UNIFORM COMMERCIAL CODE
ARTICLE 2B:
SOFTWARE CONTRACTS AND LICENSES
OF INFORMATION

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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With Notes

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UNIFORM COMMERCIAL CODE ARTICLE 2B

CARLYLE C. RING, JR., 1401 H. Street, N.W., Suite 500, Washington, DC 20005, *Chair*
DAVID E. BARTLETT, 455 Golden Eagle Drive, Broomfield, CO 80020, *The American Law Institute Representative*
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JOHN A. CHANIN, 1020 Aoloa Place, Suite 206B, Kailua, HI 96734
STEPHEN Y. CHOW, One Beacon Street, 30th Floor, Boston, MA 02108
PATRICIA BRUMFIELD FRY, University of North Dakota, School of Law, P.O. Box 9003, Grand Forks, ND 58201
THOMAS T. GRIMSHAW, Suite 3800, 1700 Lincoln Street, Denver, CO 80203
LEON M. McCORKLE, JR., P.O. Box 387, Dublin, OH 43017-0387
THOMAS J. McCRACKEN, JR., Room 600, 134 N. LaSalle Street, Chicago, IL 60602
JAMES C. McKAY, JR., Office of Corporation Counsel, 6th Floor South, 441 4th Street, N.W., Washington, DC 20001
BRUCE MUNSON, Revisor of Statutes Bureau, Suite 800, 131 W. Wilson Street, Madison, WI 53703
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211 E. Ontario Street, Suite 1300
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PART 1

GENERAL PROVISIONS

[A. Short Title and Definitions]

SECTION 2B-101. SHORT TITLE. This article may be cited as Uniform Commercial Code - Software Contracts and Licenses of Information. [Transactions in Computer Information]

Reporter's Note: The bracketed language indicates a change in title that might be considered in light of the new scope. It has not been considered or approved by the relevant groups.

SECTION 2B-102. DEFINITIONS.

(a) In this article:

(1) "Access contract" means a contract electronically to obtain access to, or information in electronic form from, an information processing system not owned or controlled by the licensee, or the equivalent of such access.

(2) "Access material" means a document, authorization, address, access code, acknowledgment, or other material necessary for a party to obtain authorized access to information, or control or possession of a copy.

(3) "Attribution procedure" means a procedure established by law, regulation, or agreement, or a procedure otherwise adopted by the parties, for the purpose of verifying that an electronic message, authentication, record, or performance is that of a person, or for the purpose of detecting changes or errors in content.

(4) "Authenticate" means to sign, or otherwise to execute or adopt a symbol or sound, or to use encryption or another process with respect to a record, with intent of the authenticating person to:

(A) identify the person;

(B) adopt or accept the terms or a particular term of a record that includes or is logically associated with or referenced in a record containing the authentication; or

(C) establish the integrity of the information in a record that includes or is logically associated with or referenced in a record containing the authentication.

(5) "Automated transaction" means a contract formed by electronic means or by electronic messages in which the electronic actions or messages of one or both parties are not intended to be reviewed in the ordinary course by an individual.

(6) "Cancellation" means the ending of a contract by a party because of a breach by the other party. "Cancel" has a corresponding meaning.

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

(8) "Computer information" means information, including software, that is in a form directly capable of being processed or used by, or obtained from or through, a computer, but does not include information referred to in Section 2B-104(2).

(9) "Computer information transaction" means a license or other contract whose subject matter is (i) the creation or development of, including the transformation of information into, computer information or (ii) to provide access to, acquire, transfer, use, license, modify, or distribute computer information. The term does not include a contract for distribution of information in print form, such as in a book, newspaper or magazine, or to create information for the purpose of distribution in print form even if the information provided for distribution pursuant to the contract is delivered in electronic form.

(10) "Computer program" means a set of statements or instructions to be used directly or indirectly in a computer to bring about a certain result. The term does not include

informational content such as a separately identifiable motion picture or sound recording or the like.

(11) "Consequential damages" include compensation for losses resulting from a party's general or particular requirements and needs of which the other party at the time of contracting had reason to know and which losses could not reasonably be prevented by the aggrieved party, and compensation for losses from injury to person or property proximately resulting from any breach of warranty. The term does not include direct or incidental damages.

(12) "Conspicuous", with reference to a term, means so written, displayed, or otherwise presented that a reasonable person against which it is to operate ought to have noticed it. A term in an electronic record intended to evoke a response by an electronic agent is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react without review of the record by an individual. Conspicuous terms include, but are not limited to, the following:

(A) with respect to a person:

(i) a heading in capitals in a size equal or greater than, or in contrasting type, font or color to, the surrounding text;

(ii) language in the body of a record or display that is in larger or other contrasting type, font, or color or is set off from the surrounding text by symbols or other marks that call attention to the language; or

(iii) a term prominently referenced in an electronic record or display which is readily accessible and reviewable from the record or display; and

(B) with respect to a person or an electronic agent, a term or reference to a term that is so placed in a record or display that the person or electronic agent cannot proceed without taking some additional action with respect to the term.

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

(14) “Consumer transaction” means an agreement under which a consumer is the licensee.

(15) “Contract fee” means the price, fee, rent, or royalty payable in a contract under this article.

(16) “Contractual use restriction” means an enforceable restriction created by agreement which restriction concerns the use of or access to licensed information or informational rights, including an obligation of nondisclosure and confidentiality and a limitation on scope or manner of use.

(17) “Copy” means the medium on which information is fixed on a temporary or permanent basis and from which it can be perceived, reproduced, used, or communicated, either directly or with the aid of a machine or device.

(18) “Court” includes an arbitration or other dispute-resolution forum if the parties have agreed to use of that forum or its use is required by law.

(19) “Delivery” means the voluntary physical or electronic transfer of possession or control of a copy.

(20) “Direct damages” includes compensation for losses measured by Section 2B-708(b)(1) or 2B-709(a)(1). The term does not include consequential or incidental damages.

(21) “Electronic” means of or relating to electrical, digital, magnetic, wireless,

optical, or electromagnetic technology or any other technology that entails similar capabilities. "Electronically" has a corresponding meaning.

(21) "Electronic agent" means a computer program or other automated means used by a person independently to initiate or respond without review by an individual to electronic messages or performances on behalf of that person.

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

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

(24) "Incidental damages":

(A) include compensation for any commercially reasonable charge, expense, or commission reasonably incurred by an aggrieved party after breach of contract:

(i) in inspection, receipt, transmission, transportation, care, or custody of rightfully refused copies or information;

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

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

(iv) otherwise incident to the breach; and

(B) do not include consequential or direct damages.

(25) "Information" means data, text, images, sounds, mask works, or works of authorship. The term includes software.

(26) "Information processing system" means an electronic system or facility for generating, sending, receiving, storing, displaying, or processing electronic information.

(27) "Informational content" means information that is intended to be communicated to or perceived by an individual in the ordinary use of the information, or the equivalent of such information. The term does not include computer instructions that control the interaction of a computer program with other computer programs or with a machine or device.

(28) "Informational rights" include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks, publicity rights, or any other law that permits a person, independently of contract, to control or preclude another person's use of or access to the information on the basis of the rights holder's interest in that information.

(29) "License" means a contract within this article that authorizes access to or use of information or of informational rights that exist or are to be created and expressly limits the contractual rights, permissions, or uses granted, expressly prohibits some uses, or expressly grants less than all rights in the information. A contract may be a license whether or not the transferee obtains title to a copy. "License" includes an access contract and, for purposes of [the Uniform Commercial Code], a consignment of a copy. The term does not include a reservation or creation of a security interest.

(30) "Licensee" means a transferee in an agreement under this article, whether or not the agreement is a license. A licensor is not a licensee with respect to rights reserved to it under the agreement.

(31) "Licensor" means a transferor in an agreement under this article, whether or not the agreement is a license. As between a provider of access in an access contract and its customer, the provider of access is the licensor. As between the provider of access and a provider of the informational content to be accessed, the provider of content is the licensor. If performance consists of an exchange of information or informational rights, each party is a

licensor with respect to the information, informational rights, or access it provides.

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

(33) “Mass-market transaction” means a transaction within this article that is a consumer transaction or that is a transaction with an end-user licensee which transaction involves information or informational rights directed to the general public as a whole under substantially the same terms for the same information. A transaction other than a consumer transaction is a mass-market transaction only if the licensee acquires the information or rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in the retail market. A transaction other than a consumer transaction is not a mass-market transaction if it is:

(A) a contract for redistribution;

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

(C) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee other than minor customization using a capability of the information intended for that purpose;

(D) a site license; or

(E) an access contract.

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

its occupation holds itself out as having such knowledge or skill.

(35) "Nonexclusive license" means a license that does not preclude the licensor from transferring to other licensees the same information, informational rights, or contractual rights within the same scope. For purposes of the [Uniform Commercial Code], the term includes a consignment of a copy.

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

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

(38) "Reason to know" means that a person has knowledge of a fact or that, from all the facts and circumstances known to the person without investigation, the person should know that a fact exists.

(39) "Receive" means:

(A) with respect to a copy, to take delivery; and

(B) with respect to a notice:

(i) to come to a person's attention; or

(ii) to be delivered to and available at a location designated by agreement for that purpose or, in the absence of an agreed location:

(I) to be delivered at the person's residence, or the person's place of business through which the contract was made, or at any other place held out by the person as a place for receipt of such communications; or

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

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

(41) "Release" means an agreement not to object to, or exercise any remedies to limit, the use of information or informational rights, which agreement requires no affirmative acts by the party giving the release to enable or support the other party's use. The term includes a waiver of informational rights.

(42) "Return", with respect to information to which a rejected record or term applies, means:

(A) with respect to a licensor that rejects a record or term, return of any information delivered and a right to stop any future delivery or access and reimbursement of any amounts previously paid to the licensee with respect to the rejected record; and

(B) with respect to a licensee that rejects a record or term:

(i) reimbursement of any contract fee paid from the person to which it was paid or from another person that may offer to reimburse that fee, and a right to stop payment of the contract fee, on proof of purchase and delivery to the licensor of the information

and all copies within a reasonable time after delivery to the licensee; and

(ii) with respect to multiple products integrated into a bundled whole but retaining their separate identity and transferred for one bundled fee:

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

(b) in all other cases, reimbursement of any separately stated fee that is paid for the information to which the rejected record applies, on proof of purchase and return of the information and all copies within a reasonable time after delivery.

(43) "Scope", with respect to a license, means terms of the license which define:

(A) the licensed copies or information and the informational rights involved;

(B) the use or access authorized, prohibited, or controlled;

(C) the geographic area, market, or location; and

(D) the duration of the license.

(44) "Send" means, with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed, to (i) deposit in the mail or with a commercially reasonable carrier; (ii) deliver for transmission to or creation in another location or system; or (iii) take the steps necessary to initiate transmission to or creation in another location or system. In addition, with respect to an electronic message, "send" means to initiate operations that in the ordinary course will cause the record to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, if the recipient uses or otherwise has designated or held out that system as a

place for the receipt of such communications. Receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(45) "Software" means a computer program, any informational content included in the program, and any supporting information provided by the licensor. The term does not include a separately identifiable motion picture or sound recording and does not include a computer program included in a copy of the picture or recording if the purpose of the program is merely to make possible the display or performance of the picture or recording.

(46) "Software contract" means:

(i) a sale of a copy of software;

(ii) a license of software; or

(iii) a conveyance of ownership of informational rights in software.

(47) "Standard form" means a record, or a group of related records, containing terms prepared for repeated use in transactions and so used in a transaction in which there was no negotiation by individuals except to set the price, quantity, method of payment, selection among standard options, or time or method of delivery.

(48) "Termination" means the ending of a contract for a reason other than its breach under a power created by agreement or law. "Terminate" has a corresponding meaning.

(49) "Transfer", with respect to contractual rights, includes an assignment of the contract. The term does not include an agreement to perform contractual obligations or exercise contractual rights through a delegate or a sublicensee.

(b) Article 1 contains general definitions and principles of construction which apply throughout this article. In addition, the following definitions in other articles of [the Uniform Commercial Code] apply to this article:

"Financial asset" Section 8-102(a)(9)

"Funds transfer"	Section 4A-104 (as applied to credit orders)
"Identification" to the contract	Section 2-501
"Instrument"	Section 9-105(i) (1995 Official Draft); 9-102(a)(47) (1998 Approved Draft)
"Item"	Section 4-104
"Investment property"	Section 9-115(f)
"Letter of credit"	Section 5-102
"Negotiable instrument"	Section 3-104
"Payment order"	Section 4A-103 (as applied to credit orders)
"Sale"	Section 2-106

REPORTER'S NOTES:

1. "Access contract." An access contract is a contract that authorizes access to an electronic facility, including a computer or an Internet site, or a contract that authorizes obtaining electronic information from that type of facility. The term does not include contracts that grant a right to physically enter a building or other physical location, nor does it include the purchase of a television, radio, or other similar goods that create an ability to access electronic data. Use of a library card to enter and check out a book from a library does not come within this definition because it is not an electronic acquisition of information. Access contract" is typified by "on-line" services and Internet transactions. It also includes contracts for remote data processing, third party E-mail systems, and contracts allowing automatic updating from a remote facility to a database held by the licensee.

The term does not encompass ordinary interactions among computer programs within a single system permitted because each program is licensed; such transactions do not involve access to a facility. However, if an on-line data provider elects to provide access in part by allowing its database to be loaded into the computer of a client, this method of performance retains all of the characteristics of an access arrangement and is within the definition. Thus, if a database provider arranges with a high volume user to transfer all or part of its database to the client's system, allowing access and use on the same terms as in the remote system, the arrangement is an access contract. The same is true if the contract provides a copy of the database on media to be loaded into the user's system, but the data are intermittently updated through transfers of data from remote systems. On the other hand, if a software publisher allows access to and downloading of software into a licensee's systems, the continuing right to use the software after it is downloaded is a license, but not an access contract.

Many access contracts do not depend on intellectual property rights. The owner of a computer system has a fundamental right recognized in criminal law and property law to exclude others from access to its system and to condition the terms on which it permits access. This does not mean that access to identical information cannot be obtained elsewhere, but merely that the access provider can establish contractual terms of access that bind the other party even though the licensee could, if it chose, obtain identical information from other sources or its own research.

An access provider may, or may not, be in a position to give contractual rights in the information accessed. In some cases, that information is controlled by the access provider, while others enatil a three-party framework. In a three-party relationship, one party provides access, while another (the content provider) licenses use of the information. This latter transaction involves two and, in some cases, three contracts. The first is between the content provider and the access provider. This may be an ordinary license or an access contract that gives the access provider a right to provide a gateway to access information contained in a system controlled by the content

provider. The second is between the access provider and the end user. This is an access contract. The third arises if the content provider contracts directly with the end user. The various contracts are independent of each other.

2. "Attribution procedure." In electronic commerce an "attribution procedure" refers to an agreed on, adopted, or otherwise established procedure to identify the person who sent an electronic message, or to verify the absence of changes in the content of the message. Agreement to or adoption of a procedure may be between the two parties or through a third party. For example, the operator of a multi-database system, which system includes databases provided by third parties, may arrange with database providers and customers for agreement to or adoption of a particular attribution procedures. Those separate arrangements, although made with the third party, may establish an attribution procedure for purposes of this article between the customers and the individual database providers.

Electronic commerce is anonymous in character and depends on such procedures and their recognition in law and practice. The effect of an attribution procedure is discussed in Sections 2B-114 to 2B-117. The benefits of using an attribution procedure only pertain to procedures that are commercially reasonable. In general, use of a commercially reasonable procedure for attribution entitles the user to a presumption that the facts are as established by the procedure.

3. "Authenticate." This term replaces "signature" and "signed," terms which are more appropriate for paper transactions but not as appropriate for electronic transactions. The term "authenticate" is also used in Articles 4A, 5, 8, and 9 of the Uniform Commercial Code. It incorporates all signatures under prior law, but clarifies that qualifying electronic processing systems used in modern commerce are adequate. Any act that would be a signature is an authentication under Article 2B.

An "authentication," as does a "signature," may express three different effects, namely: (i) identifying the person, (ii) adoption of the record or its term(s), and (iii) verifying the content. As under prior law for "signature," what effects are intended are determined by the context and objective indicia associated with that context. Unless the circumstances indicate a different intent, authentication embraces all three effects.

Authentication may be on or logically associated with or linked to the record. Subparagraph (B) follows the proposed *EU Directive on Electronic Signatures* and reflects the fact that, in digital technology, the analogy between "signing" a record electronically and signing a paper is not precise. "Logically associated" makes it clear that the association between an authentication and record need not be physical in nature. It can be electronic. There must be, however, a direct association such that it can be reasonably inferred that the party that makes the authentication intends by that act to adopt or accept the associated record.

Authentication includes qualifying use of identifiers such as a PIN number, a types or otherwise signed name. In addition, it includes qualifying actions and sounds such as encryption, voice and biological identification, and other technologically enabled acts used to authenticate a record.

Authentication systems are often used to identify the person and indicate its acceptance of a record or term. In addition, in some contexts, authentication may be intended to establish the integrity of the record. "Integrity" means that the record is in unimpaired condition, i.e., that it has not been altered or affected by errors caused by transmission or otherwise.

In "digital signature" systems, the term "authentication" is sometimes used differently. In those systems, it is common that one party applies an encryption technology to a record or message and a second party (recipient) take actions that confirm the identity of the party. Sometimes, the confirming actions of the recipient are referred to as "authenticating" the record. That usage is not followed in this article. In this article, "authenticate" describes the acts (and intent) of the person executing the symbol or taking the initial action and not what another party (the recipient) does to confirm the identity of the other person, its acceptance of the record, or the integrity of the record. Authenticate refers to the signing, not the confirming, step in digital signature technology and in any other technology developed or used to provide electronic signature capability.

The definition is technologically neutral. "Digital signatures" recognized in some state laws and which rely on a specific encryption technology and certification system qualify as authentication. Article 2B, however, recognizes that technology and commercial practice are evolving. No specific standards of technological sufficiency are set or appropriate. Rather, procedures are subject to evidentiary scrutiny as to the requisite intent, proof that they were used, and assessment of whether the procedures are commercially reasonable.

4. "Automated transaction." This term refers to relationships formed and made effective as a contract even though one or both of the parties are represented by an electronic system, rather than a human being. Automated contracting is widely used. While law could fictionally attribute intent to these automated activities, this article directly recognizes that operations of automated systems can create binding legal obligations for those who use them for that purpose.

5. "Cancellation." This definition is from original Section 2-106. The effect of cancellation is as is stated in 2B-702.

6. "Computer program." This definition parallels copyright law. 17 U.S.C. § 101 (1996). In this article, a distinction exists between programs as operating instructions and "informational content" communicated to people. "Computer program" refers to functional and operating aspects of a digital system, while "informational content" refers to output that communicates to a human being. There is an inevitable overlap. However, if issues arise that require a close distinction, the answer lies in whether the issue addresses operations (program) or communicated content (informational content). This reference to functionality pertains solely to contract law issues under this article. It does not relate to the copyright law question of distinguishing between a process and copyrightable expression. The distinction here is more like that made in copyright law between a computer program as a "literary work" (code) and the output as an "audiovisual work" (images, sounds). In copyright, the distinction relates to whether a copyrighted work was created or infringed. In Article 2B, the distinction relates to contract law issues in determining liability risk and performance obligation.

7. "Consequential damages." This term corresponds to original Article 2. Consequential damages do not include "direct" or "incidental" damages. Consequential loss deals with loss of benefits anticipated as a result of not being able to exploit the expected contracted performance. These damages include lost profits resulting from that lost opportunity, damages to reputation, lost royalties expected from a licensee's proper performance, lost value of a trade secret from wrongful disclosure or use, wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss or damage to data or property caused by a breach.

