) should the obligation be phrased as a non-disclaimable reasonable care obligation or in other terms, 2) should that obligation be generally disclaimable as are all implied warranties or should it be non-disclaimable with reference to some mass market transactions. This Draft creates a direct reasonable care obligation. Under subsection (b), the standard cannot be satisfied solely by contract language of packaging in the case of a merchant in information of the kind operating other than in the access contract environment of the Internet or other on-line venues. Conspicuous language giving reason to know is effective to satisfy the obligation in on-line transactions where security issues are significant and for non-merchants. In effect, the obligation is not disclaimable in the ordinary mass market since Article 1 does not permit disclaimer of reasonable care obligations. Given this restructuring, safe harbor language for cases covered by the rule is provided, creating a more limited situation of application than was present in the prior draft.

Subsection (e) clarifies that liability for a virus is to be determined by this section and the express contract terms, indicating that the issue does not come within implied warranty theory. The rationale is that this is the more specific section and sets out the balanced deemed appropriate in contrast to the absolute liability risk that exists in an implied warranty.]

1. This section apportions contractual liability for electronic viruses. The section creates a mutual obligation to exercise reasonable care to exclude viruses in all electronic performances and messages. The obligation does not constitute a warranty, but a basic contractual obligation. The obligation applies to both the licensee and the licensor. Indeed, in news reports, at least, virus problems in a contractual relationship as often result from acts of the licensee as from acts of the licensor. The section expands the obligation of the performing party as compared to current law where the contractual obligation is entirely disclaimable.

2. Article 2B does not define the term "virus", but what is intended here is to focus on the entire range of damaging, extraneous code or programs that might be injected into software, whether common language refers to them as worms, viruses or by any other word. The term does not deal with design choices, however, and therefore concentrates on code that is extraneous to the program itself. The obligation here is subject to 2B-318 and 2B-712 which do not refer to viruses, but to enforcement elements in digital products.

3. Reasonable care does not equate to absolute liability. It creates a flexible standard that, as indicated in this section, gauges the party's conduct against a variety of contextual considerations. No requirement exists that a party take extraordinary steps to preclude viruses in all cases. Thus, for example, in a situation where the rate of new virus risk created daily exceeds any reasonable testing or preventative developments, compliance with reasonable activities suffices even if it fails to disclose all viruses. Similarly, the standard varies depending on the party to whom it applies. A retailer producer that makes no effort to screen a virus from its packaged products would not be acting in a reasonable manner. On the other hand, under contemporary conditions, a private individual with no expertise may be acting reasonably even if it takes no particular screening efforts.

4. Under subsection (b), the reasonable care obligation cannot be satisfied with respect to a merchant dealing in information of the kind merely by inclusion of language in a contract or in packaging. That language may have an effect on determining the nature of the obligation in context, but cannot be a complete disclaimer. This covers all mass market transactions and many other commercial deals. It does not, however, apply to transactions on the Internet or in other on-line media (access contracts) where it was thought that the need to satisfy the obligation by conspicuous warnings was important to allow for multi-layered development of this new distribution methodology. A party who is not a merchant can satisfy the obligation by conspicuous warnings as can an Internet provider.

> **Illustration 1:** Jane is a licensee in a continuous access contract with AL. Jane posts data to an AL bulletin board, but the data contains a virus. A DuPont employee, acting in the scope of his employment, downloads the data and the virus. Damage is caused to the AL system and the DuPont system. Jane is liable to AL if she failed to exercise reasonable care to exclude the virus. AL is liable on the same basis to DuPont. What degree of care each was required to exercise, however, varies based on consideration of the nature of the parties and the like. AL here has a greater obligation than Jane.
>
> **Illustration 2:** The University of Houston creates a website at which parties can for a fee download digital copies of faculty articles and books. Because it lacks staff, Houston cannot make assurances about virus protection. It must conspicuously indicate that no precautions are taken. If it does not, the duty of care to which it is required to conform relates to the nature of the circumstances, including general standard on the web.
>
> **Illustration 3:** James sets up a web site to distribute information for a fee about policies at Consumer's Union. Being a college student, he does not concern himself about viruses. When the national political party downloads data from the site and pays its fee, the data includes a virus placed there by a user of the system. Whether James is liable for the resulting damages depends on the standard of care for a person such as James. James could avoid liability by providing on his initial screens that he has made no effort to exclude viruses.
>
> **Illustration 4:** Vendor distributes an art database in a retail market through the licensing of diskettes to the general public. Arthur obtains a copy of the database which has a virus. Vendor's license disclaimed any duty of care and any liability for viruses. The disclaimer is ineffective under Article 1 and the Vendor's liability (and that of any retailer) hinges on whether the virus came from or before its performance and whether it exercised what would be a relatively high standard of care for the retail market.

5. Subsection (c) limits the obligation to reasonable care in the party's performance and not to requiring control of subsequent activities. The following illustration captures the issue:

Illustration 5: Novell transfers software to Distributor who is licensed to integrate the software into a system with other software and hardware and then distribute the system on the retail market. During the integration, a virus is introduced by an employee of Distributor. The system is acquired by Thomas Inc. and the virus causes damage to Thomas. Novell is not liable under this section since the virus was not a result of its performance and came after it completed its role. Distributor is liable if it failed to exercise reasonable care.

6. Subsection (d) introduces a concept of comparative fault based on exercise of care to avoid loss. As with the primary obligation, the nature of the reasonable care duty varies with the party and the type of transaction. IBM may have a high duty to screen viruses in major software licenses it acquires, while a consumer may have no obligation in acquiring software in a retail package over the counter.

7. Under current law as to contractual transactions, the basis for liability, if any, is unclear.

(a) In cases of delivered diskettes or the like, claims of liability for viruses would probably fall within the general warranty of merchantability. Under current Article 2, virus liability pertaining to contractual relationships hinges on implied warranties. The warranty of merchantability presumably requires that a court ask two questions about an alleged virus. The first deals with whether the "extraneous code<cq> falls within normal expectations regarding the particular type of software or performance. If its does not, then there may be a breach of warranty under current law. Perhaps, courts faced with the issue would refer by analogy to cases dealing with food products for standards. The second issue would ask whether the implied warranty was disclaimed. In most transactions, that warranty is disclaimed. Disclaimers are effective in both the mass market and the commercial marketplace.

(b) In cases that would not fall within Article 2 (e.g., on-line systems), the basic standards would refer to general common law contract about the performance of a contract. In some (but not all) states, that obligation engages a duty to exercise reasonable and workmanlike care in performance. That standard has never been litigated with respect to a virus.

8. This Article does not deal with criminal law risks. In most states, criminal law proscribes "knowing" introduction of viruses that damage the computer system of another person. Article 2B does not alter the criminal law and related civil liability issues there, but merely sets out an appropriate treatment of contract risk allocation. The question of how to apportion loss cannot be answered by a simple distinction between licensor and licensee because of the various different transactional formats covered.

SECTION 2B-314~~9~~. ELECTRONIC REGULATION OF PERFORMANCE.

(a) ~~Subject to subsection (b), a~~A party entitled to enforce a limitation or restriction ~~in a license~~ may include in the information and utilize, a program, code or ~~an electronic or other~~ device that restricts use in a manner consistent with the ~~terms of the~~ agreement if:

~~(b)~~(1) a ~~A~~ term in the contract ~~a license~~ authorizes ~~ing the use~~use of the program, code or a device; ~~to enforce a limitation is required to enforce rights under subsection (a) unless:~~

(2~~1~~) the program, code or device or the licensor provides reasonable notice to the licensee before the program, code or device prevents ~~preventing~~ further use at the expiration of the term of the license~~ for that use~~;

(3) the information is obtained for a stated period of not more than thirty ~~time less than five~~ days or for a stated number of uses and the code or device merely enforces that time or use limitation;

(4~~2~~) the program, code or device merely prevents use of the information other than in a manner ~~in~~consistent with the license, but does not destroy or alter the information; or

(5) the program, code or device merely prevents use of the information in a manner inconsistent with a licensor's right under copyright or patent law not granted by law or by contract to the licensee, but does not ~~otherwise~~ destroy or alter the information; or

(b~~c~~) Operation of a program, code or device that restricts use consistent with ~~a term of~~ the agreement is not a breach of contract, and the party that included the code or device is not liable for any loss created by its operation. However, operation of a code or device that prevents use permitted by the agreement is a breach of contract.

(c~~d~~) This section does not preclude electronic replacement or disabling of an earlier version of information by the licensor with a new version of the information pursuant to an agreement with the licensee.~~.~~

UNIFORM LAW SOURCE: None
COORDINATION: Unique to Article 2B.
SELECTED ISSUE:

1. Should the section be approved?

REPORTER'S NOTES:
[This section was discussed in November without substantial comment; it has been rewritten in light of the November meeting and further discussion.]

1. This section deals with electronic limitations on use, but does not involve electronic devices used to make a repossession or force discontinuation of use in the event of breach. Those are covered in Section 2B-711 and are subject to significant, additional restrictions. The electronic restrictions in this section all derive from and enforce contract terms; they limit use consistent with contract terms or terminate a license at its natural end. The few reported cases that deal with electronic devices support use even in the case of breach if disclosed to the licensee; the cases have not considered the less controversial use of restrictive devices not associated with enforcing claims related to breach of contract.

2. The basic principle in this section is that a contract can be enforced. Where the contract places time or other limits on a party's use of licensed information, electronic devices that merely enforce those limitations are appropriate. This is an important new capability created by digital information systems. As a general rule, the provisions of this section apply only to licenses since these are the types of contracts that involve express limitations on use (time-based or otherwise). The primary exception to that is in new subsection (a)(5). However, the section does not state exclusive rules. Federal or other law (including other sources of contract law) may also allow limiting devices designed to enforce copyright and copyright management information.

3. Active Devices. Subsection (a) generally distinguishes between active and passive electronic devices. An active device terminates the ability to make further use of the information. Since this section deals only with cases where no breach of contract occurs, the contractual right to do this arises only in the event of termination of the agreement pursuant to contractual terms. Subsections (a)(1) and (a)(2) state the basic principle in such cases. Creation and use of the electronic means to terminate a contract (end it other than for breach) requires either a contractual term permitted the action or reasonable notice before termination which notice under (a)(2) can come from the program, code or device itself. The exception to this focuses on short term agreements, such as shareware or trial copies, or the new Java-based software modules whose use is limited to a brief period of time. The argument for requiring consent or notice in longer term agreements deals with avoiding problems due to stale information. In the brief contracts, that is not an issue. The subsection dealing with this issue employs thirty days as the cut-off based on the fact that this is a common period in so-called shareware or limited use demonstration systems. This provision would also apply to various pay per view and similar systems, since it reflects the ability to enforce short term limitations on service or use through electronic devices without specific or special notice other than that inherent in the contract itself.

Some argue that enforcing a contractual right not associated with breach should not require any notice or other requirements. In a one year license, ending the ability to use after the term merely enforces the agreement. Although that position has strength, the choice here limits the right to enforce contract termination on the argument that a licensee might be disadvantaged by being forced to strictly stay within contract limits in the absence of a contract term indicating the enforcement tool was present. Notice may occur either in the terms of the contract itself or in actions of the licensor or the electronic system giving notice to the licensee before precluding further use. Code that precludes further use of a program after one year would be effective under this section if either the contract provides for electronic enforcement of the one year term or the code itself displays notice of the impending termination a reasonable time before implementing it (e.g., five days before the end of the term).

Illustration 1. A software license requires monthly payments of $1,000 due on the first of the month and covers a one year term with a right to renew based on written notice before the expiration of the term. Licensee makes a payment five days late because of accounting problems. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract. Section 2B-711 applies and the action may be appropriate if the breach was material.

Illustration 2. In Illustration 1, there was no late payment, but the licensee fails to give notice of renewal within the contractual time period. Licensor turns off the software. This action is covered by this section. The termination electronically is valid if either the contract contained a term authorizing that action, or the licensor or the device gave prior, reasonable notice of termination to the licensee.

4. Passive Devices. Special notice is not required of the electronics merely restrict use without otherwise disabling the use of information by the licensee. This authorizes use of passive electronic devices to enforce use limitations under subsection (a)(4). It is especially important for **smaller** suppliers whose ability to enforce contracts against often larger licensees is limited by costs of monitoring and judicial enforcement. The limitations, for example, might entail a ~~a~~ counter which can be used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation inconsistent with the agreement constitutes a breach of contract and that it has contracted for the substantive limitation itself, while the device merely precludes breach.

Illustration 3: The license provides that no more than five users may employ the word processing software at any one time. An electronic counter is embedded in the software and, if a sixth user attempt to sign on for simultaneous use, that sixth user is denied access until another user discontinues use. This limiting device is effective without prior notice or contractual authorization.

Illustration 4: The same situation as in Illustration 3, except that the limiting device permanently disables the software if a sixth user attempts access. This device is not authorized by the this section since it involves a cancellation for breach. Section 2B-711 applies.

Illustration 5. ABC Publishing includes an anti-copying device in a CD-ROM version of its novel, "Gone with the Sea" which it licenses subject to express terms precluding making additional copies of the work. The device allows normal loading into memory and use relating to a computer system, but prevents making an additional copy. No separate contract term is required to authorize the device since it merely enforces a limitation in the contract and does not otherwise disable the data.

5. Subsection (a)(5) allows use of passive devices that merely preclude going beyond the contract to make or distribute copies that are not within the transferee's prerogatives~~prerogativess~~ under the contract or under "first sale" law. Once again, the passive-active distinction applies. Merely preventing the act does not require contract or other notice. Disabling the system as a result of attempting to do the act, may not be authorized under this section at all and would require authorization under 2B-711 or other law.

6. Subsection (b) states the obvious premise that actions consistent with a contract are not a breach and do not give rise to liability under this Article or the contract.

~~**SECTION 2B-320. ACKNOWLEDGMENT OF ELECTRONIC MESSAGE.**~~ **[moved]**

~~**SECTION 2B-321. FINANCE LEASE: RIGHTS OF PARTIES.**~~ **[deleted]**

~~**SECTION 2B-322. FINANCE LEASE: RIGHT TO POSSESSION.**~~ **[deleted]**

~~**SECTION 2B-323. FINANCE LEASES: IRREVOCABLE PROMISES.**~~ **[deleted]**

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING AUTHORITY AND NONINFRINGEMENT.

(a) A licensor warrants that:

(1) the licensor has authority to make the transfer;

(2) the licensor and any person holding a claim or interest created by an act of the licensor other than a financier of the licensee will not interfere with the licensee's enjoyment of its rights under the contract;

(3) if the information is transferred under an exclusive license for redistribution by the licensee, the intellectual property rights that are the subject of the license are valid and exclusive to the licensor within the scope of the license; and

[Alternative A]

(4) if the licensor is a merchant regularly dealing in information of the kind, at the time of the transfer the licensor has no reason to know that the transfer, any copies transferred by the licensor, or the information, when used in any authorized use, infringes an existing intellectual property right of a third party, except as disclosed to or known by the licensee.

[Alternative B (to be added as new subsection)]

(4) subject to the provisions of 2B-715, a licensor that is a merchant regularly dealing in information of the kind indemnifies and holds the licensee harmless against any final judgment rendered in favor of a third party for infringement against the licensee with reference to the information and any copies thereof transferred by the licensor to the licensee to the extent that the infringement pertains to an intellectual property right in existence at the time of the transfer of rights. Performance of this indemnity excludes any other liability to the licensee for the infringement.

[end of alternatives]

(b) The warranty under subsection (a)(4) does not apply to a license of a patent accomplished without any agreement by the licensor to provide to the licensee any property or services to enable the licensee to exercise the rights transferred or to a compulsory or other license required by law or collective management arrangement.

(c) A licensee that furnishes specifications to a licensor or a financier shall indemnify and hold the licensor and the financier harmless against any claim by way of infringement that the licensee had reason to know would arise out of compliance with the specifications.

(e) A warranty under this section may be disclaimed or modified only by express language or by circumstances giving the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to transfer only the rights that it has. In an electronic transaction that does not involve review of the record by an individual, language is sufficient if conspicuous. Otherwise, language in a record is sufficient if it states "There is no warranty of title or authority" or "There is no warranty that the [information] [computer program] does not infringe the rights of others", or words of similar import

UNIFORM LAW SOURCE: Section 2A-211; Section 2-312. Revised.
COORDINATION: Differences in subject matter justify differences here.
COMMITTEE VOTES:

a. Voted to adopt a "reason to know" standard in lieu of "knowledge."

b. Rejected a motion to bar disclaimer in "mass market" contracts.

SELECTED ISSUES:

1. Should the Draft adopt the proposed indemnity language in lieu of the infringement warranty?

REPORTER'S NOTES:

[This section was restructured for clarity. An alternative provision has been suggested to replace the infringement warranty with an indemnity obligation. If the indemnity alternative is adopted, we may move the licensor and the licensee indemnity language into a separate section. Additionally, in this Draft, the exclusivity warranty was modified to reflect concerns about the scope of the exclusivity and the effect of governmental regulations. Subsection (c) was shortened to correspond to current law in Article 2A.]

1. This section creates a warranty of quiet enjoyment and right to continue in possession of property over the term of a contract, rather than warranties that center solely on the initial delivery of the property as is the case in Article 2.

2. As redrafted, subsection (a) contains the affirmative warranties created in reference to the licensor. Subsections (a)(1) and (a)(2) deals with issues **other than** intellectual property infringement. First, the licensor represents it has authority to make the transfer. Authority here would refer to possible defects in the chain of title or authorization. For example, if a licensee holds information under a non-transferable license, a transfer to another licensee occurs without authority and, thus, breaches this warranty. Second, the licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. The combination of these two subsections takes language from Article 2 (authority) and 2A (interference and enjoyment), making the resulting warranty broader than either of the other two articles. Authority and non-interference represent 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).

3. Subsections (a)(3) and (a)(4) deal with intellectual property risks. Subsection (a)(3) refers to validity and exclusivity. It limits warranties in reference to both issues to situations in which the transfer purports to convey exclusive rights in the information. **In current law,** the idea of title has several different connotations. The issues can be broken down into three parts:

public domain risk: Whether enforceable rights exist in the technology that is transferred. In essence, this asks whether the information is in the public domain and thus useable by anyone with access to it..

exclusivity risk: Whether the transferor has the sole right to 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.

Subsection (a)(3) deals with the first two of these, Most contracts deal with these explicitly. If the transferee relies on the rights transferred to create a product for third parties, affirmations about validity define an important aspect of the deal. Copyright licenses aimed at redistribution 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]. See M&A Assoc. v. VCX, 657 F.Supp. 454 (E.D. Mich.

1987), aff'd, 856 F.2d 195 (licensor's failure to place appropriate copyright notices on motion picture violated warranty of title). Exclusivity (including public domain) is typically not relevant to the ordinary licensee in an end user license.

4. Subsection (a) (3) also deals with exclusivity. The title risk includes that a portion of the rights may be vested in another person. Coequal rights exist where co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In either case, while a transfer may convey rights, it may be no more than equal to rights vested in and available for conveyance by the third party co-author. Depending on the underlying 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. Subsection (a)(3) reflects practice in motion picture and publishing industries and states what may be an appropriate warranty for those settings. Exclusivity is an important issue where a licensee undertakes significant investment on the assumption that its rights are exclusive as to other competitors. As to **end users and non-exclusive licenses**, the question of whether intellectual property rights are **exclusive** in the licensor is seldom significant because exclusivity does not alter the end user's ability to continue to use the licensed rights without challenge from third parties.

6. Subsection (a)(4) contains a warranty relating to the infringement risk. whose substantive scope is expanded beyond current Article 2 and 2A, but which uses a reason to know standard. Based on discussion at the November, 1996 meeting, an alternative approach is suggested. Replacing the warranty concept with an indemnity obligation.

7. Current 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 disclaimed. Case law holds that this does not cover a warranty that **use** 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. Section 2A-211 speaks not in terms of good title, but of an implied warranty 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." In this draft, the warranty of noninfringement covers not only the information as delivered, but the information as used in a manner authorized under the contract. The expansion gives the licensee greater protection against process patents and against the fact that "copies" made during ordinary use of software in a machine may infringe a primary copyright. Neither of these assurances exists in current law.

Balancing against this, the warranty focuses on a "no reason to know" standard. This does not impose a duty of inquiry, but relates only to facts actually known to the party. The choice between a "reason to know" and an absolute liability warranty requires a balancing of the interests of the licensor and licensee in an ordinary case where infringement claims may arise without direct fault of either party. Both in 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 made here places knowing misconduct risk on the licensor, but in cases where neither party had knowledge that an infringement would ensue, to allows 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. Note that this 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 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.

Part of the difficulty involves the fact that patents are not knowable or readily checked by the myriad of small producers in this market place and that, therefore, an absolute warranty would place liability exposure on them without an effective means of protection.

> **Illustration 1:** Sunspot Software develops a multi-terminal operating system for Citibank. After installation of the system, a patent issues to Lansing which patent reads on the process created by the Sunspot program. If the warranty refers to "reason to know", Citibank bears the loss since an unissued patent could not be known. If the warranty applies without knowledge, Sunspot bears the loss so long as the warranty extends to uses of the software.

8. The issue is especially important in on-line systems where the licensor may be providing a service that includes allowing the posting and subsequent downloading of material from third parties. Case law under copyright indicate that, in some cases, the vendor may be liable for infringement, but that this liability does not exist in all cases. The issue here is whether a reason to know standard best serves in our context.

> **Illustration 2:** Adam opens an Internet website providing access for a fee to photographs of football players

for three cents a piece, not restricting the use of the photographs by its licensees. The photographs are supplied by third parties in digital form to Adam. Alumni Magazine acquires a photograph of Jones and uses it in its May issue, distributed to 10,000 subscribers. Jones and the photographer, who never consented to Adam's use, sue Magazine which in return sues Adam for $100,000. Should Adam be liable for breach of contract and consequential damages in addition to any liability for copyright infringement?

SECTION 2B-402. EXPRESS WARRANTIES.

(a) Except with respect to published informational content, a licensor creates an express warranty as follows:

(1) An affirmation of fact, promise, or description of information made by the licensor to a licensee which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information and any services required under the agreement will conform to the affirmation, promise, or description.

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

(b) The licensor need not use formal words, such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, a mere affirmation of the value of the information, a display of a portion of the information to illustrate the aesthetics or market appeal of the informational content, or a statement purporting to be the licensor's opinion or commendation of the information does not create a warranty.

SELECTED ISSUE:

1. Should the section be approved as drafted?

UNIFORM LAW SOURCE: **Section 2A-210. Section 2-313.**

COORDINATION: Article 2B may remain different from revised Article 2.

COMMITTEE VOTES:

a. Deleted former subsection (b) that warranties are limited to the time of transfer based on the argument that this merely restates current law.

b. Motion to limit this section to the immediate parties, allow other parties to be included if courts decide to do so. Rejected: 4-5

c. Motion to amend by adding "except for published informational content" and delete (c), comments or section to make it clear that it's neutral on the law development here. Adopted 7-3.

REPORTER'S NOTE:

[This section was modified to reflect Committee votes.]

1. This section adopts existing law in two crucial respects. It follows current Article 2 regarding express warranties in general and preserves current law relating to express warranty obligations in reference to published information content.

2. The introductory clause to subsection (a) preserves existing law for published informational content. While there are many reported cases dealing with express warranties in the context of goods and using the standards outlined here, no such case law exists with respect to warranties in reference to published information. This subject matter entails significant First Amendment interests and courts that deal with liability risk pertaining to that subject matter must balance contract themes with more general social policies. By excluding this type of information content from the coverage of this section, the intent is to leave undisturbed any existing law dealing with under what obligations can be created and how they are established with reference to published information. Courts may, if inclined to find liability in reference to published information, do so under any general contract law theory. The Drafting Committee, however, concluded that merely adopting Article 2 concepts applicable to sales of goods would risk a large, and substantially uncontrollable over-reaching of liability in this sensitive area. Comments to this section will underscore that the goal is not to make information providers immune from liability, but to let first amendment case law continue to evolve.

3. The term, "published information content" focuses on information **content** not customized to particular end users. (see Section 2B-201) The terms of that phrase are derived from case law under the Restatement which does not impose liability on providers of general information outside special relationships. The exclusion here follows current law, requiring more than just general, undifferentiated statement for expanding liability in the public market of ideas and content. The basic assumption in current law is that liability for information content does not exist unless there is a special or direct relationship creating it. There are no cases using warranty theory for generally distributed information based on contract concepts and only a small number of cases under other theory.

3. A second preservation of current law involves material other than published information. This section retains the "basis of the bargain" standard in current Article 2 and Article 2A. This allows courts to draw on an extensive body of prior case law for distinguishing express warranties from puffing and other, non-enforceable statements made during bargaining. 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 Digital 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."). By retaining current Article 2, Article 2B allows courts to use the full panoply of doctrines that they have evolved.

In Article 2 revisions, debate has focused on express warranties through advertising. Article 2B does not change existing law on this point. Some argue that current law creates advertising warranties; clearly, no conceptual barrier exists to a published statement becoming part of the bargain sufficient to constitute a warranty. This draft does not alter that. The Draft, however, does not adopt the controversial approach of revised Article 2 which creates an express advertising warranty rule. In an area such as information contracts where the development of liability and warranty theory is less fully established than in goods and encounters first amendment and related restrictions, the draft adopts a cautious, rather than aggressive approach toward creating new forms of liability. Either the advertising liability exists under current law and is carried forward here, or it does not exist under current law and is not created here.

4. Subsection (a)(2) deals with samples and the use of beta models. These are employed in testing developmental, not yet completed products. A beta model may include elements that are not carried into the final product and may include defects that are not cured in the final product. In either event, the parties both expect that the product being demonstrated or used is not representative of what will eventually be the product and the exclusion here is designed to protect against harm to either party as a result (e.g., licensee believes a defect will be cured, but it is not cured; licensor elects to delete an element in the test model when it produces the eventual product).

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

A licensor that is a merchant with respect to a mass-market license of a computer program warrants that the computer program and media are merchantable. To be merchantable, the computer program and any tangible media containing the program must:

(1) pass without objection in the trade under the contract description;

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

(3) substantially conform to promises or affirmations of fact made on the container, documentation, or label, if any;

(4) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved; and

(5) be adequately packaged and labeled as the agreement or circumstances may require.

(b) In cases not governed by subsection (a), if a licensor that is a merchant with respect to computer programs of that kind delivers a program to a licensee, the licensor warrants that any media on which the program is transferred will be merchantable and that the computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation or specifications provided by the licensor at or before the delivery of the program. An affirmation of the value of the program or a statement of opinion or commendation does not create a warranty.

SELECTED ISSUE:

1. Should the section be approved?

UNIFORM LAW SOURCE: Section 2-314. Revised.

COORDINATION: Article 2B to conform to definition of merchantability insofar as appropriate to the subject matter.

COMMITTEE VOTES:

a. Rejected a motion to add language warranting that the program will not damage ordinary configured systems.

REPORTER'S NOTES:

1. Article 2B warranties blend three disparate legal traditions. One tradition stems from the UCC and focuses on obligations about the quality of the product. This tradition centers on the result 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 process 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. The third tradition comes from the area of contracts dealing with informational content and essentially disallows implied obligations of accuracy or otherwise in reference to information transferred outside of a special relationship of reliance. Under current law, these two traditions apply or not depending on characterizations about whether a transaction involves goods or not. That distinction is not reliable in information contracting, especially in light of the ability to transfer intangibles electronically without the use of any tangible property to carry the intangibles.