Consequential damages may be recovered by either party. The losses must be an ordinary and predictable result of the breach. In the case of economic and similar losses, they must be foreseeable. This means that, for the injured party to recover compensation for losses resulting from its special circumstances, the party in breach must have had notice of those circumstances at the time of contracting. The particular needs and circumstances must be made known at that time. In contrast, losses from ordinary general requirements can often be presumed to have been within the contemplation of the other party. In addition, of course, to be foreseeable the losses must not derive from atypical risk taking by the aggrieved party, such as in a failure reasonably to maintain back-up systems for retrieval of important data.

The burden of proving loss is on the party claiming damages. This article does not require proof with absolute certainty or mathematical precision or beyond the standard of proof at common law. Section 1-103. Article 1 requires liberal administration of remedies, but does not permit recovery of losses that are speculative or otherwise highly uncertain. See Section 2B-707 and *Restatement (Second) of Contracts* § 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended. See *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) ("[Plaintiff's] expectancy interest in the royalties … was speculative.").

The definition does not specifically refer to mitigation through cover, but the concept of mitigation (including cover) limits all damage claims under Section 2B-707. No change in law is intended by deletion of the reference to "cover" from the original Article 2 definition. A party can recover compensation only for losses that it could not reasonably have prevented by cover or otherwise.

The definition continues current law as to recovery of damages for personal injury or property damage that "proximately" resulted from the breach. For example, where the injury follows use of a computer program without discovery of a defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the licensee to use the information without an inspection that would have revealed the defect. If it was not reasonable for it to do so or if the licensee did in fact discover the defect prior to use, the injury would not proximately result from the breach of warranty. Also, proximate causation may not exist where the damages are the result of a misuse of the computer information or a use that violates clear warnings against the particular type of use. Similarly, if injuries allegedly arise from use of informational content created by use of a program, whether they are a proximate result of the defect depends on the reasonableness of the use and the reasonableness of the user's reliance on the result in light of any decision-making that may intervene between creation of the content and the loss-causing use.

8. "Conspicuous." This definition generally follows original Article 1, but makes some deletions and adds some new concepts for electronic commerce. As under current law, whether a term is conspicuous is a question to be determined by the court. Section 2B-106(d). The basic standard is that a term is conspicuous with respect to an individual if it is so positioned or presented that the attention of an ordinary reasonable person can reasonably be expected to be called to it. Often, this involves presentation in a record, but the concept is not so limited; it includes verbal or automated voice presentation that meets the basic standard. Whether a term is

conspicuous is gauged by the condition of the message as it would be received or first viewed by a person using an ordinary system or method of receiving or reviewing such messages. If a transaction involves use of an electronic agent, to be conspicuous as to the electronic agent requires presentation of the term in a manner capable of invoking a response from a "reasonably configured" electronic agent.

This article delineates some of methods of making a term conspicuous. These have an important role in commercial practice. The purpose of requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term on how that result can be achieved). The illustrations establish safe harbors intended to reduce uncertainty and litigation. A term that conforms is conspicuous. The illustrations, however, are not exclusive. In cases outside the illustrative safe harbors, a court should apply the general standard.

The definition encompasses several new methodologies with relevance in modern commerce, including electronic commerce. Paragraph (A)(ii) contemplates setting off the term or a label by symbols which can be reliably transferred in electronic commerce, whereas font size, color and other attributes may not. It includes a term or reference that provides: *** Disclaimer *** or <<< Disclaimer >>>. Paragraph (A)(iii) deals with hyperlinks and related Internet technologies. It contemplates a case in which a computer screen displays a term, a summary or reference to the term, or an image, and the party using the screen, by taking an action with reference to the display, is promptly transferred to a different file location wherein the contract term is available. To be conspicuous, the image, term, or summary must be prominent and its use must readily enable review of the term. The access must be <u>from</u> the screen or display and not by taking other actions such as a telephone call or physically going to a location. When the term is accessed, it must be readily reviewable. The fact that an entire record is prominently referenced does not automatically mean that a particular <u>term</u> in that record is conspicuous.

Paragraph (B) recognizes a procedure by which, without taking action with respect to the term, the party cannot proceed further in reference to the file or location. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" and is displayed in a way that precludes the user from proceeding without assent to or rejection of this condition, suffices.

The deletion of word "clause" from the prior definition is non-substantive. The definition, however, rejects current law that all terms in a "telegram" are conspicuous and also requires, unlike current law, that for a heading to be conspicuous it must be in larger or contrasting type than the surrounding text. As to telegrams, since a "telegram" includes "any mechanical method of transmission" no rule that the terms are automatically conspicuous is justified.

9. "Consumer." A "consumer" is an individual that obtains information for personal, household, or family purposes. Whether an individual is a consumer with reference to a particular transaction is determined at the time of contracting. It depends on the then intended use of the information at that time. Many "personal" uses of information or informational rights are not consumer uses (e.g., stock broker personally using software to monitor client investments). The definition distinguishes profit making, professional or business use, from primarily non-business personal or family use, treating only the latter as a consumer use. The term also includes ordinary management of personal assets by a family.

The definition resolves an issue faced in many areas of law. A transaction aimed at providing information for profit-making or income production by the transferee is not a consumer transaction, unless it is for ordinary family asset management. The profit-making standard is applied in many of areas of law. See, e.g., *Thomas v. Sundance Properties*, 726 F.2d 1417 (9th Cir. 1984); *In re Booth*, 858 F.2d 1051 (5th Cir. 1988) ("[The] test … is whether it was incurred with an eye toward profit."); *In re Circle Five, Inc.*, 75 B.R. 686 (Bankr. D. Idaho 1987) ("Debt used to produce income is not consumer debt primarily for a personal, family or household purposes."); Truth in Lending Act 15 U.S.C. § 1603 (excluding "extensions of credit primarily for business, commercial, or agricultural purposes"). A stated purpose in the agreement of the parties would ordinarily determine the purpose of the transaction for this definition.

10. "Contract fee." This term includes any money payment required under a contract.

11. "Contractual use restriction." This term includes any enforceable restriction on use or disclosure of information or informational rights created by contract. Use restrictions relate only to the copies and information provided under the license. Unless otherwise expressly indicated, a contractual use restriction does not restrict use of the same information lawfully obtained from other sources. The restriction must come from contract terms. The term does not include limitations imposed by property or regulatory law. The definition does not include terms unenforceable under this article or other law, including laws which limit enforcement of some restrictions on use of information. Thus, if trade secret law precludes enforcement of a particular non-disclosure or non-competition term, that term is not a contractual use restriction to the extent of its unenforceability.

12. "Copy" refers to the media containing information and not the information itself. In Article 2B, the term relates to questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, in appropriate cases, the time during which the information is fixed on a particular medium can be temporary. For example, an agreement to deliver a copy of information that can be reviewed by the transferee for one hour is met by delivery of or access to the information from a tangible medium on which it remains only for the temporary period of one hour. Article 2B does not deal with the copyright law question of whether a brief reproduction in computer memory is an infringement under copyright law. *Stenograph v. Bossard*, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

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

14. "Delivery." Delivery can occur either through transfer of possession of a tangible copy or by electronic transfer. The method of transfer does not matter. Under modern technology, it is often true that a copy does not move from one location to another. Electronic transfers more often involve copying the information into another location or making it available in a common system shared or accessible by the recipient and the person making the delivery.

15. "Direct damages." Direct damages are compensation for losses associated with the value of the contracted for performance itself as contrasted to loss of a benefit expected from intended use of the performance or its results. Direct damages are measured by formulae in section 2B-708(b) and 2B-709(a). They are capped by the contracted for price and the market value of other consideration for the performance as appropriate. This definition rejects cases that treat as direct damages losses that relate to anticipated benefits from use of information such as *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 1982). Those are consequential damages. Thus, if software is purchased for $1,000 and, if merchantable, would yield profits or cost savings in business of $10,000, but it is totally defective, "direct" damages are $1,000. If recoverable, the lost profits or expected cost savings are consequential damages. In a contractual indemnification term, the amount to be indemnified is a form of direct damages in that it identifies a direct obligation of the party under the contract.

16. "Electronic." While most modern information systems use electronic technologies, the term here is open-ended. It also encompasses forms of information processing technology that may be developed in the future.

17. "Electronic agent." This term provides part of the framework for recognition of electronic commerce and automated contracting. It refers to an automated means for making or performing contracts. The term includes a computer program, but is not limited to that technology. The automated system must have been selected, programmed or otherwise used for that purpose by the person to be bound by its operations. In automated transactions, an individual does not deal with another individual, but one or both parties are represented by electronic agents. As indicated in section 2B-116 and 2B-204, the legal relationship between the person and the automated agent is not fully equivalent to common law agency, but takes into account that the "agent" is not a human actor. Parties who employ electronic agents are ordinarily bound by the results of their operations.

18. "Electronic Message." A message is distinguished from a "record" by the fact that it is intended to be communicated to another person or an electronic agent. Communication in modern technology does not necessarily require that the message move from one location to another. Communication of a message may entail copying it into another location or making it available in a common system shared by or accessible to the recipient and the person or electronic agent creating the message. In effect, it is "stored" for purposes of communicating to another. Two different types of message are included. One, such as a fax, a telex, or an E-mail, is intended for a human recipient. The second type involves information communicated where the intended recipient is a computer or computer program operating without review by a human.

19. "Financing party." This definition includes secured parties, finance lessors and their assignees.

20. "Good Faith." This definition expands original Section 2-103(b) and rejects the pure "honesty in fact" standard in Article 1. It expands the original Article 2 definition by extending the duty of fair dealing to persons other than merchants.

While good faith in performance is an element of all contracts, the concept does not over-ride express contract terms or their enforcement. *See Kham & Nates Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin*, 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wash.2d 563, 807 P.2d 356 (1991). A lack of good faith cannot be shown simply by the fact that the party insisted on compliance with the express terms of the agreement. The concept generally applies in situations where a party has discretion under the agreement and the implication is that the discretion should be exercised in a good faith manner. *Davis v. Sears, Roebuck & Co.*, 873 F.2d 888 (6th Cir. 1989).

Good faith is not a negligence or reasonable care standard. Fair dealing must be defined in context, but it is concerned with the fairness of the conduct rather than the care with which an act is performed.

Failure to exercise ordinary care in a transaction is an entirely different concept than failure to deal fairly in the transaction. Both fair dealing and ordinary care are judged in light of reasonable commercial standards, but the standards in each case are directed to different aspects of commercial conduct. The fair dealing concept does not alter the premise that good faith issues pertain to and do not over-ride or create express contractual obligations. *See Ohio Casualty Company v. Bank One,* 1997 WL 428515 (N.D. Ill. 1997).

This definition does not support an independent cause of action for failure to perform or enforce in good faith. Rather, it means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

21. "Incidental damages." Incidental damages refer to expenses incurred after breach. This definition follows original Article 2 dealing with sellers' recovery. Other recoveries in reliance would be within the concept of direct damages. The term includes the cost of seeking or arranging for mitigation, but not the actual expenditure for the mitigation itself. Thus, if a licensee must obtain a different computer program because of a breach, the telephone calls and related expenses in arranging for the cover are incidental damages. The cost of the new program may be considered in computing direct damages.

22. "Information." This term embraces a wide range of subject matter, but of course its scope is limited to transactions within the general scope of this article. This includes information in the form or computer information as well as information that is the subject matter of the transaction and is to be transformed into computer information. As used here, "data" refers to facts whether or not organized or interpreted. The term is not limited to subject matter to which informational property rights attach. It includes factual data if the data are the subject of a contractual relationship. On the other hand, "work of authorship" is a defined term in the Copyright Act and refers to expressive works to which copyright interests may attach. This includes literary works, computer programs, motion pictures, compilations, collected works, audiovisual works and the like. A "mask work" is also defined in federal law; the term refers to a representational technology used in creation of semiconductor products.

23. "Informational content." This term refers to information whose ordinary use involves communication of the information to a human being. This is the information people read, see, hear and otherwise experience. For example, if an electronic database of images includes the images and a program enabling display or access to the images, the images are informational content while the search program is not. The Westlaw search program is not informational content, but text of cases and statutes is informational content. The term applies even if the person creating the content does not intend others to see or have access to it since, in that case, the preparation nevertheless reflects an intent that the information be perceivable by its creator.

24. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce. It includes computers and other information processing systems. In this article, the term is used primarily in reference to standards for sending and receiving notices. In that context, whether the receiving system qualifies as a computer is not pertinent so long as it provides notice-giving or receipt functions.

25. "Informational rights." This term includes, but is not limited to "intellectual property" rights such as rights under patent, trademark, copyright, trade secret, and mask work law. It also includes rights created under any law that gives a person a right to control use of information by another independent of contract, such as may be developing with reference to privacy law and the right of publicity. Other laws determine when such rights exist and, as with traditional intellectual property law, the rights need not be comprehensive or exclusive as to all other persons and all uses. The term does not include mere tort claims such as the right to sue for defamation.

26. "License." A license is a limited or conditional contractual transfer of information or a grant of limited or restricted contractual rights or permissions to use information. A contract "right" entails an affirmative commitment that a party can engage in a specific use, while a contract "permission" means simply that the licensor will not object to the use. Either can be the basis of a license. No specific formality of language of grant or restriction is required. For purposes of the Uniform Commercial Code, the term includes consignments of copies of information, but does not otherwise alter the nature of a consignment.

The term applies only to contracts and the limitations or restrictions must be terms of the contract. A transaction is not a license merely because as a matter of law the transferor retains informational property rights that restrict the transferee's ability to use the information. The term thus does not include a unrestricted sale of a copy since the sale lacks express contractual restrictions on use. The buyer receives ownership of a copy, but copyright (or patent) law restricts its use. Restrictions flowing solely from retained ownership of informational rights do not create a license. A "copyright notice" which merely tracks the privileges and restrictions associated

with a first sale under copyright law does not transform a sale of a copy into a license. However, a license does exist if a *contract* grants greater privileges than a first sale, restricts use privileges that might otherwise exist, or deals with issues that are not explicit attributes of a first sale. Whether such terms are enforceable is determined under this article and other applicable federal and state law.

To create the contractual restrictions of a license, the requirements for an agreement must be met. Thus, language on the first page of a copy that restricts use to educational purposes do not create a license if there is no agreement to the terms or assent that makes them part of a contractual arrangement. A mere copyright notice may or may not become part of a contract. If there is no agreement to terms, they are not contractually enforceable. This article does not address whether or not a notice is enforceable under other law. Similarly, the term does not include the myriad of non-commercial, casual or other exchanges of information that occur in normal political or social discourse where the focus of the interchange is on that conversation even though there may be incidental restrictions on use of the information. These casual exchanges are not within Article 2B because they do not involve a contractual relationship even if a strained analysis might argue that an enforceable promise was made concerning the information itself. Thus, when one friend approaches another and offers to describe the latest marital problems of a third party if the other does not "tell anyone else," that exchange of information is not an Article 2B issue because it is not a contract.

Whether a license is created does not depend on whether the contract transfers ownership of a copy. Ownership of a copy is analytically and commercially distinct from questions about the extent to which use of the information is controlled by a license. A license pertains to rights in information and the copy is the conduit, not the focus of the transaction. The court's analysis in *Applied Information Management, Inc. v. Icart*, 976 F. Supp. 147 (E.D.N.Y. 1997) indicates how the issues may be separable.

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

28. "Mass-market license" and "mass-market transaction." The definition of "mass market" must be applied in light of its intended and limited function. That function is to describe small dollar value, routine and anonymous transactions involving information that is directed to the general public in cases where the transaction occurs in a retail market available to and used by the general public. The term includes all consumer transactions and some transactions between business in a retail market. It does not include ordinary commercial transactions between businesses using ordinary commercial methods of acquiring or transferring commercial information.

A "mass-market" transaction is characterized by 1) the *context* in which the transaction occurs, 2) the *terms* of the transaction, and 3) the *nature* of the information involved. The context involves transactions in a retail market where information is made available in pre-packaged form under generally similar terms to the general public as a whole and in which the general public, including consumers, is a frequent participant. The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract, the general public as a whole. They are also characterized by the fact that, while retail merchants make transactions with other businesses, the predominant type of transaction involves consumers. In a retail market, the majority of the transactions also involve relatively small quantities, non-negotiated terms, and transactions to an end user rather than a purchaser who plans to resell the acquired product. The products are available to anyone who enters the retail location and can pay the stated price.

"Mass-market" refers to transactions that involve information aimed at the general public as a whole, including consumers. This does not include information products for a business or professional audience, a subgroup of the general public, members of an organization, or persons with a separate relationship to the information provider. In determining where is a distribution to the general public, courts should rely on the purpose of the definition which is to avoid artificial distinctions among business and consumer purchasers in an ordinary retail market where the purchasers have relatively similar expectations shaped by the retail environment itself. The transactions covered are purchases of true mass-market information and do not include specialty software for business or professional uses, information for specially targeted limited audiences, commercial software distributed in non-retail transactions, or professional use software. The transactions involve information routinely acquired by consumers or that appeals and intends to appeal to a general public audience as a whole, including consumers. Generally, this is inconsistent with substantial customization of the information for a particular end user. Customization that is routine in mass markets or that is done by the licensee after acquiring the information, of course, does not take the information, and therefore the transaction, outside the concept of a mass-market transaction.

The transaction must be with an end user. An end user licensee is one that generally intends to use the information or the informational rights in its own internal business or personal affairs. An end user in this sense

is not engaged in the business of reselling, distributing, or sub-licensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information commercially available to third parties.

The definition excludes a transaction for redistribution or for public display or performance of a copyrighted work. These are never a mass-market transaction because they involve no attributes of a retail market. In the on-line world, consumer transactions are mass-market transactions. However, the definition, by excluding on-line transactions not involving a consumer establishes an important principle. In the new transactional environment of on-line commerce, it is important not to regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer interests.

29. "Merchant." This definition comes from original Article 2. The definition covers a person that holds itself out as experienced even though the person did not actually engage in prior transactions of the type involved to qualify as a merchant. The term "merchant" has roots in the "law merchant" concept of a professional in business. The professional status may be based upon specialized knowledge as to the information, specialized knowledge about the business practices, or specialized knowledge as to both. Which kind of specialized knowledge may be sufficient to establish merchant status is indicated by the nature of the provisions. In Article 2B, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Section 2B-401(a) and 401(e), and Section 2B-403, however, require a more focused expertise in the particular type of information involved. This draft contains a bracketed strikeout intended to conform the definition to original Article 2, but which the Committee has not yet reviewed.

The reference to attributing knowledge by the employment of an agent confirms that merchant status does not always depend on the principal's knowledge. Similarly, of course, an organization is charged with the expertise of its employees and even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel familiar with business practices.

30. "Non-exclusive license." This is the most common type of commercial license. The licensor grants limited rights and does not foreclose itself from making additional licenses involving the same subject matter and general scope. A non-exclusive license has been described as nothing more than a promise not to sue. While it often has more proactive commercial aspects in modern commerce, a license does not convey property rights to the licensee.

31. "Present value." This definition corresponds to Section 2A-103 and Section 1-201(37)(z). It modifies those rules to cover present valuation of performances other than future payments.

32. "Published informational content." This term refers to the type of information most closely associated with free expression. This is the material of newspapers, books, motion pictures and the like, which is distributed to the public and intended to communicate knowledge, sounds, or other experiences to a human being, rather than simply to operate a machine. The term includes interactive content since, in interactive products, the information is generally available and the end user selects from the available information. This is like the reader of a newspaper who reads part, but not all, of the newspaper.

The term does not include information provided in a special relationship of reliance. That phrase, which is also used in Section 2B-404, should be given the same interpretation in both contexts. It excludes transactions in which the provider knows that the particular licensee plans to rely on the particular data that the licensor provides and expects that the licensor will tailor the information to the particular client's business needs. The relationship arises only with respect to persons who possess unique or specialized expertise or who are in a special position of confidence and trust with the licensee such that reliance is justified and the party has a duty to act with care. In a special relationship of reliance the information provider is specifically aware of and personally tailors information to the needs of the particular licensee as an integral part of the provider's primary business of providing such content. A reliance relationship does not arise for information made generally available to a group in standardized form even if those who receive the information subscribe to an information service they believe relevant to their commercial needs.