2. This section and the next following section seek to define a different basis on which the different traditions apply, focusing on a distinction between "computer programs" and services or information content transactions. This expands the scope of the quality warranty here by including at least some cases where a court would otherwise conclude that the transaction is actually a services contract. See, e.g.~~e.g~~,, Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W.D. Pa. 1991) (license of manufacturing process described as "services"). Compare Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992); The Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993)

3. Comments to the final draft will spell out the distinction drawn here. Importantly, the two implied warranties are not mutually exclusive and, in many cases, both will apply to the same transaction and the same digital product (e.g., an encyclopedia). Notes will be developed containing illustrations indicating the manner in which the warranties work together.

> **Illustration 1:** Party A contracts to transfer software to Party B that will allow B to process its accounts receivable. Whether the transfer is by diskette or by electronic conveyance into B's computer, the implied warranty in this section applies. Under current law, this would be a transaction in goods with an implied warranty attached to the performance of the product.

> **Illustration 2:** Party A licenses Party B to use a copy of the Marvel Encyclopedia. This warranty applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia. Under current law, this would be an information contract most likely involving no warranty about the accuracy of the information.

> **Illustration 3:** Party A reaches a license with Party B. Party A will transfer its data to B's computer for processing there. B agrees to return various reports and summaries to A. The 2B-403 warranty does not apply since the contract did not deliver a computer program to A, but use of B's facility. Under current law, most cases hold that this is a services contract containing at most a warranty of workmanlike conduct; it is governed here under general standards of contract and by the implied warranty in Section 2B-404.

4. Merchantability sets the standard for computer programs in the mass market, where the idea of comparing a particular program to other mass market programs of similar type. This draft uses a substantial conformance to documentation standard for non-mass market software. That warranty is common in commercial licenses. The prevalence in commercial cases of disclaiming merchantability is such that virtually no software cases dealing with that warranty. The reliance on conformance to documentation reflects the wide range of variations

involved in the non-mass market. The two standards both give assurances of quality, but focus on different reference points. Merchantability asks what are normal characteristics of ordinary products of this type, while the documentation warranty focuses on the manuals and contours of the particular product. Beside conforming to ordinary commercial practice (e.g., disclaim merchantability and give substantial conformance warranty), the substantive question here deals with whether merchantability is a relevant standard and at all protective in cases where software is often relatively unique. For example, assume a commercial computer program that provides data compression functions on an ABC computer with an XYZ operating system. Merchantability would ask whether that product passes without objection among all data compression products of all types (e.g., mass market, Windows-based, Apple systems, etc.) even though the particular environment, approach and capabilities of this product may be unique. How that standard protects the licensee is not clear and in fact it may set out standards well below what the documentation provides.

5. Most negotiated agreements disclaim merchantability; there are few reported commercial cases involving merchantability in any industry. Most licenses substitute a warranty of conformance to documentation. The section treats this as the presumed warranty, conforming to a commercial norm. This warranty measures performance by reference to what is said about the particular product. The argument in favor of retaining a merchantability warranty for transactions is that it would maintain a congruence between this article and Article 2 and 2A. This may be ephemeral and could be reversed: those articles should adapt to commercial practice. Merchantability measures performance obligations by reference to other like products, while the documentation warranty measures performance by what the licensor says about its product.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT AND SERVICES.

(a) Subject to subsections (b) and (c), a merchant that provides services, ~~informational content,~~ data processing, or the like, or informational content in a special relationship of reliance, warrants that there is no inaccuracy, flaw, or other error in the informational content caused by its failure to exercise reasonable care and workmanlike effort in its performance in collecting, compiling, or transcribing ~~, or transmitting~~ the information. This warranty is not breached merely because the performance does not yield a result consistent with the objectives of the licensee or because the informational content is not accurate or is incomplete.

(b) A warranty does not arise under subsection (a) for:

(1) the aesthetic value, commercial success, or market appeal of the content;

(2) published informational content;

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

(4) informational content prepared or created by a third party, if the party, acting as a conduit, provided no more than editorial services with respect to the content, and made the informational content available in a form that identifies it as being the work of the third party, except to the extent that the lack of care or workmanlike effort that caused the loss occurred in the party's performance in providing the content.

(c) The liability of a third party under this section is not excluded by the use of a conduit described in subsection (b)(4) or by the fact that the conduit is not liable for errors under that subsection.

UNIFORM LAW SOURCE: Restatement (Second) of Torts ' 552.
COORDINATION: Unique to Article 2B subject matter.
SELECTED ISSUES:

1. Should the section limit content liability to cases of special relationships as under current law?
2. Should the approach be approved in principle?

REPORTER'S NOTES:

[The changes in subsection (a) avoid repeal of cases such as A.T. Kearney v. IBM, which like many other cases, limited liability risk for information content to reliance situations. It is consistent with the Committee decision to exclude liability for published information content. Subsection (b)(3) was amended to clarify that it refers to instructional manuals, documentation and the like, where the primary focus is on software or other information involved in the transaction; under current law and in the comments that will eventually follow here, defects in such materials are part of merchantability and express warranties.]

1. This section creates a warranty applicable to consulting, data processing, information content, and similar contracts involving an information provider or processor dealing directly with a client and, with respect to content, where the provider tailors or customizes its information for the client's purposes or being in a special relationship of reliance with that client. The warranty reflects case law on information contracts. In Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (NY 1977), for example, the New York Court of Appeals rejected a UCC warranty of fitness for a purpose in a contract for the design and installation of a sprinkler system. "[Those] who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct ... unless the parties have contractually bound themselves to a higher standard of performance..."

2. Restatement (Second) of Torts 552 regarding negligent misrepresentation provides a framework. It states that: "One who, in the cause of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."

In most states, 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). The obligation consists of a commitment that the content provided will not be wrong due to a failure by the provider to exercise reasonable care. Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (license of index; liability for inaccurate number tested under Restatement concepts in light of contractual disclaimer; information, although handled in commercial deals is not a product taking it outside this

Restatement approach). Under Restatement case law, the obligation is limited to cases involving a special or fiduciary relationship. Under subsection (a) the obligation does not center on delivering a correct result, but on care and effort in performing. A contracting party that provides inaccurate information does not breach unless the inaccuracy is attributable to fault on its part. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Liability under the Restatement for inaccurate information exists only if the information was intended or designed to guide the business decisions of the other party. This section is not limited to cases involving business guidance.

3. The cases largely exclude liability for information distributed to the public. This concept is captured in this draft by the defined termed "published informational content" in (b)(2). "Published informational content" refers to situations in which the information is made available without being customized for a particular business situation of a particular licensee and where no "special relationship" of reliance exists between the parties. It is, in effect, material made available in a standardized form to a public defined by the nature of the material involved. The information is not tailored to the client's needs. This definition reflects the vast majority of case law under the Restatement and modern values of not inhibiting the flow of content. The policy values supporting this stem in part from First Amendment considerations, but also from ingrained social norms about the value of information and of encouraging its distribution.

Illustration 1: Sam opens a website making available information on restaurants for a small monthly fee for subscribers. One item of information concerning Restaurant A is incorrect and a subscriber has a bad experience because of the error. Sam's website contains published informational content and creates no warranty or resulting liability. The same would be true of a restaurant review in the New York Times.

Illustration 2: Sam, an expert on restaurants, contracts with Able to provide advice about which restaurants should be included in Able's book on Chicago restaurants with "bad taste." Sam makes a negligent error in providing a list of restaurants about which he has received complaints. Sam has liability under this warranty since the information is not "published informational content" but was tailored to the specific purposes of the specific client.

4. This section has been reorganized for clarity and to make the various principles more compact. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy, an element present in current U.S. law and of importance in the various publishing and entertainment activities affected by this Article. This point, although it could be inferred from the affirmative terms of the warranty, has substantial importance to the motion picture and publishing industries and to their digital publishing counterparts. Additional language was added to this subsection based on suggestions from a licensee representative involved with entertainment issues.

5. Subsection (b) lists situations in which the warranty does not arise under current law. Subsection (b)(4) states as a contract law principle case law that holds the publisher harmless from claims based on inaccuracies in third party materials that are merely distributed by it. In part, this case law stems from concerns about free speech and leaving commerce in information free from the encumbrance of liability where third parties develop the information. In cases of egregious conduct, ordinary principles of negligence apply. As a contractual matter, however, merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to that data by the third party. See Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991); Walter v. Bauer, 109 Misc 2d 189, 439 N.Y.S.2d 821 (S. Ct. 1981). Compare: Brockelsby v. United States, 767 F.2d 1288 (9th Cir. 1985) (liability for technical air charts where publisher designed product) (query whether this is a publicly distributed product).

6. The issue is important for information systems analogous to newspapers and are treated as such here for purposes of contract law. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship). The District Court in Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information."

SECTION 2B-405. IMPLIED WARRANTY: EFFORT TO ACHIEVE PURPOSE.

Except in reference to the aesthetic value, commercial success, or market appeal of informational content, ~~I~~if a licensor at the inception of the contract has reason to know of any particular purpose for which the information is required and that the licensee is relying on the expertise of the licensor:

(1) if the contract is for a fixed price for performance that will not be paid if the end product is not suitable for the particular purpose, there is an implied warranty that the information will be fit for such purpose; but

(2) if, from all the circumstances, it appears that the licensor was to be paid for the amount of its time or effort regardless of the suitability of the end product, there is an implied warranty that the licensor will make a workmanlike effort to achieve the licensee's purpose. ~~to develop, design, select, compile, or substantially modify the information to meet the licensee's purposes, the licensor makes an implied warranty that it will make a workmanlike effort to achieve that purpose. However, if, from all of the circumstances, it appears that the licensor agreed not to be paid in full unless the information fulfills the licensee's purposes, the licensor warrants that the information will meet that purpose.~~

UNIFORM LAW SOURCE: Section 2-315; 2A-213. Substantially revised.
COORDINATION: Committee concluded that there were differences justified by subject matter.
SELECTED ISSUE:

1. Is the choice of a rule appropriate?

Reporter's Note:
[This section was substantially rewritten to reflect Committee debate in November. The goal of the section is to distinguish between a services-based implied obligation and one developed under the UCC. In the redraft, these two options are stated as parallel rules with a standard set out for determining when on or the other applies. In modern law, if paid by the hour, a services contract arises and, under current cases, no duty to complete to a perfect result exists unless the contract expressly so provides.]

1. The 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. Those cases choose between a warranty of result and a warranty of effort based on whether the court viewed the transaction as involving goods (result) or services (effort). The reported cases split almost evenly on this issue, often turning on the subjective view of the court, rather than on any differences in the actual transactions. 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).

2. Software development contracts are covered without regard to classification of the contract as one involving services or goods. This is an important step in eliminating uncertainty and arbitrary factors determining outcome. 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).

3. This section balances between the two results. This section incorporates the differences between results and efforts, but makes the distinction depend on judgments about payment expectations. The test here gives a better measure for courts to use to determine which implied obligation fits.

SECTION 2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Language or conduct relevant to the creation of an express warranty and language or conduct tending to disclaim or modify the warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, language or conduct disclaiming or modifying a warranty are inoperative to the extent that such a construction is unreasonable.

(b) Subject to subsection (c), to disclaim or to modify an implied warranty, the following rules apply:

(1) Except as provided in paragraphs (5) and (6), language of disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty under Section 2B-403 or 2B-404, language that mentions "warranty of quality", "warranty of merchantability", "warranty of accuracy", or words of similar import, is sufficient. Language sufficient to disclaim one of the warranties is sufficient to disclaim the other. Language sufficient to disclaim the warranty of merchantability in a transaction governed by Article 2 is sufficient to disclaim the warranties

contained in Section 2B-403 and 2B-404.

(3) To disclaim or modify an implied warranty arising under Section 2B-405, stating “There is no warranty that the subject of this transaction will fulfill any of your particular purposes or needs,” or language of similar import, is sufficient. Language sufficient to disclaim a warranty of fitness under Article 2 is sufficient to disclaim the warranty under Section 2B-405.

(4) All implied warranties are disclaimed or modified only by specific language complying with ~~the~~ paragraphs (1) through (3) or other language that in common understanding ~~or under the circumstances~~ calls the licensee's attention to the exclusion of all warranties. The expression that the information is provided “~~"~~as is”~~"~~ or “~~"~~with all faults”~~"~~ or similar language excludes warranties under 2B-403 and 2B-404 [and 2B-405].

(5) An implied warranty may be disclaimed or modified by course of performance or~~,~~ course of dealing~~, or usage of trade~~.

(6) No implied warranty exists with respect to a defect that was known or discovered by, or disclosed to the licensee prior to entering into the contract, or that would have been revealed to the licensee if it had not refused to make reasonable use of an opportunity reasonably provided to it to examine, inspect or test the information or a sample thereof made available prior to entering into the contract, unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time.

(c) In a mass-market license, language that disclaims or modifies an implied warranty must comply with subsection (b) and be conspicuous. To disclaim all implied warranties in a mass-market license, other than the warranty in Section 2B-401, language in a record is sufficient if it states: “Except for express warranties stated in this contract, if any, this [information] [computer program] is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user," or words of similar import.

(d) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer that complies with this section is effective with respect to all performance that occurs after the contract is formed.

(e) A contractual term disclaiming implied warranties that complies with this section is not subject to exclusion under Section 2B-308.

SELECTED ISSUES:

1. Should language sufficient in Article 2 be sufficient for the similar warranty in Article 2B?

2. Is the proposed revision of (b)(6) appropriate or should we return to current law?

UNIFORM LAW SOURCE: Section 2A-214. Revised.

COORDINATION: Language should be conformed to the extent possible.

COMMITTEE VOTES:

a. Voted to delete requirement of conspicuousness for non-mass market disclaimers.

b. Rejected a motion to delete conspicuousness for mass market contracts.

c. Rejected a motion to delete (b)(5) by a vote of 3 - 6.

d. Accepted a motion to delete (b)(6) by a vote of 6 -4 with the ability to rewrite to focus and clarify effects, perhaps in reference to known defects.

e. Adopted a motion to delete the reference to use of trade in (b)(5) by a vote of 8 - 2.

f. Adopted a motion to restrict the impact of the "as is" language to exclude coverage of 2B-405 because it deals with services like obligations. Vote was 6- 3.

g. Motion to adopt the idea of mass market, rather than the idea of consumer on disclaimers. Adopted 8-2

h. Motion to adopt language from Article 2 precluding disclaimer of consequential damages relating to personal injury, rejected by a vote of 2-8.

i. Motion to delete subsection (e) and replace that section with provision indicating that a term that is conspicuous is not a refusal terms under 2B-308. Accepted 9-1

REPORTER'S NOTE:

[The language in (b)(4) should be added if the Committee adopts the change proposed in 2B-405 since that change affects the rationale for deletion of this language in the prior draft Revised subsection (b)(6) deals with concerns expressed during the November meeting which led to a vote to delete prior language which had been taken directly from existing Article 2. The revised language emphasizes knowledge or opportunity to know of the defect and also expressly disallows a licensor's failure to disclose defects that it knows to be present. Equally important, by focusing on reasonable use and resulting disclosure, the redraft avoids the potential problem in existing Article 2 which essentially might disallow any implied warranty where inspection was as fully as the licensee "desired". In complex systems often provided through retail outlets, that standard is not workable. The language in subsection (b)(2) is added to avoid creating problems in practice based on a mistake as to which law governs. If a party disclaims effectively under Article 2, that disclaimer should be effective with reference to equivalent implied warranties under Article 2B. This section excludes 2-216(4) from current law relating to limiting remedies with no intent to change the law and that point will be noted in the comments.].

1. Subsection (a) restates current law.

2. Subsection (b) brings together provisions dealing with commercial disclaimers. Subsection (b)(1) requires that the disclaimer be in a record, thus not following the possibility contained in current drafts of Article 2 that an oral disclaimer suffices Subsection (b)(2) sets out a safe harbor for the merchantability warranties and also proposes language that allows an Article 2 disclaimer to be effective in reference to the two merchantability like warranties in Article 2B. The purpose of this latter proposal is to avoid traps for inexperienced or unwary drafts

persons. The parties need not guess about coverage of the two articles. Importantly, as in existing and revised Article 2, the specified language is not mandatory, but merely sets out a safe harbor. This language works, but other language may also work. (b)(3) provides a more common language disclaimer treatment than in current law.

3. Contrary to existing law, the Committee voted to delete reference to “usage of trade” in (b)(5).

4. Subsection (c) deals with mass market disclaimers. The subsection adds two requirements applicable to mass market transactions that do not apply for other transactions. First, the disclaimer must be conspicuous. That requirement does not apply to commercial transactions in Article 2B. Second, if the intent is to disclaim all warranties in a single sentence, the subsection sets out a common language disclaimer based on proposals by the software industry as a means of giving more disclosure to the consumer of what is disclaimed. That language is a safe harbor, rather than a required statement.

5. Subsection (e) exempts disclaimers that qualify under this section from further consideration under the “refusal terms” concepts outlined in Section 2B-308.

SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM. Modification of a computer program by a licensee voids any warranties, express or implied, regarding the performance of the modified copy of the program unless the licensor previously agreed that the modification would not void the warranty or the modification was made ~~by~~ using ~~the~~ capabilities of the program intended for that~~ose~~ purpose~~s~~ in the ordinary course of operation of the program. A modification occurs if a licensee ~~knowingly~~ alters, deletes, or adds code to the computer program.

SELECTED ISSUE:

1. Should the section be approved as drafted?

UNIFORM LAW SOURCE: None

COORDINATION: Unique to Article 2B.

REPORTER’S NOTES:

[This section was modified based on discussions at the November meeting. The effect of the section is to eliminate warranties only as to the modified copy. If a licensee can prove a defect existed in the unmodified version of the program, it can recover for losses caused by that defect. Comments will make that clear. The policy derives from the fact that the complicated nature of software makes proof of whether or when an even seemingly small modification causes unexpected effects very difficult and costly.]

1. This method of losing warranty protection applies only to warranties related to the performance or results of the software. It does not apply to title and non-infringement warranties. More importantly, the voiding of performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

2. The basis for the provision lies in the fact that in software systems changes may cause unanticipated and uncertain results. This language follows common practice. It voids the warranties whether the modification is authorized or not unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section 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 is 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 an inconsistent implied warranty.

UNIFORM LAW SOURCE: ' 2-317.
COORDINATION: Article 2B and 2 should conform, except with respect to consumer exception contained in Article 2 subsection (3)
COMMITTEE ACTION:
Approved in principle.
REPORTER'S NOTE:
This language matches existing Article 2. A substantive difference exists between this Draft and the proposed revisions to Article 2 which indicate that an express warranty does not prevail over inconsistent implied warranties in a consumer contract.

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(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~~ich~~ 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 who provides the information to an individual as a licensee is deemed to have intended to supply the information to any other individual who is in the immediate family or household of the licensee if it was reasonable to expect that such ~~the~~ individual would rightfully use the copy of the information delivered to the licensee.

(c) A disclaimer or modification of a warranty, or of rights and remedies, which is effective against the licensee is also effective against a beneficiary under this section. An expressed intent that limits or excludes ~~there are no~~ third-party beneficiaries excludes any obligation or liability under the contract with respect to third parties excluded by the contract other than ~~the~~ persons~~parties~~ described in subsection (b).

SELECTED ISSUE: Should this section be approved in principle?
UNIFORM LAW SOURCE: 2-318.
COORDINATION: Article 2B to remain different.
COMMITTEE ACTION:

a. Motion to adopt language precluding disclaimer of consequential damages relating to personal injury, rejected; vote of 2 - 8.

REPORTER'S NOTES:

1. This section defines a third party beneficiary concept applicable to information contracts. The section neither expands nor limits tort concepts that might apply with reference to third party risks in reference to information. The field of products liability remains outside this Article and subject to tort case law in each jurisdiction. In the absence of prior law creating product or other tort liability for the subject mater covered by this Article, Article 2B allows the development of that theme to common law courts.

The section deals with when a beneficiary status exists. For a discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994). For a discussion of information liability to third parties, see Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts Restatement test; "By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information receive notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.").

2. The idea expressed in subsection (a) derives from and should be interpreted in light of both the contract law concept of "intended beneficiary" and the concept in the Restatement (Second) of Torts ' 552. In both instances, with respect to information contexts, the contract-based liability is restricted to intended third parties and to those in a special relationship with the information provider. The scope of liability extends to **transactions** that the provider of information intended to influence. This Section incorporates those concepts. The section also must be considered in light of the scope of warranties under this Article which create no implied warranty of accuracy pertaining to published informational content.

3. Subsection (b) modifies beneficiary concepts to include the family of a licensee regardless of intent in reference to the licensor. Subsection (c) defines allows a party to exclude intended beneficiaries.

4. Unlike in goods, the willingness of courts and legislatures to avoid privity restrictions and impose third party liability under either tort or contract theory has been limited in information products. The Restatement (third) on products liability recognizes this; noting that information content is not a **product** for purposes of that law. The only reported cases imposing products liability on information products all involve air craft charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context by any court. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided one of the air chart cases, but later commented that public policy accepts the idea that information content once placed in public moves freely and that the originator of the data does not own obligations to those remote parties who obtain it. Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991). See also Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817, 824 (3rd Cir. 1951); Berkert v. Petrol Plus of Naugatuck, 216 Conn. 65, 579 A.2d 26 (Conn. 1990) ("[The] imposition of liability against a trademark licensor under [tort law] is appropriate only when the licensor is significantly involved in the manufacturing, marketing or distribution of the defective product...."); Porter v. LSB Industries, Inc., 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993) (product liability cannot be imposed on a party that is outside the manufacturing, selling, or distribution chain); E.H.

Harmon v. National Automotive Parts, 720 F. Supp. 79 (N. D. Miss. 1989) (strict liability cannot be imposed on one who neither manufactures nor sells the product); Snyder v. ISC Alloys, Ltd, 772 F Supp. 244 (W. D. Pa. 1991) (16 UCC Rep. Serv.2d 38); Jones v. Clark, 36 N. C. App. 327, 24 UCC Rep. Serv. 605, 244 S.E.2d 183 (N. C. App. 1978) (implied warranty cannot be imputed to one who simply allows its seal of inspection to be placed on a product manufactured by another; if some type of implied warranty were arguably applicable such a warranty could not meet privity requirements since sellers purchased unit from manufacturer and it was only the manufacturer which dealt directly with the laboratory).

While there may be a different policy dealing with embedded software in products, this Article does not deal with embedded products. Tort issues regarding, for example, the software that operates the brakes in an automobile falls within Article 2. No reported cases place products liability on software products that are not embedded in hardware products.

5. Restatement (Second) of Torts ' 552 establishes a limited third party liability structure for persons who provide information to guide others in business decisions. It states, in relevant part:

> (2) ... the liability stated in Subsection (1) is limited to [pecuniary] 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 most states, no liability arises under this theory of action unless there is a "special relationship" between the information provider and the injured party.

Modern case law is increasingly oriented toward the terms of the Restatement. See Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992). This is a contract law statute. To the extent that greater liability is desired, that should come from tort law development, rather than from an expanding notion of contract liability.

6. 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.

7. 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. See, e.g., Winter v. G. P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991) (publisher of encyclopedia of mushrooms has no duty of care respecting accuracy); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer). Compare Brockelsby v. United States, 767 F.2d 1288 (9th Cir 1985); Saloomey v. Jeppeson & Co., 707 F.2d 671 (2d Cir 1983); Aetna Casualty & Surety Co. v. Jeppeson & Co., 642 F.2d 339 (9th Cir. 1981). Both of the latter cases deal with highly technical and highly specialized information products and impose liability on the author-publisher running to persons with no privity. They have not been followed with respect to any other information liability case.

PART 5

TRANSFER OF RIGHTS

SECTION 2B-501. TITLE TO RIGHTS AND COPIES.

(a) ~~If a licensee receives title to a copy from the owner of intellectual property rights or an authorized person, the licensee receives all of the rights of an owner of a copy under federal~~

~~law.~~

~~(b)~~ If an agreement transfers title to intellectual property rights and does not specify when title is to pass, title passes when the information has been so far identified to the contract as to be distinguishable in fact from similar property, even if it has not been fully completed and any required delivery has not yet occurred.

(b~~c~~) Transfer of title to or possession of a copy of information does not transfer ownership of intellectual property rights in the information.

(c~~d~~) In a license, the following rules apply to copies of information:

(1) A licensee's right to possession or control of a copy is governed by the contract and does not depend on title to the copy.

(2) Title to a copy is determined by the contract.

(3) If a license includes a license of intellectual property rights of the licensor, reservation of title to a copy reserves title in that copy and any copies made by the licensee unless the license contemplates that the licensee will make and sell copies of the information to other parties, in which case, reservation of title reserves title only to copies delivered to the licensee by the licensor.

(d) If the parties intend to transfer title to a copy and the contract does not specify when title transfers: ~~In the absence of contractual provisions:~~

(1~~A~~) ~~If the copy remains in the possession of the licensor, title to the copy remains in the licensor.~~

~~(B)~~ Physical transfer of a copy from the licensor ~~to the licensee under a mass market license or otherwise~~ transfers title to the copy on delivery to the licensee.

(2~~C~~) Delivery ~~Transfer~~ of a copy by electronic means to the licensee transfers title of the copy if the transfer constitutes a first sale under copyright law.

SELECTED **I**SSUES**:**

1. Should the section be approved?

UNIFORM **L**AW **S**OURCE**:** Section 2-401; section 2A-302. Revised.

COORDINATION**:** Subject matter differences justify differences in treatment.

COMMITTEE **V**OTE**:**

a. Voted 11-0 to delete a sentence the ability to exercise rights until it pays according to the terms of the contract. That concept can be transferred to comments in a form that also accommodates in kind and other value.

REPORTER'S **N**OTES**:**

[Former subsection (a) was deleted based on a number of comments that it was redundant at best (merely stating that federal law applies without indicating the consequences) and misleading at worst. Remainder of section was reorganized. As restructured, the section makes presumptive title transfer rules only with reference to transactions where that intent is present. We should consider whether, as in the case of Article 2A, we should refrain from default provisions about title to a copy in a license. Subsection (c)(3) was modified to deal with the situation of a photographer who licenses use of its photograph in a magazine or book, but retains title to the photograph. This does not, obviously, retain title to each copy in each book.]

1. This section distinguishes title to the copy from ownership of the intellectual property rights, a point that is made explicit in subsection (b). This distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may carry with it some rights with respect to that copy, it does not convey ownership of the underlying rights to the work of authorship or the patented technology. This represents a basic theme in differentiating intangibles and tangible objects. The media here is not the message, but the conduit.

2. Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that limit. The subsection solves the problem in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article 2 theories of title transfer to goods to hold that title to an intangible (a computer program) being developed for a client could not pass until the program was fully completed and delivered.) The transfer of title hinges on completion to a sufficient level that separates the transferred property from other property of the transferor. See In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallows transfer of title in software where "new" code could not be separately identified from old or pre-existing code.).

3. Under subsection (c), in a license, the right to the copy of information depends on the terms of the contract and not on the label one applies to handling underlying media. This is a default rule that applies regardless of the terms of the license contract. As in Article 2A, this draft does not spell out title transfer rules with reference to licenses. The question of whether title to a copy in fact transfers in a license may depend on the terms of the license and the marketplace in which the license transaction occurs. Especially in many commercial licenses, it is inappropriate to presume that title does pass to the licensee in the absence of contractual reservation. The typical presumption is that the transfer there is conditional as reflected in the license terms, rather than presumptively a sale of the copy. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (licenses transferred rights for exhibition or distribution and did not constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license not a sale). The circumstances may be different in the mass market even where purchasers are aware that a license agreement will be involved. As drafted, the section takes no position on that issue or how one distinguishes these cases. The mass market licensee receives protections under applicable default rules that are not based on title issues. If the issue were to become important in litigation and were not dealt with by contract, a court would presumably inquire about the intent of the parties as to title to the copy.

4. Subsection (d) deals with cases involving an intent to sell a copy and states various presumptions relating to when title passes to copies. The basic theme is that the contract controls. Absent contract terms, the draft distinguishes between tangible and electronic transfers. The rule for tangible transfers of a copy parallels Article 2 in current law. The electronic transfer approach defers to federal law on a potentially controversial issue. The White Paper on copyright in the Internet suggests and legislation is being considered to implement that the electronic delivery of a copy of a copyrighted work is not a first sale because it does not involve transfer of a copy from the

licensor to the licensee. While state law could control questions of title to personal property, this draft suggests that the issue be left to federal policy.

SECTION 2B-502. ASSIGNMENT OR TRANSFER OF PARTY'S INTEREST.

(a) Except as otherwise provided in this section, a party's rights under a contract 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, or materially impair the other party's likelihood of obtaining return performance.

Except as provided in Section 2B-504, a licensee may not transfer, voluntarily or involuntarily, rights under a nonexclusive license without the consent of the party that holds intellectual property rights in the information~~, and the consent of any finance lessor or secured creditor with an interest in the licensee's rights under the contract,~~ unless:

(1) the licensee received delivery of a copy subject to a mass-market license and transfers the original copy and all other copies made by it; or

(2) the licensee received title to the copy of the information by~~through~~ a transfer from the party that holds intellectual property rights in the information, the license did not preclude transfer of the licensee's rights, and the transfer of the licensee's rights complies with applicable provisions of federal law for the owner of a copy to make the transfer.

(c) A licensor's rights under a contract may be transferred voluntarily or involuntarily, unless the transfer:

(1) creates a delegation of a material performance of the licensor; or

(2) extends to information ~~in~~ which the licensee designated as confidential or that is otherwise protected under intellectual property law and the licensee does~~has~~ not consent~~ed~~ to

transfer.

(d) Subject to subsection (a), either party may transfer the right to receive payment from the other party.

(e) A transfer made in violation of this Section is ineffective.

Selected Issue:

1. Should this section be approved?

Uniform Law Source: Section 2A-303. Substantially revised.

Coordination: Substantive differences justify largely different treatment.

Committee Vote:

a. Voted 7-1 to add a provision to allow transfer when the licensee owns the copy of the information.

Reporter's Notes:

1. The provisions of this Section apply in the absence of contractual restrictions. The effect of contract restrictions on alienation are treated elsewhere as is the enforceability of a security interest. "assignment" is used in the sense understood in intellectual property law, rather than the conditional assignment concept common in Article 9 financing.

2. The bracketed language in subsection (b) directs attention to an issue regarding the appropriate treatment of security interests. This issue was discussed at the last meeting, but decisions were deferred until the January meeting to allow the further consideration of finance lease and similar issues based on industry recommendations. A draft section 502A which follows is presented for discussion. If adopted, it would allow for creation of a security interest despite strong issues of federal preemption of such an action. If that alternative is not adopted, treatment of security interests will be left in this section and the bracketed language will be deleted.

3. Subsection (a) states a general principle of transferability subject to that being disallowed in cases where the transfer jeopardizes significant interests of the other party to the license contract. This is consistent with general UCC themes, except that the subsections spell out additional protected interests that block transfer and that are important here, but not in reference to sales of goods. Included among those interests are transfers that create and actual disclosure or threaten a disclosure of confidential material. Whether this occurs must be viewed in context of the original transaction. The application of this concept would be limited to cases where actual trade secret or confidentiality relationships had been established with respect to some of the information that forms the subject matter of the contract.

4. Subsection (a) expressly refers to transfers that disclose or threaten to disclose trade secret or confidential material of the other party. Whether particular information is confidential or not will ordinarily be determined by other law, including common law contract and trade secret law. Application of this limitation on transfer hinges on the existence of such an interest. The restriction on transfer that results occurs only if the transfer increases the risk of confidentiality disclosure juxtaposed to the original transaction itself. Thus, for example, if arguable trade secrets are embedded in object code of a computer program, but the contract does not place confidentiality restrictions on the licensee, merely transferring the copy to another party, if that is otherwise permitted, does not jeopardize the secrets for purposes of subsection (b). With reference to both the transferor and transferee, in the absence of enforceable confidentiality restrictions in the contract or otherwise in law, discovery of the secret information may be appropriate and the degree of risk does not change for the secret owner. On the other hand, where confidential material is subject to restrictions or is directly disclosed as a result of the transfer, the limitation in (a) applies. Of course, even if the limitation grounded in confidentiality concepts does not apply, a non-exclusive license may be otherwise non-transferable under the other provisions of this section.

4. Subsection (b) follows current law which holds that a licensee cannot assign its rights in a nonexclusive license. For patents and copyrights, this represents federal policy. The fact that this federal policy overrides state law was restated and accepted by the Ninth Circuit in 1996. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996); Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972). The non-transferability premise flows from the fact that a nonexclusive license is a personal, non-assignable contractual

privilege, representing less than a property interest. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (copyright); In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W. D. Tenn. 1987).

5. The Ninth Circuit explained the policy basis for this federal law rule in reference to patent licenses in the following terms:

> Allowing free assignability— or, more accurately, allowing states to allow free assignability—of nonexclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute number of licenses in existence under a free-assignability regime, it would lose the very important ability to control the identity of its licensees. Thus, any license a patent holder granted—even to the smallest firm in the product market most remote from its own—would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be absolutely unwilling to license. As a practical matter, free assignability of patent licenses might spell the end to paid-up licenses such as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for per-use royalties, if the license could be assigned to a completely different company which might make far greater use of the patented invention than could the original licensee. Thus federal law governs the assignability of patent licenses because of the conflict between federal patent policy and state laws, such as California's, that would allow assignability.

Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996). The approach to non-exclusive copyright licenses in federal law is the same. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984).

6. The two exceptions in subsection (b) to the non-transferability concept attempt to define situations in which the basis of this policy are not present or offended by a general rule allowing assignment. The first, mass market licenses, indicates the fact that in a mass market environment the licensor has essentially chosen not to be concerned about the identity of the particular licensee, but rather places the information out to the general public. In the second exception, federal law rules relating to first sales apply and allow the owner of a copy to distribute that copy, presumably along with the right to use/ copy that work in the case of computer software. See 17 USC ' 117.

7 Subsection (e) states a rule on the effectiveness or ineffectiveness of transfers of non-exclusive license rights by a licensee that makes the transfer ineffective unless authorized by this section. Given the carve outs for mass market and owned-copy transactions in subsection (b), this rule carries forward the federal policy and the underlying personal nature of the non-exclusive licensee's rights. Cases such as Everex indicate not only that the attempted assignment violates contract provisions, but that it is invalid without the licensor's consent. The Ninth Circuit in Everex indicated that federal law sets out a bright line test invalidating the transfer without consent and entirely independent of whether there was (or was not) actual impact on the licensor's interests. The predominant interest here focuses on the licensor's intellectual property rights and control of to whom the intellectual property is given. Article 2A, dealing with tangible property, makes the contrary assumption in 2A-303(5), but would generally enable a lessor to cancel the lease because of the transfer. Under the intellectual property regime that governs here, that additional step is not warranted and may be barred by existing case law. It is important to recognize, however, that the net effect of this section and the parallel rule in Section 2B-503 is to increase significantly the transferability of licensee rights.

SECTION 2B-503. CONTRACTUAL RESTRICTIONS ON TRANSFER.

(a) Except as otherwise provided in subsection (b), a contractual restriction or prohibition on transfer of an interest of a party to a contract or of a licensor's ownership of intellectual property rights in information that is the subject of a license is enforceable.

(b) The following contractual restrictions are not enforceable:

(1) A term that prohibits a party's assignment of or creation of a security interest in an account or in a general intangible for money due or which requires the other party's consent to such an assignment or security interest.

(2) A term that prohibits creation or enforcement of a security interest except to the extent that creation or enforcement would be precluded in the absence of the term under Section [2B-502] or [2B-502A].

(c) A transfer made in breach of an enforceable provision that prohibits ~~voluntary or involuntary~~ transfer ~~of an interest of a party under a contract~~ is ineffective.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).
Committee Vote:

a. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license.

Reporter's Note:
Based on suggestions from the lending community, comments will make it clear that the validation of "no transfer" provisions extends not only to cases involving simple licensor-licensee relationships, but also cases involving a finance lessor or another lender.

SECTION 2B-504. FINANCIER'S INTEREST IN A LICENSE.

(a) The creation or enforcement of a financier's interest in a licensee's rights under a nonexclusive license is effective without the consent of the licensor if a transfer of the licensee's interest would be effective under Section 2B-502 and 2B-503. In all other cases, unless the licensor otherwise consents, the creation or enforcement of a interest in the licensee's rights is effective only to the extent that it does not result in:

(1) an actual transfer of the use or possession of, or access to, the information; or

(2) an actual delegation of a material performance or obligation of the licensee.

(b) A financier that creates or enforces a security interest under subsection (a) and any transferee thereof is subject to the terms of the license regarding the transfer, use, possession or control of the information.

(c) The creation or enforcement of a licensee's rights in an exclusive license is effective if a transfer of those rights would be effective under Section 2B-502 and 2B-503.

(d) In the event of a default, as between the financier and the licensee, the financier has a right to possession of any copies of the information and any materials related thereto covered by its security interest. The financier's right to possession as against the licensor is subject to subsection (a). The financier remains subject to the terms and limitations of the license and to the licensor's intellectual property right and may not use, sell or otherwise transfer rights in the copies or the information without the consent of the licensor unless the conditions for transfer under Section 2B-502 and 2B-503 are met.

COMMITTEE ACTION:

a. Motion to delete this section deferred and subsequently not considered.

b. Consensus that Article 2B should allow creation of limited rights in licensee rights in non-exclusive licenses, but not permit sale and the like without consent of the licensor.

REPORTER'S NOTES:

1. In the December meeting, the Committee accepted the approach proposed in an earlier draft to allow creation of an interest in a non-exclusive license, but to restrict the taking or possession, resale or the like in light of the over-riding federal law and policy concerns relating to the interests of a licensor in such transactions. This section implements that decision and the related decision to make the finacing concepts more generic, not distinguishing the finance lease and security interest approaches.

2. The definition of "financier" covers both secured parties and lessors. See 2B-102.

3. This section is an attempt to pushes the scope of secured lending in the absence of licensor consent as far are possible in light of that strong contrary and preemptive federal policy. The approach assumes that the license is non-assignable and personal for reasons noted in the cases cited in Section 2B-502 notes, but tailors a right to create a security interest without the licensor's consent in a manner that attempts to avoid preemption by satisfying the policy interests that underlie the basic non-assignability principle. Thus, while an interest can be created, it cannot, without the licensor's consent, result in an actual change of control, access or use. This preserves the licensor's protected interest under federal law in controlling the identity of the licensee to whom it transfers rights in its intellectual property. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996).

4. The approach is modeled after Article 2A-303(3) which limits the enforceability of lease provisions restricting security interests in the lessee's interests. It applies here to both a contract clause and to a non-exclusive license that contains no such clause because, unlike in leases, the underlying law does not routinely allow assignment of the licensee's interest.

5. The provisions here allow creation of a security interest in many cases because mere creation does not make an actual change of possession, use, or access, nor does it delegate obligations. The argument against preemption is that "creating" a security interest does not "transfer" or assign the interest under the license. The **Everex** case indicated that one aspect of the federal policy was that the intellectual property rights holder has a protected interest in restricting the use of its intellectual property by persons other than those it specifically authorizes. The approach in this draft draws a balance that allows full pursuit of that federal policy, but gives substantial scope to the state law policy of allowing creation of security interests. The same would not be true, for example, with a rule that allows all assignment of rights under the other section of transferability, a rule that would be specifically subject to preemption.

6. The comments to Article 2A-303 state: “[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them.” Article 2A-303, Comment 3. As in Article 2A, the licensor (lessor) has a right to control who is in effective possession (including use and access) of the subject matter of the license. In many cases, this will preclude foreclosure or sale of the licensee’s rights without the licensor’s consent. It does not prevent repossession and sale if the licensed rights would be transferable under the underlying rules of Section 2B-502. This parallels Article 2A. The draft also runs parallel to Article 2A in providing that the secured lender and any transferee take subject to the terms of the original license.

SECTION 2B-505~~4~~. DELEGATION OF PERFORMANCE; SUBCONTRACT. A party may delegate or subcontract ~~license its performance~~ to another person performance of its contractual obligations unless ~~the~~ transfer would be prohibited under 2B-503, the other party otherwise has a substantial interest in having the original promissor perform or directly supervise or control the performance, or the contract prohibits delegation or subcontracting~~licensing~~.

Committee Action:
This section was reviewed in November, 1996, without substantial comment except that adjustments should be made to clarify that the section is subject to restrictions on transfer.
Uniform Law Source: Section 2-210; Section 2A-303.
Coordination: Language should conform in substance.
Reporter’s Notes:
[The prior reference to sublicense was changed to refer to subcontract with no change in substance intended.]

1. Delegation or subcontracting of performance refers to a party’s ability to use a third party in making an affirmative performance under an information contract. It does not refer to authorization or other allowance of third party exercise of rights in licensed information. pursuant to in a contract is generally allowed. In both cases, while the performance may be made by the delegee, the original; party remains bound by the contract and responsible for any breach thereof. The ability to delegate performance must be read in contrast to the general limitations on transferability of non-exclusive licenses under in 2B-502. A delegation or subcontract works a transfer equivalent in substance to a transfer or assignment of

2. Delegation is subject to contrary agreement. Thus, for example, a contract that permits use of licensed information only by a named person or entity controls with respect to any delegation and precludes it. The result in such cases is determined by both the general principle that contract terms control and the more specific~~specifi~~ principle that the other party has, by the contract, expressed an interest limiting performance to the designated party.

3. In the absence of a contractual limitation, delegation can occur unless the circumstances come within one of three conditions are met. The first condition that prevents delegation arises if the transfer of an interest would be precluded under 2B-503. That section disallows transfers in cases where the contract prohibits such action. The second condition, arises if the contract is silent but the other party has a substantial interest in having performance rendered by the person with whom it contracted. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions outlined in 2B-502(a). On the other hand, neither of these provisions would deny a right to delegate or subcontract performance in a mass market transaction where, under Section 502, can be freely transferred by the licensee.

SECTION 2B-506~~5~~. EFFECT OF ASSIGNMENT OR DELEGATION.

(a) Unless an assignment is limited to creating a security interest, acceptance of the assignment ~~of contractual rights~~ constitutes a promise by the assignee to perform the ~~accompanying~~ duties of the assignor. That~~e~~ promise is enforceable by the assignor or by any other party to the contract.

(b) Assignment, delegation, or sublicense does not relieve the assignor or delegator of any duty under the contract to pay or perform, or of liability for breach of contract, except to the extent the other party agrees.

Uniform Law Source: 2-210; 2A-303.
Committee Action: This section was discussed in November, 1996, without substantial comment.
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-5076. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer ~~, whether voluntary or involuntary,~~ of ~~its~~ ownership of intellectual property rights, other than by the creation ~~or enforcement~~ of a security interest, is subject to a prior nonexclusive license if the nonexclusive license is documented in a record authenticated and executed by the licensor before the transfer of ownership.

(b) A security interest created by a licensor or a transfer of ownership under a security interest in information or in copies of the information, is subordinate to a non-exclusive license which was:

(1) ~~was~~ authorized by the secured party;

(2) ~~was in the ordinary course of the licensor's business; or~~

~~(3)~~ executed ~~involved a transfer of rights completed~~ before the security interest was perfected; or~~.~~

(3) in the ordinary course of the licensor's business to a licensee who acquired the

license in good faith and without knowledge that it was in violation of the security interest.

(c) For purposes of this section, a transfer of ownership or of ~~, including creation of~~ a security interest~~,~~ occurs when the transfer is effective between the parties, but if ~~for which~~ applicable~~federal~~ law requires filing or a similar act to obtain~~attain~~ priority against other transfers ~~of ownership~~ the transfer does not occur until the date from which priority begins under that law after the filing or similar act occurs.

UNIFORM LAW SOURCE: Section 2A-304. Revised.
COORDINATION: Differences based on intellectual property concepts.
REPORTER'S NOTE:

1. This is an area heavily influenced by federal copyright law as to copyright interests and the provisions here attempt to trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption in reference to data, trade secrets and other non-federal rights. For security interests and their relationship in terms of priority to the rights created under an intangibles contract, the priority questions might be dealt with in this article as was done in Article 2A or they may be dealt with in Article 9. Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. Under the Copyright Act, a prior non-exclusive license is subordinate to a later transfer of copyright ownership unless the license is in a signed writing. This rule, while awkward and somewhat inconsistent with modern trends, was made part of the Copyright Act in 1976; there are no indications of probable repeal. The restatement of that rule here alerts persons who engage in commercial transactions about a priority rule that may not otherwise be expected. This avoids traps for unwary licensees. Note, however, that by using the new terms "record" and "authentication" this section are not yet explicitly adopted in federal law.

> **Illustration 1:** Computer Associates sells the copyright in its data compression program to Major Holdings Corp. Five days before that sale, Computer Associates entered a non-exclusive license with Boeing Corp. for a 100 user site license, which license was in an unsigned form. Three days after the sale, Computer Associates entered a non-exclusive site license with Standard Corp. Under subsection (b) **and** under federal law, the licensees' rights to copy (e.g., use) the software are subordinate to the copyright ownership of Major.

> **Illustration 2:** Lotus enters into a non-exclusive distribution license with Distributor, allowing Distributor to make and distribute copies of 1-2-3 Spreadsheet in the mass market subject to a standard form license for end users. Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale, Distributor provides a copy of 1-2-3 to Smith, who assents to the license. If the distribution license was a signed writing, the distribution was authorized by the license which has seniority over Taylor. Smith has priority over Taylor because it took through the valid license. If the distribution license was not a signed writing, Taylor's purchase is senior to that license and Smith is not an authorized user.

3. An alternative in subsection (a) would be to specifically narrow its scope to copyright transfers and provide for a broader priority rule to the extent that the conflict involves other aspects of the transaction (e.g., trade secrets). The appropriate rule might provide that the non-exclusive license takes priority if executed prior to the transfer of ownership of the intellectual property rights. This approach was rejected because it would create complicated and different results in the typical transaction where the information is covered by both copyright and trade secret law.

> **Illustration 3:** Same facts as in Illustration 1, except that Article 2B provides that a license is enforceable as to non-copyright interests if authenticated before the transfer of ownership. In that case, Boeing would be subordinate to Major as to the copyright elements, but would have priority in reference to use of any trade

secret or unprotected data elements in the program. Standard would remain subordinate as to all interests.

4. Subsection (b) also presents a preemption problem under federal copyright law, but the case for preemption is less clear since the UCC generally controls priorities and other aspects of law relating to security interests and the federal concerns in the priority statute are more focused on title transfers. This section does not take a position on whether a security interest should be filed in federal or state records systems; it simply refers to perfection of the interest. It adopts priority rules for a security interest in conflict with a nonexclusive license that parallel priority positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions that enable the licensor whose intangibles are encumbered to continue to do business in ordinary ways.

5. 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.

6. 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.

7. 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. 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.

8. 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.

SECTION 2B-508~~7~~. PRIORITY OF TRANSFERS BY LICENSEE.

(a) In a license, a creditor or other transferee of a licensee acquires no interest in information, copies, or rights held by the licensee unless the conditions for an effective transfer under this article and the license are satisfied.

(b) A creditor or other transferee of a licensee takes subject to the terms of the license.

(c) Except for rights under trade secret law and as otherwise provided in this Article, a person~~licensee~~ that acquires information ~~a copy~~ that is subject to the intellectual property rights of another~~y~~ person acquires only such rights to use the information as its licensor was authorized to transfer and as were limited by the ~~terms of the particular license~~ license ~~agreement~~ under which the licensee acquires the copy.

UNIFORM LAW SOURCE: Section 2A-305
COMMITTEE ACTION: This section was considered in November, 1996, without substantial comment.
COORDINATION: Differences are appropriate.
REPORTER'S NOTES:

1. A license, previously created, governs rights in the information and in copies thereof. A transferee acquires only the rights that the license allows. As a general principle, a license does not create vested rights and is not generally susceptible to free transfer in the stream of commerce. Subsection (a) and (b) are generally consistent with Article 2A.

2. Subsection (c) states an important principle, mandated under current intellectual property law. The idea of entrustment, which plays a major role in dealing with goods, has less role in intangibles covered by patent or copyright law, since the value involved resides in the intangibles and the concept of possession being entrusted in a manner that creates the appearance of being able to reconvey the valuable property is not ordinarily a relevant concern. Intellectual property law does not recognize a buyer in the ordinary course (or other good faith purchaser) as taking greater rights than the information or copy than were authorized to be transferred. While copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, the first sale must be by a party authorized to make the sale under the terms provided to the buyer.

> **Illustration 1:** Correll transfers copies of its software to DAC a distributor. DAC is licensed to transfer the software for educational uses only. DAC transfers a copy to Mobil Oil for use in a business application. Mobil has no knowledge of the Correll license restriction. DAC breached its contract and its distribution also constitutes copyright infringement. Mobil's copying (use) of the software is not authorized under copyright law since it did not receive an authorized distribution. The remaining question is whether Mobil should be subject to a contract action for violating the license in the DAC contract. This section takes no position on the issue.

3. Transfers in a chain of distribution that exceed a license or that otherwise are unlicensed and unauthorized by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase, but its use is likely to constitute infringement. As to software, this established principle was enforced by the court in Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). A retailer that obtained copies of software from third parties argued that the distribution was not a violation of copyright because it in good faith believed that it obtained the copies of the software through a first sale from an authorized party. The court held that there is no concept of good faith purchaser under copyright law and that the buyer cannot obtain any greater rights than the seller had. In the case where the seller is neither an owner of a copy or a person acting with authorization to

sell copies to third parties, no first sale occurs and the "buyer" is subject to the license restrictions created under any license to the third party seller. In one instance, the defendant had purchased from a licensee who was authorized to transfer the Microsoft product in sales of its machines. In fact, however, it purported to sell the product as a stand alone. This clearly exceeded the license to it and the mere fact that the alleged buyer acted in good faith did not insulate it from copyright liability. "Entering a license agreement is not a "sale" for purposes of the first sale doctrine. Moreover, the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products." See also Major League Baseball Promotion v. Colour-Tex, 729 F. Supp. 1035 (D. N.J. 1990); Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077 (D. Md. 1995); Marshall v. New Kids on the Block, 780 F. Supp. 1005 (S.D.N.Y. 1991).

4. This section does, however, allow for a bona fide purchaser in reference to trade secret claims. The essential feature of a trade secret resides in enforcing confidentiality obligations. Where a party takes without notice of such restrictions, it is not bound by them and, in effect, is a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

5. Article 2A provides that a buyer from a lessee generally acquires only the "leasehold interest in the goods that the lessee had or had power to transfer, and … takes subject to the existing lease." Section 2A-305(1). The exception to these principles in Article 2A occurs in the case of a buyer (or sublessee) from who acquires in the "ordinary course" of the lessor-seller's business. The buyer here takes free of the lease under theories of entrustment. For a buyer to acquire these rights, however, it must purchase from a "person in the business of selling goods of the kind." In effect, the goods were entrusted to a sales business. Also, the buyer must be in good faith and without knowledge that the sale violates the lease or ownership rights of the lessor.

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PART 6
PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT.

(a) A party shall perform in a manner that conforms to the ~~terms of the~~ contract and, in the absence of terms in the contract, in a manner and with a quality that is reasonable in light of the circumstances including the ordinary standards of the relevant trade.

(b) A party's duty to perform, other than with respect to contractual use restrictions, is contingent on there being no uncured material breach by the other party of ~~its~~ obligations or duties that precede in time the party's ~~particular~~ performance.

(c) In a mass-market license, if the performance consists of delivery of a tangible copy that constitutes the initial transfer of rights, the licensee may refuse ~~need not accept~~ the performance if the performance does not conform to the contract.

(d~~c~~) If a party is subject to contractual use restrictions or required to render other future or on-going performance, the party's right to exercise the rights under the contract is contingent on there being no uncured material breach of the ~~its~~ obligations or duties of that party.

(e~~d~~) If a party breaches its obligations or duties, including by failure to comply with any contractual use restrictions, the aggrieved party may:

(1) suspend its performance, other than compliance with contractual use restrictions, and demand assurance of future performance pursuant to Section [2B-622]; or

(2) exercise its rights on breach of contract under this article or the terms of the agreement, but the aggrieved party may cancel only if the agreement so provides or the breach is material and has not been cured.

(f~~e~~) For purposes of this section, "contractual use restrictions" include obligations of nondisclosure and confidentiality and limitations on scope, manner, method, or location of use to the extent that those obligations or duties are created by the contract.

Uniform Law Source: Restatement (Second) of Contracts ' 237. Substantially revised.
Coordination: Subject matter and practice justify differences.
Committee Vote:

1. Motion to make an exception to the material breach rule for mass market contracts on the issue covered by Article 2 (the right to reject a transfer of rights). **Adopted 12-0**

Selected Issue:

1. Should the section be approved?

Reporter's Notes:
[The perfect tender exception in (b) was redrafted to clarify that it does not refer to ephemeral copies delivered as part of performance of a longer term or broader contract. The intent is to replicate the perfect tender rule in current Article 2 for mass market transactions.]

1. This Article adopts the general theme of material breach (or substantial performance) as the measure of the right to cancel. That decision places the Article in parallel with common law and the modern international law of sales. The Convention on the International Sale of Goods (CISG) adopts the same position and refers to "fundamental breach," which it defines as: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional law in requiring so-called "perfect tender." Even then, these statutes do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a performance standard for when the reciprocal performance is not required is virtually unanimous.

2. This section reflects the vote of the Committee that a carve out was appropriate, allowing a standard of perfect tender in mass market transactions with respect to tender of deliver of a copy other than in an

installment contract setting. This so-called perfect tender rule does not mean that the tendered information is in fact perfect, but that it meet the general contract description in light of ordinary expectations and trade use. As in Article 2, this rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the single performance in the transaction (e.g., delivery of a television set, delivery of the diskette containing the software). As under current law, substantial performance rules apply in reference to on-going performance for both parties, services such as continuous access, and deliveries of a series of copies in an installment contract.