33. "Reason to know." This definition is consistent with *Restatement (2d) Contracts* § 19, *Comment* b. A person has reason to know a fact if the person has information from which a reasonable person of ordinary intelligence would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. The party is charged with commercial knowledge of any factors in a particular transaction which in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing. If a person has specialized knowledge or superior intelligence, reason to know is determined in light of whether a reasonable person with that knowledge or intelligence would draw the inference that the fact does or will exist. There is also reason to know if from all the

circumstances, the inference would be that there is such a substantial chance that the fact does or will exist that, exercising reasonable care with reference to the matter in question, the person would predicate the person's action upon the assumption of its possible existence.

"Reason to know" must be distinguished from knowledge. Knowledge means conscious belief in the truth of a fact. Reason to know need not entail a conscious belief in the existence of the fact or its probable existence in the future. Of course, a person that has knowledge of a fact also has reason to know of its existence. Reason to know is also to be distinguished from "should know." "Should know" imports a duty to others to ascertain facts; the term "reason to know" is used both where the actor has a duty to another and where the person would not be acting adequately in protecting its own interests if it did not act in light of the facts of which it had reason to know.

34. "Receive." This definition, as to performances, corresponds to original Section 2-103. As to notices, it revises Section 1-201(26) to cover electronic systems used to give and receive notice. As in current law, "receive" includes circumstances in which a message is delivered to a place designated by the recipient even if that place is under the control of a third party. Delivery to a private post office box is receipt by the addressee even though the addressee may not remove or otherwise obtain the message until later. Similarly, receipt of a message at an electronic mail address, even though on a third party system, constitutes receipt as to the ultimate addressee, if that electronic mail address was held out as a place for receipt of such messages. The message must be capable of being processed. This refers to processing in the type of system in its general, reasonably expected configuration and not to the details of an atypical configuration known or knowable only to the party operating the system. The message must be capable of interacting with an ordinary system of the particular type.

35. "Record." A record must be in or capable of being converted to a perceivable form. Electronic text recorded in a computer memory that could be printed from that memory constitutes a record. Similarly, a tape recording of an oral conversation or a video taping of actions could be a record. The term does not require permanent storage or anything beyond temporary recordation. Fixation can be fleeting and perception can be either directly or indirectly with the aid of a machine.

36. "Release." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information. A release is a form of a license, but it is characterized by the lack of other commercial attributes. The term is used in this article to identify a class of transactions important to the information industries in which the sole purpose of the agreement is to permit use and which agreements are often made on a less formal basis than a more typical commercial license.

37. "Return." In this article, a "return" refers to acts that place a party back into their initial position if the party has rejected a record or term of a record made available to it after having committed to, or in fact having completed, an obligation to pay or deliver and as a result of the rejection the transaction will not be carried forward. In traditional commerce, this issue has been most specifically relevant to licensees, but there are many cases where the licensee controls the timing or proposed terms, and the nature of the terms proposed. This will be even more common as modern automated commerce makes possible systems by which consumers or other licensees through automated agents can propose terms after the initial agreement in circumstances where this article recognizes that proposal as part of an on-going contracting process, rather than as a proposal for modification. See original Section 2-311(1); Section 2-305(2). When this occurs with respect to a licensor, a return requires return of information delivered that would have been covered by the rejected record of agreement. With respect to a licensee, "return" consists of a reimbursement of fees paid on return of all copies of the information and documentation.

Whether or when a right to a return exists depends on the terms of the offer and this article. Return is not a remedy for breach or a right of rescission. It is a right that arises if a party refuses a proffered license and it has previously committed to, or paid the contract fee. Making a return available in such cases is essential to allow the party an opportunity to accept or reject that license. See Sections 2B-111 and 2B-112. The right to return in those sections expires if the party assents to the license. Of course, if a party accepts a license but the information is defective, the aggrieved party may have a right to restitution of the contract fee as direct damages or may have a contractual right to a return as defined by the agreement.

Return must be sought within a reasonable time. What constitutes a reasonable time depends on the facts and the contract.

The definition deals with the difficult problem of administering a return right in "bundled" products (products that include separate items of information transferred as a whole for a single fee). Bundled transactions are not based on a mere sum of the fees required for each product in an unbundled setting and, often, include information products that are provided for no charge, even though the information may have a discernable

price in other transactions. If the products are subject to separately priced licenses, a return is for the contractual fee attributed to the item in question. Otherwise, return must be of the entire bundled product in return for the entire price. For the former, the price must be separately stated in the sense that the agreement identified an amount allocated to the particular information. A court cannot unbundle the products and estimate appropriate pricing in what is often a complex arrangement for distribution premised on the bundling of multiple products.

38. "Scope." This term refers to contract terms that define the central elements of a license. Scope provisions in a license define the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read a contract to determine that. That is not the case in the computer information industries. The same information has entirely different characteristics depending on what is the scope of rights granted. For example, a license that allows use of a word processing program in a single computer is not the same product as a license to make and distribute copies of the word processing software throughout the United States. Neither license transfers the same product as a license to use a copy for three days in one's home. They are all different even if the software itself is identical.

39. "Send." This definition adapts original Section 2-201(38) to provide criteria relevant to electronic notices. In modern technology sending a message does not require that the information move from one location to another. Electronic transfers more ordinarily involve initiating processes that copy the information into another location or make it available in a system shared or accessible by the recipient and the person or electronic agent creating the message. The message must be capable of being processed by the type of system involved. This refers to the type of system in its general, reasonably expected configuration and not to the details of an atypical system configuration. The message must be capable of interacting with ordinary systems. Of course, if the sender has knowledge of the details of the actual system to which it is sending the message, its actions must take that knowledge into account. Finally, use of the phrase "in addition" makes it clear that the electronic sending must also comply with relevant criteria for other media, such as in use of a reasonable carrier.

40. "Software contract" includes licenses of software and sales of copies of software. It also covers all software development contracts involving independent contractors. This does not depend on whether or not the contract falls within the Copyright Act definition of a "work for hire." Of course, under copyright law, most works for hire are authored by an employee in the scope of its employment. Article 2B does not deal with employee contracts. It thus does not cover a contractual arrangement under which an employee develops software for the employer within the scope of the employee's job.

The distribution of motion pictures and sound recordings in digital form even if the distributed form entails digital instructions that constitute a computer program where the only purpose of the program is to enable the display and performance of the motion picture or sound recording. Such transactions are, in any event, exclude from the scope of this article by virtue of the combined effects of Section 2B-104(1) and Section 2B-104(6). The motion picture is excluded under subsection (6), while the program is excluded under subsection (1) as a mere incident of the transfer of the motion picture product. The language in the definition here merely corresponds to and confirms that result.

41. "Standard form." The definition refers to forms, not standard terms. A form consists of record containing a group of terms prepared for frequent use as a group. Standard forms in modern commerce are ubiquitous. The definition does not cover a tailored contract comprised of "terms" selected from prior agreements. The record must itself have been prepared for repeated use and actually have been used without negotiation other than of the ordinarily tailored terms noted in the definition. If a standard form is offered but then negotiated or changed other than with respect to the ordinarily tailored terms noted in the definition, the resulting record is not a standard form contract.

42. "Terminate." This definition conforms to original Section 2-106.

[B. General Scope and Terms]

SECTION 2B-103: SCOPE

(a) This article applies to computer information transactions.

(b) If a transaction involves computer information and goods, the following rules apply:

(1) This article applies to the computer information and to copies of computer information, its packaging and documentation, but does not apply to a copy of software contained in and transferred as part of other goods unless:

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

(B) giving the purchaser of the goods access to or use of the software is a material purpose of the transaction.

(2) Except as provided in paragraph (1), Article 2 or 2A applies to goods in the transaction.

(c) Except as provided in subsection (b), if another article of the [Uniform Commercial Code] applies to a transaction, this article does not apply to the subject matter of the other article.

(d) The parties may by agreement provide that all or part of this article, including contract formation rules, governs a transaction in whole or in part or that other law governs the transaction in whole or in part. An agreement that this article does or does not apply to some but not all of a transaction cannot alter a rule that otherwise applies and cannot be varied by agreement. In all other cases, following rules apply to the agreement:

(1) An agreement to opt out of Article 2B cannot alter standards of good faith, unconscionability, or public policy invalidation, or the defense in Section 2B-118 and the limitations in Section 2B-716. An agreement to opt into Article 2B is subject to any similar restrictions in otherwise applicable law. Neither agreement can alter an otherwise applicable consumer protection law referenced in Section 2B-105.

(2) In a mass market transaction, the following rules apply:

(A) An agreement to opt into or opt out of Article 2B is enforceable only if the transaction involves subject matter governed by Article 2B and subject matter governed by other contract law, or if there is good faith uncertainty about whether Article

2B or other contract law governs.

(B) The agreement cannot alter law applicable to distribution of information in non-electronic form.

(3) Except for mass market transactions, the following rules apply:

(A) An agreement to opt out of Article 2B is not enforceable unless the transaction involves subject matter not governed by Article 2B or there is good faith uncertainty about whether Article 2B or other contract law governs.

(B) An agreement to opt into Article 2B is not enforceable unless the subject matter of the transaction includes information or informational rights or there is good faith uncertainty about whether Article 2B or other contract law governs.

Definitional Cross Reference:
"Agreement": Section 1-201. "Computer": Section 2B-102. "Computer information": Section 2B-102. "Computer information transaction": Section 2B-102. "Consumer": Section 2B-102. "Copy": Section 2B-102. "Goods": Section 2-1--. "Electronic": Section 2B-102. "Information": Section 2B-102. "Party": Section 1-201. "Purchaser": Section 1-201. "Software": Section 2B-102.

Reporter's Notes:

1. ***General Structure.*** Section 2B-103(a) states the affirmative scope of Article 2B. Unless a transaction is a "computer information transaction," this article does not apply. *See* Section 2B-102 (defining "computer information transaction"). Subsections (b) and (c) deal with mixed transactions. Subsection (d) allows the parties to opt into or out of the article by agreement. An "agreement" does not require a signed writing, but refers to the bargain of the parties in fact, including applicable usage of trade and course of dealing. Section 2B-104 states several exclusions from the scope of the article. As a contract statute, Article 2B does not alter or even deal with intellectual property rights law.

2. ***Scope of the Article.*** This article applies to "computer information transactions" as defined in Section 2B-102. The article focuses on transactions involving creation or distribution of computer software, multimedia or interactive products, computer data, Internet, and online distribution of information. This leaves unaffected the many transactions in the core businesses of other information industries (e.g., print, motion picture, broadcast, sound recordings) whose business practices in their core businesses differ from those of the computer software, online, and data industries. This article does not apply to print books, newspapers, or magazines. Whether a magazine publisher can place contractual limitations on purchasers of copies of its magazines or books is not addressed in Article 2B.

The scope of Article 2B is limited by the affirmative scope statement in subsection (a) which does **not** include:

- Sales or leases of goods, except as indicated in Section 2B-103(b).
- Services contracts, except as in the definition of "computer information transaction".
- Creation or distribution of print materials (books, magazines, newspapers).
- Still photography.
- Casual, non-contractual exchanges of information.
- Creation or distribution of motion pictures, sound recordings, broadcast or cable programming.
- The subject matter of other articles of the Uniform Commercial Code.

3. ***Transactions in Computer Information.*** Transactions in computer information are contracts whose subject matter entails the acquisition, development or distribution of computer information. "Computer information" is information in a form directly capable of being processed or used by, or obtained from or through, a computer, but does not include information of a type or used in a manner referred to in Section 2B-104(2). See Section 2B-102.

Transactions in computer information differ from sales or leases of goods because the focus of the transaction is on the information, its content or capability, rather than on the tangible items that contain the information is delivered. In a sale of goods, the buyer obtains ownership of the subject matter of the contract (e.g., the specific toaster or television). That ownership creates exclusive rights in the subject matter (e.g., the toaster). In contrast, a person in a transaction whose subject matter involves obtaining the computer information and that acquires a copy of computer information may obtain ownership of the copy but does not, and cannot reasonably expect to, own the information or the rights associated with it. Unlike a buyer of goods, the purchaser of a copy often has little interest in retaining possession or control of the original disk that contained the information unless the information remains on that disk and nowhere else. Often, a purchaser copies the information into a computer, rendering the original diskette largely immaterial.

Transactions in computer information differ from transactions in other information because of the nature of the information involved. Information capable of being processed in a computer is more readily susceptible to modification and to perfect reproduction than information in other form such as printed books or magazines. Indeed, to use computer information, one must copy it into a machine. *See Stenograph v. Bossard*, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993). In order to access and view computer information from a remote computer, one must copy it into the local computer. This creates copyright law issues with which this article does not deal. It also creates contract law issues addressed in this act.

4. ***Computer.*** The term "computer" is defined in Section 2B-102. The definition comes from a leading dictionary of terms related to the computer industry and conforms to ordinary definitions. It does not include traditional televisions, VCR or similar systems whose automated functions are primarily intended to receive or transmit broadcasts, or to perform or display motion pictures or sound recordings. In any event, this article does **not** apply to all information received or processed by a computer and **does not** apply to computers per se. Whether or not received by a computer, motion pictures, broadcast and similar programming are excluded from this article under Section 2B-104.

5. ***Included Transactions.*** The scope of this article turns on the definition of "*computer information transaction*." "Computer information transactions" include transactions involving the creation, distribution, or license of computer information, including software. Section 2B-102. Transactions for information not in a form directly capable of computer processing are excluded unless the parties agree to be governed by its provisions.

For a transaction to be included, acquiring the computer information, access to it, or its use must be the subject matter of the transaction and not a mere incident of another type of transaction. The mere fact that information is sent or recorded in digital form is not sufficient. Thus, for example, a contract for airplane transportation does not become an Article 2B transaction simply because the ticket is in electronic form. The subject matter of the transaction is not the computer information, but the service – air transportation from one location to another. Similarly, an insurance policy prepared for a client and recorded in digital form is not a computer information transaction, but simply a contract for insurance whose result or terms is evidenced in digital form. A contract for a digital signature certificate is a contract for digital certification or identification services, not a contract whose subject matter is the computer information. This article does not apply to the many cases in which a person provides information to another person for purposes of another transaction such as making an employment or loan application.

Typically, a contract included in this article is for commercial use or distribution of the computer information. The article thus includes, for example, a license allowing a company to transform photographs into digital form for re-licensing in that form to others. It also includes a contract to compile in digital form a database of names for use by a client as a product furnished to others for use as a mailing list.

a. Creation, Development and Support. The article applies to contracts for the development or creation of computer information, such as software development contracts and contracts for the creation of computer databases. Contracts of this type have been subject to inconsistent court rulings, applying the U.C.C. or common law contract theories based on fine and not clear distinctions. Article 2B applies to all such transactions. The article does not, however, cover contracts for development or creation of motion pictures, sound recordings, or broadcast programs. These are excluded from the definition of "software" and the definition of

"computer information." In any event, transactions of this type are excluded under Section 2B-104. This article also does not cover contracts for the creation or development of print books or articles which do not involve computer information.

b. Computer information Transaction. The article covers transactions for access to, acquisition, transfer, use, or distribution of computer information. This includes all transactions involving the distribution or use of computer programs. Such transactions are covered whether they involve a license or an unrestricted sale of a copy of the program.

This article also covers transactions involving access to or information from a computer system. This encompasses Internet and similar systems that allow access to information databases. This form of information distribution does not include broadcast of digital information involving motions pictures, sound recordings or the like.

6. ***Mixed Transactions.*** Inevitably, as with Article 2 transactions in goods, some transactions in computer information present questions about to what extent the transaction is governed by Article 2B and to what extent it is governed by common law or law in another statute. Transactions that are governed by several sources of contract law in a single transaction (i.e., "mixed transactions") are so common under current law as to be unexceptional and, indeed, virtually universal. They routinely exist in all consumer transactions (e.g., videos, CDs, and software) and all transactions involving copyrighted works. For consumer goods, transactions are governed by common law, Article 2 (or 2A), and state or federal consumer law. For copyrighted works, transactions are variously (and non-uniformly) governed by common law, copyright law, Article 2 (or 2A), and various state statutes. While Article 2B provides more uniformity and clarity on the issues it addresses, it is supplemented by common law (Section 1-103), copyright law, and consumer or other state law (Section 2B-105).

Here, the relevant issue is not whether a single or multiple sources of contract-related law apply (because multiple sources always apply), but whether Article 2B, rather than another source, is involved in the mix. On this issue, courts use two distinct approaches under other U.C.C. provisions and under common law.

- A "gravamen of the action" standard: applies rules tailored to a subject matter only to that particular subject, asking in effect to which subject matter does the particular dispute pertain.
- A "predominant purpose" standard: makes a determination about the overall transaction and applies the law applicable to the predominant subject matter to the "entire" transaction.

Article 2B adopts a modified gravamen of the action approach in subsection (b) with respect to goods and in subsection (c) with respect to the subject matter of other articles of the U.C.C., but as discussed in a following note, courts may to use a predominant purpose test with respect to non-U.C.C. subject matter.

7. ***Computer Information and Goods.*** In a transaction in which computer information and goods are involved, Article 2B applies to the computer information, while Article 2 (or Article 2A) applies to the goods. This recognizes the differences in the two types of subject matter and the transactional differences that result from the different subject matter.

There are two exceptions. The first, in Section 2B-103(b), is that Article 2B applies to goods that are merely a copy, documentation, or packaging of the computer information covered by this article. In effect, these "goods" are mere incidents of the computer information and, as such, should be incorporated into this article to prevent unintended results through the interface of the U.C.C. transactional articles. Article 2B covers both the computer software and the media on which the software is copied or documented.

The second exception in subsection (b) concerns copies of software contained in and sold or leased as part of goods. Section 2B-103(b)(1) provides that, if software is embedded in goods, Article 2B applies to the copy of the software only if it is part of a computer or a computer peripheral or if giving the purchaser access to the functional attributes of the software is a "material purpose" of the transaction. In fact, however, in most mass market transactions where the issues are most significant, which law applies often does not alter the outcome.

Article 2B governs contract issues for software embedded in goods other than a computer or a computer peripheral **only** if a material purpose of the transaction is to provide the functional attributes of the program. Thus, while a television may be operated by software, the material purpose of the a sale of an ordinary television set is to acquire the set and television reception. This is not an Article 2B transaction, but that result may change if television sets evolve into computing systems in which a material purpose for the user is to obtain software processing. Similarly, while an automobile may have some functions operated by a computer program, the program that operates the brakes or other functions is not a primary purpose of the transaction for the purchaser. The transaction is within Article 2 or 2A. On the other hand, the development or supply contract for the program that enables the manufacturer to use the program in its system, however, is in Article 2B. Similarly, separately licensed software in a digital camera that enables the camera to be linked to a computer so that images can be

transferred back and forth and manipulated is within Article 2B. Factors suggesting that the program's processing capacity is a material focus of the transaction include the extent to which the processing capabilities of the software is a dominant focus of the product's appeal, the extent to which discussions of the parties focused on that processing capacity in contrast to other attributes of the product, and the extent to which the agreement makes those processing capabilities a separate focus for agreed terms.

8. ***Computer Information and other UCC Articles.*** The articles of the U.C.C. are parallel and control with reference to the subject matter with which they deal. For example, this article does not deal with handling of investment securities or rights or remedies with respect to that subject matter, even though in modern practice securities may be dealt with through information and informational representations in a computer. The same principle applies with respect to the subject matter of Article 4 and Article 4A. This, in effect, is a gravamen of the action standard and follows the same rule that applies under original Article 2 and 2A with reference to such subject matter.