3. Former sections 601 and 602 were restructured in the September Draft and placed into a single section dealing with duties applicable to **both** parties. The language of the section was shifted to the term "material breach" rather than using the term "substantial performance" since this more accurately conveys the intended standard. This draft corresponds to Section 237 of the <u>Restatement</u>. <u>Restatement (Second) of Contracts</u> ' 237 states: "[It] is a condition of each party's remaining duties to render performances ... under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time."

> **Illustration 1:** Tom Jones has agreed to develop systems software for DNY. DNY promises to pay the purchase price of $300,000 in three installments once every three months and does not expressly link payment . Jones fails to complete stage 1 in month 2 and this failure is material. When the first payment is due, if the failure remains uncured, DNY is not required to pay. It can cancel the contract or seek assurances of performance. To alter this result would require an express agreement severing the obligation to pay from the performance of the deliveries.

3. This section sets 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 sets out generally applicable rules. Other sections dealing with specific types of contract **supplement these with more specific provisions that enhance and amplify the general rules**, but displace them only if there is a conflict.

4. This section adopts a theme of material breach in transactions not involving mass market licenses. This replaces the Article 2 idea of perfect tender with a standard that is routinely applicable under common law **and the CISG**. Definitions in Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach is defined in Section 2B-107 and is discussed in the Reporter's Notes to that Section. The definition largely adopts the definition in the <u>Restatement (Second) of Contracts</u> **'** 241, adding some specificity related to the commercial context. 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.

5. The concept is simple: **A minor defect in the transfer does not warrant rejection of performance or cancellation of a contract. Minor problems constitutes a breach of contract, but the remedy is compensation for the value lost.** The objective is to avoid forfeiture based on small errors and to recognize that, especially if performance involves multiple, ongoing activity, fully complete and perfect performance cannot be the expected norm. This is especially true in information contracts. Software often contains "bugs" or imperfections. Information services often entail small errors and incompleteness. The policy choice here adopts general law and allows a party whose performance has minor errors to expect performance by the other party; subject, in appropriate cases, to offsets and compensation for the problems.

6. The substantial performance rule does <u>not</u> hold that substantial (but imperfect) performance of a contract is not a breach. Substantial (but imperfect) performance is a breach of contract. The significance of substantial performance lies in the remedy for the injured party. Substantial performance is sufficient to trigger the injured party's obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject the initial tender or cancel the contract on that account, but it can obtain financial satisfaction for the less than complete performance.

7. Article 2 applies a "perfect tender" rule to only one setting: the initial tender (transfer) of goods in a contract that does not involve installment sales. Article 2 does not allow the buyer to assert a failure of perfect tender in an installment contract (that is, a contract characterized by an ongoing relationship). Even in a single delivery context, the theory of perfect tender is hemmed in by a myriad of countervailing considerations. As a matter

of practice, a commercial buyer cannot safely reject a tendered delivery for a minor defect without considering the rights of the vendor to cure the defect under the statute or under commercial trade use. White and Summers state: "**[we found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . .**" Indeed, in one case involving software, a court applied a substantial performance test to a UCC sales transaction. See D.P. Technology Corp. v. Sherwood Tool, Inc., 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven economic loss).

SECTION 2B-602. SUBMISSIONS OF INFORMATIONAL CONTENT [new].

(a) If a party submits informational content to a licensee pursuant to an agreement that requires that the information be to the subjective satisfaction of the licensee:

(1) The submission is not a tender of performance and the provisions of sections 2B-607 through 2B-613 do not apply.

(2) If the informational content is not immediately satisfactory to the licensee, the parties may engage in efforts to correct the deficiencies over a period of time and in a manner consistent with the ordinary standards of the trade or industry.

(3) Neither refusal nor acceptance of the submitted informational content occurs unless the licensee makes an express, affirmative indication of refusal or of acceptance of the submission to the licensor.

(4) Refusal of the submitted informational content terminates the agreement and does not constitute a breach of contract.

(b) If a party submits informational content other than pursuant to an agreement and the person receiving the submission maintains a procedure reasonably available to the general public to receive and review such submissions, no contract is created unless the information was submitted pursuant to that procedure and the party receiving the submission expressly agrees to contractual terms respecting use of the submission.

Prior Uniform Law: None.

Reporter's Notes:

1. This section is new. It deals with a problem that was raised recurrently during the discussion of the

Committee concerning the carrying forward of Article 2 rules concerning tender, acceptance and rejection into situations involving the informational content industries where practices are much different that in traditional sales of goods. The Section attempts to solve that conflict of approach by simply carving out the content submission situation from the circumstances involved in reference to tender of a required performance in other respects.

2. For transactions involving traditional book and publishing upstream agreements, the solution lies simply in recognizing that the submission of a manuscript, even pursuant to an agreement, does not represent a tender of performance analogous to that involving a delivery of goods that requires immediate acceptance or rejection. Rather, the delivery of informational content in this context triggers a process that typically centers around the fact that the licensee has the right to refuse if the content does not satisfy its expectations. Once that fact is recognized, the inapplicability of the various rules on acceptance and the like becomes apparent. The provisions of subsection (a) attempt to capture basic principles of content submission in such case, but need to be reviewed by members of the industry for relevance and desirability.

3. An important aspect of the difference in the two circumstances lies in subsection (a)(3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since, by presumption, the circumstances are keyed to the subjective satisfaction of the receiving party.

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

SECTION 2B-603~~2~~. TRANSFER OF RIGHTS; LICENSOR'S OBLIGATIONS.

(a) If a contract requires a transfer of rights, a licensor must complete the transfer of rights. A transfer of rights occurs when, pursuant to a contract, a licensor completes the acts required to make information available to a licensee and gives the licensee any notice reasonably necessary to make it aware of that occurrence. If no act is required to make information available, the transfer of rights occurs when the contract becomes enforceable between the parties.

(b) If the information is made available by delivery of a copy, the following rules apply:

(1) If the contract is silent as to delivery:

(A) in the case of physical transfer of copies, the licensor shall make the copies available to the licensee at the licensor's place of business or, if it has none, its residence, but if the copies are identified at the time of contracting and located elsewhere, the licensor shall make the copies available at that place; and

(B) in the case of transfer of copies by electronic means, the licensor shall make the information available in an information processing system designated by the licensor and provide the licensee with authorization codes, addresses, or any other materials necessary to obtain the information.

(2) If the contract requires or authorizes delivery of copies held by a third party which are to be delivered without being moved, the licensor shall deliver any documents, authorizations, addresses, access codes, or other materials necessary for the licensee to obtain the copies.

(3) If the contract requires or authorizes the licensor to send a copy~~ies~~ of the information to the licensee or to a third party but does not expressly require the licensor to deliver it~~them~~ to a destination:

(A) in the case of a physical transfer of a copy~~ies~~, the licensor shall put the copy~~ies~~ in the possession of a carrier, make such a contract as is reasonable for ~~their~~ transportation to the licensee or the third party with the costs of the shipment to be borne by the licensee, and deliver any documents necessary to obtain the copies from the carrier; and

(B) in the case of transfer of a copy~~ies~~ by electronic means, the licensor shall initiate an appropriate transmission of the information to the licensee or the third party.]

(c) If a transfer of rights is to occur by making access available to the licensee or providing the licensee with access to a facility containing the information, a licensor shall complete such acts as are necessary to make access available, including providing the licensee with any documents, authorizations, addresses, access codes, or other materials necessary for the licensee to obtain access.

(d) In electronic transmission or delivery, information must be made available in a manner consistent with the technological capabilities of the receiving party ~~that are~~ known to the licensor or the ordinary methods in the trade or industry for ~~of making~~ transfers of the particular kind.

Uniform Law Sources: 2-401, 509(a), 308
Reporter's Notes:
[This section was extensively discussed in November. In light of the various differences in practice, the section opts to retain current law in (b)(1). Should publisher (information submission) contexts be excluded from this section.]

This section brings together various rules defining the obligations of the licensor relating to completion of a transfer of rights. The section corresponds to Section 2B-606 which deals with tender of performance. The actual transfer of rights is, when applicable, an obligation of the contract (like delivery and passing title in Article 2), tender is the present offer to complete the transfer.

This section corresponds to the treatment of title and delivery in Article 2. While title itself is not a key concept in article 2, the seller's obligations for delivery correlate to obligations relating to title transfer and risk of loss. In article 2B, title and delivery are relatively less significant. The keys are transfers of rights which involve making information available to the transferee. The default rules here correspond to standards in Article 2 relating to delivery and title transfer, but they account for transactions involving access and electronic transfers.

As described in Article 2 and as exists under current law, the default provision in subsection (b)(1) is subject to contrary agreement and, in development or similar contexts, that agreement typically occurs explicitly in the contract (e.g., by requiring installation or testing on site) or implicitly in performance of the parties. Under Article 2, despite similar fact settings, current law chose an approach that effectively corresponds to so-called shipment contracts. Absent contrary agreement, the assumption is that the licensor (or seller in Article 2) is not obligated to transport without charge the material to the licensee's location.

SECTION 2B-604~~3~~. PERFORMANCE AT SINGLE TIME. If it is commercially reasonable to render all of one party's performance at one time, the performance is due at one time, and the other party's reciprocal performance is due only on tender of the entire performance.

Uniform Law Source: Section 2-307.
Coordination: Article 2B to conform to Article 2 language.
Committee Action: This section was reviewed in November without substantive comment.
Reporter's Note:

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.

SECTION 2B-605~~4~~. WHEN PAYMENT DUE.

(a) If a 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.

(b) If payment cannot be apportioned or the agreement or circumstances indicate that payment may not be demanded for part performance, payment is due only on tender of completion of the entire performance.

Uniform Law Source: Restatement (Second) Contracts; Section 2-310.
Coordination: Language to be coordinated.
Committee Action: Considered in November, 1996, without substantive comment.
Issue: Should section be approved?

[B. Tender of Performance; Acceptance]

SECTION 2B-6065. ACCEPTANCE: EFFECT.

(a) A party shall pay or render other performance required according to the contractual terms for any performance it accepts.

(b) The burden is on the party that accepted the performance to establish any breach of contract with respect to the performance accepted.

Uniform Law Source: Section 2-507.
Committee Action: Considered in November, 1996, without substantive comment.
Issue: Should section be approved?
Reporter's Note:

1. This section should be read in context of the right to revoke, the licensor's obligation to cure immaterial breaches, and the licensee's right to recoup from future payments even in the case of an immaterial breach where the amounts to be recouped are liquidated amounts. The additional language in new (b) is taken from current Article 2-607(4).

2. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received. Buyer remedies arise when the seller "fails to perform any of his obligations," Art. 45(1), and are preserved if proper notice is given. Art. 39(1). There is no rejection remedy in general and the buyer is obligated to pay the purchase price unless the contract can be avoided for "fundamental breach." Art. 25. This model more closely resembles the Restatement. The Article 2 Drafting Committee has considered and rejected use of this in lieu of the acceptance-rejection model on several occasions.

3. In cases of rejection, proposed Article 2 reflects this model in part by providing that "If the use of the goods is reasonable … and is not an acceptance, the buyer on returning or disposing of the goods, shall pay the seller the reasonable value of the use to the buyer. This value must be deducted from the sum of the price paid to the seller … and any damages …" 2-605 (b)(2).

SECTION 2B-6076. TENDER OF PERFORMANCE; RIGHT TO ACCEPTANCE.

(a) A tender of performance occurs when a party, with manifest present ability to do so, offers to complete the performance. If a performance by the other party is due before the tendered performance, the other party's performance is a condition to the first party's duty to complete the tendered performance.

(b) Tender of performance that substantially conforms to the contract entitles the party to acceptance of that performance. However, in a mass-market license, if the performance consists of the delivery of a copy that constitutes the initial transfer of rights, the licensee may refuse the performance if it does not conform to the contract.

(c) If performance is a transfer of rights, a licensor shall tender first but need not complete the performance until the licensee pays and tenders other performance required at that time. Tender must be at a reasonable hour and requires that the licensor:

(1) notify the licensee that the information or copies of the information are available or have been shipped;

(2) tender any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for the licensee to obtain access to, control over, or possession of the information; and

(3) hold the information, copies, and materials at the licensee's disposal for a period reasonably necessary to enable the licensee to obtain such access, control, or possession.

(d) Tender of payment is sufficient if made by any means or in any manner acceptable in the ordinary course of business unless the other party demands payment in money and gives any extension of time reasonably necessary to procure it.

Uniform Law Source: ' 2-510, 511(a)(b). Restatement (Second) of Contracts ' 238.

Reporter's Notes:

[At the November meeting, there was concern expressed about how this section corresponds to ordinary practices in reference to manuscript submissions. That issue is solved in proposed Section 2B-605A. There was also concern about the fit with practice in development contracts. Rather than implement different treatment in the text of the section, the proposed approach is to deal with the issues in comments as reflected in the revised notes.]

1. This section brings together various rules from existing Article 2.

2. Subsection (a) states a general principle of what constitutes tender. It is drawn from the Restatement. Unlike in Article 2, the performances here are not always actions relating to an offer to delivery goods and to pay for them. As a result, general language in (a) provides an important baseline.

3. Subsection (b) states the substantial performance rule and the mass-market exception developed approved by the Drafting Committee in September, 1996. In contracts where the information must be to the satisfaction of the licensee, performance that is not satisfactory does not satisfy the condition stated in subsection (b) and creates no obligation to accept.

4. Subsection (c) chooses who goes first when the performance involves a transfer of rights. Current law (2-511(1)) states that tender of payment is a precondition for the duty to tender or complete delivery. In this draft, the licensor, must tender first. The basic model is that tender of a performance means to offer to perform, and typically precedes actual performance. In reference to transfers of rights, Article 2B follows Article 2 by requiring tender, then payment, then completion. For tender, the circumstances must clearly indicate that performance is immediately forthcoming. This is the function of the references to shipment, tender of materials and the like.

5. As in the case of Article 2, the licensee's duty to accept typically hinges on its right to inspect the tendered copy as outline in 2B-607 and elsewhere. In the case of development contracts, the common practice typically expands on the inspection right, creating a period of testing before acceptance. at the end of the contract. In such cases, the tender itself implies an opportunity to test and inspect the copy. The duty to accept conforming property comes afterwards.

> **Illustration 1.** Jones contracts for the development of a system by Smith. Smith completes what it anticipates to be the full system and tenders a disk containing the software to Jones. Jones has a right to inspect the information before paying pursuant to an interaction of this section and the section on inspection. If the parties agreed to acceptance tests, those tests define the scope of the inspection right. If not, a reasonable inspection is required. Payment follows satisfactory inspection.

6. Subsection (d) is drawn from former 2B-608 and Article 2.

SECTION 2B-608. COMPLETED PERFORMANCES. [new]

(a) If performance involves delivery of informational content, entertainment or other services, that because of the nature of the information or services cannot be returned once delivery or performance is received by the licensee, the acceptance and rejection rules do not apply and the rights of the parties are determined under Section 2B-601 and the ordinary practices of the applicable trade or industry.

(b) In a contract governed by subsection (a), a party may inspect the media and label or packaging of a performance prior to payment, but may not view or receive the performance before payment unless the contract provides otherwise.

REPORTER'S NOTES:

This is a first draft of an effort to deal with a problem arising from the nature of the subject matter covered in this article. Some such subject matter is, in effect, fully delivered when made available to the party and ideas of inspection, rejection and return are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. In cases such as this, the goods-based concepts of Article 2 are not appropriate and the parties should be left to general, common law remedies as described in section 2B-601. If the delivered performance constitutes a material breach, the receiving party can obtain its money back or sue for damages, but it cannot demand full performance prior to payment as would be the case with anything other than the limited inspection right described in subsection (b).

SECTION 2B-609~~7~~. LICENSEE'S RIGHT TO INSPECT; PAYMENT BEFORE - INSPECTION.

(a) If performance requires delivery of a copy, the following rules apply:

(1) Except as provided in this section, ~~Subject to paragraphs (3) and (4) and subsection (b), a~~ a licensee has a right before payment or acceptance to inspect the media and the performance of the information and to obtain any related documentation at a reasonable place and time and in a reasonable manner in order to determine conformance to the agreement.

(2) Expenses of inspection must be borne by the licensee, but reasonable expenses may be recovered from the licensor if the performance is rightfully refused.

(3) ~~A licensee's right to inspect is subject to the confidentiality of the information. If inspection would disclose a trade secret or confidential information, jeopardize confidentiality, or provide the licensee substantially with the value of the information before payment, the licensee does not have a right to inspect before payment.~~

~~(4)~~ A place or method of inspection, or a standard for inspection fixed by the parties, is presumed to be exclusive. However, unless otherwise expressly agreed, the fixing of a place or method of inspection does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance with the method becomes impossible, inspection must be made as provided in this section unless the place, method, or standard fixed by the parties was intended as an indispensable condition, the failure of which avoids the contract.

(4) A licensee's right to inspect is subject to the confidentiality of the information. Unless the licensor otherwise agrees, the licensee may not inspect before payment in a manner that would disclose or jeopardize information designated by the licensor as a trade secret or confidential.

[(5) If inspection would provide the licensee substantially with the value of the information before payment, the licensee does not have a right to inspect before payment.]

(b) If a right to inspect exists under subsection (a) and the agreed procedures for payment or the terms of the contract are inconsistent with an opportunity to inspect before making payment, the licensee does not have a right to inspect before payment. Nonconformity in the tender does not excuse the licensee from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-610~~8~~; or

(2) in a documentary transaction, despite tender of the required documents the circumstances would justify injunction against honor.~~ under this [Act].~~

(c) Payment pursuant to subsection (b) is not an acceptance of performance and does not impair a licensee's right to inspect or preclude other remedies of the licensee.

Uniform Law Source: Section 2-513; CISG art. 58(3); Section 2-508. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
[There was substantial discussion of the relationship between confidentiality and inspection at the November meeting. New subsection (a)(4) was modified from the prior draft to clarify that confidentiality does not vitiate the right to inspect, but merely limit it and that the limitations hinge on designation of what is confidential by the licensor. The changes reflect the discussion and a reorganization of the material. The bracketed information should be deleted if the Committee adopts 2B-608.]]

1. This section combines former 2B-607 and 2B-608 with new material relevant to the information industries.

2. Subsection (a)(4) deals with the relationship between confidentiality and the right to inspect. Absent contrary agreement, inspection prior to payment is not appropriate if the type of inspection involved would reveal designated trade secrets or confidential information. This does not bar any inspection, but merely indicates that a right to see trade secret information cannot be presumed. Also, the balance here is limited to situations where the licensor designates information as confidential or a trade secret.

3. Subsection (a)(5) concerns situations in which the nature of the information is such that inspection would effectively convey substantially all of the value to the licensee before payment. Thus, for example, in a transaction where the essence of the deal is to reveal discrete information known to one party (e.g., the profit record of a company for the past year), inspection would communicate the subject matter of the deal and that communication cannot effectively be taken back if payment does not follow. The parties can agree to this result if they so choose, but it is not appropriate for law to presume it. This rule would not apply, however, where merely inspecting information conveys it. Thus, an author's submission of a manuscript to a publisher would not trigger this rule since the publisher's does not obtain the value by merely examining the manuscript.

4. Subsection (b) follows the rules stated in current law in Section 2-512.

SECTION 2B-610~~8~~. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b), ~~and Section 2B-618,~~ if a tender of performance, or the tendering party's previous performance, constitutes a material breach of contract, as to the particular tendered performance, the party to which it is tendered may:

(1) refuse the entire performance;

(2) accept the entire performance; ~~or~~

(3) accept any commercially reasonable units and refuse the rest; or

(4) permit an opportunity to cure the nonconformity.

(b) In a mass-market license, a licensee may refuse a performance that consists of the delivery of a copy that constitutes the initial transfer of rights if the performance does not conform to the contract.

(c) Refusal is ineffective unless (i) made within a reasonable time after the tender and the completion of any permitted effort to cure, (ii) ~~and~~ before acceptance, and (iii) the party whose performance is refused is notified within a reasonable time after the breach was or should have been discovered.

Uniform Law Source: Combines §§ 2-601, 2-602, 2A-509. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Votes:

1. The Committee voted to adopt a "perfect tender" carve out for cases involving the tender of delivery of

a copy in circumstances equivalent to those where the perfect tender rule applies in Article 2.

Selected Issue: Should the section be approved?

Reporter's Note:

[The section was modified to reflect the norm in many situations of a response involving a permitted effort to cure. This section no longer applies to information submissions.]

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. 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.

SECTION 2B-611~~09~~. DUTIES FOLLOWING RIGHTFUL REFUSAL.

(a) After refusal or revocation, any use or exercise of rights by a licensee with respect to the information or copies involved in the performance, or any disclosure of a trade secret or confidential information of the other party inconsistent with the agreement, ~~action, the natural consequence of which would be to reduce substantially the value of the information to the licensor or convey a further substantial benefit to the licensee, is wrongful as against the licensor and~~ constitutes a breach of contract, except that use or exercise of rights for a limited time solely to avoid or mitigate loss is not prohibited if not inconsistent with the licensee's refusal of the performance.~~.~~

(b) A licensee that takes possession of copies or documentation or has made additional copies, shall return all copies and documentation to the licensor or hold them with reasonable care for disposal at the licensor's instructions for a reasonable time. In this case, the following additional rules apply:

(1) If the licensee elects to hold the documentation or copies for the licensor's disposal, the licensee shall follow any reasonable instructions received from the licensor. However, instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

(2) If the licensor does not give instructions within a reasonable time after being notified of refusal, the licensee may in a reasonable manner to avoid or mitigate loss store the documentation and copies for the licensor's account or ship them to the licensor with a right of reimbursement for reasonable costs of storage, shipment, and handling.

(c) A licensee has no further obligations with regard to information or related copies and documentation refused, but both parties remain bound by any obligations of nondisclosure or confidentiality and any limitations or restrictions on use which would have been enforceable had the performance not been refused.

(d) In complying with this section, a licensee is held only to good faith and a standard of care that is reasonable in the circumstances. Conduct in good faith under this section does not constitute acceptance or conversion and is not the basis for an action for damages or equitable relief.

Uniform Law Source: Section 2-602(2), 2-603, 2-604. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
[Subsection a was modified to narrow the limitation on post refusal use. The intent is to limit the general restriction to cases that breach a confidentiality agreement in addition to uses or exercise of rights.]

1. This section does not give the licensee a right to sell goods, documentation or copies related to the intangibles under any circumstance. The materials may be confidential and may be subject to the overriding influence of the proprietary rights held and retained by the licensor in the intangibles. As Comment 2 to current ' 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in respect of information. The licensor's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

2. Subsection (a) was modified to provide for a limited right to use solely for purposes of mitigation. The use does not extend to disclosure of confidential information or sale of the copies. It cannot be inconsistent with the refusal. This asks courts to reach the balance discussed in Can-Key Industries v. Industrial Leasing Corp.,593 P.2d 1125 (Or. 1979) and Harrington v. Holiday Rambler Corp., 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved here.

2. Subsection (c) was modified at the suggestion of a licensee attorney to reflect that both parties remain bound by confidential information. It is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate.

3. It should be made clear that a wrongful refusal is not a refusal for purposes of this and other sections, but simply a breach of contract. That breach may or may not be material, but in either event, it triggers the sequence of remedies contained in the contract and this article, rather than the duties stated here.

SECTION 2B-612~~0~~. WHAT CONSTITUTES ACCEPTANCE.

(a) Subject to subsection (b) and (c), acceptance of a performance occurs when the party receiving the performance:

(1) substantially obtains the value or access expected from the performance and, without objecting, retains the value or utilizes the access beyond a reasonable time to refuse the performance;

(2) signifies or acts with respect to the information in a manner that signifies to the other party that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(3) fails effectively to refuse performance under the terms of the contract or Section 2B-610~~8~~;

(4) acts in a manner that makes compliance with the licensee's duties on refusal impossible because of commingling; or

[(5) receives a substantial benefit or ~~valuable~~ knowledge of valuable informational content from the ~~information,~~ performance~~, or access~~ and the benefit or knowledge cannot be returned.]

(b) Except in cases governed by subsection (a)(4) and (5), if a right to inspect exists under Section 2B-607 or the agreement, acceptance of performance that involves delivery of a copy occurs only when the party has a reasonable opportunity to inspect the copy and any document.—

(c~~c~~) If an agreement requires performance in stages with respect to portions of the information or with respect to its capacity to perform, this section applies separately to each stage. Acceptance of any stage is conditional until completion of the transfer of rights in the completed information or all stages required under the agreement.

Uniform Law Source: Section 2A-515. Revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
[This section should be read in light of the provisions of the proposed section on information submissions. Subsection (a)(5) was modified based on Committee discussion; it should be deleted if a section on self-executing transfers is added. Subsection (a)(3) will be the applicable section in cases of efforts to cure a defect and, by cross-reference to 2B-608, requires that a court consider the cure efforts in determining whether refusal is effective.]

1. Subsections (a)(2) and (3) conform to the language of Article 2A, clarifying as in Article 2A, that actions as well as communications can signify acceptance. This section does not adopt existing Article 2 provisions relating to actions inconsistent with the party's ownership since, as in Article 2A, there is a split between performance and retention of ownership in many cases. That split indicates that, as in 2A, the ownership standard is not relevant to use of information assets and other performance relevant here.

2. Subsection (a)(4) and (5) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(4), the key fact is that it would be inequitable or impossible to reject the data or information having received and commingled the material. The receiving party can exercise rights in the event of breach, but rejection is simply not a helpful paradigm. Recall that a rejecting licensee must return or to keep the digital information available for return to the licensor. Commingling does not refer only to placing the information into a common mass from which they are indistinguishable; it also includes cases in which software is integrated into a complex system in a way that renders removal and return impossible or where they are integrated into a database or knowledge base that they cannot be separated from. Commingling is significant because it precludes return of the rejected property.

3. The second situation (a)(5) involves use or exploitation of the value of the material by the licensee. In information transactions, it is simply the case that in many instances, merely being exposed to the factual or other material transfers the significant value. Also, often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient of the information can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due..

> **Illustration 1:** Licensee receives a right to use a mailing list of names of customers of Macey's store. It notices that the list contains no names from a particular zip code, but goes ahead with an initial mailing. It then seeks to reject the performance. While this would not fit within subsection (a)(5), the section provides that the acceptance already occurred if substantial value was received. Licensee can collect damages for the error and, if the breach was material, avoid obligation for the price. But it cannot reject because of (a)(1).

> **Illustration 2:** A contracts with B to obtain the formula to Coca Cola and information from B about how to mix the formula. B delivers the formula, but the mixing information is entirely inadequate. If the mixing information is not significant to the entire deal, A cannot reject because it received substantial performance. If the mixing information is significant, a right to reject may arise because of a material breach. However, subsection (a)(5) bars rejection if A received substantial value by obtaining knowledge of the formula and cannot return that knowledge. Even though it can return copies of the formula, knowledge would remain. A can sue for damages, but cannot reject after the formula is made known to it.

> **Illustration 3:** Intel contracts with John for a right to use John's list of the ten largest users of Motorola chips in the Southwest. The price is $1 million. John supplies the list, but there are two names that, through negligence, are not correct. After reading the list, Intel desires to reject the performance and cancel the contract. Subsection (a)(5) would ask whether Intel received substantial valuable knowledge and, thus, cannot reject. If so, its remedies are for breach under applicable sections involving a recovery for the difference in promised and received value. If it can reject, it can recover the part of the price already paid, plus any relevant and provable loss under the methods described in this Article.