While Article 2B does not apply to the subject matter of the other articles of the U.C.C., it does of course control questions related to its own subject matter, such as the creation, enforcement, scope, termination and cancellation of a license. Thus, for example, Article 9 applies to security interests and secured parties, while Article 4 applies to checks and Article 4A applies to funds transfers. However, if a computer information transaction is involved, such as a license of computer information, Article 2B applies to the terms and enforcement of that license. If the specific terms of a provision of Article 9 conflict with a provision of Article 2B, the Article 9 rule controls with respect to the position of the security interest or secured party.

9. ***Computer Information and Other Contract Law.*** Where the issue does not involve goods or the subject matter of other articles of the U.C.C., courts should follow general interpretation principles to determine the applicability of Article 2B. In most cases involving computer information and other subject matter, this will entail application of a form of the "predominant purpose" test as used in most states with respect to original Article 2, but modified here to reflect the issues presented in reference to Article 2B. The predominant purpose is judged as of the time of the contracting.

If computer information is the predominant purpose of the transaction, Article 2B rules apply instead of other contract law (e.g., common law). The predominant purpose test has been applied by courts dealing with the scope of Article 2 where goods and other subject matter (e.g., services) are involved in a transaction. The basic test asks whether Article 2B or other subject matter constitutes the main intended focus of the contract. Thus, in a contract between an author and a publisher, if the author agrees to allow the publisher to distribute the work in "book, motion picture or digital form", the agreement is outside Article 2B if the predominant purpose is to give the publisher the right of first publication in book (printed) form or the right to motion picture uses. This is true if, for example, the intended primary exploitation of the contracted-for work is in print or motion picture form, both of which are outside Article 2B. The fact that "electronic rights" are also covered in the agreement does not result in Article 2B coverage since the focus is on other rights. Similarly, a contract with a producer whose predominant purpose is to develop a motion picture for distribution as such does not come within Article 2B simply because the grant includes secondary rights to use parts of the film in interactive contexts. The predominant purpose is creation of a motion picture. On the other hand, a contract giving a software publisher the right to reproduce a photographic image in "software and other works" is governed by Article 2B if the predominant purpose is to allow use in computer information even though use in print form is also permitted. Similarly, a license to acquire rights to use software by a motion picture studio which may use the software as a tool in creating motion pictures is an Article 2B transaction, while a license to use digital scenes or images in a motion picture is excluded.

In applying the predominant purpose test to information transactions, the standard should be refined to include consideration of the type of transaction envisioned in the parties' agreement. For example, in a loan transaction a loan officer might deliver a diskette containing interest rate calculations for use by the borrower. Under the predominant purpose test, no part of the transaction is covered by Article 2B because the predominant purpose of the agreement between the lender and borrower is the common law loan. Further, the transactional type mirrors a common law loan transaction and the mere presence of the software does not alter this fact. This type of an approach is more appropriate than that of some courts which, under prior law, applied sale of goods rules to software development transactions because, even though the bulk of the contract concerned development services, the program was to be delivered on a diskette or tape. The proper analysis should have been whether the principles of Article 2 (e.g., damage calculation rules, conforming tender rule, rules on timing of ownership transfer, rules on duration of license, effect of negligence, contract modification, etc.) fit the nature of the transaction in fact better than would the rules available under other law (e.g., common law regarding services contracts). This more nuanced analysis is more appropriate for new technology areas in order to avoid elevating form over substance

While the cases under Article 2 thus provide some guidance, it is appropriate to consider additional factors. Thus courts should consider the extent to which the transaction as a whole corresponds to the transactional framework involved in computer information transactions. If it does, Article 2B should apply to the entire transaction, but if not, it is possible that Article 2B should not apply at all. Among the transactional factors that courts should consider are: 1) the nature of the underlying intellectual property rights involved, including, with respect to copyrighted works, differences in the rights provided under the Copyright Act for different types of works, 2) the extent to which regulatory regimes apply to the subject matter and were considered in the transaction, 3) the extent to which allocation of liability risk for inaccurate or improperly functioning information is a concern, and 4) the extent to which the parties involved are performing services rather than information-related transactions.

The test applies at various levels of use or distribution, but the result may differ at each level. For example, a courier company that licenses communications software from a software publisher is engaged in an Article 2B transaction. The subject matter of the agreement a license in the software itself. If the courier company provides the software to customers merely to access data on the current location of packages, however, the predominant purpose may be the services. If the software publisher enters into a license with the end user, that license is in Article 2B.

The predominant purpose test can apply only if the parties have not otherwise agreed as to coverage by Article 2B or other law. In the foregoing illustrations, for example, if the parties elect coverage under Article 2B, that agreement governs as would an agreement that Article 2B should not apply at all. In any event, Article 2B coverage or non-coverage does not create "mixed contracts." The only issue is whether Article 2B supplants common law or other rules otherwise applicable to a transaction. Agreement here, as elsewhere in the U.C.C., can be found in the express terms of the contract as well as in the usage of trade or course of dealing between the parties, or as inferred from the circumstances of the contracting.

10. ***Contract Choice.*** Subsection 2B-103(d) follows the basic rule that contract choices control and applies this principle to determining what law governs. The subsection distinguishes between decisions to opt entirely into or out of Article 2B subsection (d)(1-3), and decisions to do so only in part (subsection (d)).

The parties can agree to have Article 2B apply to the entire transaction, part of the transaction, or none of the transaction. These choices, of course, deal with applicability of Article 2B and not with whether other law continues to apply to issues not dealt with in Article 2B. Also, a contract choice here is effective irrespective of any "predominant purpose" of the transaction. An enforceable decision to opt into or out of Article 2B may render the "predominant purpose" test moot.

In determining whether the agreement to opt-into or opt-out of Article 2B was formed and is enforceable, a court will ordinarily apply the contract formation rules of this article and the general concept of agreement in the U.C.C. This is especially true where the transaction involves some subject matter governed by Article 2B. Here, as elsewhere, an agreement can be found as easily in the express terms of the contract of the parties as in course of dealing, usage of trade, or as inferred from the circumstances.

For commercial parties, the ability to choose Article 2B or another body of state contract law gives an important opportunity to avoid uncertainty and the effects of potentially conflicting rules potentially applicable under multiple bodies of state contract law (e.g., Article 2B, Article 2, Article 2A, and common law). This power of contract choice is especially important in that Article 2B does not apply to all transactions in information. On the other hand, especially in contracts with no bargaining, there is an interest on the part of the party who receives non-negotiable terms that the choice not unfairly deprive it of protections mandated under the other law that may not be varied by agreement. This interest, of course, does not validly apply to contract rules that can be varied by agreement. The provisions of subsection (d) balance the interests in other contexts.

a. General Limits: Opting Entirely Out. Contract terms on this issue are subject to rules on unconscionability and fundamental public policy concerns. In addition, subsection (d) contains several restrictions on enforcing the choice of the parties on whether Article 2B governs or not.

(1). Subject Matter Limitations. The ability to *opt out* of Article 2B exists only in certain cases. In essence, in both a mass market and any other transaction, the parties by agreement can opt out of Article 2B only if the transaction includes subject matter that would not otherwise be governed by Article 2B (a "mixed transaction"), or if there is good faith uncertainty about whether Article 2B applies. Thus, in the latter case, the parties may agree to opt out (or opt into) Article 2B to avoid the uncertainty of whether Article 2 or Article 2B applies. The opt out is presumably into the law that governs the other subject matter or the one whose application was uncertain.

A contract choice here is effective irrespective of any "predominant purpose" of the transaction, but may render the "predominant purpose" test moot. The "predominant purpose" test is applicable only if in fact

the transaction does involve Article 2B subject matter *and* other subject matter, at least in part, or if a contract choice to opt out is ineffective in whole or in part under this section. In the latter event, a court could conclude that under a predominant purpose test, particular law governs.

(2). Rules Affected. Subsection (d)(1) states the general rule that a decision to *opt out* of Article 2B cannot alter certain fundamental rules that would be applicable to the contract if Article 2B applied to part of the transaction. These include standards of good faith, unconscionability and the public policy rule in Section 2B-105(b). For other than the listed Article 2B provisions, opt out is not substantively restricted, but it is limited with respect to the transactions in which it can be used.

In reference to substantive rules, in most cases, Article 2B allows their variation by agreement and, thus, these rules can be varied by a general opt-out. For those few Article 2B rules that cannot be varied by agreement, except as listed in the subsection, the interest in allowing certainty prevails. An opt-out places the entire contract under a different legal regime with its own applicable rules that deal with these topics. This is true, for example, for limits on liquidated damage terms. Common law, Article 2 and Article 2A all contain provisions dealing with this topic and, while somewhat similar, these rules make a balance attuned to those other legal regimes. A rule which makes ineffective a general contract choice to the extent it affects this rule would create a situation in which an agreement would be required to comply with Article 2B (for its subject matter), Article 2 (for goods) and common law (for other subject matter) in the same transaction. The alternative concept, adopted here, is that the opt-out brings with it both the positive and the restrictive parts of the other body of law in full, and results in the loss of both the positive and restrictive parts of Article 2B. This is also true, for example, in a decision to opt out of Article 2B where Article 2 is the other law and governs as to the creation and disclaimer of warranties. It is also the case of the effect of an opt-out on the provisions of Section 2B-208 on both the enforceability of a mass market form and the return right. If there is an opt- out, other law applies to <u>both</u> issues.

The basic theme is that a contract choice to opt out of Article 2B as a whole (see subsection (d)(4) on partial opt out) should ordinarily be enforced and that the interests of the parties are properly safeguarded under the other law (U.C.C. or common law) as a whole. The issues listed in subsection (d)(1) represent exceptions under current law or policies that are so fundamental that their variance should not be permitted.

b. General Limits: Opting Fully In. Contract terms on this issue are subject to standards of unconscionability and public policy concerns. In addition, subsection (d) contains several restrictions on enforcing the choice of the parties on whether Article 2B governs or not.

(1). Subject Matter Limitations. The ability to opt into Article 2B exists only in certain cases. In a mass market transaction, the parties can opt in only if the transaction involves Article 2B subject matter (along with other subject matter) or if there is good faith uncertainty about whether Article 2B applies. In addition to simply recognizing the role of contract choice, the goal of allowing this option to take effect is to allow parties to reduce conflicting rules and uncertainty, some of which are caused by Article 2B itself (because of the decision to focus on a narrow group of transactions). If there is no Article 2B coverage and no good faith uncertainty, the transaction in the mass market should be governed under otherwise applicable law In this respect, subsection (d)(3)(B) further indicates that a decision to opt into Article 2B cannot alter the law regarding distribution of non-electronic copies, such as books and magazines, which are outside the scope of this article.

Outside the mass market, interests in allowing parties to make and enforce contractual choices is even greater. Yet, even here, it seems inappropriate to allow a decision to opt into Article 2B where the transaction involves subject matter entirely unrelated to the general nature of this article – transactions in information. Subsection (d)(3) allows a decision to opt into Article 2B, but only if the transaction subject matter includes information or informational rights. Thus, a decision by parties to a commercial trademark license to be governed by Article 2B is enforceable, while the decision by parties to a real estate lease is not enforceable.

The overall effect of the subsection is as follows: Assume that three commercial parties enter an agreement to create a product involving cable services (common law), software or multimedia (Article 2B) and hardware (Article 2). The parties to the commercial agreement may agree that any of the three laws governs and, thus, avoid inconsistent and overlapping rules. As to Article 2B subject matter, the agreement does not alter good faith, unconscionability, public policy or self-help rules. If the resulting product is distributed in a mass market transaction, if it involves Article 2B subject matter, the agreement may elect Article 2B or other law as covering the deal, with the limits as stated above, but if there is no Article 2B subject matter in the product, Article 2B cannot be made to apply.

(2). Rules Affected. Subsection (d)(1) states the general rule that a decision to *opt in* cannot alter any rule <u>of otherwise applicable law</u> similar to the listed rules: good faith, unconscionability, the public policy rule in Section 2B-105(b), the self-help limitation, and the electronic consumer defense. The rules must be

similar in the sense that they are not subject to varying by agreement and are either so fundamental as to be essential to the transaction (e.g., good faith) or such as have no clear corresponding protections in Article 2B. In addition, neither an opt-out, nor an opt-in can vary consumer protection laws described in Section 2B-105.

The discussion in the notes dealing with limits on the right to opt out are relevant here. In reference to substantive rules, in most cases, contract law allows variation by agreement and these rules can be varied by a general opt-in. For those few other rules, the interest in allowing contract choices that enhance certainty prevails, especially where the rule does not involve a consumer protection that cannot be varied by contract. Opting into Article 2B places the entire contract under this legal regime. The basic theme is that a contract choice to opt into Article 2B as a whole (see subsection (d)(4) on partial opt-in) should ordinarily be enforced.

c. Partial Opt-In or Out. Subsection (d) recognizes the right partially to opt into or out of Article 2B. Selective choices of this nature, however, create risks of manipulation that are not present when an agreement must select the governing law in full. Thus, subsection (d)(4) provides that a partial option in or a partial option out cannot alter any terms of Article 2B or other law that are not generally variable by agreement.

SECTION 2B-104. EXCLUSIONS FROM THIS ARTICLE. This article does not apply to:

(1) a contract or a transaction that provides access to, use, transfer, clearance, settlement, or processing of:

(A) deposits, loans, funds, or monetary value represented in electronic form and stored or capable of storage electronically and retrievable and transferable electronically, or other right to payment to or from a person;

(B) an instrument or other item;

(C) a payment order, credit card transaction, debit card transaction, or a funds transfer, automated clearing house transfer, or similar wholesale or retail transfer of funds;

(D) a letter of credit, document of title, financial asset, investment property, or similar asset held in a fiduciary or agency capacity; or

(E) related identifying, verifying, access-enabling, authorizing, or monitoring information;

(2) a contract to create, perform in, include information in, acquire, use, reproduce, distribute, license, display, or perform:

(A) audio or visual programming by broadcast, satellite, or cable as defined in the Federal Communications Act as that Act existed on January 1, 1999, or similar

methods of delivering such programming; or

(B) a motion picture or sound recording as defined in the Federal Copyright Act as that Act existed on January 1, 1999; or

(3) a compulsory license under federal or state law.

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

Definitional Cross References:

"Computer": Section 2B-102. "Computer program": Section 2B-102. "Copy": Section 2B-102. "Electronic": Section 2B-102. "Financial asset": Section 8-102. "Funds transfer": Section 4A-104. "Information": Section 2B-102. "Instrument": Section 3-305. "Item": Section 4-104. "Investment property": Section 9-115. "Lease": Section 2A-103. "License": Section 2B-102. "Letter of credit": Section 5-102. "Sale": Section 2-106.

Reporter's Notes:

1. ***Effect of the Section.*** This section states several exclusions from Article 2B. These exclusions reflect decisions that the principles set out in Article 2B should not be applicable absent agreement to the specifically excluded subject matter because the excluded transactions are different in type than transactions within Article 2B. Ordinarily, a court should not apply Article 2B by analogy to these excluded transactions, but should refer to other law, including when applicable, Article 2 and Article 2A.

2. ***Core Financial Functions.*** Section 2B-104(1) excludes core banking, payment and financial services activities. Article 2B does not cover transactions governed under other UCC law (e.g., Article 4A, Article 4, Article 8). It is also preempted by certain federal banking regulations. This is not an exclusion of banks or financial institutions. Modern technology and developments in digital cash and similar systems place many companies other than banks in direct competition. Regulations, such as federal Regulation E on funds transfer, do not apply solely to banks, but to any holder of a qualifying account. To the extent that non-banks engage in the activities indicated in the exclusion, those activities are also excluded from this article. Modern banks engage in many activities identical to licensing, however. The on-line systems are within Article 2B to the extent that they involve activities such as on-line shopping, database access, and other activities not within the exclusion. As the information industries converge, so too is the banking industry converging into fields of the information industries. Those non-banking activities are covered by Article 2B.

3. ***Core Entertainment and Broadcast.*** Section 2B-104(2) excludes upstream agreements to create, and subsequent contracts to distribute, motion pictures, sound recordings, broadcast programming and cable programming. These are excluded regardless of whether in digital or other form. The exclusion covers the core activities of the entertainment industry, including creation and distribution of theatrical motion pictures or television and radio programs.

There are a number of reasons for the exclusion. One reflects the existence of a regulatory overlay (cable and broadcast). Also, historically the different nature of liability and other issues involved in the entertainment industries as contrasted to the software and data industries leads to transactional formats that are different. Similarly, even for works within the general property realms of copyright law, a different configuration of rights may exist. For example, under copyright law, a first sale of either a computer program or a video game does not allow the buyer to reconvey that copy through a rental agreement with a third party. That retained "rental right", however, does not exist in respect of motion pictures or sound recordings. The exclusion here of motion pictures, sound recordings, and the listed broadcast or cable activities leaves liability and other issues to general law, including when appropriate, Article 2, and not affected by this article. Because these transactions differ from those covered by this article, the liability limitations, contract formation, and other principles set out in this article should not be applied to those areas of practice either to lessen or increase liability risk.

A motion picture is an "audiovisual work" consisting of a "series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any." 17 U.S.C. § 101. As used here, the term "motion picture" has the meaning used in the Copyright Act. A motion picture is, thus, one

type of work within the broader class of audiovisual works. The Copyright Act and the registration system it enacts makes distinctions among and between various types of works, such as audiovisual works generally, video games, literary works, computer programs, and motion pictures and sound recordings on the other. These distinctions have become part of accepted industry practice and are followed here.

The term, motion picture, includes traditional motion pictures regardless of how distributed, e.g., it includes digital video disk distribution of motion pictures for home or other viewing, even though these are digital works and may be distributed in a form that includes in the disk a computer program designed solely to enable display or performance of the motion picture. These digital products are not governed by Article 2B. Either Article 2 or Article 2A, along with common law apply. The term "motion picture" does not include an interactive computer game, multimedia product, or similar work, nor does it include audio visual effects included in such interactive works. The term refers to the work as a whole and does not include images or visual motion within another work or software, such as the animated help feature of a word processing program or images or sequences of motion in an interactive computer encyclopedia.

Section 2B-104 also excludes contracts associated with audio and visual programming by broadcast, cable, or satellite and like methods of delivering such programming. These terms are defined in federal Communications Act. 47 U.S.C. § 522 defines "video programming" as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." Audio programming refers to audio programming comparable to ration broadcasts. Both "broadcast" and "cable" are defined in the Communications Act also. Satellite transmission refers to satellite broadcast or cable. See 47 U.S.C. § 548. The basic effect in this article is to exclude traditional broadcast and cable services, regardless of whether transmitted in digital or another form, including to exclude transmissions analogous to broadcast but made through the Internet. On the other hand, broadcast, satellite, or cable programming does not include data transmission, interactive services, or similar computer information not analogous to broadcast programming.

SECTION 2B-105. RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

(a) A provision of this article which is preempted by federal law is unenforceable to the extent of that preemption.

(b) If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the impermissible term, or it may so limit the application of any impermissible term as to avoid any result contrary to public policy, in each case, to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of that term.

(c) Pursuant to Section 1-103, among the laws supplementing, and not displaced by this article, are trade secret laws and unfair competition laws.

(d) Except as otherwise provided in subsection (e), if this article conflicts with a consumer protection statute or regulation of this State in effect on the effective date of this

article, the conflicting statute or regulation prevails.

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

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

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

(3) A requirement that a 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 term is satisfied by an action that manifests assent to a term in accordance with this article.

(f) Failure to comply with a statute or regulation referred to in subsection (d) has only the effect specified in the statute or regulation.

(g) A statute authorizing electronic or digital signatures in effect on the effective date of this article is not affected by this article.

Legislative Note: Each state should review the statutes that may be affected by subsection (e) to determine whether under their fundamental policy the effect should not apply to some of those statutes. If any, the state should exclude such statutes from subsection (e).

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

Definitional Cross References:

"Agreement": Section 1-201. "Authenticate:" Section 2B-102. "Conspicuous": Section 2B-102. "Consumer": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Notice": Section 1-201. "Record": Section 2B-102. "Rights": Section 1-201. "Signed": Section 1-201. "Term": Section 1-201. "Writing": Section 1-201.