4. This section must be read in relationship to the reduced importance of acceptance. Refusal and revocation both require material breach in order to avoid the obligation to pay according to the contract. This is unlike Article 2 which follows a perfect tender rule for rejection, but conditions revocation on substantial impairment. Acceptance does not waive a right to recover for deficiencies in the performance.

SECTION 2B-613~~1~~. REVOCATION OF ACCEPTANCE.

(a) Subject to subsections (b) and (c), a licensee may revoke acceptance of a commercial unit that is part of a performance by the licensor if the nonconformity of the commercial unit is a material breach of the contract and the party accepted the performance:

(1) on the reasonable assumption that the breach would be cured and it has not been seasonably cured;

(2) during a period of continuing efforts at adjustment and cure and the breach has not been seasonably cured; or

(3) without discovery of the breach and the acceptance was reasonably induced by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party sends notice of it to the other party and is barred if:

(1) the revocation does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) the revocation does not occur before any substantial change in condition or identifiability of the information not caused by the breach; or

(3) the party attempting to revoke acceptance received a substantial benefit to it or knowledge of valuable informational content from the performance or access and the benefit or knowledge cannot be returned.

(c) A party that justifiably 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.

Uniform Law Source: Section 2A-516; 2-608.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

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. National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785, 787 (Mich. App. 1975) ("Here, the malfunctioning was continuous. Whether the plaintiffs could have made it functional is not the issue. The machine's malfunctions continued after the plaintiff was given a reasonable opportunity to correct its defects. [The] warranty was breached."); Integrated Title Data Systems v. Dulaney, 800 S.W.2d 336 (Tex. App. 1990); Eaton Corp. v. Magnovox Co., 581 F.Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may constitute a waiver); St. Louis Home Insulators v. Burroughs Corp., 793 F.2d 954 (8th Cir. 1986) (limitations bar); The Drier Co. v. Unitronix Corp., 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495, rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use precludes rejection); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573 (8th Cir. 1982); Aubrey's R.V. Center, Inc. v. Tandy Corp., 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App. 1987) (nine month delay did not foreclose revocation); Triad Systems Corp. v. Alsip, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years after the initial delivery of software and hardware system); Money Mortgage & Inv. Corp. v. CPT of South Fla., 537 So.2d 1015 (Fla. Dist. Ct. App. 1988) (18 month delay permitted); Softa Group v. Scarsdale Development, No. 1-91-1723, 1993 WL 94672 (Ill. App. March 31, 1993); David Cooper, Inc. v. Contemporary Computer Systems, Inc., 846 S.W.2d 777 (Mo App 1993); Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

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 and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation does not, however, serve as a precondition to suing for damages. In the context of information transactions, revocation is not appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection (b)(3).

6. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received.

[C. Special Types of Contracts]

SECTION 2B-614~~2~~. ACCESS CONTRACT.

(a) A continuous access contract grants rights of access to the information as modified from time to time over the duration of the license.

(b) Information obtained by a licensee in an access contract is free of any restriction by the licensor except ~~express contractual restrictions and~~ restrictions resulting from the intellectual property rights of a licensor or other applicable law unless the information is is received subject to a license.~~:~~ The licensee may make a transitory copy for purposes of viewing the information only [and, if the agreement allows creation of a permanent copy, the licensee may also make ~~retain a copy of the information [and~~ a backup copy for protection against loss~~]~~].

(c~~b~~) In a continuous access contract, access must be available at times and in a manner consistent with:

(1) express terms of the agreement; and

(2) to the extent not dealt with by the terms of the agreement, in a manner and with a quality that is reasonable consistent with ordinary standards of the trade for the particular type of agreement.

(d~~c~~) In a continuous access contract, intermittent and occasional failures to have access available do not constitute a breach of contract if they are consistent with:

(1) standards of the trade or industry for the particular type of agreement;

(2) the express terms of the agreement; or

(3) reasonable needs for maintenance, scheduled downtime, reasonable periods of equipment, software or communications failure, or events reasonably beyond the licensor's control.

Uniform Law Source: None
Coordination Meeting: No equivalent in Article 2.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
[Subsection a is revised to reflect the circumstances in which mere viewing information constitutes the norm of the transaction; where the agreement enables the creation of a permanent copy, the default provision is that this also authorizes creation of a back up copy.]

1. This section applies to a "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. The transaction 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. 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. The prototypical transactions involve relationships with Westlaw, Compuserve and the like.

2. Subsection (b) outlines two important default positions with respect to the treatment of information obtained through access to an information system. The first is that, except for license terms dealing with the information, information obtained by access is obtained on an unrestricted basis, subject only to whatever intellectual property rights may apply. Thus, for example, if an access contract merely enables access to news articles, but does not further limit their use by the licensee, no limitation exists other than as applied under copyright law. In contrast, if the agreement contains license restrictions on use of the articles obtained by the access, those license terms would be governed under Article 2B and other law.

3. The second issue considered in subsection (b) concerns the making of copies. The default position here recognizes that access contracts will involve a wide variety of contexts, many of which do not contemplate that the license make and retain a copy of the information accessed (e.g., video on demand). The default rule assumes that transitory copies to enable viewing of the information are implicitly authorized. If, however, the agreement allows making a permanent copy, then a back up is authorized unless expressly excluded.

4. Access contracts are a form of license in the pure common law sense that they entail a grant of a right to have use of a facility or resource owned or controlled by the licensor. This involves less of a traditional intellectual property license and more of a modern application of traditional concepts of licensed use of physical resources. Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993). See also Soderholm v. Chicago Nat'l League Ball Club, 587 NE2d 517 (Ill. App. Ct. 1992) (license revocable at will). For a discussion of how one potential vendor handles these problems, see Proposed Rule Regarding Postal Electronic Commerce Service (39 C.F.R. ' 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed regulations and terms of use for Postal Service electronic commerce systems).

5. Under current law, these contracts are services or information contracts. The fault based warranties noted in the warranty sections apply insofar as one deals with the accuracy of content or processing. The contract obligation deals with an obligation to make and keep the system available. Obviously, availability standards are subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, 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. See Reuters Ltd. v. UPI, Inc., 903 F.2d 904 (2d Cir. 1990); Kaplan v. Cablevision of Pa., Inc., 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

6. In continuous access contracts, the transferee may receive substantial value before or despite problems in the overall transaction. The remedies provide for a concept of partial performance. For example, the fact that a company continues to use a remote access database processing system for several years while encountering problems and seeking a replacement system, may allow it to reject the future terms of the contract, but leaves the transferee responsible for the past value received. Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

SECTION 2B-615~~3~~. CORRECTION AND SUPPORT~~UPDATE~~ CONTRACTS.

(a) If a party agrees to correct errors or provide similar services, the following rules apply:

(1) If the services cover a limited time and are part of a limited remedy in a contract between the parties, the party undertakes that its performance will provide the licensee with information of a quality that conforms to that contract.

(2) In cases not covered by paragraph (1), the party shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the terms of the agreement, in a workmanlike manner and with a quality that is reasonably consistent with ordinary standards of the trade for similar contracts.

(3) In cases governed by paragraph (2), the party providing the services does not warrant~~guarantee~~ that its services will correct all defects or errors unless expressly so provided by the agreement.

(b) ~~An agreement to provide updates or new versions requires that the licensor provide only such updates or new versions that are developed by the licensor from time to time unless the terms of the agreement expressly provide that the licensor will develop and provide new versions or updates in a timely manner.~~ A licensor is not required to provide support or instruction for the licensee's use of information or licensed access after completion of the transfer of rights. If a person agrees to provide support for the licensee’s use of information, the person shall make the support available in a manner and with a quality consistent with the terms of the agreement and, to the extent not dealt with by the agreement, in a workmanlike manner and with a quality that is reasonably consistent with ordinary standards of the trade or industry for the particular type of agreement.

~~If a licensor must provide only updates or new versions of information that are developed from time to time, the following rules apply:~~

~~(1) The licensor is not required to provide new versions or upgrades that it has not made available to the public or relevant customer base and need not make new versions or upgrades available to the public or the customer base.~~

~~(2) The licensor shall make the new versions or upgrades available in a manner and with a quality consistent with the terms of the agreement and, to the extent not dealt with by the agreement, in a manner and a quality that is reasonably consistent with ordinary standards of the trade for the particular type of agreement.~~

~~(3) New versions or upgrades must conform to the same standards of quality applicable to the information involved in the initial performance unless the licensor indicates that compliance is not intended and the licensee accepts performance knowing of the lesser quality.~~

~~(c) Breach of a contract to correct or update information does not entitle the licensee to cancel an underlying contract concerning the information unless the breach is a material breach of the underlying contract.~~

Uniform Law Source: Uniform Law Source: Restatement (Second) of Torts § 299A.
Coordination: Similar but different context than in revised 2-504.
Selected Issue: Does this section correctly capture default term obligations?
Reporter's Notes:
[The provisions of subsection (b) are deleted based on requests of various licensee representative and on the general admonition that the default provisions should not be overly detailed. In addition, it was clear that the prior draft focused solely on rules applicable to software update contracts and would require significant revision to cover other industries. The first sentence of (b) was moved to a general default rule section. Subsection (c) in the former draft was deleted based on suggestion of Committee members and the fact that debate on the subsection indicated that no good default provision could be developed to answer when breach of one contract yields a right to cancel the other New subsection (b) was moved here from former 2B-614 and modified to reflect suggestions from licensee representatives]

1. 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 some cases. In modern software 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, here we are dealing more with new products when we are referring to generally available upgrades or new versions.

2. As a general rule, contracts to provide corrections are services contracts. As in any other services contract situation, the obligations of the services provider are to provide a reasonable and workmanlike effort to correct identified problems. Subsection (a) sets out this basic principle, but recognizes an important, alternative obligation that is presumed when the obligation to correct errors arises in lieu of a remedy under a contract.

3. Subsection (a)(1) clarifies the focus in those situations in which the promissor agrees to a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort. The prior draft provided for an obligation to complete an appropriately error free result if the promise to correct errors was "in lieu of a warranty." That reference left open a large number of potential interpretation issues and did not focus squarely on the nature of the intended focus. The obligation stated in subsection (a)(1) arises in any case where the repair/ correction obligation is set out as a form of remedy for any breach of the contract. The focus is on the classic "replace or repair" warranty. When the obligation to correct errors arises in that context, the promissor's obligation is to complete a product that conforms to the contract.

4. Subsection (a)(2) deals with the broader case of the general repair obligation outside of the limited remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a perfect result.

5. Subsection (b) provides a default rule regarding the time, place and quality of the services in a support agreement that is subject to contrary agreement. The standard reflects a theme of "ordinariness" that provides default performance rule throughout the chapter. It measures a party's performance commitment by reference to standards of the relevant trade or industry.

> **Example:** Software Vendor agrees to provide a help line available for telephone calls from its mass market customers. If this agreement constitutes a contractual obligation, the availability and performance of that help line is measured by reference to similar services or by express terms of a contract.

~~SECTION 2B-614. SUPPORT CONTRACTS~~ [MOVED]~~.~~

SECTION 2B-6165. PUBLISHERS, DISTRIBUTORS AND RETAILERS.

(a) In a contract between a retailer and an end user, if the parties understand that the end user's right to use the information is to be subject to a license from the publisher, the following rules apply:

(1) The contract between the end user and the retailer is conditional on the end user's assent to the publisher's license.

(2) If the end user refuses the terms of the license with the publisher, the end user

may return the information to the retailer and receive from it a refund of any license fee already paid in an amount consistent with Section 2B-113(b) and avoid any obligation for performance of future payments to the retailer regarding the information. Refund by the retailer under this paragraph also constitutes a refund under Section 2B-113.

(3) The retailer is not bound by the terms of, and does not receive the benefits of an agreement between the publisher and the end user unless the retailer and end user adopt those terms as part of their agreement.

(b) An authorized retailer that in good faith compliance with its contract with the publisher performs warranty or remedy obligations of a producer under a publisher's license with the end user is entitled to reimbursement from the publisher for the reasonable costs of the performance.

(c) A retailer that makes a refund in good faith pursuant to Section 2B-113 to its end user because the end user refused the publisher's license is entitled to reimbursement from the authorized party from whom it obtained the copy of the amount paid for the copy paid by the retailer on return of the copy and documentation to that person.

(d) A publisher that makes a refund in good faith pursuant to Section 2B-113 to the end user is entitled to reimbursement from the retailer of the difference between the amount refunded and the price paid by the retailer to the publisher for the refunded product.

(e) If an agreement contemplates distribution of tangible copies of information in the ordinary course, a retailer or other distributor shall distribute such copies and documentation as received from the publisher and subject to any contractual terms provided for end users.

(f) A retailer who enters an agreement with an end user is a licensor in its transaction with an end user for all purposes under this article.

(g) For purposes of this section, the following rules apply:

(1) A retailer is a merchant licensee that receives information from a licensor for sale or license to end users.

(2) A publisher is a licensor that is not a retailer, but that enters into an agreement with an end user with respect to the information.

(3) An end user is a licensee that acquires the information for its own use and not to distribute to third parties by sale, license, or other means.

Uniform Law Source: None
Coordination Meeting: No Article 2 equivalent.
Selected Issues:

1. Should a retailer have the benefit of warranty disclaimers in the publisher's license if these are assented to by the end user?
2. Should this section also deal with "warranties in a box"?

Reporter's Note:

1. This section deals with the three part relationship common in modern information transactions, especially in reference to digital products. The three party transaction involves a publisher, retailer, and end user. While the end user acquires the copy of information from a retailer, the retailer often lacks authority to convey a right to use a copyrighted work to the end user or, even, the right to transfer title to the copy. The right to "use" (e.g., copy) arises by agreement between the end user and the producer (party with ownership or control of the copyright). Often, in the mass market, this latter agreement is a screen license or a shrink wrap license. The enforceability of the terms of that license with respect to the licensee and publisher are dealt with elsewhere.

2. While there are three parties involved in separate relationships, it is clear that the relationships are linked. Subsection (a) deals with the relationship from the perspective of the **retailer's** contract with the **end user**. The basic principle in (a)(3) is that a retailer is not bound by nor does it benefit from any contract created by the producer with the end user. This mirrors modern law and limited case law dealing with sales of goods where manufacturer warranties and warranty limitations do not bind the retailer, but also do not benefit that retailer. A prior draft of this section stated the opposite position, but that met strong dissent. This means, of course, that the retailer does not have the benefit of warranty disclaimers made in a mass market publisher's license. That result can be changed by contract, of course. However, it gives the end user two different points of recourse - retailer and publisher. Subsection (f) confirms that warranties exist on the part of the retailer by stating that the retailer is a licensor with respect to its licensee.

3. Subsection (a)(1) and (a)(2) deal with the practical reality that performance of the retailer's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the retailer and that this depends on the license between the producer and the end user. The net effect is to give the end user who declines a license a right to refund. and to not being forced to pay the purchase price to the retailer. This refund concept creates a refund right, rather than an option on the part of the retailer. It reflects the conditional nature of the transaction with the end user. It differs from the publisher's option to provide a refund opportunity as a means of enabling the effective assent to the publisher's license terms. While they are distinct, however, a refund made by the retailer under the conditions of subsection (a) satisfies the refund opportunity required under 2B-113 for creating an opportunity to review.

4. There are several ways to view the retailer-end user relationship in reference to the publisher's license. One is to treat the publisher's license in full as an element of the retailer contract, understood as present by both the retailer and the end user from the outset, even if the precise terms are not yet known. See ProCD v.

Zeidenberg, 86 F.3d 1447 (7th Cir. 1996). An alternative is to treat the retailer's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter unless or until the end user assents to the publisher's license since, in most cases, the retailer's contract with the publisher authorizes only distributions subject to end user licenses and distributions that go outside this restriction constitute copyright infringement in cases where the information consists of copyrightable material. The end user's assent to the producer's license is then, as to its situation with the retailer, either a condition precedent (there being no final agreement until the end user can review and assent to or reject the license) or a condition subsequent (the agreement being subject to rescission if the terms of the license are unacceptable). In either case, if the end user declines the license, it can return the product to the retailer and obtain a refund or, if it has not already paid, avoid being forced to pay the license fee. Subsection (a)(1) and (a)(2) create this result. The contract between the retailer and end user is a license in that the end user's use rights are subject to assent to and the terms of the publisher's license. When the end user assents to the license, the publisher's license in effect replaces the retailer-end user license except as to obligations expressly created and earmarked as continuing on the part of the retailer (such as a services or support obligation). Of course, in addition, if the information breaches a warranty, the right to recover from the retailer remains present unless it was disclaimed by the retailer's contract.

5. In a recent European case, Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd., the court gave the end user a right to return the software and not pay the purchase price as to the retailer when the contract terms were unacceptable. The analysis was that the retailer's contract with the end user must have contemplated that the end user would have a right to copy/use the software, but that right could be obtained only through license or other agreement from the copyright owner. When the end user declined the license, in effect the conditions of the retailer's obligation were not met. The court did not treat this as a breach of contract, but as a failure to conclude the contract between the parties. No final agreement was present until the end user could review and accept or reject the license terms. In effect, the contract was concluded (or to be concluded) over a period of time, as opposed to at a single point in time over the counter.

Illustration 1: User acquires three different software programs from Retailer for a price of $1,000 each to be used in its commercial design studio. User is aware that each software comes subject to a publisher license. When it reviews one license, however, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the retailer did not provide a useable package and the end user did not pay simply for a diskette. Because the failed sale occurred due to the license terms, the refund under this section is from the retailer. An alternative refund option would be from the publisher who cannot obtain consent to its license unless it offers a refund for those who decline the terms. In most cases, of course, the publisher will establish this alternative refund process as at least initially coming through the retailer.

6. In most cases where an end user license is contemplated, the publisher's arrangements with distributors are licenses that retain ownership of all copies in the publisher and permit distribution only subject to a license. The legislative history of the Copyright Act indicates that, whether there was a sale of the copy or not, contractual restrictions on use are appropriate under contract law. "[The] outright sale of an authorized copy of a book frees it from any copyright control over … its future disposition…. This does not mean that conditions … imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).

7. To the extent that the retailer performs the producer's warranty obligations, the presumption is that it has a right of reimbursement from the producer. The provisions regarding refunds coordinate this section with the obligations incurred in creating an opportunity to review the terms of a license, which opportunity requires that there be a refund if the terms of the contract are refused. The consumer is entitled to refund of the retail price of the refused product and may obtain that either from the retailer or the producer. However, as between the producer and the retailer, the retailer can only receive reimbursement for what it paid to the producer. Thus, for example:

Illustration 2: Consumer refuses a program because it dislikes the license. It obtains a refund of the price paid to retailer ($100). Retailer is entitled to reimbursement from Producer of the $75 price that Retailer paid Producer for the product (if it returns the product). On the other hand, if Consumer obtains the $100 from Producer, Producer is reimbursed $25 from Retailer.

8. Subsection (d) sets out a basic default rule that corresponds with current law. The distributor is bound in its distribution by the terms of the contract with the producer and, as a default assumption, must redistribute in a form and subject to the conditions contained in the materials as received by it from the producer.

SECTION 2B-617~~6~~. DEVELOPMENT CONTRACT. If an agreement requires the development of a computer program, as between the developer and the client, the following rules apply.

(1) Unless an authenticated record provides for different treatment of ownership of the intellectual property rights:

(A) the developer~~licensor~~ retains ownership of the intellectual property rights in the program except to the extent that the program includes intellectual property of the client or the client would be considered a co-owner under other law; and

(B) the client ~~licensee~~ receives a nonexclusive, unrestricted and irrevocable license within this country unless the agreement restricts the licensee's use. ~~to use the program in any manner consistent with the uses for which the development was undertaken.~~

(2) On request of the client~~licensee~~ asserting its rights under this section, the developer~~licensor~~ shall notify the client~~licensee~~ if the developer~~licensor~~ used independent contractors or information provided by other third persons to which intellectual property rights may apply and shall provide the client~~licensee~~ with a statement that either confirms that all applicable intellectual property rights have been obtained or will be obtained from any independent contractor so used, or that it makes no representation about those rights beyond any stated in the agreement. [The response must be made within 30 days after the request is received. If the time for performance is less than 30 days, the request must be made at or before the time of contracting, and the response must be made before the transfer of rights.]

(3) If an authenticated record ~~the agreement~~ provides that ownership of the intellectual

property rights in the completed program will pass to the client~~licensee~~, but the agreement does not otherwise cover the following issues:

(A) Ownership ~~Title~~ passes in accordance with Section 2B-501 with respect to all components and code in the program developed pursuant to the contract.

(B) The client~~licensee~~ receives the program free of any restrictions on use on the part of the developer~~licensor~~. Its rights in the program may not be canceled by the developer~~licensor~~ after ownership payment of the contract price.

(C) If the agreement provides that the developer~~licensor~~ retains ownership of the intellectual property rights in any components or code used in the program that were developed prior to or independent of performance of the contract, the client~~licensee~~ has an irrevocable license to use or modify in any manner in connection with its use of the program or any modifications thereof, such components or code as were delivered to the client~~in any manner in connection with its use of the program or any modifications thereof~~.

(D) The developer~~licensor~~ has an irrevocable nonexclusive right to use in other contracts generally applicable components or code, including development tools or the like, developed by it in performance of the contract if ~~such components or code are not specific to the project and if~~ the use will not ~~lessen the value of the program for the licensee or~~ disclose confidential information of the client~~licensee~~.

(4) To provide that ownership of intellectual property rights in the completed program will pass to the client or be retained by the developer, language in an authenticated record is sufficient if it states “All rights, title and interest in the completed program will be owned by [named party],” or words of similar import.

(5) In this section, a “developer” is a person hired to create, modify, or develop a

computer program and a “client” is the person who hired the developer.

Uniform Law Source: None
Coordination Meeting: No Article 2 equivalent
Selected Issue:
a. Does this section provide proper default rules for development contracts?
b. Is the safe harbor language in (4) appropriate?
Reporter's Notes:
[This section was extensively discussed at the December meeting, reflecting the importance of the issue. Subsection (a) has been modified based on criticisms about the uncertain nature of the “purposes” test in the prior draft. The section sets out the premise that both party receive maximum rights, but that use and the like can be limited by agreement. Thus, for example, an oral agreement that assumes that the licensee can use the program only for internal purposes would be effective here, even though the implicit license would otherwise be unrestricted. Subsection 3(D) was modified based on extensive discussion at the December Meeting. The goal in this statute is to outline an appropriate balance of interests between developer and client in reference to general application tools to avoid a developer becoming captive of the client, while ensuring that the client receives all that it bargained for. The specific reference to development tools was recommended by a licensee representative. Subsection (4) was added at the suggestion of several observers that safe harbor transfer language would be desirable. The terminology adopted was designed to clearly indicate that more than a transfer of a copy was contemplated.]

1. This section deals with an important area of contracting in the software industry. It is an area affected by federal intellectual property law rules and also characterized by both, extensively negotiated contracts as well as very informal relationships. In many cases, the licensor-developer is a smaller firm dealing with larger companies. The section is specifically limited to development contracts relating to computer programs.

2. Subsection (1)(A) states a default rule that corresponds to current copyright law rules about ownership. In the absence of an employment relationship, ownership remains in the creative individual or company unless the contract expressly provides for a transfer of that ownership to the client (licensee). While the rule of retained ownership may be counter-intuitive, it is important that state law here provide clear notice of that result and guidance as to its consequences. Subsection (a)(2), however, ameliorates the possibility of a misunderstanding by providing what amounts to an implied license for the licensee in such cases. The license is non-exclusive but allows any use of software consistent with the intended purpose of the development. The license here is effectively a fully paid up license if the client performs its part of the development contract, and would be a perpetual license under this draft. Several recent cases involving the client-developer relationship have implied a similar non-exclusive license in cases where the contract did not provide for a transfer of intellectual property ownership.

2. Subsection (2) provides important protection for a licensee not found in current law. 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. The section places an obligation on the developer of software in a development context to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to potentially avoid those problems.

3. Subsection (3) was revised based on extensive commentary received from several sources. The intent of that section is to provide basic guidance on a difficult negotiation issue. The prior draft contained two alternatives that borrowed language from model agreements on the various points raised. The use of a default rule here is intended to provide protection for small developers and small licensees who may not address the three basic questions presented. The basic theme is that ownership transfers in all code developed for and included in the program and that no conditions limit the licensee’s use. However, two issues are balanced: 1) the developer’s right to continue to use general applicability code and tools and 2) the licensee’s rights to use code developed outside the project. In each case, a split between ownership and a non-revocable license is used to give each party rights in the materials as a default rule. The developer retains ownership of previously developed materials, but the licensee has an irrevocable license to use them. In reference to included general tools, on the other, the licensee has ownership, but the developer has a license to continue to use.

~~**SECTION 2B-617. SYSTEM-INTEGRATION CONTRACT.**~~

Deletion of this section is proposed based on substantial uncertainty expressed about the scope of the section and general recommendations that the Draft reduce the level of detail in content. The subject matter is covered under the implied fitness warranty and is ordinarily dealt with in the contract. Also, if a party relies in fact, that reliance is protected without the section. If it does not rely, no protection existed under the section.

SECTION 2B-618. FINANCIAL ACCOMMODATION CONTRACTS [new].

(a) A financier is subject to the terms and limitations of the license and to the intellectual property rights of the licensor and the financier's ability to create an interest in a license is governed by the provisions of 2B-504.

(b) If a financier is not a licensee who sublicenses or otherwise transfers the license to a licensee receiving financial accommodation:

(1) The financier is not bound to perform the obligations owed to the licensee under the license, and does not receive the benefits of the license.

(2) The licensee's rights to use the information and obligations pertaining thereto, are governed by the license and any rights of the licensor under other law and, to the extent not inconsistent with the license or other law, the terms of the financial accommodation agreement.

(3) The licensor's rights and obligations with respect to the licensee are governed by the terms of the license and any rights of the licensor under other law.

(c) If a financier is a licensee who sublicenses or otherwise transfers the license to a licensee receiving the financial accommodation:

(1) The sublicense or transfer to the licensee is not effective unless the transferor qualifies as a financier under this article or the conditions for effective transfer under this article are met.

(2) Following an effective transfer to it, the licensee becomes a party to the

license and the licensee's rights to use the information and obligations pertaining thereto, are governed by the license and any rights of the licensor under other law and, to the extent not inconsistent with the license or other law, the terms of the financial accommodation agreement. The licensor's rights and obligations with respect to the licensee are governed by the terms of the license and any rights of the licensor under other law.

(3) With respect to the licensee, on completion of an effective transfer to the licensee, the financier is no longer a licensor and, except for the warranty in 2B-401 concerning authority and quiet enjoyment, makes no warranties to the licensee other than any express warranties in the agreement.

(4) If the information was not selected or supplied by the financier, if the financier does not hold intellectual property rights in the information, and if the license is not a consumer license, the licensee's promises to the financier under the financial accommodation agreement and any related agreements become irrevocable and independent of the license if the financial accommodation agreement so provides, on the licensee's acceptance of the license and payment by the financier to the licensor.

(5) As between the financier and the licensee, if the financial accommodation agreement so provides, the financier is entitled to possession of any copies, upgrades, new versions, or other modifications of the information provided by the licensor pursuant to the license, but the financier's rights with respect to the licensor are determined under Section 2B-504.

(d) On breach of the financial accommodation agreement by the licensee, the financier may cancel that agreement, but may not cancel the license.

Committee Action:
In December, 1996, the Committee concluded by a consensus, that treatment of financing arrangements was appropriate, but that it should be limited and generic. The over-riding concept would allow creation of an interest, but not sale and reflect important differences in the license arrangement as contrasted to lease and security interests in goods.

Reporter's Notes:

1. This section reflects the consensus of the Committee at the December meeting that treatment of lease and other financing was appropriate and should reflect a model that allows some creation of rights, but restricts transfer by the financier without the licensor's consent when dealing with a licensee's interest. The sense of the discussion by the Committee was that lease and security interest issues should be compressed and made more generic than in the prior draft.

2. This section deals with the relative rights among the parties, while Section 2B---- on financier's rights deals with the basic creation and enforcement of the interest. The term "financier" includes both a secured creditor and a lessor. The critical distinction, implemented here and in the definition of the term is between a traditional loan arrangement where the financier does not become a party to the license and the relationship that exists more in reference to traditional tree party leasing where the lessor (financier) acquires the property (license) and transfers this down to the licensee.

3. An important licensee protection makes the accommodation in the second of these two cases conditional on the licensee's assent to the license. In the absence of such assent, the licensee may have no rights to use the information and, thus, the transaction is illusory from its standpoint. The definition of "financier" incorporates this concept, requiring that the licensee's assent be a condition to the creation of the lease. This transaction is different from the ordinary equipment lease because of the central importance of this license agreement and the provisions here recognize that importance. (see also the treatment of when promises become irrevocable).

4. Subsections (b) and (c) outline some attributes of the two scenarios that seem to be present here. In (b), the case involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract relationship with the licensee. The key factor here is that the lessor is not bound by the obligations of the license, but is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement. In subsection (c) we deal with the less common situation where the license is actually entered with the lessor and then passed down through to the licensee. Here, when the licensee takes on the license, the lessor is taken out of the transaction for purposes of qualitative and other issues except for quiet enjoyment and authority to transfer consideration. The licensee becomes a direct party to the license.

5. Subsection (c)(4) provides rules pertaining to so-called hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context. Additionally, the provisions have been modified to reflect a problem not present in ordinary equipment leasing. Article 2A-407 provides that the promises become irrevocable on the lessee's acceptance of the goods. In the stereotypical transaction under that article, the goods are sold to the lessor and sent to the lessee. If there is non-payment by the lessor, the seller's remedies are against the lessor (not the lessee). In a license transaction, however, there are two different factors. First, in many cases, the licensee contracts directly with the licensor. Non-payment then may give a contractual right of action for the price against the licensee even though its lease called for payment by the lessor. Second, in a license, payment is typically a condition on the licensee's rights to continue to use the information. Thus, although the lessor was to pay, the licensee may be placed in a position of paying twice if the lessor fails to do so. To avoid this type of problem, the irrevocability concept is limited here not only to acceptance of the transfer, but also payment to the licensor.

Article 2A has been criticized for treating irrevocability as a pure default rule without requiring mention in the contract or consent from the lessee. This draft does not follow that rule.

6. Subsection (c)(5) deals with a common area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As between the licensor, however, the general provisions of Section 2B-502A control.

7. Subsection (d) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. Performance Problems; Cure]

SECTION 2B-619~~8~~. CURE.

(a) A party in breach of a contract, at its own expense, may cure the breach if the party in breach:

(1) without undue delay notifies the other party of its intent to cure; and

(2) effects cure promptly and before cancellation or refusal of a performance by the other party.

(b) If a licensor, other than in a mass-market license, receives timely notice of a specified nonconformity and demand from a licensee that accepted a performance as required because a nonconformity was not material, the licensor promptly and in good faith shall make an effort to cure unless the cost of the effort would be disproportionate to the adverse effect of the nonconformity on the licensee.

(c) A breach of contract that has been cured may not be used to cancel a contract, but mere notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source: Sections 2-508; 2A-513; 11 USC 365
Coordination Meeting: Different context because of substantial performance standard.
Selected Issues:
1. Should cure be subordinate to the right to cancel or should there be a right to cure?
Reporter's Note:
[If the proposed section on information submission is adopted, this section does not apply to publishing contracts with authors. The comments will make clear that (b) deals with a non-material breach that did not justify cancellation or refusal. They will also clarify that, in most situations, there is no ability to cure a breach of confidentiality.]

1. In this Article, the idea of cure applies in both directions, affecting important performance obligations on both the licensee and the lic~~s~~ensor, unlike in Article 2 where the sole emphasis is on the seller's right to cure. For licensees cure is likely to be an issue with respect to missed payments, failures to give required accountings or other reports, and misuse of information, For licensors, depending on the context, the issues will often focus on timeliness of performance, adequacy of delivered product, breach of warranty and the like. In addition to the two way nature of the issue, in this Article, unlike in Article 2, with the exception of mass market licenses, the events that trigger a cure effort typically (e.g., refusal of a performance, revocation of acceptance) do not occur unless there was a material breach. This shifts the equities somewhat in reference to the extent to which a cure right is created. This Section does not create a "right" to cure. The basic policy is that, when there exists a material breach, the aggrieved party's interests prevail over the vendor's interests.

2. The idea that a breaching party may, if it acts promptly and effectively, alleviate the adverse effects of its breach and preserve the contractual relationship is embedded in modern law. Restatement (Second) of Contracts ' 237 provides that a condition to one party's performance duty in a contract is that there be no uncured material breach by the other party.

3. Although the idea of cure is embedded in modern law, there is some significant disagreement in pertinent statutes and statements of contract law as to the scope and balance applied to the operation of a cure.

a. The UNIDROIT Principles seemingly go the furthest in establishing a **right** to cure indicating that a cure is not precluded even by notice of termination of the contract for breach and by not limiting the opportunity to cure in any manner related to the timing of the performance. That is, cure is neither more nor less possible as a right if it occurs during the agreed time for performance than if it occurs afterwards. The UNIDROIT Principles, of course are not enacted law in any state. They condition cure on "prompt" action and allow it if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing the cure. UNIDROIT art. 7.1.4

b. Current Article 2, in contrast, distinguishes between cure made within the original time for performance (essentially allowing a right to cure) and cure occurring afterwards (which it restricts to cases where the vendor expected the tender to be acceptable). Draft revisions of Article 2 were discussed at the Article Committee's last meeting and are in flux, apparently attempting to blend the older Article 2 concept with the open-ended Unidroit concept.

c. The UN Sales Convention is not consistent with Unidroit except that it too does not distinguish between cures occurring within or after the original agreed date for performance. It allows the seller to cure if it can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty. Sales Convention art. 48. However, the cure right is subject to the party's right to declare the contract "avoided" (e.g., cancel) if the breach amounts to a fundamental breach of contract.

4. This section is consistent with the Sales Convention and does not follow existing Article 2. That is based on the principle that the use of materiality as a standard for cancellation or refusal creates a context here that is unlike the context in Article 2 and on the view that the more recent legal developments (Unidroit and Sales Convention) use a different timing paradigm that does not distinguish timely and late cures.

5. This Section allows cure if it is prompt, but does not create a right to cure. The cure is subject to prior cancellation or refusal by the other party. This places control in the aggrieved party who has suffered a material breach by the other person. In a mass market setting, it enables a clearly delineated right to end the transaction which many from the consumer context have viewed as significant.

6. Subsection (b) states an obligation of the breaching licensor to attempt a cure in a situation where the licensee accepted the information because there was only a nonmaterial conformity. One might ask whether this obligation should be mutual and apply to situations where the licensor has been required to accept nonmaterial breaches. Failure to undertake the effort is a breach, but consistent with comments to other sections, this will be pointed out in comments, rather than in the statute.

7. For purposes of simplifying the statute consistent with suggestions about reducing detail, prior provisions dealing with what are the constituent elements of cure have been deleted from the statutory text and will, instead, be discussed in the comments. The variety of issues presented and the fact that, throughout contract law, there is a pattern of dealing with ideas of cure on a case by case basis indicates that specification in the statute is not appropriate. The elements that would be discussed include: fully perform the obligation that was breached, compensate for loss, timely perform on all assurances of cure, and provide assurance of future performance.

SECTION 2B-620~~19~~. WAIVER.

(a) Any claim or right arising out of an alleged breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record authenticated by the party making the waiver.

(b) A party that accepts a performance, knowing or with reason to know that the performance constitutes a breach of contract:

(1) waives its right to revoke acceptance or cancel because of the breach, unless the acceptance was on the reasonable assumption that the breach would be seasonably cured, but acceptance does not in itself preclude any other remedy provided by this article; and

(2) waives any remedy for the breach if the party fails within a reasonable time to object to the breach.

(c) Except with respect to a failure of a performance to meet a contractual requirement that it be to the subjective satisfaction of a party, a ~~A~~ party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on the unstated defect to justify refusal or to establish breach only if:

(1) the other party could have cured the defect if stated seasonably and the other party was not aware of the defect; or

(2) between merchants, the other party after refusal of a performance has made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.

(d) A waiver may not be revoked as to the performance to which the waiver applies. However, waiver of breach in one performance does not waive the same or similar breach in future performances of like kind unless the party making the waiver expressly so states. Other than a waiver pursuant to subsection (a) and a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance is required in the future of any term waived unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Committee Action: This section was considered in December without substantial substantive concern.

Reporter's Notes:

[Comments will indicate that subsection (a) does not preclude other ways of making an effective waiver, but that it merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a state, remain effective. Subsection (c) was modified at the suggestion of a consumer representative.]

1. As with respect to cure, ideas of waiver in this Article must be considered as running in both directions. Conduct and words may constitute a waiver by either the licensor or the licensee. This section brings together rules from various portions of existing Article 2 dealing with waiver issues and recasts those rules to fit the broader number and variety of types of performance that are involved in Article 2B transactions. A prior version of this section is carried forward in revised Article 2-505 (July Draft). The section also applies principles from the Restatement. In general, a "waiver" is "the voluntary relinquishment of a known right."

2. Subsection (a) stems from 2A-107. It accommodates written waivers. In effect, these are contractual modifications. The Restatement is consistent with this view. Restatement (Second) **"**277 ("a written renunciation signed and delivered by the obligee discharges without consideration a duty arising out of a breach of contract.").

3. Subsection (b) brings together rules from current Article 2-607(2) and (3)(a) and generalizes the language. In Article 2, the rules apply **only** to a tender by the seller and acceptance of delivery by the buyer. Here, the effect also applies to acceptance of tendered performance by the licensee (e.g., a payment of royalties). The rule does not apply to cases where the party merely knows that performance under the license is not consistent with the contract unless that defective performance is tendered and accepted. Draft Article 2 does not impose a waiver by the accepting **buyer** unless the seller is prejudiced by the failure to object under what is here subsection (b)(2). This section on waiver is from current law in Article 2 and follows that rule. It is also consistent with the Restatement (Second) **'** 246 which provides that retention of a performance with reason to know it was defective creates a promise to perform despite the breach. The following illustrates the rule here:

> **Illustration:** Licensee has an obligation to pay royalties to the Licensor based on 2% of the sale price of products licensed for its manufacture and distribution. The royalty payments must be received on the first of each month. A 5% late fee is imposed for delays of more than five days and the license provides that delay of more than five days is a material breach. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts the tender it knows of the breach and cannot thereafter cancel the contract for that breach. If it fails to object in a reasonable time to the late tender and the nonpayment of the late fee, it is also barred from recovering that amount.

3. Subsection (c) comes from current article 2-605 and, except for changes that adopt the language of waiver, are substantively identical to that section. The basic principle is that, having given notice of refusal, there is ordinarily no further obligation to delineate the reasons for refusal.

4. Subsection (d) sets out a default rule common in most contracts involving ongoing relationships by indicating that waivers are presumed to be related to the performance accepted only. This does not alter estoppel concepts; a waiver by performance may create justifiable reliance as to future conduct in an appropriate case. Such common law principles continue to apply. The section goes on to take language from former 2B-303 and the Article 2 predecessor of that section setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see Restatement (Second) of Contracts **'** 84, comment f.

SECTION 2B-621θ. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes on a party an obligation not to impair another party's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, in a record 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 performance has not already been received.

(b) Between merchants, the ~~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 that is adequate under the circumstances of the particular case is a repudiation of the contract.

Committee Action: This section was considered in December without substantial substantive comment.
Uniform Law Source: 2-609.
Coordination Meeting: Conform to Article 2 language.

SECTION 2B-622~~1~~. ANTICIPATORY REPUDIATION.

(a) If either party to a contract repudiates a performance not yet due and the loss of performance will substantially ~~substantially~~ impair the value of the contract to the other, the aggrieved party may:

(1) await performance by the repudiating party for a commercially reasonable time or pursue~~pursuee~~ any remedy for breach of contract, even if it has urged the repudiating party to retract the repudiation or has notified the repudiating party that it would await the agreed performance; and

(2) in either case, suspend its own performance or proceed under Section 2B-710.

(b) Repudiation includes but is not limited to language that one party will not or cannot make a performance still due under the contract or voluntary affirmative conduct that reason appears to the other party to make a future performance impossible.

Committee Action: This section was considered in December without substantial substantive comment.
Uniform Law Source: 2-609.
Coordination Meeting: Conform to Article 2 language.
Selected Issue: Should the section be approved?
Reporter's Note: Conformed to Article 2.

SECTION 2B-623~~2~~. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) A repudiating party may retract a repudiation until its next performance is due unless an aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction under subsection (a) may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 2B-620.

(c) Retraction under subsection (a) reinstates a repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay caused by the repudiation.

Committee Action: This section was considered in December without substantial substantive comment.
Uniform Law Source: Section 2-610.
Coordination Meeting: Conform to Article 2 language.
Selected Issue: Should the section be approved in principle?
Reporter's Note: Conformed to Article 2.

[E. Loss and Impossibility]

SECTION 2B-624~~3~~. RISK OF LOSS.

(a) Except as otherwise provided in this section, the risk of loss as to a copy of information passes to the licensee on receipt of the copy. In a continuous access contract, risk of loss as to the information to be accessed remains with the licensor, but risk of loss as to information copied by the licensee as a result of that access passes to the licensee when it receives the copy. ~~If the contract does not contemplate that a 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 send 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 delivered to the carrier, even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the copy arrives there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered in a manner that enables the licensee to take delivery.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains on the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, the risk of loss passes to the licensee upon:

(1) ~~upon~~ the licensee's receipt of a negotiable document of title covering the copy;

(2) ~~upon~~ acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) ~~after~~ the licensee's receipt of a ~~nonnegotiable document of title or~~ record directing delivery or access, or of access codes enabling delivery or access.

Uniform Law Source: Section 2-509
Coordination Meeting: Different subject justifies differences.
Selected Issue: Should the section be approved in principle?
Reporter's Notes:
[Changes in (a) reflect a more accurate treatment of internet or similar transactions involving continuous access. The risk remains with the licensor, but as to copies made by the licensee passes on the making of the copy.

Subsection (c) was modified to reflect practices in the motion picture industry and in on-line distributions which may not require acknowledge and do not entirely adhere to the documentary transaction format found in reference to goods.]

While, in many cases, there is no risk of loss element present in an 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).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 access to, taken possession of copies, or received control of the information.

SECTION 2B-6256. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Delay in performance or nonperformance by a party is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made; or

(2) compliance in good faith with any applicable foreign or domestic governmental regulation, statute, or order, whether or not it later proves to be invalid, if the parties assumed that the delay would not occur.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance. If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall also allocate performance among its customers in a manner that is fair and reasonable and notify the other party of the estimated quota made available. However, the party may include regular customers not then under contract as well as its own requirements for further manufacture.

(c) A party that receives notice in a record of a material or indefinite delay, or of an allocation which would be a material breach of the whole contract, may:

(1) terminate and thereby discharge any unexecuted portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(d) If, after receipt of notification under subsection (b), a party fails to terminate or modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

(e) The procedures in subsection (c) and (d) may be varied by agreement only to the extent that the parties have assumed a different obligation under subsection (a).

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.
Committee Votes:
1. Voted unanimously to delete former section 2B-624, with reporter free to replace some of the concepts in another section.
2. Voted 12-1 to delete former section 2B-625 (invalidity of intellectual property), with reporter free to replace some of the concepts elsewhere.

Selected Issue: Should the section be approved in principle?
[This section has not been revised based on the December Meeting. It will be modified to ensure that the principles of the deleted sections can be found under this section, but the modifications have not been made yet.]

[F. Termination]

SECTION 2B-626~~7~~. SURVIVAL OF OBLIGATION AFTER TERMINATION.

(a) Except as otherwise provided in subsection (b), on termination of the contract, all obligations that are still executory on both sides are discharged.

(b) The following survive termination of the contract:

(1) a right or remedy based on breach of contract or performance;

(2) a limitation on the use, 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 information, materials, documentation, copies, records, or the like to the other party~~, which obligation must be promptly performed~~ or of a party to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes through means of alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for providing notice;

(8) an indemnity provision; and

(9) any right, remedy, or obligation stated in the agreement as surviving.

Committee Action: This section was reviewed by the Committee in December with no substantial substantive concerns.
Uniform Law Source: Section 2A-505(2); Section 2-106(3).
Coordination Meeting: Article 2 to conform to Article 2B..
Selected Issue: Should the section be approved in principle?
Reporter's Note:
[The Comments will point out that the identified rights survive unless survival is expressly negated. Thus, a list of two or three surviving clauses will not implicitly exclude the listed items.]

1. This section states the principle impact of termination, which refers to the discharge of executory obligations. This corresponds to current law and revised Article 2.

2. Subsection (b) provides a list of provisions and rights that presumptively survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The exceptions deal with remedies. The list indicates terms that would ordinary be treated as surviving in a commercial contract and the intent is to provide background support, reducing the need for specification in the contract with resulting risk of error. Of course, under the basic theme of contract flexibility, additional surviving terms can be added and the terms provided here can be made to be non-surviving.

SECTION 2B-6278. NOTICE OF TERMINATION.

(a) Subject to subsection (b), a party may not terminate a contract, except on the happening of an agreed event, such as the expiration of the stated term, unless the party gives reasonable notice of termination to the other party.

(b) Access to a facility under an access contract not involving information that the licensee provided to the licensor may be terminated without notice.

(c) In cases not governed by subsection (b), a contractual term dispensing with notice required under this section is invalid if its operation would be unconscionable, but a contract term specifying standards for the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)
Coordination Meeting: Recommends that section conform to Art. 2 requirement.
Selected Issue:

a. Should the section be approved in principle?

b. Should the section conform to Article 2 and use "receipt" as the standard, rather than "give" notice?

Reporter's Notes:

1. The notice must be reasonable. Article 2 requires receipt of notice, but this section allows "giving" notice. The receipt standard creates potential uncertainty and the party here is merely exercising a contractual right. The uncertainty is especially important in online or internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

2. Of course, to terminate, the terminating party must have a right to do so under the contract or other applicable law.

3. The language in 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.

4. Subsection (c) corresponds to current draft Article 2 as edited at the Style Committee meeting. It invalidates waivers of notice so far as they may be unconscionable, but allows specification of standards for notice subject to a standard of manifest unreasonableness. This standard derives from Article 9 law and sets a limit on standards setting, while maintaining contractual flexibility in this context which may be important for the parties.

SECTION 2B-628~~9~~. TERMINATION: ENFORCEMENT AND ELECTRONICS.

(a) On termination of a license, a party in possession or control of information, materials, or copies it does not own, but which are the property of the other party or subject to a possessory interest of the other party, shall return all materials and copies or hold them for disposal on instructions of the other party. If the information, materials, or copies were subject to restrictions on use or disclosure, the party in possession or control following termination shall cease continued exercise of the terminated rights. Continued exercise of the terminated rights or other use is a breach of contract ~~and wrongful as against the other party~~ unless pursuant to a contractual term that survives cancellation or which was designated in the contract as irrevocable. If information, materials, or copies are jointly owned, the party in possession or control shall make the materials or copies thereof available to the other joint owner.

(b) Each party is entitled to enforce by judicial process its rights under subsection (a). To the extent necessary to enforce those rights, a court may order the party or an officer of the court to:

(1) take possession of copies or any other materials to be returned under subsection (a);

(2) render unusable or eliminate the capability to exercise rights in the licensed information and any other materials to be returned under subsection (a) without removal;

(3) destroy or prevent access to any record, data, or files containing the licensed information and any other materials to be returned under subsection (a) under the control or in the possession of the other party; and

(4) require that the party in possession or control of the licensed information and any other materials to be returned under subsection (a) assemble and make them available to the other party at a place designated by that other party or destroy records containing the materials.

(c) In an appropriate case, the court may grant injunctive relief to enforce the rights under this section.

(d) A party may utilize electronic means to enforce termination without judicial process pursuant to Section 2B-320. If termination is for reasons other than expiration of the license term, the party terminating the contract by electronic means shall notify the other party before using the electronic means.

Uniform Law Source: None.
Coordinating Meeting: Subject matter differences.
Selected Issue: Does the section properly balance rights in the absence of breach?

1. This section only deals with licenses and does not include sales or other forms of software contracts that are not a license. Subsection (a) states the unexceptional principle that the expiration of the contract term justifies immediate termination of contract rights and performance.

2. Termination, of course, differs from cancellation in that cancellation applies only in cases of ending a contract for breach. The provision of subsection (c) is not intended to blur that distinction, but to protect a party from loss through simple mislabeling of its conduct. There are greater procedural and substantive safeguards interjected in reference to electronic cancellation in the section on that issue.

3. Subsection (d) deals with electronic means to enforce contract rights, a phenomenon present in digital information products, but not generally available in more traditional types of commercial products. The provisions here involve use of electronics to enforce contract rights that are not characterized by enforcing a breach

of the agreement. Enforcement in the event of material breach is discussed in 2B-712. The ability to use electronic means to effectuate a termination does **not** allow use of those means to destroy or recapture records, **but merely enables the licensor to preclude further use of the information.** Section 2B-320 requires notice in the contract, except in stated cases. The electronic means to enforce termination would include, for example, a calendar or a counter that monitors and then ends the ability to use a program after a given number of days, hours, or uses, whichever constitutes the applicable contract term.

Illustration 1: Sun licenses Crocker to use a word processing system for one use; the system operates through the internet and the use of mini-program modules that are downloaded into the system as needed and remain in the system for brief periods. The license as to each applet terminates at the end of its brief use period. This section allows the use of electronic means to effectuate that termination.

PART 7

REMEDIES

[A. In General]

SECTION 2B-701. REMEDIES AND DAMAGES IN GENERAL.

(a) The remedies provided in this article 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 otherwise provided in this article, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of reasonable systems for backup or retrieval of lost information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(c) Rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury.

(d) Except as otherwise provided in a term liquidating damages for breach of contract, 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. If a remedy cannot reasonably be applied to a particular performance, the remedy is not available.

~~[~~(e) In a case involving published informational content, ~~or a nonmaterial breach that does not cause personal injury,~~ neither party is entitled to consequential damages unless the agreement expressly so provides.~~]~~

(f) If a party breaches a contract and the breach is material as to the entire contract, the other party may exercise or pursue all remedies available under this article or the agreement, subject to the conditions and limitations applicable to the remedy, including remedies available for nonmaterial breach. If a breach is material only as to a particular performance, the remedies may be exercised only as to that performance.

(g) If a party breaches a contract, except as limited by the contract, the aggrieved party may recover any unpaid license fees and royalties for performance accepted by the party in breach but not yet paid, and recover other [direct] [general] damages incurred in the ordinary course as measured in any reasonable manner, including, in the case of a proper refusal of a tender of a copy under 2B-608, any fee already paid for the refused copy; together with incidental and consequential damages less expenses avoided as a result of the breach.

(h) The remedy for breach of contract relating to disclosure or misuse of information in which the aggrieved party has a right of confidentiality or holds as a trade secret may include compensation based on the benefit received by the party in breach as a result of the breach. A remedy under the agreement or under this article for breach of confidentiality is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.

(i~~g~~) If a party is in breach of contract, the party seeking enforcement has the rights and remedies provided in this article and the agreement and may enforce the rights and remedies available to it under other law.

Committee Votes:

a. Voted 7-6 in March, 1996 to allow consequential damages only in cases where the parties agreed to provide for that remedy.

b. Voted 14-0 in September, 1996, to return to consequential damages rule of common law, but to consider specific types of circumstances in which consequential damages should be allowed only if agreed to by the parties.

c. Voted 5-7 in December, 1996, to reject a motion to reverse the consequential damages presumption in the case of a battle of forms.

d. Consensus in December, 1996, to retain the exception for consequential damages in reference to published informational content.

Uniform Law Source: Section 2A-523. Revised.

Coordination Meeting: Differences in approach acceptable.

Selected Issues:

1. Should the article contain sections summarizing the remedies for each party and making a cross-reference as in Article 2A?

Reporter's Note:

[New subsection (g) is taken from former Section 2B-702 which provided a measure of damages applicable to nonmaterial and material breaches. The terms of that section were modified at the request of consumer groups to clarify that refusal of a tender (under the perfect tender or the substantial performance rule) triggers a right to recover money paid (e.g., a refund).]

1. This section organizes a number of principles relating to administration of the damages and general remedies provisions of the article. It tracks a similar set of general principles in draft Article 2, but adds several concepts specifically applicable to transactions covering information. The prior draft excluded consequential damages as a remedy unless agreed to by the parties, but this draft reinstates the common law concept of consequentials being available unless excluded by contract. The earlier position was based on ordinary commercial practice and the idea that a commercial statute should reflect what parties would agree to in most cases if the contract were fully negotiated. Neither position affects personal injury issues under tort law. As discussed below, the Committee plans to review specific cases for whether the consequential damages rule should not apply.

2. Subsection (a) restates a basic theme of contract law remedies: placing a party in the position that would occur if performance had occurred as agreed. This language could be deleted as not necessary, but gives explicit guidance to a court and to parties to a contract. Section 1-106(1) provides that "remedies ... shall be administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed ...."

3. Subsection (b) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. The idea that an injured party must mitigate its damages permeates contract law jurisprudence, but has never previously been stated in the UCC. The basic principle flows from the idea that remedies are not punitive in nature, but compensatory. Especially in context of the information products considered here, the need to consider whether mitigating efforts occurred are significant given the potentially wide ranging losses that breach might entail.

4. Subsection (c) provides that the remedies in this article are cumulative and there is no concept of election of remedies such as would bar seeking multiple forms of remedy. This is a fundamental approach in the UCC and expressed in Section 2A-501(4) as to leases. This cap is appropriate for contract-related remedies.

5. Subsection (d) gives the court a right to deny a remedy if it would place the injured party in a <u>substantially better position</u> 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 <u>substantial</u> injustice. The basic remedies model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation idea as a safeguard. This issue was debated in Article 2 and the term “substantially” was deleted in an apparent decision to allow the court to entirely control the choice of damage computation. That decision is not as appropriate in context of the myriad transactions considered in Article 2B, where the best measure of recover is not always clear. However, some safeguard is important.