Reporter's Notes:

1. ***General Principle and Scope of the Section.***

Subsections (a), (b) and (c) clarify that this article does not displace or alter the relationship between contract law and intellectual property, competition or trade regulation law. Subsection (d) states a similar principle for consumer protection statutes subject to the limited electronic commerce rules in subsection (e).

The transition from print to digital media has created new demands for information. Because digital information is so easily copied, increased attention has been focused on the formulation of rights in information in order to encourage its creation and on the development of contracting methods that enable effective development and efficient marketing of information assets. Here, as in other parts of the economy, the fundamental policy of contract law is to enforce contractual agreements. At the same time, there remains a fundamental public interest in assuring that information in the public domain is free for all to use from the public domain and to provide for access to information for public purposes such as education, research, and fair comment. While the new digital environment increases the risk of unfair copying, the enforcement of contracts that permit owners to limit the use of information and the development of technological self-help measures have given the owner of information considerable means of enforcing exclusivity in the information they produce or collect. This is true not only against those in contractual privity with the owner, but also in some contexts against the world-at-large.

The effort to balance the rights of owners of information against the claims of those who want access is very complex and has been the subject of considerable controversy and negotiation at both the federal level and internationally. The extent to which the resolution of these issues at the federal level ought to preempt state law is beyond the scope of this article, the central purpose of which is to facilitate private transactions in information. Moreover, it is clear that limitations on the information rights of owners that may be imposed in a copyright regime where rights are conferred that bind third parties, may be inappropriate in a contractual setting where courts should be reluctant to set aside terms of a contract. Subsections (a), (b) and (c) deal with aspects of drawing the balance between fundamental interests in contract freedom and fundamental public policies such as those regarding innovation, competition, and free expression.

2. ***Federal Law: Preemption.*** Subsection (a) restates a rule that would otherwise be applicable in any event. If federal law invalidates a state contract law or contract term in a particular setting, federal law controls. See, e.g., *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996) (patent license not transferable); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984) (copyright license not transferable); *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993) (copyright preempts rule on licenses terminable at will); *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989) (federal policy controls over state contract law interpretation rules; interpretation must protect the rights-holder). Subsection (a) refers to preemptive federal rules, but other doctrines grounded in First Amendment, copyright misuse and other federal law may limit enforcement of some contract terms in some cases. In general, however, except for federal rules that directly regulate specific contract terms, no general preemption of contracting arises under copyright or patent law. See *National Car Rental System, Inc. v. Computer Associates Int'l, Inc.*, 991 F2d 426 (8th Cir. 1993); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). No effort is made in this article to define whether or to what extent such a preemption may arise.

3. ***Public Policy Invalidation.*** Contract terms may be unenforceable because of federal preemption under subsection (a) of this section or because the term is unconscionable under section 2B-110. In addition, subsection (b) acknowledges the general legal principle that, in certain limited circumstances, terms may be unenforceable because they violate a fundamental public policy that clearly overrides the policy favoring enforcement of private transactions as between the parties. The principle that courts may invalidate a term of a contract on public policy grounds is recognized at common law and in the *Restatement (Second) of Contracts* § 178 et. seq. It is a supplementary legal principle incorporated under Section 1-103 and applies to all contract law and all articles of this Code. Subsection (b) is designed to clarify the nature of the policies that have particular relevance to the subject matter governed by Article 2B.

Fundamental state policies are most commonly stated by the legislature. In the absence of a legislative declaration of a particular policy, courts should be reluctant to override a contract term. In evaluating a claim that a term violates this subsection, courts should consider a variety of factors including the extent to which enforcement or invalidation of the term will adversely affect the interests of each party to the transaction or the public, the interest in protecting expectations arising from the contract, the purpose of the challenged term, the extent to which enforcement or invalidation will adversely affect other fundamental public interests, the strength and consistency of judicial decisions applying similar policies in similar contexts, the nature of any express legislative or regulatory policies, and the values of certainty of enforcement and uniformity in interpreting contractual provisions. Where the parties have negotiated terms of their agreement courts will be even more reluctant to set aside terms of the contract. In light of the national and international integration of the digital environment, courts should be reluctant to invalidate terms based on purely local policies. In applying these , courts should consider the position taken in the *Restatement (Second) of Contracts § 178, comment b* ("In doubtful cases … a decision as to enforceability is reached only after a careful balancing, in light of the circumstances, of the interests in the enforcement of the particular promise against the policy against the enforcement of such terms. …

Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in enforcement of the particular term.").

The public policies most likely to be applicable to transactions within this article are those relating to innovation, competition, and fair comment. Innovation policy recognizes the need for a balance between conferring property interests in information in order to create incentives for creation and the importance of a rich public domain upon which most innovation ultimately depends. Competition policy prevents unreasonable restraints on publicly available information in order to protect competition. Rights of free expression may include the right of persons to comment, whether positively or negatively, on the character or quality of information in the marketplace.

In practice, enforcing private contracts is most often consistent with these policies, largely because contracts reflect a purchased allocation of risks and benefits and define the commercial marketplace in which much information is disseminated and acquired. Thus, a wide variety of contract terms restricting the use of information by one of the contracting parties present no significant concerns. For example, contract restrictions on libelous or obscene language in an on-line chat room promote interests in free expression and association and such restrictions are enforced to a much broader degree arising out of contractual arrangements than if imposed by governmental regulation. However, there remains the possibility that contractual terms, particularly those arising from a context without negotiation may be impermissible if they violate fundamental public policy.

Contracting parties may have greater freedom contractually to restrict the use of confidential information than information that is otherwise publicly available. While a term that prohibits a person from criticizing the quality of software may raise public policy concerns if included in a shrink-wrap license for software distributed in the mass-market, a similar provision included in an agreement between a developer and a company applicable to experimental or early version software not yet perfected for the marketplace would not raise similar concerns. Trade secret law allows information to be transferred subject to considerable contractual limitations on disclosure which facilitates the exploitation and commercial application of new technology. On the other hand, trade secret law does not prohibit reverse engineering of lawfully acquired goods available on the open market. Striking the appropriate balance depends on a variety of contextual factors that can only be assessed on a case by case basis with an eye to national policies.

A term or contract that results from an agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b). This article and general contract law recognizes the commercial necessity of also enforcing mass market transactions that involve the use of standard form agreements. The terms of such forms may not be available to the licensee prior to the payment of the price and typically are not subject to affirmative negotiations. In such circumstances, courts must be more vigilant in assuring that limitations on use of the informational subject matter of the license are not invalid under fundamental public policy.

Even in mass market transactions, however, limitations in a license for software or other information such as terms that prohibit the licensee from making multiple copies, or that prohibit the licensee or others from using the information for commercial purposes, or that limit the number of users authorized to access the information, or that prohibit the modification of software or informational content without the licensor's permission are typically enforceable. See, e.g., *Storm Impact, Inc. v. Software of the Month Club*, 1998 WL 456572 (N.D. Ill. 1998) ("no commercial use" restriction in an on-line contract). On the other hand, terms in a mass-market license that prohibit persons from observing the visible operations or visible characteristics of software and using the observations to develop non-infringing commercial products, that prohibit quotation of limited material for education or criticism purposes, or that preclude a non-profit library licensee from making an archival copy would ordinarily be invalid in the absence of a showing of significant commercial need.

Under the general principle in subsection (b), courts also may look to federal copyright and patent laws for guidance on what types of limitations on the rights of owners of information ordinarily seem appropriate, recognizing, however, that private parties ordinarily have sound commercial reasons for contracting for limitations on use and that enforcing private ordering arrangements in itself reflects a fundamental public policy enacted throughout [the Uniform Commercial Code] and common law.

In part because of the transformations caused by digital information, many areas of public information policy are in flux and subject to extensive debate. In several instances these debates are conducted within the domain of copyright or patent laws, such as whether copying a copyrighted work for purposes of reverse engineering is an

infringement. Article 2B does not specifically address these issues of national policy, but how they are resolved may be instructive to courts in applying this subsection.

With reference to contract law policies that regulate the bargain of the parties, this article makes express public policy choices. Contract law issues such as contract formation, creation and disclaimer of warranties, measuring and limiting damages, basic contractual obligations, contractual background rules, the effect of contractual choice, risk of loss, and the like, including the right of parties to alter the effect of the terms of this article by their agreement should not be invalidated under subsection (b) of this section. This subsection deals with policies that implicate the broader public interest and the balance between enforcing private transactions and the need to protect the public domain of information.

The court, if it finds a particular term unenforceable under this section, may enforce the remainder of the contract if it is possible to do so. In considering this issue the court should consider the factors described in *Restatement (Second) of Contracts §*184.

4. ***Supplemental Principles: Unfair Competition and Trade Secrecy.*** Subsection (c) also restates a principle in Section 1-103 that this article being supplemented by state law in some cases. It specifically refers to unfair competition and trade secret law. For example, these state laws may limit the term during which a contract restriction on competition can be enforced. This article does not alter that rule. In addition to being expressly so stated here, that principle is also incorporated in the definition of "contractual use restrictions", which enforces such terms only to the extent enforceable under other law.

The principle with respect to trade secret and unfair competition law stems from the general concept of Section 1-103. Other important rules are likewise not displaced by this article. For example, this article does not alter developing law with respect to the enforcement of copyright or patent notices that, with or without contractual support, effectively limit the permissions extended to the party receiving a transfer of a copyrighted work or patented information or product.

5. ***State Law: Consumer Law.*** Article 2B does not generally alter state consumer protection statutes in effect on the effective date of Article 2B. This recognizes the role of independent and potentially divergent state consumer protection statutes in the fifty states as a complement to the UCC. Consistent with the stated purpose of the UCC, Article 2B deals with general contract law and commercial contract law principles. It does not promulgate a consumer protection code, although Article 2B does contain certain new consumer protections. Historically, consumer protection issues have been resolved on a state-by-state basis. These statutes reflect extensive policy review about the relationship between protection and contract freedom in each state. Article 2B, as a general commercial statute, does not override these judgments. With the exception of the electronic commerce rules in subsection (e), a state's consumer protection statutes or regulations trump the general contract law of this Article. Thus, for example, a consumer protection statute that mandates disclosure of local service outlets or the location of the licensor's main business office in a consumer transaction is not affected by Article 2B.

In addition, Article 2B contains a number of consumer protection rules for consumer transactions within this Article or under the more general reference to mass-market licenses, a category that includes all consumer transactions. These rules augment existing consumer protection statutes and the existing protections control to the extent of any conflict. A conflict, for this purpose, would occur if an Article 2B rule provides less protection for the consumer than does the consumer protection statute. The provisions of this article in many cases provide consumer protections that go beyond original Article 2 for software contracts or general common law for other contracts or that restate protections under original Article 2. The consumer-related rules include: 2B-107 (choice of law); 2B-118 (electronic error); 2B-208 (limit on mass-market license; right to return); 2B-303 (limit on no-oral modification clause); 2B-304 (limit on modification of continuing contract); 2B-406 (warranty disclaimer); 2B-409 (third-party beneficiary); 2B-609 (perfect tender); 2B-619 (limit on hell and high water clauses); 2B-703 (exclusion of personal injury claim).

6. ***State Law: Electronic Commerce Issues.*** Subsection (e) states a significant electronic commerce rule. It provides a limited displacement of state law requiring a "writing" or a "signature," shifting those requirements to standards consistent with the electronic commerce treatment in this article. This parallels the treatment of the question in digital signature laws. See, e.g., RCW 19.34.300(1) (signature); RCW 19.34.320 (writing). This rule is appropriate and necessary to achieve the substantial cost savings and expanded access to information that electronic commerce offers, which benefit consumers as well as other entities.

Subsection (e) allows electronic records to suffice for a required writing. This assumes, of course, that the form and presentation of the record otherwise meets the substantive intent of the relevant consumer statute. In some cases, such statutes require that the consumer be able to retain the writing; this subsection would not alter

that retention requirement. Similarly, in some consumer statutes requiring a writing, the expectation is that the consumer will actually see the terms of the record. Subsection (e) does not alter that rule; the record that substitutes for a writing in such case must be adequate to achieve the underlying consumer protection policy.

For Article 2B transactions, the rules of this article ordinarily supplant other law as to contractual issues and the rule stated in this section merely reflects that principle. For consumer transactions, however, many contract-related rules are preserved. The four stated electronic commerce issues reverse that rule in a limited way that balances the benefits of modernization with retention of other consumer rules. This limited approach does not alter the other substantive terms of the other laws.

Digital signature statutes that predate Article 2B are not repealed or affected by Article 2B.

7. ***State Law: Computer Viruses.*** Article 2B does not deal with computer viruses and does not alter existing criminal or tort law on that subject. In general, a "virus" consists of computer code put into a software or other system with the intended effect of disrupting the system or altering or destroying information in that system. Law in most states and federal law makes the knowing or intentional introduction of a computer virus a criminal act. See *Raymond Nimmer, Information Law* ¶ 9.04 (1997).

Most state law and enforcement concerning viruses falls under criminal law. As this indicates, most virus risks result from acts of third parties not in a contractual relationship with the victim. Acts that cause losses from a computer virus might also create liability in tort in appropriate cases under concepts of trespass or negligence. While few civil actions have been brought, the liability of the wrongdoer involves issues other than under contract law.

As to contractual issues, virus problems typically arise between two, ordinarily innocent, contracting parties. In licensing law under Article 2B, they may be handled as any other contract risk. A virus may cause the information to fail to perform. The remedy in contract is determined by the general rules of this article or the agreement, if the agreement allocates the risk. Absent agreement, no clear basis for allocating the risk under contract principles is manifest and this article leaves the allocation of risk to other law. The remedy under tort law or the sanction under criminal law are determined by those laws.

SECTION 2B-106. VARIATION BY AGREEMENT; RULES OF CONSTRUCTION; QUESTIONS DETERMINED BY COURT.

(a) Except as otherwise expressly provided in this article or in Section 1-102(3), the effect of any provision of this article, including allocation of risk or imposition of a burden, may be varied by agreement of the parties.

(b) Except to the extent provided in the following sections, an agreement may not vary the effect of:

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

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

(3) the provisions invalidating an unconscionable contract or term in Sections 2B-110, 2B-208(a), 2B-626(c), and 2B-703(d);

(4) the provisions defining manifest assent and opportunity to review in Sections 2B-111 and 2B-112;

(5) the provisions on electronic errors in Section 2B-118;

(6) the limitations on enforceability of an agreement in Section 2B-201;

(7) the limits on mass-market licenses in Section 2B-208;

(8) the requirements for an enforceable term in Section 2B-303(b), Section 2B-406, and Section 2B-704(a);

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

(10) the limitations on self-help repossession in Sections 2B-715(b) and 2B-716.

(c) In applying this article, the following rules of construction apply:

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

(2) The fact that a provision of this article states a condition for a result does not of itself mean that the absence of that condition yields a different result.

(3) To be enforceable, a term need not be conspicuous, negotiated, or expressly assented or agreed to unless this article expressly so requires.

(d) Whether a term is conspicuous or is excluded under Sections 2B-105(a) or (b) or 2B-208(a) is a question to be determined by the court.

Uniform Law Source: None.

Definitional Cross References:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 1-201. "Court". Section 2B-102. "Electronic": Section 2B-102. "Term". Section 1-201. "Transfer". Section 2B-102.

Reporter's Notes:

1. ***Basic Principle.*** This article follows the fundamental policy of the common law and the Uniform Commercial Code: freedom of contract. Contract choices control unless over-riding policy considerations mandate restraints recognized in this article, such as in the doctrine of unconscionability. Subsection (b) specifies the sections of this article where contract choice does not control. With these exceptions, all rules in this article are default rules that apply only in the absence of contrary "agreement." Freedom of contract is especially important in this field of converging industries and richly diverse commercial practice.

2. ***Altering the Effect.*** Subsection (a) states that freedom of contract is the basic principle of this article. See also Section 1-102(3). The "effect" of a provision may be varied by "agreement." The meaning of the

statute is found in its text, but an agreement can change the legal consequences which would otherwise flow from the provisions of the article between the parties to the agreement. An "agreement" does not require a formal writing. It includes the full bargain of the parties in fact; an agreement altering the effect of a section may be as easily found in express terms of the contract as in course of dealing, course of performance, or usage of trade or inferred from the circumstances of the transaction. Section 1-201(3). The effect of an agreement between two parties on the rights of third parties is left to specific provisions of this article, the remainder of the U.C.C., and supplemental principles under Section 1-103.

3. ***Mandatory Language.*** Article 2B provisions generally do not use the phrase "unless otherwise agreed" and frequently use mandatory language such as "shall" or "must." Neither drafting convention alters the basic principle that the agreement controls. Subsection (c)(1) rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware*, 910 F. Supp. 1009 (D. Del. 1995) (disallowing alteration by agreement of a particular section). The dominant rule is that the effect of all of this article's provisions may be varied by agreement except as expressly indicated.

4. ***Negative Inference.*** Subsection (c)(2) resolves questions about the existence of a negative pregnant in rules in this article. The statement of an affirmative result does not indicate that a different result occurs if the conditions in the statute are not met. Thus, if a provision states: "If the originator of a message requests acknowledgment, then the following rules apply: ---", this does not indicate what rule governs in the absence of a request. Similarly, a provision that states that particular language or procedure yields a specific result does not indicate what result occurs with different language or procedure. It merely states the affirmative proposition. If a different interpretation is intended, it is made express in the statutory language.

5. ***Language Limiting Contract Effect.*** Agreed terms that alter default rules in this article do not require specific reference to the default rule and ordinarily do not require use of specific language, presentation or assent. In some situations, however, this article expressly imposes a requirement such as that the term be conspicuousness or that there be manifested assent to the term. Subsection (c)(3) states the underlying premise that such requirements exist only if expressly imposed under this article or in requirements might arise under consumer protection statutes. Section 2B-105.

6. ***Issues as a Matter for the Court.*** Subsection (d) follows original Article 2 and the common law. Other issues in this article are also made questions for the court. These are indicated in the relevant statutory section or in applicable case law or procedural rules.

SECTION 2B-107. CHOICE OF LAW.

(a) The parties in their agreement may choose the applicable law. However, in a consumer transaction, the choice is not enforceable to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply in the absence of the agreement as determined under subsections (b) and (c).

(b) In the absence of an enforceable choice-of-law term, the following rules apply:

(1) An access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor is located when the agreement is made.

(2) A consumer transaction that requires delivery of a copy on a physical medium is governed by the law of the jurisdiction in which the copy is or should have been delivered to the consumer.

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

(c) In cases governed by subsection (b), if the jurisdiction whose law governs under that subsection is outside the United States, the law of that jurisdiction governs only if it provides substantially similar protections and rights to a party not located in that jurisdiction as are provided under this article. Otherwise, the law of the jurisdiction in the United States which has the most significant relationship to the transaction governs.

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

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

Definitional Cross Reference:

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

Reporter's Notes:

1. *Scope of the Section.* This section deals with two issues. The first concerns the enforceability of contract terms choosing the applicable law. Subsection (a) adopts a freedom of contract position with respect to commercial contracts, limited by a consumer protection rule (see Note 2). The second issue concerns choice of law in the absence of a contract term. Subsection (b) and (c) provide needed certainty in electronic commerce and enact a uniform general rule for other commercial transactions, replacing current uncertainty (see Note 3).

2. *Purpose of Rules.* Contract terms that choose the applicable law are routine in commercial agreements. The information economy accentuates their importance because communications capabilities allow remote parties to enter into and perform contracts through systems spanning multiple jurisdictions that may not depend on the physical location of either party or of the information itself. Validating choice of law contract terms is especially important in this article since many computer information transactions occur in cyberspace, rather than in fixed locations. This allows many small businesses to engage in multistate or multi-national business. If an agreement cannot designate applicable law, even the smallest business on the Internet would be subject to the law of all fifty states and all countries in the world. If permitted, that result would have adverse effects on electronic commerce, imposing substantial costs and uncertainty on providing products over the Internet. This section is one of the most important contributions of Article 2B to electronic commerce.