6. In deciding to reinstate the common law consequential damage rule, which holds that such damages are available to either party harmed by a breach unless the contract disclaims or limits this liability, the Committee concluded that it should consider situations in which that rule would not be appropriate for the commercial transactions that this article considers. This leaves open issues about in what contexts the rule should be modified. The second sentence of subsection (d) suggest two contexts. Both are important. In addition, however, the Committee should consider the broader issue of what criteria apply in choosing or rejecting the idea that, for a specific context, consequential damage risk should not apply unless the parties agree to make it available.

7. An extensive body of academic literature exists about the effect of a rule that imposes consequential damages unless disclaimed. For several years, many argued that the rule creates a "penalty default" by forcing a party with special knowledge of risks to disclose those risks and bargain around them. The more recent literature, however, concludes that no proof can be developed that this occurs in ordinary, real world contexts and that the effect of the rule presuming consequential damages cannot be shown to be efficient or non-efficient if one considers the full, complex environment in which contracting actually occurs. This judgment leaves open the question of how one makes decisions about when or whether the presumption should be applied or rejected. While one might believe on faith that the rule forces one or the other party to negotiate around it if they have special information, that theory does not withstand analysis if one assumes a real world, rather than an abstract context. The alternative belief is that, by denying consequential recovery in the absence of express agreement, law places the onus on a party with special knowledge of risk to step forward and obtain coverage for that risk expressly. A failure to do so allows the risk to stay with the silent party and avoids placing unpredictable liability risk on the other.

8. As a matter of policy, there are various contexts in which one could decide that consequential damages should not be imposed unless expressly agreed to by the parties. The two suggested in this section are discussed in the next note. Among others indicated as plausible by comments received are the following:

(1) Not presumed in commercial (non-mass market) transactions

(2) Not presumed except for bad faith conduct

(3) Not presumed except for foreseeable personal injury damages

(4) Not presumed in an exchange of conflicting standard forms

(5) Not presumed where the transaction emphasizes low cost, high volume and consequential damage risk would stifle commerce or hugely increase costs

(6) Not presumed if the risk would restrict distribution of information that should be widely and broadly available.

(7) Not presumed if the typical licensor is a small entity that cannot sustain the risk and continue to function.

(8) Not presumed unless one party is clearly in a stronger economic position than the other party.

What this indicates is that various approaches are reasonable, but some concept of when and why the consequential damage theme should be used or reversed must be considered by the committee. Unlike in revisions of Article 2 and 2A, the range of topics considered in Article 2B includes many setting in which, under current law, consequential damage risk is not present unless a party agrees to accept that risk.

9. This draft excludes consequential damages for "published informational **content**." As noted elsewhere, published informational (Internet and newspaper) invokes many fundamental and important values of our society. Whether characterized under a First Amendment analysis or treated as a question of simple social policy, our culture has a valued interest in promoting the dissemination of information, this Article should take a position that strongly advocates support and encouragement of broad distribution of information content to the public. Indeed, a decision to do otherwise would place this Article in diametric contrast to how modern law has developed. One aspect of promoting publication of information is to reduce the liability risk; that principle has generated a series of Supreme Court rulings that deal with defamation and libel. Beyond the global concern about encouraging information flow, there are other principles that suggest the same result. As indicated in the definition of published informational content, the context involves one in which the content provider does not deal directly with the data recipient in a setting involving special reliance interests. The information is merely compiled and published. That activity should be sustained. Furthermore, the information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. Finally, with few exceptions, modern law recognizes the liability limit even under tort law and the exclusion would merely decline to change the law on this issue. The Restatement of Torts, for example, limits exposure for negligent error in data to cases involving an intended recipient and even then to "pecuniary loss" which courts typically interpret as direct damages.

Illustration 1: Dow Jones distributes general stock market and financial transaction information through sales of newspapers and in an on-line format for a fee of $5 per hour or $1 per copy. Dow, the financial officer of Dupond, reviews information in the online system and relied on an error to trade 1 million shares of Acme at a price that caused a $10 million loss. If Dupond was in a situation of special reliance on Dow Jones, the consequential loss would be recoverable. If this is published content, Dupond cannot recover for the consequential loss.

Illustration 2: Disney licenses a motion picture to Vision Theaters. Vision shows the movie to audiences under a ticket contract that qualifies as an access contract (e.g., on-line). One member of the audience who pays five dollars hates the movie and spends a sleepless week because the movie was more violent than expected. That audience member should have no recovery at all, but if it can show that there was a breach, the individual could not recover consequential loss because this is published content. If liability for a violent movie exists, it exists only under tort law.

10 Instead of the provisions in subsection (d), prior drafts included a summary and detailed list of remedies available to licensors and licensees. This was deleted based on stylistic questions, but the Committee should consider whether that approach should be reinstated.

11. Subsection (g) was moved here for style reasons. It defines a broad approach to remedies intended to cover the myriad of contexts that are potentially encountered within this Article. Unlike in current Article 2, reliance on formula-driven damage computation is not appropriate in Article 2B. Breach does not always or even primarily entail defects in delivered products or failures to pay by a recipient (e.g., buyer). The Article covers a wide range of performances and this section allows a court and a party to resort to general, common sense approaches to damage computation for such occurrences. Article 2A-523(2) provides for recovery of "the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner … less expenses saved in consequence of the lessee's default."

12. Consistent with the approach of this Article to damages, this section makes clear that a party may elect to use this measure in the case of either material or non-material breach. This election is subject to general limitations on double recovery and the like. However, the principle is that the aggrieved party controls the choice, while the court (or jury) controls the computation. The <u>Restatement (Second)</u> provides for computation of damages in the following manner: "Subject to [limitations], the injured party has a right to damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or deficient, **plus** (b) any other loss, including incidental or consequential loss, caused by the breach, **less** (c) any cost or other loss that he has avoided by not having to perform.**"**

13. Subsection (g) maintains the distinction between general or direct damages and consequential damages. The measurement provided here is intended to relate only to direct loss and the definition suggested in 2B-102 should be considered in placing limitations on this concept. That definition provides: **"**Direct [general] damage" means compensation for losses to a party consisting of the difference between the value of the expected performance and the value of the performance received." Direct [or general] damage refers to the value of the performance, while consequential loss refers to foreseeable resulting losses caused by breach.

Illustration 3: OnLine Corp. provides access to stock market price quotations for a fee of $1,000 per hour. It fails to have the system available during a period that proves to be critical for Meri-Lynch, a client, during a ten minute period. Meri-Lynch can recover as direct damages under this formula, the value of the breached performance (e.g., the difference in the value of the monthly performance if perfect and as delivered), but losses from not being able to place profitable investments during the ten minute period are consequential damages, if recoverable at all.

Illustration 4: Sizemore Software licensed its database software to General Motors, restricting the licensed use to no more than twenty simultaneous users. General Motors used the system with an average of twenty two simultaneous users over a two month period. Sizemore can recover as direct damages the difference in the value of a twenty-two person license for the applicable term and the value of the twenty person license, or may recover the value difference as measured in any reasonable manner. The excessive use is also likely to constitute copyright infringement.

14. Illustration 3 brings up a question that permeates the damages issues and requires further drafting and analysis. The question is whether the use in violation of a contractual limitation yields consequential or direct damages under the current framework and how it would be treated in a different framework of damages

classifications?

~~**SECTION 2B-702. DAMAGES FOR NONMATERIAL BREACH OF CONTRACT.**~~ **[moved to 2B-701(g)]**

~~**SECTION 2B-703. LOSS OF CONFIDENTIAL INFORMATION.** An aggrieved party that has a right or interest in confidential or trade secret information may recover as consequential damages an amount as measured in any reasonable manner that compensates it for any loss of, or damage to, the party's interest or right in that information caused by a breach of contract involving disclosure of the information.~~

SECTION 2B-703~~4~~. CANCELLATION: EFFECT.

(a) A party may cancel a contract if the other party's conduct constitutes a material breach which has not been cured or if the contract so provides.

(b) Cancellation is not effective until the canceling party notifies the other party of cancellation.

(c) On cancellation, a party in possession or control of information, materials, or copies shall comply with ~~[~~Section 2B-623~~9~~(a)~~]~~.

(d) On cancellation, all obligations that are executory at the time of cancellation are discharged. However, the rights, duties, and remedies described in Section 2B-626~~7~~(b) survive cancellation.

(e) A contractual term providing that a licensee's rights may not be canceled is enforceable and precludes cancellation as to those rights. However, a party whose right to cancel is limited retains all other rights and remedies under this article or the contract.

(f) Unless a contrary intention clearly appears, language of cancellation, rescission, or avoidance or similar language is not 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.
Coordination Meeting: Article 2B should generally conform to Article 2, but retain structural differences.
Selected Issue:

1. Should the section be approved?

Reporter's Note:
[Comments will indicate that, in the case of a single delivery in the mass market, refusal of that delivery obviates a need to cancel the contract, refusal itself does this and the standards there control. Additionally, the commentary discussion will indicate that methodology of cancellation can be effectively outlined in the contract.]

1. This section outlines the remedy of cancellation. In UCC terminology, cancellation means putting an end to the contract **for breach** and is distinct from termination (this terminology is not necessarily common in licensing practice, which tends to treat ending the contract for breach as a termination of the contract). In this article, the right to cancel exists **only** if the breaching party's conduct constitutes a **material breach** of the entire contract or if the contract creates the right to cancel under the circumstances. There is substantial case law in licensing and other contexts on this point. The concept of a breach material as to the entire contract is also found in Article 2A (Section 2A-523) and Article 2 (installment contracts). Interestingly, Article 2A defines any failure to pay rent as such a breach, while this draft treats non-payment of fees as material only if substantial. The primary issue in this section concerns whether the injured party must give notice to the other party before the cancellation for material breach is effective.

2. In an ongoing relationship, the remedy of cancellation is important to the injured party because it obviates the party's duty to continue to perform executory obligations under the agreement. In licenses that involve intellectual property rights, cancellation or termination are relevant not only as contract remedies, but 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 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, but both types of recovery exist and the ability to cancel the license may trigger the intellectual property recovery right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228 (2d Cir.1982). A license is a permit granted by the licensor to the licensee that allows the licensee to use, access or take whatever other actions are contracted for with respect to the intangibles without threat of infringement action by the licensor. If the license terminates, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying intellectual property rights of the licensor exposes itself to an infringement claim. Intellectual property remedies are in addition to contract remedies. The infringement and the contract remedies deal with a different injury (breach of contract expectation vs damage to exclusive rights).

3. The right to cancel (rescind) the license and pursue an infringement claim in lieu of or in tandem with the contract claim is important in two respects unique to information contracting. First, if the information is covered by federal intellectual property law, the infringement claim places the licensor within **exclusive** federal court jurisdiction. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992). Schoenberg comments: "If the breach would create a right of rescission, then the asserted claim arises under the Copyright Act." In order to sue for infringement (in addition to or in lieu of the breach of contract), the licensor must establish that the contract no longer grants permission to the licensee to do what it alleges that the licensee is doing. A contract claim arises under state law and comes under federal jurisdiction under diversity or pendent jurisdiction concepts. Second, licensors often prefer intellectual property remedies, rather than contract remedies because the recovery is greater and there is a clearer right to prevent further use. Damages for copyright infringement include "actual damages suffered by [the copyright owner] as a result of the infringement **and** any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages...." 17 U.S.C. ' 504(b). There is also a

statutory damages provision.

4. Of course, the fact that a material breach occurred does not require the injured party to cancel. It may continue to perform and collect damages under other remedial provisions. Under the section dealing with cure, the ability to cure a material breach is subject to the injured party's right to cancel. Thus, there is no obligation to wait for a possible cure. Cancellation may be immediate. However, if cure precedes cancellation, cure precludes cancellation.

5 In this draft, cancellation is effective when the injured party notifies the other party of this act. Since the right to cancel arises in the event of a **material** breach, the equities favor optimal flexibility for the injured party. Nevertheless, the draft does not allow cancellation without any effort to notify the breaching party. "Notifies" is defined in Article 1 (1-201(26)) as taking steps reasonably required to inform the other party of the fact, but does not require **receipt** of the notice. An obligation to ensure receipt would be inconsistent with the balance of rights here and other law, such as in Article 9. Since cancellation requires a material breach, however, the Committee should consider whether an precondition of giving notice should be imposed at all or whether, at least in some cases, cancellation without notice is appropriate.

6. Subsection (e) clarifies the enforceability of contract terms that provide that a licensee's right cannot be canceled, even for material breach. These have importance in transactions where the licensee contemplates distribution of the information product developed or licensed by the other party and makes a significant investment in developing the information product based on the license. The non-cancellation term has as much or more importance in information industries as does the refund and replacement term in transactions involving the sale of goods.

Subsection (f) is from original Article 2.

SECTION 2B-7045. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance of any obligation, other than the obligation to pay a fee for information or services already received, if:

(1) the agreement expressly provides for that remedy and specific performance is possible; or

(2) the contract was not for personal services, but the agreed performance is unique and monetary compensation would be inadequate.

(b) A decree for specific performance may contain any terms and conditions the court considers just, but must provide adequate safeguards consistent with the terms of the contract to protect the confidential information and intellectual property of the party ordered to perform.

(c) An aggrieved party has a right to recover information that was to be transferred to and thereafter owned by it, if the information exists in a form capable of being transferred and, after reasonable efforts, the aggrieved party is unable to effect reasonable cover or the circumstances indicate that an effort to obtain cover would be unavailing.

Uniform Law Source: 2A-521. Section 2-716. Revised.
Coordination Meeting: Article 2B should generally conform to Article 2 approach, but retain special treatment of confidentiality.
Issues: Should subsection (a)(1) be deleted as an inappropriate attempt to confer equitable jurisdiction.
Reporter's Notes:
[There was substantial debate about the appropriateness of subsection (a)(1) but no motions or consensus reached at the December meeting.]

1. This section explicitly affirms the right of parties to contract for specific performance, so long as a court can administer that remedy. Literature clearly supports that this contractual option promotes freedom and flexibility of contract. This premise is consistent with the overall approach in this Article to favor and support freedom of contract. The principle excludes the obligation to pay a fee, however, since this is essentially equivalent to a monetary judgment and not relevant to the principle of contract remedy choice. [Comments will discuss how this works with respect to development contracts; it depends on the type of commitment made in the contract.]

2. The second principle in subsection (a) outlines a common basis for specific performance (the unique nature of the performance). That principle cannot apply to a “personal services contract” in light of traditional concerns about not imposing judicial obligations requiring work or services by an individual. Article 2 does not deal with this latter issue, since it is not involved in transactions that might fall within this category. Excluding specific performance of the price element of a contract avoids creating a surrogate form of contempt proceeding. Of course, if there is a specific performance order requiring transfer of property under court order, a reciprocal obligation to pay any relevant fees is an appropriate condition of the specific performance decree.

3. Article 2 allows specific performance "where the goods are unique or in other proper circumstances." UCC " 2-716(1). The comments state: "without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with specific performance of contracts of sale." UCC ' 2-716, comment 1. There are few cases ordering specific performance in a sale of goods. In most cases, a court concludes that adequate substitutes are available and that any differences in quality or cost can be compensated for by an award of damages. Article 2A has a similar specific performance section. ' 2A-521.

4. In common law, despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance in the form of allowing the licensee continued use of the property. Courts often rule that a monetary award fits the circumstances, unless the need for continued access is compelling. See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985); Johnson & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co., 715 F. Supp. 110 (D. Del. 1989). Very few cases award specific performance in information-related contracts.

5. The Restatement (Second) of Contracts distinguishes between specific performance awards and injunctive relief. Restatement (Second) of Contracts ' 357. Specific performance relates to ordering activity consistent with the contract. The most common use concerns injunctions against acts that the defendant promise to forebear or mandatory injunctions demanding performance of a duty that is central to preserving the licensor's position. The Restatement states: "The most significant is the rule that specific performance or an injunction will not be granted if damages are an adequate remedy [to protect the expectation interest of the injured party]." Restatement (Second) of Contracts ' 357, Introductory note. Non-uniform case law deals with under what circumstances a damage award is or will be considered to be inadequate. The Restatement catalogues the following circumstances under which damages may be inadequate:

> (a) the difficulty of providing damages with reasonable certainty,
> (b) the difficulty of procuring a suitable substitute performance by means of money ...,
> (c) the likelihood that an award of damages could not be collected.

Restatement (Second) of Contracts ' 360. The most frequently discussed illustrations of when these conditions are sufficiently met are cases in which the subject matter of the contract is unique.

6. Subsection (b) recognizes judicial discretion, but provides an important protection for confidential information that is relevant for both the licensor and the licensee. The section casts the balance in favor of a party not being required to specifically perform in cases where that performance would jeopardize interests in confidential

information of the party. Confidentiality and intellectual property interests must be adequately dealt with in any specific performance award. Article 2A allows the court to order conditions that it deems just, but does not deal with confidentiality issues.

7. Subsection (c) creates an important right for a licensee It adapts language from Article 2 and Article 2A to give the licensee a right to force completion of a contractual transfer if, at the time of breach, the information is capable of being identified and the contract contemplated that the licensee would own the information product had the transaction been fully performed. It applies in cases where the contract calls for a transfer of the intangibles, not merely rights to use. This occurs, for example, in cases of software development where the software is at least partially developed, but not yet delivered to the transferee. See, e.g., In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (uses Article 2 title rules to resolve rights in incomplete software in a bankruptcy proceeding).

SECTION 2B-7056. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may add to, limit, or provide a substitute for the measure of damages recoverable for breach of contract, or limit a party's other remedies such as by precluding the licensor's right to cancel or limiting the remedies to return of all copies of the information and refund of the license fee, or repair and replacement of copies of the information by the licensor.

(b) Resort to a modified or limited remedy is optional, but a remedy expressly described as exclusive precludes resort to other remedies. However, if the agreed remedy requires performance by the party that breached the contract and the performance of that party in providing the agreed remedy fails to give the other party the remedy, the aggrieved party is entitled to specific enforcement of the agreed remedy, or to the extent that the agreed remedy failed, subject to subsection (c), to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of separate terms relating to consequential or incidental damages unless the separate terms are expressly made subject to the performance of the agreed remedy.

(d) Consequential damages and incidental damages may be excluded or limited by agreement, unless the exclusion or limitation is unconscionable. A conspicuous term enforceable under this Section is not subject to invalidation under 2B-308(b).

Uniform Law Source: Section 2-719 (revised).
Coordination Meeting: Any decision on conformity is premature.

Selected Issue:

a. Should the section be adopted as drafted?

Reporter's Note:

[There was substantial discussion in December of the concept of " minimum adequate remedy" which is in the commentary, but not the statutory language, of existing Article 2 and has been adopted in some states, but probably a minority. Proposed Article 2 revisions elevate that to black letter. There was no motion to this effect in the December meeting. Discussion in support of the concept suggested that it could be implicitly or expressly restricted to a remedy such as refund.]

1. This section was rewritten to reflect decision of the Drafting Committee regarding consequential damages. Since consequential damages are presumed unless disclaimed, the section no longer provides a standard for inclusion of such damages in the form of manifest assent. The section contains numerous differences from the treatment of similar issues currently proposed in Article 2.

2. Subsection (a) validates the ability of parties to contractually limit and shape remedies. It generally conforms to current law, but lists additional remedy limitations (e.g., non-cancellation) that are relevant in information transactions, but not in modern sale of goods law. The list does not purport to be an exclusive exposition of what options are appropriate, but to provide guidance on what options are clearly acceptable, if performed.

3. Subsection (b) begins with language from current article 2: a contractual remedy is not the exclusive remedy unless the terms of the contract expressly so provide. The second sentence of subsection (b) clarifies language used in current Article 2 which provides that the contractual limit is obviated if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential purpose". This language has led to a myriad of case law rulings and does not truly identify what is at issue in failed remedy cases. The need for clarification was suggested from the floor of the NCCUSL meeting in 1995. The basic principle is that, if a party agrees to some performance as a remedy in lieu of other remedies, its failure or inability to perform its own agreement on remedies vitiates the remedy limitation or allows specific performance at the aggrieved party's option. Language in this draft and in revisions of Article 2 differs on this point.

3a. The provision regarding exclusive remedies must be interpreted in this context as not being exclusive as to all "rights" of a party, such as the right to prohibit use or copying, or disclosure.

4. This Draft does not restate the sales law presumption that exclusion of loss for personal injury in **consumer** cases is unconscionable. Case law holds that in information products and services, reliance on inaccurate information does not cause liability even in the case of personal injury to the relying party except in unusual cases or cases of digital software incorporated into more general products. Sales law concepts of products liability are not generally present in reference to information. An assumption that limitation of such loss is wrongful is not appropriate since the availability of such a remedy is not generally established in law. The draft simply takes no position on this issue.

5. Subsection (c) deals with a controversial topic that has produced inconsistent results in litigation. It concerns whether a failure of a limited remedy causes a failure of a limit or exclusion of consequential damages. Case law under Article 2 splits; most states holding that the failure of one remedy does not necessarily exclude enforceability of the other limitation. This draft takes the position that the two contract terms are separate unless made dependent by the agreement. Draft revisions of Article 2 also change the standard; the current draft provides **that, on the failure of a limited remedy, "agreed remedies outside the scope of and not dependent on the failed agreed remedy are enforceable as provided in this Section."**

SECTION 2B-706~~7~~. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach of contract by either party may be liquidated in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. A term fixing unreasonably large liquidated damages is unenforceable. If a term liquidating damages is unenforceable, the aggrieved party has the remedies provided in this article or the agreement.

(b) A party in breach is entitled to restitution of the amount by which the payments it made for which performance was not received exceeds the amount to which the other party is entitled under terms liquidating damages in accordance with subsection (a).

(c) A party's right under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under this article or the agreement other than under the terms liquidating damages in accordance with subsection (a).

Uniform Law Source: 2-718. Revised.
Coordination Meeting: Conform to Article 2 given that standard is clarified that compliance with either element of the test validates the liquidated damages.
Committee/ Other votes:
1. At the annual meeting, in reference to Article 2, that Drafting Committee accepted a motion from the floor to clarify that no after the fact determination of excessive or too minimal damages is intended.
Reporter's Note:
[A sentence is added to subsection (a) at the suggestion of a consumer representative to clarify the effect of not meeting the stated standard.

This draft continues the presumption that contractual choices should be enforced unless there is a clear, contrary policy reason to prevent enforcement or there is over-reaching. If the choice made by the parties was based on their assessment of choices at the time of the contract, that choice should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party.

SECTION 2B-707~~8~~. STATUTE OF LIMITATIONS.

(a) An action for breach of contract under this article must be commenced within the later of four years after the right of action accrues or one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued. By agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues ~~[~~and may extend it to a term of not longer than 8~~10~~ years.~~]~~ ~~[and the period may not be extended].~~

(b) A right of action accrues when the act or omission constituting the breach occurs or should have occurred, even if the aggrieved party~~'s~~ did not know of the breach. Breach of warranty occurs when the transfer of rights occurs, except that if a warranty extends to future conduct, breach of warranty occurs when the conduct occurs, but no later than the date the warranty expires.

(c) A right of action for breach of ~~the~~ warranty under 2B-401 ~~of noninfringement or~~ or for a breach of contract involving disclosure or misuse of confidential information accrues on the later of when the act or omission constituting the breach is or should have been discovered by the aggrieved party. A cause of action for indemnity accrues on the later of when the act or omission that constitutes a breach of the obligation to indemnify is or should have been discovered by the indemnified party.

(d) This section does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; 2-725. Revised.
Coordination Meeting: Differences in subject matter and transaction justify different rules.
Selected Issues:

1. Should the section be approved?

Reporter's Note:
[Language on indemnity was added based on discussion at the December meeting.]

1. This section combines a discovery rule with a rule of repose, based on discussion of the Drafting Committee in January, 1996. The discovery rule extends the overall limitations period for one additional year if applicable.

2. The cause of action as a general rule in this draft when the <u>conduct constituting</u> a breach occurs. In ordinary warranties, including all implied warranties, the warranty is met or breached on delivery of a product or service, even if the performance problem may not appear until later. Performance, in the sense of the operations of a program, is not the measure of when the breach occurs. Performance in the sense of completion of one's required conduct in the transaction is the appropriate measure.

3. This draft follows Article 2A and Article 2 regarding a four year limit for the contract action, but allows extension by one year if the breach could not have been discovered earlier. Article 2A adopts a "discovery" rule. In a license, this can create an extended period of exposure to suit because of the long term nature of the contract and because many defects in software and similar intangibles do not become manifest until particular conditions arise. Additionally, of course, breaches occur during the contract performance and do not relate to circumstances present at the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause of action arises, except in cases where warranty extends to future performance and the breach cannot be discerned until that performance occurs. In most warranty cases, the breach of warranty arises on delivery. See <u>Intermedics, Inc. v. Ventritex, Inc</u>., No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) (cause of action for contract breach related to the misappropriation would not entail a continuing breach); <u>Computer Associates International, Inc. v. Altai, Inc.</u>, (Tex. 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute of limitations in trade secret misappropriation claim). A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

4. Subsection (a) applies the basic principle of contract freedom and holds that parties can contract for a longer period of limitations than under the statute. Current Article 2 precludes this, but modern practice

routinely allows and relies on “tolling agreements” in contractual disputes. The basic issue is whether a contract can extend as well as limit the term. The draft allows extension with a ten year maximum. Draft Article 2 retains the non-extension rule, and precludes shortening the term for consumer contracts.

5. This section deletes the "future performance" remedy exception as defined in current Article 2 and substitutes a standard that avoids the litigation that the current standard generates. In current Article 2, the time of accrual standard is dropped entirely if a warranty extends to future performance. The basic decision to be made is whether a breach occurs when the actions that relate to it did or should have occurred, or whether a discovery rule applies.

[B. Licensor=s Remedies]

SECTION 2B-708~~9~~. LICENSOR'S DAMAGES FOR BREACH OF CONTRACT.

(a) Subject to subsection (c), for a material breach of contract by a licensee, the licensor may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, accrued and unpaid license fees for any performance for which the licensor has not been paid, plus:

(A) the present value of the total unaccrued license fees for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;

(B) the present value of the profit and general overhead which the licensor would have received from full performance by the licensee; or

(C) damages calculated pursuant to Section 2B-702; and

(2) the present value of any consequential and incidental damages, as permitted under this article and the agreement, determined as of the date of entry of the judgment.

(b) The date for determining present value of unaccrued license fees and date for determining the sum of accrued license fees under subsection (a) is:

(1) if the licensee never received a transfer of rights, the date of the breach of contract;

(2) if the licensor cancels and discontinues the right to possession or use, the date

the licensee no longer had ~~possession of or~~ the actual ability to use the information; or

(3) if the licensee=s rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.

(c) To the extent necessary to obtain a full recovery, a licensor may use any combination of damages provided in subsection (a), but damages must be reduced by due allowance for the proceeds of any substitute transaction entered into by the licensor regarding the same subject matter and made possible by the breach.

Uniform Law Source: Section 2A-528; Section 2-708. Revised.
Coordination Meeting: Differences in subject matter cause different approaches.
Selected Issue:

1. Should the parties be able to contractually select a discount rate?
2. Are the specific formulas appropriate?
3. Should the section be approved?