4. *Contractual Choice of Law.* Article 2B enforces choice of law agreements. This rule follows

cases dealing with the issue in information-related contracts. See *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 *Restatement (Second) of Conflict of Laws* § 188 proposes a similar rule for contract issues that can be resolved by agreement. This section rejects law that allows a court to invalidate a contract term if the chosen law does not have a "reasonable relationship" to the transaction. In a global information economy, limitations of that type are inappropriate and arbitrary. White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997, ("The U.S. should work closely with other nations to clarify applicable jurisdictional rules and to generally favor and enforce contact provisions that allow parties to select substantive rules governing liability.").

Agreed terms choosing applicable law may in certain circumstances be restricted by a court. For example, a contract choice inconsistent with over-riding fundamental public policy of the forum state may be unenforceable. Section 2B-105(b). See *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App.4th 881, 72 Cal. Rptr.2d 73 (Cal. App. 1998) (term partly invalidated). Compare *Lowry Computer Products, Inc. v. Head*, 984 F. Supp. 1111 (E.D. Mich. 1997). Also, under subsection (a), the agreement cannot override an otherwise applicable consumer protection rule that cannot be altered by agreement. This rule imposes significant costs on Internet commerce, but this article adopts the view that the fundamental policy of freedom of contract should be varied to preserve consumer rules when individual states, having addressed that cost separately, determine that the applicable rule is of a mandatory, non-waivable nature. The relevant consumer law includes both Article 2B and the consumer laws referenced in Section 2B-105(d). The source of the consumer protection law referred to in this section is the law of the state whose law would apply in the absence of the contractual choice under the principles on choice of law stated in this section.

5. *Choice of Law: no contract term.* Subsection (b) states the choice of law rules that apply in the absence of a contract term deciding the issue. Information commerce is not like sales of goods nor should the choice of law themes be based on determinations about applicable tort law. By stating uniform default rules here, Article 2B enhances certainty in transactions. Without such guidance, electronic commerce would be immersed in choice of law doctrine whose condition is described in the following comment: "[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….The disarray in the courts may be worse." *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992). That does not facilitate global commerce in information.

Article 2B adopts a basic rule similar to *Restatement (Second) of Conflicts of Law*, but enacts two superseding concepts. The most commercially important is in subsection (b)(1), which deals with electronic transactions and selects applicable law based on the location of the licensor. This enhances certainty in planning in a context where by virtue of the nature of the distribution systems an on-line vendor, large or small, makes direct access available to the entire world via the Internet. Any other rule would require that the information provider comply with the law of all states and all countries since under the technology it will not necessarily be clear or even knowable where the information is being sent. The licensor's location is described in subsection (d) and does not depend on the location of the computer that contains the information.

Subsection (b)(2) is a consumer rule for transactions involving physical delivery of tangible copies not involving remote access contracts. The rule selects the law of the place where the copy was to be delivered. Thus, if a consumer was to receive delivery of software in Chicago, the transaction is subject to the law of Illinois unless the agreement indicates otherwise. That rule is consistent with current U.S. law. It is followed in many European consumer laws relating to goods and services. Because the transaction involves delivery of a tangible copy, the licensor knows where delivery will occur.

Subsection (b), of course, only deals with contract law. It does not affect tax, copyright, or similar issues. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (tax nexus); *Allarcom Pay Television, Ltd. v. General Instrument Corp.*, 69 F.3d 381 (9th Cir. 1995) (copyright).

4. *Most Significant Relationship.* In the absence of an agreement on the governing law and except for the rules in subsections (b)(1) and (b)(2), subsection (b) adopts a "most significant relationship" test. The *Restatement (Second) of Conflicts of Law* uses a similar test and cases interpreting that rule are applicable here. The "most significant relationship" standard requires consideration of various factors including: (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, (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, and (k) certainty, predictability and uniformity of result.

5. *Foreign Countries.* Subsection (c) provides a rule in cases of foreign choices of law where the effect of using the applicable rule would locate the choice in a location that is substantively inappropriate. This is especially important in Internet commerce. This rule does not apply if the agreement chooses applicable law. In applying subsection (c), courts should reverse the basic choice of law rule only in extreme cases. It is not sufficient to conclude merely that the foreign law is different. The differences must be substantial and adverse to the party not located in that jurisdiction. The subsection does not address which party has the burden to establish the foregoing.

SECTION 2B-108. CONTRACTUAL CHOICE OF FORUM.

(a) The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust.

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

Definitional Cross References:

"Agreement": Section 1-202. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with contractual choice of an exclusive judicial forum. It does not deal with contracts that permit, but do not require that litigation occur in a designated jurisdiction. Permissive choice of forum clauses are governed by general contract law. The section deals only with choice of a judicial forum. Arbitration or other non-judicial forum choices are governed by other law.

2. *General Rule.* Contractual choice of forum clauses are ordinarily enforceable under current law. This section adopts the approach of modern cases as stated in *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972). See *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). A choice of forum clause is presumptively valid subject to the restrictions stated in this section. The rule applies whether the term is in a custom agreement or a standard form. The *Restatement (Second) of Conflicts of Law* states a similar rule.

Choice of forum terms are especially important in electronic commerce. This section is a major contribution to electronic commerce in information. By 1998, almost one hundred reported decisions dealt with personal jurisdiction in Internet. The decisions reveal an uncertainty about when doing business on the Internet exposes a party to jurisdiction in all states and all countries. The uncertainty affects both large and small enterprises, but has greater impact on small enterprises. Choice of forum terms allow parties to control this issue and the risk or costs it creates. This section allows control of the issue by agreement, but restricts the contract term based on fundamental public policy considerations. *See* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997.

Court have also recognized the importance of the issue in electronic commerce and similar contexts. The comments of the court in *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998) on this point are relevant. In Internet transactions, a contractual choice of forum is ordinarily enforceable. The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991) is relevant to determining reasonableness in Internet contracting:

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

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

reasonable.

3. *Fairness Limitation.* The choice of forum term is enforced unless it is "unreasonable and unjust." This rule follows Bremen. The term is invalidated if it has no valid commercial purpose and has severe and unfair affects on the other party. This precludes enforcement of clauses that choose a forum solely to prevent the other party from contesting disputes. Such terms may be unreasonable in that they have no commercial purpose or justification and their impact is unjust in that it unfairly harms the other party. On the other hand, a contractual choice of forum that reflects valid commercial purposes is not invalid simply because it has an adverse effect on a party, even if that party had less bargaining power that the other party. The burden of establishing that the clause fails lies with the party asserting its invalidity. *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972); *Pelleport Investors, Inc. v. Budco Quality Theaters, Inc.*, 741 F.2d 273 (9th Cir. 1984); *Restatement (Second) of Conflicts of Law* § 80, comment c (1989 rev.)

The contract choice may be limited in additional ways. In some cases, a contract choice may be inconsistent with over-riding fundamental public policy of the forum state or an express statute that, if applicable to a transaction precludes the choice of forum. Section 2B-105(b). Also, agreements obtained through fraud or duress may be invalidated under general provisions of law that supplement this article. Section 1-103.

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

(a) Whether a party is in breach is determined by the agreement or this article. A breach occurs if a party fails to perform an obligation in a timely manner, repudiates a contract, or exceeds a contractual use restriction. A breach, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach is material if:

(1) the contract so provides;

(2) the breach is a substantial failure to perform an agreed term that is an essential element of the agreement; or

(3) the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the trade or industry, or the character of the breach, indicate that:

(A) the breach caused or is likely to cause substantial harm to the aggrieved party; or

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

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

Uniform Law Source: Restatement (Second) Contracts § 241. Article 2A-501(1).

Definitional Cross References:

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section defines what constitutes a breach of contract and standards to distinguish between a material and a non-material breach.

2. *Policy Basis.* The section follows the rule in common law and international contract law that a party's remedies are determined by whether a breach is material or not. See *Restatement (Second) of Contracts* § 237; *Convention on the International Sale of Goods* Art. 25; *UNIDROIT Principles of International Commercial Law* art. 7.3.1. A non-material breach entitles an aggrieved party to a remedy, but not to cancel the contract. A material breach creates a right to damages and a right to cancel. In both cases, contract terms may alter and control the outcome. The "conforming tender" rule in original Article 2 with respect to contracts requiring a single delivery of a product is preserved in Section 2B-609 for mass-market transactions.

3. *What is a Breach?* What constitutes a breach is determined by the agreement or this article. The obvious rule is that a party must conform to the contract. A breach occurs whenever a party acts in a manner that violates the contract or fails to act in a manner required by the contract. This includes a failure timely to perform, a breach of warranty, a repudiation, non-delivery, wrongful disclosure, uses inconsistent with the contract, exceeding contract limits, and other breaches.

4. *What Remedies Apply?* If a party does not conform to the contract, the aggrieved party is entitled to remedies for the breach. The remedies that are permitted, however, depend on the nature of the breach. The aggrieved party can cancel the contract if the breach was material. For non-material breaches, the remedy is damages. If the breach is material, the party may cancel the contract. For either type of breach, of course, there is an intermediate remedy in that a party whose expectations of future performance are impaired may suspend performance and demand adequate assurance of future performance from the other party. Section 2B-620.

Article 2B thus adopts a rule followed throughout U.S. and international law. Parties are entitled to the performance for which they bargained, but some breaches are so immaterial that they do not justify forfeiture of the entire bargain. In such cases, it is better to preserve a contract despite minor problems than to allow one party to cancel for minor defects and thereby cause an unwarranted forfeiture or allow unfair opportunism. For example, a one day delay in payment may or may not be material such as to allow the vendor to cancel the license. The determination of materiality depends on the circumstances, but normally it would not be material. A failure to fully conform to advertisements about the capability of software to handle 10,000 files may not be material such as to allow cancellation of the contract if the licensee's use never exceeds 4,000 files and the software is able to process substantially the advertised number. Materiality is judged from the aggrieved party's perspective and the benefits it expected from full performance of the contract.

5. *Contract Terms.* The agreement defines what is a material breach in three ways. The first two are by expressly providing a remedy for a particular breach or by expressly defining a particular breach as per se material. In either case, the bargain of the parties controls. Of course, however, a court must reasonably interpret the contract. Thus, a term providing that *any* failure to conform to *any* contract term permits cancellation must be interpreted in light of commercial context. The context may indicate that in light of usage of trade or course of dealing, minor breaches are not in fact material. Section 1-205.

The third involves contractual creation of express conditions. If the contract indicates that conforming to a specific requirement is a precondition to the performance of the other party, that condition should be enforced. The express contractual condition also conditions the remedy – breach allows the other party to not perform.

Illustration 1. In a software development contract, the contract requires that the final product meet 10 criteria before it is acceptable. One condition is operation at "no less than 150,000 rev. per second." The product does not meet that standard. Failure to meet the condition justifies refusal of the product if the condition is an essential element of the agreement.

Illustration 2. In a contract for a computerized mailing list, no delivery date is specified. The product is

delivered one day later than expected. Whether the breach is material depends on whether the timing was in fact a breach under applicable usage of trade and course of dealing, and if so, on the effect of the delay in reference to the entire bargain.

6. *What is a material breach?* A statute cannot define materiality in detail, but only the appropriate reference point. Subsection (b) provides three approaches: contract terms defining materiality, materiality found in a substantial failure to performance an essential term of the agreement, and materiality in that the breach causes substantial harm to the aggrieved party or a denial of a reasonably expected benefit. This last consideration, of course, refers to substantiality in context of the agreement itself. Thus, in a contract for a ten dollar software license, a breach causing ten dollars of harm would be material even though, in thirty million dollar license, a ten dollar loss would likely be non-material.

The list in subsection (b) is not exclusive. The standards in this section should be interpreted in light of common law and Restatement principles. See *Rano v. Sipa Press*, 987 F.2d 580 (9th Cir. 1993); *Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd.*, 950 F.2d 1492 (9th Cir. 1991). One of the general principles is that common law concepts preclude unreasonable forfeiture of interests for minor defalcations. The *Restatement (Second) of Contracts* § 241 (1981) lists five significant circumstances: 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 the party 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.

SECTION 2B-110. UNCONSCIONABLE CONTRACT OR TERM.

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

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

Uniform Law Source: Section 2-302.

Definitional Cross References:

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

Reporter's Note:

1. *Scope of the Section.* This section adopts the Article 2 doctrine that allows courts to invalidate unconscionable contracts or terms. The use of the word "term," rather than "clause," is stylistic only with no substantive change intended.

2. *Basic Policy and Effect.* This section allows courts to rule directly on the unconscionability of the contract or a particular term therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the terms involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (b) makes it clear that it is proper for the court to hear evidence on these questions. The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.

3. *Electronic commerce.* While this article confirms the enforceability of automated contracting practices involving "electronic agents," in some cases automation may produce unexpected results because of errors in programs, problems in communication, or other unforeseen circumstances. When this occurs, common law concepts of mistake may apply, as may the provisions of Section 2B-118 and Section 2B-204. In addition, unconscionability doctrine may apply to invalidate a term caused by breakdowns in the automated contracting processes.

4. *Remedy.* The court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single term or group of terms which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

5. *Decision of the court.* Unconscionability is a decision to be made by the court. The commercial evidence allowed under subsection (b) is for the court's consideration, not the jury's. Only the terms of the agreement which result from the court's action on these matters are to be submitted to the general triers of fact for resolution of a matter in dispute.

SECTION 2B-111. MANIFESTING ASSENT.

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

(1) authenticates the record or term;

(2) in the case of the conduct or statements of a person, the person intends to engage in the conduct or make the statement and has reason to know that the other party may infer from the conduct or statement that the person assents to the record or term; or

(3) in the case of operations of an electronic agent, the electronic agent engages in operations that the circumstances clearly indicate constitute acceptance.

(b) If this article or other law requires assent to a specific term, a person or electronic agent does not manifest assent to that term unless it had an opportunity to review the term and the manifestation of assent relates specifically to the term.

(c) Conduct or operations manifesting assent may be proved in any manner, including a showing that a procedure existed by which a person or an electronic agent must have engaged in the conduct or operations in order to obtain, or to proceed with use of the information or informational rights. Proof of assent depends on the circumstances. Proof of compliance with

subsection (a)(2) is sufficient if there is conduct that assents and subsequent conduct that electronically reaffirms assent.

Uniform Law Source: Restatement (Second) of Contracts § 19.

Definitional Cross References.

"Authenticate". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Record". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

1. *Scope and Purpose.* This section defines "manifestation of assent." "Manifesting assent" has several roles in general contract law and in this article. The two primary roles respectively treat manifested assent as 1) one way by which a party indicates agreement to a contractual relationship and 2) one standard used to determine when a party adopts the terms of a record as the terms of the contractual relationship. Section 2B-207; 2B-208. Most often, the same act both adopts the terms of a record and constitutes agreement to the relationship itself. In addition to these roles, in some cases, this article requires agreement or assent to a term to establish the enforceability of the term.

2. *Source and General Theme.* The term comes from the *Restatement (Second) of Contracts* § 19. This section corresponds substantively to the *Restatement*. While the concepts that underlie this term are found throughout U.S. law, the concept is more fully explicated here than in case law and thus lends itself more to uniform terminology and application. The section codifies the underlying principles and makes uniform the conditions for finding a manifestation of assent.

Manifesting assent does not require a signature, any specific type of language or conduct. It can be shown by an appropriate authentication, by conduct including use or other performance with respect to the subject matter, or by words. In electronic commerce, it especially important to clarify the conditions under which conduct may establish contractual relationships and to expressly recognize the diverse alternatives that exist.

3. *Three analyses.* Determining whether a person manifested *assent to a record* under this article entails analysis of three issues:

- First, the person must have had knowledge of the record or term or an opportunity to review it. Opportunity to review requires that the record be available in a manner that ought to call it to the attention of an ordinary reasonable person. Section 2B-112.
- Second, assuming an opportunity to review, the person must authenticate the record or term, orally express assent, or engage in conduct with reason to know that in the circumstances the conduct indicates assent. *Restatement (Second) of Contracts* § 19. Authenticating a record requires executing or adopting a symbol or processing the record with intent to authenticate. Section 2B-102. Conduct manifests assent if the party acted with knowledge or reason to know that this would infer assent.
- Third, the conduct or authentication must be attributable to the person to be bound. General agency law and Section 2B-116 provide standards for attribution.

4. *Assent by Authentication.* Subsection (a)(1) recognizes that a person indicates assent to a record or term by signing the record or a term. In this article, "authentication" replaces the "signature", but the concept is the same. The authentication must be intended to assent to the record or term. In most cases, as under prior law on signatures, no real question will exist about the meaning of a signature or authentication or the meaning can be presumed to be that the authentication expresses agreement to the record authenticated. In the few cases in which doubt exists, the authentication must be made with intent to adopt or agree to the record. Section 2B-119 states a presumption generally true under prior law on signatures: unless the circumstances indicate to the contrary, an authentication encompasses an intent to identify the party, accept or adopt the record and its terms, and establish the integrity of the record's contents. The intent pertains to the person making the authentication, not to the person receiving the authenticated record. See notes to Section 2B-102(4).

5. *Assent by Conduct or Words.* Assent occurs if a party acts (or fails to act) or makes statements with reason to know these will be inferred as assent by the other party. Determining when this is true entails analysis of the overall circumstances. The issue does not involve proof of subjective intent, knowledge, or purpose of the assenting party, but whether there was an act or a failure to act voluntarily engaged in with had reason to know the inference of assent that would be drawn. Assent does not require that the party have an ability to negotiate or alter terms, but the person's conduct must be voluntary. This is satisfied if the alternative of refusing the offered contract existed in fact even if refusal leaves no alternative source available for the refused deal.

Of course, actual knowledge that the inference will be drawn suffices. More generally, reason to know can be indicated by one or more of the following: the nature of the conduct; whether the context, including any language on a package, a container or in a record, indicates what actions indicate assent; whether the actor could decline to engage in the conduct and return the information; what information was communicated to the actor before the conduct occurred; whether the conduct resulted in access to and use of information that was offered subject to contract terms; what are the ordinary expectations of other persons in similar contexts; what are the standards and practices of the business, trade or industry; or other relevant factors. As in the *Restatement*, failure to act is conduct and constitutes assent if the party that fails to act has reason to know this will create an inference of assent.

No particular type of conduct or formality is required. The concept recognizes the wide range of behavior and interactions that in modern commerce establish a contractual relationship between parties and the terms of that relationship. However, subsection (c) makes clear that if the assenting party has an opportunity to reconfirm or deny assent before proceeding to obtain or further use the information, the reconfirmation establishes the assent. This sets out one method of establishing the relevant criteria of subsection (a)(2). In many cases, of course, a single indication of assent by an electronic or another act such as by opening a container or commencing to use information suffices if it occurs under circumstances giving the actor reason to know that this signifies assent. On the other hand, an act that does not bear a clear relationship to a contract or a record would fail under the general standard. Similarly, acts that occur in context of a mutual express reservation of the right to defer agreement do not assent to a contract that neither party intended.

> **Illustration 1:** The registration screen for NYT Online prominently states: "Please read the license. It contains important terms about your use and our obligations with respect to the information. Click here to review the License. If you agree to the license, indicate your agreement by clicking the "I agree" button. If you do not agree to the License, click the "I decline" button." The on-screen buttons are clearly identified. The underlined text is a hypertext link which, if selected, promptly displays the license. *A party that indicates "I agree" manifests assent to the license and adopts the terms of the license*
>
> **Illustration 2:** The first screen of an on-line stock-quote service requires that the potential licensee enter a name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. In the center of the screen amid other language in small print, is the statement: "Terms and conditions of service; disclaimers" indicating a hyperlink to the terms. The customer's attention is not called to this sentence nor is the customer asked to react to it. *Even though entering name and identification coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this article*

6. *Objective standard.* Manifesting assent requires that, from all the facts known to it, a reasonable person has reason to know that particular conduct will indicate that the actor assents to the record. Actions indicating assent are effective even though the actor subjectively intends otherwise. This section follows traditional contract law theory of "objective" manifestation of assent. This is especially important in electronic commerce where many transactions do not involve direct contacts between individuals. Information providers and licensees must rely on actions as confirming the existence of a contract, and the acceptance of contract terms. Doctrines of mistake, supplemented by Section 2B-118, as well as doctrines invalidating the effects of fraud and duress apply in appropriate cases.