Reporter's Note:

1. This section gives the licensor a right to elect damages under any of three measures described in (a), the third standard, of course, being a general and opened approach to damages that allows consideration of special circumstances. Including this third, general option is consistent with the approach of Article 2A-523(2). As is also true for licensee remedies, the basic principle assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables a double recovery. Thus, no order of preference is stated for the three options.

2. Licensor 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 digital information assets are prime candidates for damage assessment focusing on net return or profit lost to the licensor. Most importantly, this draft eliminates the resale 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.

3. The three measures reflect the nature of the subject matter. Unlike with reference to goods, information can be replicated many times over with little cost or none. Thus, the remedies do not relate to resale or re-license of the particular diskette or copy. Instead, the approach taken here allows a court to consider cost savings and alternative transactions made possible by the breach. The general reference to alternative transactions is in subsection (c). This due allowance approach is borrowed from Article 2A and is very appropriate in this setting because of the nature of the subject matter. Similar language is employed in the **Restatement.** In addition, of course, the injured licensor is also subject to an obligation to mitigate damages.

> **Illustration 1:** Chamlers agrees to supply a master disk of its software to Wilson Distributing and agrees to allow Wilson to distribute 10,000 copies of the software in a wholesale marketplace. This is a nonexclusive license. The cost of the license is $1 million. The cost of the disk is $5. Wilson fails to pay, but instead repudiates the contract. Under (a)(1)(A), Chambers recovers $1 million less the $5. Chambers recovery is also to be reduced by (1) proof of any alternative transaction made possible by this breach (e.g., another transaction in a market created by the lack of the 10,000 products, and (2) by any issue about his failure to mitigate under 2B-701.

Illustration 2: Same as in Illustration 1, except that the contract also requires Chambers to deliver manuals, boxes and other distribution materials for Wilson to distribute the software. The cost of 10,000 of these materials is approximately $800,000. In computing damages, the $800,000 cost savings is deducted from the $1 million. In considering what "due allowance" should be made for any alternative transactions, a court should take into account that this expense adjustment already reflects some accommodation to the alternative transaction, but if a second deal had the same terms, the issue would be whether the second transaction was made possible by the breach.

Illustration 3: Same as Illustration 1, but the license was a worldwide exclusive license. On breach, Chambers makes a similar license with Second Distributor for a fee of $900,000. This transaction was possible because the first was canceled. Chambers recovery is $100,000 less any net cost savings that are not accounted for in the second transaction.

4. The lost profits concept, of course, parallels the approach taken in (a)(1)(A), but allows flexibility in computation. It, too, is subject to the possibility that a transaction made possible by the breach will apply to diminish the recovery. See Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996) (discussing of the application of the alternative transaction concept in reference to a lost profits claim relating to a license breach.

Illustration 4: Compart licenses robotics software designed to operate aircraft engine plants making a particular type of engine. There are five such plants in the world. One is operated by Boeing. Boeing decides to sell the plant to Douglas and, since the license is not transferable, it repudiates the license at the time of sale. Douglas enters into a separate license with Compart. The second transaction was made possible solely because of the breach by Boeing. The profit and license fees it generates off-sets any profit or fees lost in the Boeing breach.

Illustration 5: Parkins grants an exclusive license to Telemart to distribute products comprised of copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches the license and Parkins cancels. It sues for damages. Its recovery is the present value of the remaining license fees with due allowance for alternative transactions made available by virtue of the breach and subject to a duty to mitigate. Here, since the breached license was exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution of the encyclopedia.

5. The damages rules follow common law and give both the licensor and the licensee a right to consequential damages. Current Article 2 law does not allow consequential recovery for the seller, but the common law rule here is more appropriate because the effect of a default on the licensor's interests may and often does go beyond the confines of the particular contract price. 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. Recovery, of course, is limited by the principle that the loss must be proven with reasonable certainty. See ' 352. The **UN Sales Convention** applies the same damages approach to the buyer as to the seller. UN Convention art. 74.

6. If the breach relates to use or disclosure restrictions, consequential damages~~losses~~ are appropriate. Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) involved a patent license dealing with manufacturing which 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 was enforceable even though not limited to patent infringement or to confidential material. It was breached when the licensee incorporated features and designs into other 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.

7. In United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) the license involved an exclusive agreement between the licensor of a book and the projected paperback edition publisher. The

licensor was the hardcover publisher. The breach occurred when the licensee published and distributed over a million copies of the book in paperback before the date permitted under the contract. Premature publication did not constitute copyright infringement because the exclusive licensee was, essentially, the owner of the copyright for purposes of paperback publication and could not infringe its own property right. The premature publication did breach the contract entitling the licensor to lost profits caused by the effect of early publication on the sales of hard copies.

8. In the cases noted above, a question arises about when present value will be determined to computer damages. The Section provides that, for consequential damages, present values are measured as of the date of the entry of the judgment. The section distinguishes between license fees and royalties on the one hand (as direct damages) and consequential damages on the other. As to the direct damages, a distinction will often be required between when a fee is accrued and when a fee is not accrued. The provisions of subsection (b) provide guidance on this issue, making computation of accrued and unaccrued fees occur on the same date.

> **Illustration 6:** A five year license requires that the Sony pay a $5 royalty to Smith, the licensor, for each copy of the Power Rangers video game that it produces for the retail market from a master copy given to it by the licensor. Payments are made on a monthly basis. After non-payment for three months, Smith notifies Sony that it is canceling the license. Assume that $50,000 of royalty fees would accrue each month of the ten year contract. Under (b)(2), the date for distinguishing accrued and unaccrued fees arises when Sony no longer had possession or the ability to continue use of the information. Assume that it returned the master disk at the end of month 3. The sum of accrued and unpaid fees is $150,000, while the unaccrued fees total (assuming this can be proven or reliably estimated) $50,000 times the remaining 57 months of the license. The present value of that amount would be determined as of the end of the third month. If Sony's performance also breached quality requirements in the license, Smith may be able to recover consequential loss to the value of the images as computed on the date of judgment,

9. The **Restatement (Second)** measures expectation damages under the following standard: "Subject to [limitations], the injured party has a right to damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or 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."

10. The **UNIDROIT Principles** provide: "[An aggrieved party is entitle to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain by the aggrieved party resulting from its avoidance of cost or harm. **UNIDROIT** art. 7.4.2.

11. The licensor may have remedies under other law. The primary alternative is intellectual property law. The section positions contract remedies as a parallel source of recovery for breach and other problems stemming from a license relationship. Default by the licensee introduces the possibility of an infringement claim if (a) the breach results in cancellation (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the default consists of acting outside the scope of the license and in violation of the intellectual property right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir.1982). "[Under] federal and state law a material breach of a [copyright] licensing agreement gives rise to a right of rescission which allows the non-breaching party to terminate the agreement. After the agreement is terminated, any further distribution would constitute copyright infringement." Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

12. 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...." 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.")

13. Infringement of a patent entitles the patent holder to damages computed so as to place the patentee in the position that it would have been in had the infringement not occurred. 35 U.S.C. ' 284 (damages "adequate to compensate for the infringement.") The Patent Act also authorizes a court to award treble damages in the event of a willful infringement committed with a conscious disregard for the rights of the patent holder. Actual damages are assessed in terms of loss suffered by the patent holder with the measure of "loss" frequently gauged in terms of loss of profits in reference to the patented invention. Zegers v. Zegers, Inc., 458 F.2d 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132 (1972); Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959).

14. Trade secret law is grounded in state law relating to the enforcement of confidential relationships relating to information. There are three sources of trade secret law: the Restatement (First) of Torts ' 757, the Restatement (Third) of Unfair Competition, and the Uniform Trade Secrets Act (UTSA). While the first Restatement has dominated this field, the majority of all states have now adopted the UTSA. Restatement: in addition to injunctive and other relief, the trade secret owner may recover "damages for past harm ... or be granted an accounting of the wrongdoer's profits" and provides that the owner of the trade secret can have two or more of these remedies in the same action. Restatement (First) of Torts ' 757 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may recover damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust enrichment caused by the misappropriation that is not taken into account in computing damages for actual loss."

15. Licensors often opt for intellectual property remedies, rather than contract remedies under current law because the recovery is often greater and the standards for damages are more clearly defined. Federal intellectual property remedies do not preempt or displace contract remedies provisions since they deal with different issues. The contract remedies focus on placing the licensor in the position that it would have been in had there been performance of the contract, while the intellectual property recoveries deal with remedies for damage to a property right and recovery that prevents a wrongdoer from taking advantage of its wrongful acts. The two remedies may raise dual recovery issues in some cases. The general principle is that all remedies are cumulative, except that double recovery is not permitted. See Harris Market Research v. Marshall Marketing & Communications, Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing and processing fees due under sublicense admissible on the issue of damages under either the theory of copyright infringement or of breach of license agreement); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (award of damages for a breach of license contract and copyright infringement by unauthorized display was not an award of double damages).

SECTION 2B-709~~10~~. LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, the licensor, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, may either complete and identify the information to the contract or cease work on the information. In either case, the licensor may recover damages or pursue other remedies.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.
Coordinating Meeting: Language differences to be conformed, but subject matter and transactional differences will remain.

Selected Issue: Should this section be approved as drafted?

Reporter's Notes:

1. This section adopts the premise of both Article 2 and Article 2A that the licensor faced with a material breach by the licensor while a development contract is in process can choose to complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to damages and other remedies gauged by the situation in which it finds itself following the choice. If the transferor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails. Article 2A-524 (2) provides: "If the goods are unfinished, in the exercise of reasonable commercial judgment … the [lessor] may either complete the manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner."

2. This section does not use language in Article 2 and Article 2A that refers to a seller's right to identify goods to the contract or to treat goods "demonstrably intended" for the contract as a subject of resale even if they have not been finished at the time of the breach. These sections follow a policy similar to that adopted here, but deal with facts specifically linked to transactions in goods. The rights implied in the other language, to the extent appropriate, are covered within the more general theme in this section. As a general matter, identifying and completing the intangibles will be inappropriate since most intangibles have infinite number of transfers contained in or available with respect to one fund of information. The notion of resale as a way of relieving loss is often inappropriate.

3. This draft applies the cases in which contracts involve development or compilation. In such cases, intangibles may not have a general market. The option to complete often will often be commercially reasonable

SECTION 2B-710~~1~~. LICENSOR'S RIGHT TO ~~OBTAIN~~ POSSESSION; DISCONTINUE PERFORMANCE.

(a) After a breach of a license by the licensee that is material as to the entire contract, the licensor has a right to take possession of any copies of the licensed information and of any other materials that were to be returned by the licensee pursuant to the contract and to prevent the licensee's continued exercise of rights in the licensed information. Subject to subsection (c), to the extent necessary to enforce these rights, a court may enjoin the licensee from continued exercise of rights in the information and may order that the licensor or an officer of the court take the steps described in [Section 2B-629(b)]. The licensor may proceed by judicial action under this section, but may proceed without judicial process if it complies with Section 2B-712.

(b) If the agreement so provides, a court may 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.

(c) The remedies under subsections (a) and (b) ~~this section~~ are not available if the information, before breach and in the ordinary course of performance under the license, was altered or commingled so as to be no longer reasonably separable or identifiable from other property or information of the licensee to the extent the remedy cannot be administered without undue harm to the information or property of the licensee or another person.

(d) In the event of a material breach of contract, a licensor may discontinue access by the licensee in a continuous access contract; or instruct any third person that is assisting the transfer of rights or performance of the contract to discontinue its performance.

Uniform Law Source: Section 2A-525; Section 9-503; Section 2A-525(1);. Sections 2A-526; 2-705. Revised.

Coordination Meeting: No equivalent Article 2 section. Tighter limits here than in Article 2A may be justified, but the justification should be considered.

Selected Issue: Should this section provide rights to either party to discontinue or obtain possession through judicial means?

Reporter's Notes:

1. This section defines the right of a licensor to use judicial process to prevent retake copies and to further use of information after material breach by the licensee. The right to act without judicial process, if any such right exists, is covered under the next section and is more substantially restricted than the equivalent rights in Article 9 and Article 2A. Article 2A-525 states: "After default [that is material], 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 … The lessor may proceed … without judicial process if it can be done without breach of the peace or the lessor may proceed by action." This, however, gives the lessor a right to repossess in the event of any non-payment of rentals. Article 9 repossession rights are even less limited in that they do not hinge on a material breach.

2. The right under this section flows from the conditional nature of the transaction. It arises only in the case of a license and applies only if there is a material breach of the contract. 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 also covered later. The section has been streamlined without substantive change by deleting the specific actions permitted and cross-referencing the identical list in Section [2B-630].

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. New subsection (d) consists of provisions previously contained in Section 2B-713 and is moved here as part of the consolidation of the Draft without substantive change. This subsection 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 future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This subsection derives in part from Section 2A-525(1). It does not create special rules for insolvency. Cases of insolvency will be handled either in the definition by contract of material breach or in the rules dealing with insecurity about future performance. This differs from and grants lesser rights to the transferor than do either Article 2 or 2A. Both give a right to stop shipment in the event of discovered insolvency.

5. The right to discontinue described in (a)(2) is recognized in licenses whose basic nature entails a contractual permission to access or use a resource owned or controlled by the licensor. In such cases, the contract will be treated as preemptively subject to termination a will (even without a breach). See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned facilities).

SECTION 2B-711~~2~~. LICENSOR=S SELF-HELP.

(a) A licensor may proceed under Section 2B-710~~1~~ 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 acting without judicial process can be done without a foreseeable breach of the peace, risk of injury to person, or significant 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 before breach of contract.

(c) A licensor may not include in the subject matter of a license the means to enforce its rights under subsection (a) unless the licensee manifests assent to a term of the license providing that it may do so. If a contractual term authorizes the licensor to include a means to enforce its rights, the following rules 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-710~~1~~. Exercise of the means to prevent further use in circumstances in which the licensee has not committed a material breach of contract constitutes a breach of contract by the licensor.

(2) If the licensor's use of the means to prevent further use of the information is

improper under this section and results in loss to the licensor as described in subsection (a), the licensee may recover damages from the licensor, including damages incurred by the licensee resulting from any foreseeable breach of the peace and injury to persons.~~harms property or information of the licensee, the licensee may recover as damages for that harm compensation for any loss resulting in the ordinary course as measured in any manner that is reasonable, in light of the difficulty or ease of restoring or recreating any information that was harmed.~~

(d) Except as otherwise expressly provided in this section, the licensee's remedies and the limitations on the licensor under this section may not be waived or altered by agreement.

Uniform Law Source: Section 9-503. Revised.

Coordination Meeting: No equivalent Article 2 section. Tighter controls as compared to Article 2A may be justified.

Selected Issue:

a. Are greater restrictions than in Article 2A merited?

b. Should the section be approved?

Reporter's Notes:

[Subsection c(2) was modified at the suggestion of a Committee member. The section has otherwise not been revised in response to discussion in December.]

1. In modern practice, self help remedies are being used, including remedies of "electronic self-help." This section applies to situations where electronic remedies are used in enforcing rights in the event of breach. The restrictions and options here are different from those provided in Section 2B-629, which entail and are limited to situations in which electronics are utilized to enforce contract rights not connected to breach.

1a. This section balances the rights of a licensor to specifically enforce its contract and any property rights that it holds as against the rights of the licensee to not be exposed to unwarranted pressure and risk of loss. It allows self help, but requires notice and materiality of breach as preconditions, while also exposing a licensor to some risk of liability in the event of its causing damages. The issue of self-help is important in a number of settings, but has been urged most strongly by representatives of smaller licensors as a means to enforce rights against larger licensees.

2. The remedy applies only in a license. Given the definition of licensor, the section applies to either party to the extent that the party transferred information to the other under conditions restricting use. Since this requires action in response to a material breach, this section deals with active, rather than passive electronic restrictions. It also only applies in the case of breach. Other sections deal with electronic monitoring of performance and electronic termination at the end of a license.

3. As compared to either Article 9 or Article 2A, the self-help remedy outlined here is substantially more restricted and limited. The limits are explicit in this section and in Section 2B-711, a predicate for proceeding under this section. One issue relates to coordination between this section and Articles 2A and 9. In both of those articles, a transaction governed under their provisions entails a right of self-help without the restrictions placed here and that right Article 2A contains an express right held by the lessor to repossess leased property after default. 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). However, the materiality can be determined by contract (which cannot occur in this draft) and applies in concept to any failure to pay rent (in this context, the failure must be material). As to self help, Article 2A merely provides: "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.

4.. In this draft, self-help cannot be pursued unless the breach is material without consideration of contract definitions of materiality. Thus, for example, a contract that provides that a one day delay in payment (or delivery) is a material breach would not, in itself, justify action under this section. It would still be necessary to determine whether the actual delay was a material breach under general standards of materiality.

5. Under subsection (c), for electronic repossession there must be a manifestation of assent to a contract term giving notice and authorizing the licensor to include a electronic capability <u>and</u>, under subsection (a), the use of that option is limited by breach of the peace and by the fact that it cannot result in foreseeable damage or destruction of property not related to the license. The position taken 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 Farrell 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>Farrell</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."

6. The few reported cases on this point are consistent with an emphasis on prior notice, although they do not necessarily imply the explicit notice suggested in this draft. See Franks & Son, Inc. v. Information Solutions, Computer Industry Litigation Rep. 8927-25 (ND Okla. 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of inclusion); Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc., 157 App. Div. 2d 689, 549 NYS2d 789 (1990).

7. The draft also adopts a concept of proportionality by providing 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. 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.

8. Considered together with the prior section, self help remedies are limited in the following manner: a) **non-electronic 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 licensees information or property (irrespective of commingling); b) **electronic self-help** can occur only if the foregoing conditions are met **and then only** if the party manifests assent to the specific term that authorizes the electronic measures, **furthermore, even if the preconditions are appropriate** the licensor is liable for damages caused to the information or property of the licensee.

8. The licensee protections cannot be waived.

~~SECTION 2B-712. LICENSOR'S RIGHT TO DISCONTINUE [moved to another section].~~

[C. Licensee's Remedies]

SECTION 2B-712~~4~~. LICENSEE'S DAMAGES.

(a) Subject to subsection (b), on material breach of contract by a licensor, the licensee may recover as damages compensation for the particular breach of performance or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, payments made to the licensor for performance that has not been rendered, plus :

(A) the present value, as of the date of breach, of the market value if any of any performance not provided minus the license fees for the performance, both of which must be calculated in the case of damages for the entire contract, for the remaining contractual term plus any extensions available as of right;

(B) damages computed pursuant to Section 2B-701~~2~~; or

(C) if a licensee has accepted performance from the licensor and not revoked acceptance, the present value, at the time and place of performance, of the difference between the value of the performance accepted and the value of the performance had there been no defect, not to exceed the agreed price plus the amounts reasonably expended by the licensee to make the information usable; and

(2) the present value of incidental and consequential damages resulting from the breach as of the date of the entry of judgment.

(b) The amount of damages calculated under subsection (a) must be:

(1) reduced by expenses avoided as a result of the breach; and

(2) if further performance is not anticipated under the agreement, reduced by any unpaid license fees that relate to performance by the licensor which has been received by the licensee, but increased by the amount of any license fees already paid that relate to performance by the licensor which have not been received by the licensee.

(c) Market value is determined as of the place for performance. Due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contractual terms, performance, and information that were similar in terms, quality, and character to the information or agreed performance.

(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.
Coordination Meeting: Differences reflect subject matter.
Selected Issue: Should the section be approved?
Reporter's Notes:

1. As in licensor remedies, this section allows the licensee to choose among computational alternatives. Given a court's general overview to prevent excessive damages, there is no reason to make one option preferred over the other. Also, the type of breach involved here is more varied; greater flexibility is needed. Because of the diverse problems that might be involved in dealing with breach of a license, the narrow structure of Article 2 remedies for a licensee (buyer) is not appropriate. 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 concepts of mitigation and avoiding double recovery.

2. Option 1 parallels the Article 2 concept of comparing contract price to market value for performance not received. It is predicated on the initial assumption that the breaching party will also return any license fees already received for that performance. Unlike in Article 2, there is no provision dealing with a remedy based on contract price compared to "cover." This remedy is removed because, in dealing with intangibles that are, by their nature, often distinct or unique, the option of "cover" is often not viable and often 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 unless it affects concepts of mitigation. This approach was built on ideas from Article 2A. For purposes of subsection (a), performance has not been provided by the licensor if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, and with respect to any performance that was executory at the time that the licensee justifiably cancels.

Illustration 1: Amoco Oil contracts for a 1,000 person site license for database software from Meed Corp. The contract price is $500,000 in initial payment and $10,000 for each month of use. The contract term is two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and sues, applying subsection (a)(1). It is entitled to return of the $500,000 payment plus recovery of any difference between the contract price and the market price for a similar site license of similar software.

Illustration 2: Same facts as in Illustration 1, but Amoco goes to Oracle Software and obtains a license for a 1,000 user site license for the Oracle database software. The contract terms involve a $900,000 initial payment and a monthly use payment of $12,000. The term is two years. In its lawsuit, if the issue is raised, the court must consider to what extent this second transaction gauges the market value applicable to the Meed contract. The issue would involve the terms of the license, the nature of the software and any other relevant variables.

Illustration 3: Same facts as in Illustration 2, but Amoco obtains a license for the Meed software from an authorized distributor (Jones) for a $600,000 initial fees and under other terms identical to the Meed contract. The issue of similarity is the same, but giving due weight to this alternative transaction will presumably limit the Amoco recovery to its initial payment, $100,000, and any incidental or consequential damages.

3. The <u>Restatement (Second) of Contracts</u> 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.

4. The third alternative is limited to cases in which the breach relates to performance that has been delivered and accepted. It parallels the provisions of current Article 2, but caps the recovery by the contract price. This is ~~to~~ based on a differentiation between consequential and direct or general damages. For "accepted" goods under Article 2 (sales), the damages formula is in Section 2-714, consisting of any incidental and consequential damages resulting from the seller's plus: (1) the "loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable" or (2) "the measure of damages for breach of warranty [which is] the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." UCC ' 2-714. Section 2A-519(3) provides that the measure of damages for accepted goods is: "loss resulting in the ordinary course of events from the lessor's default as determined in any manner which is reasonable" plus incidental and consequential damages less expenses saved. Article 2A provides that for breach of warranty the measure of damages is the present value of the difference between the value of the goods as warranted and their value as accepted.

5. As a general rule, the "value of the goods as warranted" focuses on the market value of the property if it were consistent with the represented quality it was to have. This should most often equal~~s~~ the purchase price, but it is not always so limited by courts. See Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3rd Cir. 1980) (allows value measure that encompassed the value that the buyer would have obtained from a perfect computer system with specific capabilities, including advantages in inventory control, profits and the like, in excess of the contracted price). This draft reverses that approach. The additional value loss (e.g., lost benefits) are consequential damages and covered by treatment of that type of damage in the contract and under the article.

6. This draft rule allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality. Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F.Supp. 364 (E.D. Mich.).

7. Courts apply a flexible approach to licensee damages outside the UCC. If the damages are proven with reasonable certainty, they can include lost profits in this context. In Western Geographic Co. of America v. Bolt Associates, 584 F.2d 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits that the licensor earned from licensing following breach. In Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984) a company was entitled to recover lost profits when a California distributor of motion pictures breached licensing agreement where California distributor knew that the owner was attempting to obtain films for redistribution in Europe and should have known that owner and company intended to resell films. In Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir. 1989) the court approved a lost profit recovery based on a failure of a licensor to make available to the licensee various films for showing in European markets. In Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir. 1989) a licensee brought action for breach of contract and for wrongful termination of license related to trademarks and manufacturing know how. The contract breach consisted in part of actions taken by the licensor in violation of the territorial exclusivity provisions of the license. The court approved an award of lost profits for breach of contract based on estimates of lost sales, but reversed on the basis of how the profits were computed requiring computation of profits based on a marginal cost approach. Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

SECTION 2B-7135. LICENSEE'S RIGHT OF RECOUPMENT.

(a) If a [a party] [licensor] is in breach of contract, the [other party] [licensee], after notifying the [party in breach] [licensor] of its intention to do so, may deduct all or any part of the damages resulting from breach from any part of [payments] [the license fee] still due and owing to the [party in breach] [licensor] under the same contract.

(b) If a nonmaterial breach of contract has not been cured, [an aggrieved party] [a licensee] may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the [other party] [licensor] and the amount of damages to be deducted can be readily liquidated under the terms of the agreement.

Uniform Law Source: Section 2-717. Revised.
Coordination meeting: Subject matter differences are appropriate.
Selected Issue: Should this right apply to either party as in common law?
Reporter's Note:

1. Subsection (a) adopts language from 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. This section deals with the licensee's recoupment and does not address the situations in which, under existing common law concepts, a right of recoupment may apply to the licensor. Unlike in reference to the sale of goods, the obligations of the parties here often run continuously and in complex ways back and forth.

2. Subsection (b) applies that principle to the case of nonmaterial breaches, recognizing the different interests that are involved in ongoing performance contracts and minor breaches. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach. Importantly, this Article creates an obligation to cure nonmaterial breaches where the cost of that cure is not disproportionate to the harm.

SECTION 2B-714~~6~~. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, the licensee may continue to exercise its rights under the contract. If the licensee elects to continue to exercise those 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, and noncompetition, and any obligations to pay license fees or royalties.

(2) Subject to Section 2B-620~~ --- (waiver)~~, the licensee may pursue remedies with respect to accepted transfers or performance, including the right of recoupment.

(3) The licensor's rights and remedies remain in effect as if the licensor had not been in breach.

Reporter's Note:
This section makes clear the consequences of a licensee's decision to accept flawed performance by the licensor and pursue remedies that do not involve a cancellation of the contract obligate the licensee to continued performance of the intangibles contract itself. A licensee faced with breach by the licensor can elect to continue the contract and

claim damages for the breach. This section clarifies that, if this choice is made, the licensee is bound by the contract terms. However, it retains rights of action with respect to the prior, defective performance.

SECTION 2B-715~~7~~. LICENSOR=S LIABILITY OVER.

(a) If a licensee is sued by a third party other than for infringement [or other claims under subsection (b)] and the licensor is answerable over to the licensee, the licensee may notify the licensor of the litigation. If the notice states that the licensor may come in and defend and that if it does not do so the licensor will be bound in any action between the licensor and the licensee by any determination of fact common in 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, defamation, and similar claims relating to information provided by the licensor, or claims of the like in reference to the information, the following rules apply:

(1) Unless the licensor has notified it of the litigation, the ~~The~~ licensee shall seasonably notify the licensor 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 a record that the licensee turn over control of the litigation, including settlement. If the licensor is answerable over to the licensee for the claim or the contract is a nonexclusive license and the demand states that the licensor will bear all of the expenses and 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. The licensor may obtain control of the action by appropriate legal remedies unless the licensee after seasonable receipt of the demand turns over control.

UNIFORM LAW SOURCE: Section 2A-516; 2-607. Revised.

SELECTED ISSUE: Should this section be applicable to either party given the existence of potential indemnity obligations on either side?

REPORTER'S NOTE:

This section adapts the answerable over rules of Article 2 to licenses. In reference to intellectual property rights, where the issue involves a nonexclusive license or a obligation over to the licensee, the licensor's interests in protecting against an adverse infringement claim are often dominant. Hence, the provisions of (b) give it a right to control the litigation. The bracketed language raises a question about whether similar issues are relevant with reference to defamation, libel and related liability concerns.