7. *Electronic Agents.* Assent may occur through automated systems. In electronic commerce, there is rapidly increasing use of computer programs (described as "bots" or "intelligent agents") programmed to search for (on behalf of a potential purchaser) or make available (on behalf of a potential licensor) particular types of information under set contractual terms or alternatives. Either or both parties may use electronic agents. The reduced transaction costs are significant and the benefits that come from a technology that enables broad comparative shopping and electronic shopping on terms set by the consumer are immense for consumers and for providers of information. For an electronic agent, assent cannot be based on knowledge or reason to know. The issue is whether the circumstances clearly indicate that the operations of the automated system indicate assent. Safeguards exist under Article 2B through unconscionability doctrine and Section 2B-204.

8. *Third Service Providers.* Assent requires an act by the party to be bound or by its agents. In many Internet situations, a party is able to reach a particular system because of services provided by a third party communications or other service provider. In such cases, the services provider typically does not intend to engage

in a contractual relationship with the provider of the information. While the "customer" activity may constitute assent to terms, they do not bind the service provider since the service provider's actions are in the nature of transmissions and making information access available by the user of the service, not assent to a contractual relationship.

This article is clear that service providers – providers of online services, network access, or the operation of facilities thereof – do not manifest assent to a contractual relationship from their provision of such services, including but not limited to transmission, routing, providing connections, linking or storage of material at the request or initiation of a person other than the service provider. If, for example, a telecommunications company provided the routing for a user to reach a particular online location, the user of the service would potentially manifest assent to an agreement or record at that location. The service provider who provided the routing to such online location would not.

Of course, in some on-line systems, the service party provider has direct contractual relationships with the content providers or may desire access to and use of the information on its own behalf and therefor assent to terms in order to obtain access. In the absence of these circumstances, however, the mere fact that the third-party service provider enables the customer to reach the information site does not constitute assent to the terms at that site.

9. *Other Means of Assent.* Manifestation of assent to a record is not the only way in which parties define their bargain. This article does not alter recognition of other methods of agreement. For example, a product description can become part of an agreement without manifestation of assent to a record repeating the description; the product description can define the bargain itself. Thus, a party that markets a database of names of consumer attorneys can rely on the fact that the product need only contain consumer attorneys because this is the basic bargain it is proposing; the provider is not required to seek manifest assent to a record stating that element of the deal. Similarly, the licensee may rely on the fact that the database must pertain to consumer lawyers, not other lawyers. The nature of the product defines the bargain if the party makes the purchase on that basis. If a product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective without requiring language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent to a record defining that nature or other agreement to it, the conditions may not become part of the agreement.

In many cases, copyright or other intellectual property notices or restrictions restrict use of a product, regardless of whether there is assent under this section. For example, common practice in video rentals places a notice on screen of the limitations imposed on the customer's use of the video under applicable copyright and criminal law, such as by precluding commercial public performances. The enforceability of such notices does not depend on compliance with this section.

10. *Authority to Act.* The person manifesting assent must be one that can bind the party seeking the benefits or being charged with the obligations or restrictions of the agreement. If a party proposing a record desires to bind the other party, it must establish that the person that acted had authority to do so or, at least, that the entity allegedly represented by that person accepted the benefits of the contract or otherwise ratified the individual's actions. Concepts of apparent authority may apply. If the person who manifested assent did not have authority and the conduct was not ratified or otherwise adopted, there may be no license. If this is the case, use of the information may infringe a copyright.

There must be a connection between the individual who had the opportunity to review and the one whose acts constitute assent. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when the CEO instructs the secretary to sign up for legal materials online or to install a newly acquired program that is subject to a screen license.

Questions of this sort arise under agency law as augmented in this article. In appropriate cases, Article 2B rules regarding attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 2B-116 deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. This article leaves to other law questions of agency law. Section 1-103.

11. *Assent to particular terms.* The section distinguishes assent to a record and, if required by other provisions of this article, assent to particular terms. Assent to a record involves conduct, expressions or an authentication with respect to a record as a whole, while assent to a particular term, if required, encompasses acts that relate to that particular term. One act, however, may assent to both the record and the term only if the circumstances, including the language of the record, clearly indicate to the party that doing the act is assent also to the particular term.

12. *Proof of Terms.* A party that relies on the terms of linked text or other electronic records must prove the content of the text at the time of the licensee's assent. One way of doing so is to retain records of content

at all periods of time or maintain a record of changes and their timing. Issues of proof are matters of evidence law.

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

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

(1) in the case of a person, ought to call it to the attention of a reasonable person and permit review; or

(2) in the case of an electronic agent, would enable a reasonably configured electronic agent to react to the record or term.

(b) Except as otherwise provided in subsection (c), if a record or term is available for review only after a person becomes obligated to pay or begins its performance, the person has an opportunity to review only if the person has a right to a return upon its rejection of the terms of the record. The right to a return may arise under Section 2B-208 or 2B-617, by agreement or otherwise.

(c) A right to a return is not required for an opportunity to review if the record or term:

(1) is a proposal to modify a contract;

(2) provides the particulars of performance pursuant to agreement under Section 2B-305; or

(3) is not a mass market license but is governed by Section 2B-207, and the parties at the time of contracting had reason to know that the record or terms would not be presented at or prior to the initial use or access to the information. .

Definitional Cross References:
"Contract". Section 2B-102. "Electronic agent". Section 2B-102. "License": Section 2B-102. "Record". Section 2B-102. "Return": Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

1. *Scope of Section.* This section gives content to the concept of "opportunity to review." An "opportunity to review" is a precondition to manifesting assent to a record. Consistent with general contract law, the concept requires an opportunity to review the record, not that the record actually be read.

2. *General Concept.* An opportunity to review in the case of a person requires that the record be

made available in a manner that ought to call it to the attention of a reasonable person and permit review. This is met if the person actually knows or has reason to know that the record or term exists and the circumstances permit review. Of course, an opportunity to review a copy of the record or term suffices if the actual record or term is the same as that made available for review.

a. Declining to Use the Opportunity to Review. An opportunity to review may exist even though the person foregoes or ignores the opportunity. Contract terms presented in an over the counter transaction or made available in a binder as required for some transactions under federal law create an opportunity to review even if the party does not use that opportunity. This is not changed because the party desires to complete the transaction rapidly, or is under external pressure to do so, or because the party has other demands on its attention, unless one party intentionally manipulates the circumstances to induce the other party not to review the record.

b. Permits Review. How a record is made available for review differs for electronic and paper records. In both settings, however, a record is not available for review if access to it is so time-consuming or cumbersome as to effectively preclude review. It must be presented in such a way as to reasonably permit review. In an electronic system, a record that is promptly accessible through an electronic link ordinarily qualifies. Actions that comply with federal or other applicable consumer laws that require making contract terms available or provide standards for doing so, satisfy this section.

3. *Return.* In modern commerce, there are circumstances in which the terms of a record are not available until after there is a commitment to the transaction. This is often true in mail order transactions, software contracts, insurance contracts, airline ticket purchases, and other common transactions. If the record is available only after that commitment, there is no opportunity to review unless the party can return the product (or in the case of a vendor that refuses the other party's terms, recover the product) and receive reimbursement of any payments if it declines the terms of the record. This return right, which does not exist in current law absent agreement, creates important protection for the party asked to assent to terms in these circumstances. In cases governed by Section 2B-208, there is a statutory right to a return.

This right is also intended to provide a strong incentive for a provider of information to make the terms of the license available up-front if commercially practicable. Doing so avoids the obligations regarding return stated in this article, both in this section and in Section 2B-208. In addition to that incentive, deferring when license terms are presented may have implications on the application of other doctrines where the choice to do so is not grounded in commercial judgment. For example, the doctrine of unconscionability has a procedural fairness aspect which might be affected by the method of presenting terms where the terms are oppressive.

The return right exists only for the first user. Subsequent parties are bound by the first contract.

Failure to provide an opportunity or a right to a return in cases of records presented after the initial commitment to the transaction, does not invalidate the overall agreement, but means that the terms of the record have not been assented to by the party to which it was presented. The terms of the agreement must then be discerned by consideration of all the circumstances, including the general expectations of the parties, applicable usage of trade and course of dealing, and the informational property rights, if any, involved in the transaction. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment in terms of the conditions or terms of the agreement. An agreement whose payment and other agreed terms reflect a right to use solely for consumer purposes can not be transformed into an unlimited right of commercial use by a failure of assent to the terms of a record.

4. *Modifications and Layered Contracting.* The return provisions do not apply to or alter law on modification of an agreement or the law regarding the agreed right of a party to specify particulars of performance. The provisions also do not apply in the commercial context of Section 2B-207(a)(2) where parties begin performance in the expectation that a record containing the contract terms will be presented and adopted later.

[B. Electronic Contracts: Generally]

SECTION 2B-113. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND AUTHENTICATIONS.

A record or authentication may not be denied legal effect solely because it is in electronic form.

Definitional Cross References:

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

Reporter's Notes:

1. *General Concept.* This section states a fundamental principle of electronic commerce that frames the remaining provisions of this article on electronic commerce. The fact that a message or record is electronic does not alter or reduce its legal impact. Of course, this principle applies only to transaction within Article 2B. It does not apply to payment orders, documents of title, or similar applications of electronic commerce.

2. *Relation to Evidence Issues.* This section only states the affirmative principle that the electronic nature of a record does not allow denying legal validity to it. This does not address the difficulties of proof that may exist, or the resolution of questions about to whom the record or authentication can be attributed.

SECTION 2B-114. COMMERCIAL REASONABLENESS OF ATTRIBUTION

PROCEDURE. The commercial reasonableness of an attribution procedure is determined by the court. In making this determination, the following rules apply:

(1) An attribution procedure established by statute or regulation is commercially reasonable for transactions within the coverage of the statute or regulation.

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

(3) A commercially reasonable attribution procedure may use any security device or method that is reasonable under the circumstances.

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

Definitional Cross References:

"Attribution procedure": Section 2B-102. "Court": Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section provides standards for determining if an attribution procedure is commercially reasonable.

2. *Effect of a Commercially Reasonable Procedure.* In this article, an attribution procedure receives enhanced legal effect only if it is commercially reasonable. Conforming to a commercially reasonable attribution procedure for authentication results in authentication as a matter of law. Section 2B-119. Complying with a commercially reasonable procedure for identifying a party or detecting errors or changes creates a rebuttable presumption of identity and the absence of errors or changes in the record. Sections 2B-116; 2B-117. On the other hand, failure to use a commercially reasonable attribution procedure does not preclude a finding that authentication occurred or of the identity and integrity of the sender and the record itself. It leaves the parties with general questions of proof.

3. *Nature of an Attribution Procedure.* This article does not dictate what constitutes an attribution procedure. Evolving technology and commercial practice make it impractical to predict future developments and unwise to preclude developments by a narrow statutory mandate. This article relies primarily on the parties to select an appropriate procedure.

In most cases, an attribution procedure is established by agreement or otherwise adopted by both parties. A procedure of which one party is not aware does not qualify. On the other hand, parties dealing for the first time may adopt a procedure for authentication of messages. These requirements assure an important element of

assent as a predicate for the creation of procedures that may affect substantive rights.

In some cases, statutes or regulations define a particular methodology as an appropriate procedure. These laws, such as digital signature statutes, establish by law a procedure that complies with the concept of an attribution procedure for purposes of this article. Under subsection (1), procedures established by statute or regulation are per se commercially reasonable within the scope of their coverage.

4. ***Commercially Reasonable.*** **The general requirement of commercial reasonableness is that the procedure be a commercially reasonable method of identifying the party as compared to others, a commercially reasonable method of detecting or preventing changes, or a commercially reasonable method of achieving any other purpose relevant to this article and to which the procedure is addressed. This does not require state of the art procedures. Rather, the requirement that a procedure be commercially reasonable in order to attain enhanced legal recognition provides an incentive that encourages good practices and allows a court to provide a direct buffer against over-reaching. It protects parties who lack knowledge of technology and use procedures established by others because if the procedure is found to be not commercially reasonable, it creates no presumption of the party's identity.**

What is a commercially reasonable procedure takes into account the choices of the parties and the cost relative to value of the transactions. How one gauges commercial reasonableness depends on a variety of factors, including the agreement, the choices of the parties, the then current technology, the types of transactions affected by the procedure, sophistication of the parties, volume of similar transactions engaged in, availability of feasible alternatives, cost and difficulty of utilizing alternative procedures, and procedures in general use for similar types of transactions. The concept is similar to that in Section 4A-202(c). The quality of the procedure may reasonably be tailored to the particular transaction and the degree of risk involved. Additionally, if a procedure results from a fully negotiated agreement of the parties, it should receive deference in terms of its reasonableness applicable to their particular situations. This flows from the principle of assumed risk and that the parties' agreement should ordinarily be enforced. The same principle may apply if the two parties, aware of the risks of a particular procedure, nevertheless agree to use the procedure for a particular transaction. In effect, the parties here have concluded that it is commercially reasonable in their context to accept the risks.

SECTION 2B-115. EFFECT OF REQUIRING COMMERCIALLY UNREASONABLE ATTRIBUTION PROCEDURE.

(a) Subject to subsection (b), between parties to an attribution procedure, a party that conditions a transaction on required use of a commercially unreasonable attribution procedure is liable for losses in the transaction for which the procedure was required caused by reasonable reliance on that procedure.

(b) The recovery of a party under subsection (a) is limited to losses in the nature of reliance or restitution and does not include:

(1) loss of expected benefit;

(2) consequential damages;

(3) losses that could have been prevented by the exercise of reasonable care by the aggrieved party; or

(4) a loss the risk of which was assumed by the aggrieved party.

(c) For purposes of subsection (a), a person does not require a commercially unreasonable procedure if the person makes available a commercially reasonable alternative.

Definitional Cross References:

"Attribution procedure": Section 2B-102. "Consequential damages": Section 2B-102. "Electronic": Section 2B-102.

Reporter's Notes:

1. *General Policy and Scope.* This section deals with cases where one party (licensor or licensee) requires the other to use an attribution procedure that is not commercially reasonable and use of that procedure causes a loss in a transaction between the parties either because of undetected errors or because of third party fraud. The section deals only with cases in which a party does in fact require use of the commercially unreasonable procedure. This does not create a principle that loss is always placed on the party whose procedure is not commercially reasonable. It deals with the more limited context where one party demands use of the commercially unreasonable procedure and prohibits alternatives.

The rule in this section is subject to Sections 2B-116 and 2B-117. Those sections establish presumptions about electronic records subject to commercially reasonable procedures. A commercially unreasonable procedure does not create those presumptions, leaving the parties to general proof. In addition, if the case is within this section, it may alter loss allocation.

2. *Imposed as a Condition.* The loss allocation in this section requires two elements. The first is that the commercially unreasonable procedure be required as a precondition to entering the transaction. This means more than that the procedure is merely made available. The party must insist on the particular procedure and be in a position where no alternatives are available or allowed. A procedure negotiated or jointly selected by the parties, selected by one from among alternatives that include a commercially reasonable option, or a mutually designed procedure, does not fall within this section. Responsibility for loss in such cases and in cases where the procedure allows a fraud in an unrelated transaction lies outside this article.

3. *Reasonable Reliance in a Covered Transaction.* The second element of allocating loss under this section is that the loss result from reasonable reliance on the required procedure in a transaction to which the requirement applies. The reliance must be reasonable. Thus, for example, a party that relies on an ordinary E-mail order for a multi-million dollar order may not be acting in reasonable reliance given the size of the transaction. What constitutes reasonable reliance depends on the circumstances, including consideration of the nature of the procedure, the size of the transaction involved, and the existence or non-existence of relevant safeguards or alternatives.

The loss must occur in a transaction to which the requirement applies. This is a contract statute that does not attempt to allocate all losses caused by fraudulent behavior. This section allocates loss within affected transactions. For example, if the unreasonable attribution procedure requires use of a bank account number and a third party invades the system and misappropriates the number, the party requiring use of such a number is not responsible for losses caused in unrelated transactions because the thief obtained the number. This section does not address the difficult problem of liability for misuse of important identifiers fraudulently to obtain goods and services from other vendors. The answers to those issues lie in tort law, criminal law, and regulation

4. *Party Responsible.* The person that required the procedure is responsible for the loss. In some cases the person imposing the requirement is the licensor and in other cases the licensee. The rule applies in either case. The section does not necessarily create an affirmative right of recovery. In some cases, it merely bars the

responsible party from recovering from the other person. Thus, pursuant to a commercially unreasonable attribution procedure a licensor might deliver information to a third party who used the inadequacies of the procedure to impersonate the named licensee. If the licensor had required the procedure, this section allows the licensee to resist any claim by the licensor to charge the licensee for the contract price. It is also likely in such case that, not being entitled to the presumption stated in Section 2B-116, the licensor will be unable to show that the order is attributable to the licensee. On the other hand, if the licensee had required the procedure, the licensor may recover against the licensee for the losses in the nature of reliance.

5. *Type of Loss*, The loss must come from use of the procedure. Thus, if an attribution procedure is unreasonable, but the party to whom it attributes a message did actually engage in the transaction and suffered loss due to a breach of contract, this section does not apply. The losses addressed here are from misattribution of who sent a message or from tampering with the content, not losses caused by ordinary breach of contract.

The losses are limited to reliance and restitution recovery. This restriction is spelled out in subsection (b). Subsection (b)(3) follows the general principle that a party cannot recover for losses that could have been avoided. This mitigation principle corresponds to general common law and the restatement of the concept in Section 2B-707. Subsection (b)(4) recognizes the concept of assumption of risk. Application of that general equity concept in the circumstances covered in this section, of course, must account for the fact that one party exercised strong leverage to impose an unreasonable procedure on the other. An assumption of risk cannot be found merely in acquiescing to this requirement.

6. *Illustrations.* The following suggest some applications of this section.

a. False Identity Cases: No Contract. Often, if a loss is suffered because a third party fraudulently used an attribution identifier to order information, this section produces results that are parallel to the results that could be inferred under other attribution rules of this article.

Illustration 1. LR (vendor) required and LE agreed to a procedure for identifying LE in placing orders with LR. Thief, purporting to be LE, obtains a $10,000 electronic encyclopedia from LR. LR seeks the license fee from LE. Under the general attribution sections, if the procedure is not commercially reasonable, there is no presumption that the sender was LE. Since LE was not the sender, it has no liability. The required attribution procedure caused a loss, but LR is responsible for that loss. It cannot shift that loss to LE.

In some false identity cases, the party demanding the use of the attribution procedure may be responsible for reliance losses in transactions to which the requirement applied.

Illustration 2. LE (purchaser) requires LR to use a procedure under which LE identifies itself when placing orders with LR. Thief uses the procedure fraudulently to obtain a $10,000 software system from LR posing as LE. Since LE required use of the procedure and it was commercially unreasonable, the loss suffered may be recovered from LE. The amount of loss is measured by reliance, not lost profit. The recovery is the cost (not license price) of the software shipped plus related expenses.

b. True Contract: Errors in Performance. If an actual contract exists and the error or fraud relates to performance, contract remedies will often provide the primary recovery and, under the principle that precludes double recovery, the reliance loss allocation in this section does not create affirmative recovery.

Illustration 3. LR (licensor) and LE (licensee) agree to a $10,000 commercial license. LR requires LE to agree to a procedure for instructions as to where to transmit the software. LE pays the license fee. A third party causes misdirection of the copy. LE demands its software. LR bears responsibility for reliance or restitution loss. LE can recover the fee or enforce the unperformed contract.

Illustration 4. In Illustration 3, assume that LE did direct transmission of the software, but now denies that it did so. If the procedure were reasonable, LR would have the advantage of a presumption of attribution of the message. Since it was not, LR must prove that LE sent the message. If it can do so, it can enforce the contract. LE suffered no loss due to the attribution procedure.

c. Errors in the Offer and Acceptance. Problems of garbled or otherwise mistaken offers and acceptances are of long-standing in commercial practice. This section allocates loss based on the reasonableness of the procedure and independent of arcane questions about what terms were accepted and when.

Illustration 5. LR (vendor) requires that LE use an unreasonable procedure for orders. LE agrees to the procedure. It places an order for ten software widgets. Because the procedure is flawed, the message arrives requesting 100. LR ships on that basis. LE desires to return the ninety excess widgets and not pay. One could argue that no contract exists because of mistake. Alternatively, a contract might be formed on the offer as sent or as received. Case law support exists for each result. This section focuses on reliance loss. Either LE or LR could be said to suffer reliance loss. Since LR required the procedure, it bears

responsibility for the loss and cannot demand the price for the ninety widgets unless LE decides to retain them.

SECTION 2B-116. DETERMINING TO WHICH PERSON AN ELECTRONIC AUTHENTICATION, MESSAGE, RECORD, OR PERFORMANCE IS ATTRIBUTED; RELIANCE LOSSES.

(a) An electronic authentication, message, record, or performance is attributed to a person if:

(1) it was in fact the act of that person or the person's electronic agent; or

(2) subject to subsection (b), the person receiving it in accordance with a commercially reasonable attribution procedure for identifying a person, reasonably concluded that it was the action of the other person or the person's electronic agent.

(b) Attribution under subsection (a) (2) has the effect provided by the statute, regulation, or agreement establishing the attribution procedure. If the statute, regulation, or agreement do not specify a different effect, attribution under subsection (a)(2) creates a presumption that the authentication, message, record, or performance was that of the person to which it is attributed [**proposed alternative:* places the burden of establishing on the person to which the authentication, record or performance was attributed to show that it was not responsible for the authentication, message, record, or performance].

(c) If subsection (b) applies and , the person to which the authentication, message, record, or performance was originally attributed is found to be not responsible in fact, that person is nevertheless liable for losses in the nature of reliance of the other party if the losses occur because:

(1) the person found not otherwise responsible failed to exercise reasonable care;

(2) the other party reasonably relied on the belief that the person found not otherwise responsible was the source of the electronic authentication, message, record, or performance; and

(3) the use of access material, computer programs, or the like created the appearance that it came from the person found not otherwise responsible and resulted from acts of a third person that obtained them from a source under the control of the person found not otherwise responsible.

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

Definitional Cross References.

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

Reporter's Notes:

1. *Scope of the Section.* This section deals with when an authentication, message, record or performance is attributed to a particular person. Attribution to a person means that the authentication, message, record, or performance is treated in law as having come from that person. The section enables electronic commerce in an open environment, while stating reasonable standards to allocate risk. The section does not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside Article 2B. It deals with an issue independent of whether the record has been authenticated. Authentication requires an act and an appropriate intent. Attribution deals with determining to whom the act is charged.

2. *Act of the Person or Electronic Agent.* Subsection (a)(1) makes a person responsible if it or its agent actually created the authentication, message, or record, or provided the performance. Common law agency rules govern for human agents. In addition, however, a person is responsible for the actions of its electronic agent. Section 2B-102; 2B-116(a)(1). Having decided to use an automated system, the person is responsible for its operations. The rules of subsection (a)(1) parallel the UNCITRAL Model Law. Article 13.

3. *Use of Attribution Procedure.* In many cases in electronic commerce, proof of actual involvement is not possible. Subsection (a)(2) makes an authentication, message, record, or performance attributable to a person if there existed a commercially reasonable "attribution procedure" and the other party used the procedure, reasonably concluding that the message came from the other person. "Attribution procedure" is a defined term, referring to a procedure agreed to or adopted by the parties, or created by law, for the particular purpose of attribution of authentication, messages, records, or performances.

This procedure yields the result in subsection (a)(2) only if the attribution procedure is commercially reasonable. Section 2B-114.

Unlike attribution to a person under subsection (a)(1), however, the effect of attribution under (a)(2) is determined under subsection (b) which, in the absence of other agreement, limits the effect to a [rebuttable presumption] [shift of the burden of proof]. While giving legal relevance to a commercially reasonable attribution procedure creates benefits for electronic commerce, the uncertainties of modern commerce indicate that, as a default rule, it is inappropriate to adopt an absolute rule that the person identified by the procedure is attributed with its results for all purposes.

Subsection (b) recognizes that fact. It provides that unless otherwise provided by agreement or by other law or regulation, attribution through a commercially reasonable procedure creates a [rebuttable presumption] [shift of the burden of proof] of the party's responsibility. Section 1-201(3!). How this might be rebutted in litigation, of course, depends on the circumstances. No general standard can be stated. However, since this is a default rule, if the parties agree that following the procedure will have a different effect, that agreement should be

enforced. Similarly, if another statute or regulation provides for a different result, that law controls.

4. *Reliance Losses.* Subsection (c) deals with when the presumption in (b) is rebutted. If a commercially reasonable procedure was used, but a third party actually sent the message, the relying party may nevertheless recover reliance loss if it proves that the loss was caused by the other party's negligence with reference to the attribution procedure and its use. What constitutes a lack of reasonable care depends on the circumstances, including the nature of the risks involved and the sophistication of the party. A consumer with no experience in attribution methodology would be expected to take fewer precautions in the relatively small transactions in which the consumer engages, than would a sophisticated company using the attribution procedure in reference to high value, large volume, or sensitive information transactions. In either case, the burden of proving a lack of reasonable care by a party rests on the person asserting the right to recover under this subsection.

The loss allocation principle recognizes a form of protected reliance where there was reliance on an agreed or otherwise established and commercially reasonable procedure. Since this is reliance-based liability, if the message, performance or context indicates that the indicated source is incorrect or gives reason to doubt the source, reliance may not be protected. This form of loss allocation adopts an intermediate position among the other potentially available loss allocation theories. Unlike in credit card and funds transfer systems, one cannot predict the relative nature of the sending and receiving parties, their economic strength, or technological sophistication. Individuals with limited resources are as likely to be on either side of a transaction in electronic commerce as are large corporations. Because of this, the rule creating a dollar cap for consumer risk for credit cards and funds transfers is not viable in this open system, heterogeneous environment. This context requires a more general structure because the problems will not routinely entail consumer protection or a licensor with better ability to spread loss.

SECTION 2B-117. ATTRIBUTION PROCEDURE FOR DETECTION OF CHANGES AND ERRORS: EFFECT OF USE. Between the parties to a commercially reasonable attribution procedure to detect errors or changes in an electronic authentication, message, record, or performance, the following rules apply:

(1) The effect of the procedure is determined by the agreement or, in the absence of agreement, by this section or any law establishing the procedure.

(2) If the procedure indicates that an electronic authentication, message, record, or performance was unaltered since a point in time it is presumed to not have been altered since that time.

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

(4) If the sender complies with the procedure, but the receiving party does not and a change or error would have been detected had the receiving party also complied, the sender is not bound by the change or error.

Definitional Cross References.
"Attribution procedure": Section 2B-102. "Electronic": Section 2B-102. "Electronic message". Section 2B-102. "Party". Section 1-201. "Presumed." Section 1-201. "Record". Section 2B-102. "Send". Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with the effect of using a commercially reasonable attribution procedure for the detection of errors or changes in electronic records. It creates default rules in terms of rebuttable presumptions and recognizes that these can be varied by agreement. The presumptions do not arise if the procedure is not commercially reasonable.

2. *Effect of Agreement and Presumptions.* If the parties agree to or adopt a commercially reasonable attribution procedure, an authentication, message, record or performance created, transferred or stored in compliance with that procedure is entitled to enhanced legal recognition. The effect of a commercially reasonable procedure can be determined by agreement or by applicable law or regulations outside this article. In their absence, use of the commercially reasonable procedure creates a presumption regarding the accuracy or unchanged nature of the record. The presumptions are limited to issues to which the procedure applies. Other presumptions may be appropriate depending on the nature of the procedure. This section does not foreclose their development by courts.

The presumptions are rebuttable and refer only to attribution procedures. The procedure must be commercially reasonable and must have been agreed to or adopted by the parties or created by other law. The principle here hinges on agreement and general considerations of commercial reasonableness. It is technologically neutral. Ultimate proof or disproof of alleged errors is left to law outside this article. The common law of mistake applies as do cases on the legal consequences of garbled or forged transmissions.

3. *Failure to Use.* Subsection (a)(4) deals in a limited way with the effect of a failure of one party to conform to an attribution procedure that is commercially reasonable (compare Section 2B-114). If the sender complies, but the recipient does not, the sender has no liability under contract law for an error that would have been detected through compliance by the recipient.

4. *Commercially Unreasonable Procedures.* If the procedure is not commercially reasonable, its effect is not governed by this section and is determined by other law.

SECTION 2B-118. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) In this section, "electronic error" means an error created by an information processing system, by electronic transmission, or by a consumer using an electronic system, when a reasonable method to detect and correct or avoid the error was not provided.

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

(1) promptly on learning of the error or of the other party's reliance on the message, whichever occurs first:

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

(B) delivers to the other party all copies of information it receives or delivers or destroys all copies pursuant to reasonable instructions received from the other party; and

(2) has not used or received any benefit from the information or informational rights or caused the information or benefit to be made available to a third party.

(c) In all cases not governed by subsection (b), the effect of the error is determined by other law.

Prior Uniform Law: None.

Definitional Cross Reference.

"Automated transaction": Section 2B-102. "Copy": Section 2B-102. "Consumer transaction": Section 2B-102. "Electronic": Section 2B-102. "Electronic message": Section 2B-102. "Good Faith": Section 2B-102. "Information". Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "Notifies": Section 2B-102. "Party": Section 1-102. "Receive": Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section creates a new right for consumers in automated transactions. It provides a statutory error correction procedure that supplements common law concepts of mistake in this setting. This section does not displace general common law concepts about the effect of mistake which continue to apply in both the electronic contexts discussed here and in other cases of error. To use the defense, the consumer must act in a prompt manner that minimizes any loss to the other party. This section does not alter the law concerning transactions that do not involve a consumer.

2. *Electronic Errors: Defined.* The section deals with electronic errors in automated contracting systems. This refers to two distinct situations. One is where the transmission or processing system causes unintended changes in a message sent. The second is where a consumer causes an error in an electronic transmission. The latter rule alters common law of mistake only as it applies to electronic errors caused by the consumer. It allows the consumer, by prompt action, to avoid the effect of its unilateral mistake.

The concept does not apply if the electronic procedure reasonably provides a means to correct the error. Thus, a consumer's mistake in entering 100 as the quantity of software copies desired may constitute an electronic error, but it does not come within this definition if the ordering system asks for confirmation of the quantity and allows the consumer a clear opportunity to correct the error before sending the order. This provides an incentive for the creation of error-correction procedures, but also provides reasonable protection to the consumer where such procedures are not made available.

Electronic errors that occur in transmission or because of defects in the processing system. In these settings, error correction systems may be less feasible, but might be created (e.g., a procedure routinely requiring confirmation of a transmission). In each case, a consumer may or may not have the ability to correct the error, but the existence of reasonable error correction procedures limits application of this section.

3. *Avoiding the Effect of Error.* If an electronic error occurs, the rule allows a consumer to avoid responsibility for unintended messages if the consumer acts promptly to do so. The message must not have been intended. Error avoidance is not a procedure to rescind a contract because the consumer has second thoughts. The procedure creates a means to avoid the complexity and uncertainty of relying on common law principles about mistakes. Under common law, in many instances of a unilateral mistake, the party making the error is responsible for its consequences. This section creates a consumer protection that avoids such decisions.

To avoid the effects of an electronic error, the consumer must act promptly on learning of the error or of the other party's reliance. The consumer must notify the other party of the error and deliver back, at the consumer's own cost, any copies of the information received. Return of copies is not required if the other party reasonably instructs the consumer to destroy the copies. However, the consumer must act in a manner that promptly returns it to the position that would have been true if the error had not occurred. Compare EU *Distance Contracts Directive* (rescission right for consumer if software returned unopened).

This concept builds on equity principles that allow a party to avoid the adverse consequences of its error or errors beyond the control of either party if the error causes no detrimental effect on another party and does not produce a benefit for the person making the mistake. It does not apply if the consumer has used or otherwise received a benefit from the erroneous order. If the consumer acts promptly to minimize the adverse effects, this section allows the consumer to vitiate the effect of the mistake. The right is grounded in equity principles. Of course, since there will be unavoidable detrimental effects on the party who received an erroneous message (e.g., costs of filling erroneous orders), courts should apply this rule with care. The basic assumption that there is no detrimental effect on the person who did not cause the error is particularly suspect if manufacturing, production, or other costs are significant. Also, a vendor who fills erroneous orders in a just-in-time inventory system can incur considerable costs for products such as computers or cars; where the product is information, the premise is that the lesser cost of manufacturing justifies the rule.

Illustration 1: Consumer intends to order ten copies from Jones. In fact, the processing system records 110. The electronic agent maintaining Jones' site disburses 110 copies. The next morning, Consumer notices the mistake. He immediately sends an E-Mail to Jones describing the problem, offering to immediately return or destroy copies; he does not use the games. Under this section, there is no contract obligation for 110 copies.

Illustration 2: Same facts as in Illustration 1, except that Consumer did order 110 copies and merely changed his mind. The conditions for application of this section are not met.

Illustration 3: Same as in Illustration 1, but Jones' system before shipping sends a confirmation, asking Consumer to confirm an order of 110 copies. Consumer confirms. There was no "electronic error" since the procedure reasonably allowed for correction of the error.

4. *Non-consumer Transactions.* This section does not alter common law in transactions that do not involve consumers. The diversity of commercial transactions make a simple rule inappropriate because of the far different patterns of risk and the greater ability of commercial parties to develop tailored solutions to this problem. A court addressing electronic errors in these other contexts should apply general common law, including an inquiry about whether any contract was actually formed. The existence of this remedy in this section for a consumer does not indicate that other remedies under the law of mistake are precluded.

SECTION 2B-119. PROOF OF AUTHENTICATION; ELECTRONIC AGENT OPERATIONS.

(a) Operations of an electronic agent are the authentication, manifestation of assent, or performance of a person if the person used the electronic agent for such purpose. A party is bound by the operations of its electronic agent even if no individual was aware of or reviewed the agent's actions or their results.

(b) Subject to Section 2B-116, compliance with a commercially reasonable attribution procedure for authenticating a record authenticates the record as a matter of law. Otherwise, authentication may be proven in any manner, including by showing that a party made use of

information or access which could only have been available if it engaged in conduct or operations that authenticated the record or term.

(c) Unless the circumstances indicate otherwise, authentication is deemed to have been done with the intent to establish:

(1) a person's identity;

(2) that person's adoption or acceptance of the authenticated record, term, or contract; and

(3) the integrity of the record or term as of the time of the authentication.

Definitional Cross References.

"Attribution procedure": Section 2B-102. "Authenticate:" Section 2B-102. "Contract". Section 1-201. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Record": Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with authentication and its effect (subsections (b) and (c)) and with electronic agent operations (subsection a).

2. *Electronic Agents.* Subsection (a) states the general principle that operations of an electronic agent bind the party that used the agent for that purpose. Section 2B-116(a)(1) states the analogous principle in reference to attribution rules. Electronic agents are automated systems that respond to or originate messages or performances. They enable important savings in transactional costs in electronic commerce and this article provides legal support sustaining their use in commerce.

The concept embodies principles like those under ordinary agency law that the electronic agent function within the scope of its intended purpose. In reference to human agents, this concept is often referred to in terms of whether the human agent acted within the scope of its actual or apparent authority. Here, since the concept deals with automation and the focus is more accurately placed on whether the agent was used for the relevant purpose. Cases of fraud, manipulation and the like are discussed in Section 2B-204.

3. *Proof of Authentication.* In dealing with an authentication, two separable issues are (1) whether the symbol or process was intended as an authentication and (2) to whom the authentication is attributed. Under Subsection (b), compliance with an a commercially reasonable procedure for authentication removes fact questions about whether an authentication was intended or occurred. It does not resolve questions of attribution pursuant to Section 2B-116 or issues under Section 2B-117. Subsection (b) concerns whether there was an authentication, while Section 2B-116 identifies who did or is responsible for the authentication. Ordinarily, of course, the two issues are resolved in a single step. On whether an attribution procedure is commercially reasonable, see Section 2B-114.

An attribution procedure is not the only way to establish an authentication. Proof of authentication can occur in any manner. Perhaps the most important form of proof in electronic commerce, other than an attribution procedure, involves showing that a process existed that required an authentication in order to proceed in an automated system. This section expressly recognizes the sufficiency of that type of proof.

4. *Effect of Authentication.* As with common law signatures, an authentication can be used with several different intended effects. Section 2B-102(1). In the absence of contrary indications present in the circumstances, the presumed intent encompasses all such effects. The contrary indications would be present if the attribution procedure was used solely for a single effect. Intention under this section must, as in other contexts, be gauged by objective criteria.

SECTION 2B-120. ELECTRONIC MESSAGES: TIMING OF CONTRACT;

EFFECTIVENESS OF MESSAGE; ACKNOWLEDGING MESSAGES.

(a) Except as otherwise provided in subsection (b) and (c), an electronic message is effective when received even if no individual is aware of its receipt.

(b) In determining when a contract is formed, if an offer in an electronic message evokes an electronic message in response, a contract is formed:

(1) when an acceptance is received; or

(2) if the response consists of furnishing or giving access to information, when the information or notice of access is received or use is enabled, unless the originating message required acceptance in a different manner.

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

(1) If the effectiveness of the message was expressly conditioned on receipt of an electronic acknowledgment, the message:

(A) does not bind the originator until acknowledgment is received; and

(B) expires if acknowledgment is not received within the time specified or, in the absence of a specified time, within a reasonable time after the message was sent.

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

(A) treat the message as no longer effective; or

(B) specify a further time for acknowledgment and, if acknowledgment is not received within that time, treat the message as no longer effective.

(d) Receipt of an electronic acknowledgment creates a presumption that the message

was received, but the acknowledgment does not in itself establish that the content sent corresponds to the content received.

Definitional Cross References.

"Electronic agent": Section 2B-102. "Electronic message": Section 2B-102. "Information": Section 2B-102. "Person": Section 1-201. "Presumption": Section 2B-102. "Receive": Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with the timing and effectiveness of electronic messages. It rejects the mailbox rule for electronic messages. It also deals with the impact of a request for an acknowledgment. The section does not deal with questions of to whom the message is attributed or with liability for errors. Section 2B-116; 2B-117.

2. *Time of Receipt Rule.* Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages. This reflects both the relatively instantaneous nature of electronic messaging and places the risk on the sending party of ensuring that receipt occurs. What rule applies in common law to modern messaging system is not clear. Here, the message is "effective" when received. Being effective, however, does not create a presumption that the message contains no errors. If errors are present, general law of mistake and Section 2B-118 determine the outcome.

The message is "effective" when received, not when read or reviewed by the recipient. A contract can exist even if no human being reviews or reacts to the electronic message or the information delivered. This applies traditional theories of assent and notice to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

3. *Effect of Requested Acknowledgment.* The effect of a request for acknowledgment depends on whether the requestor made the message conditional on acknowledgment (e.g., this message is not effective until receipt of confirmation of the message) or merely requested that an acknowledgment occur. The message sender has the right to control the effect of its messages if it does so expressly. A message that is expressly conditional on receipt of an acknowledgment does not bind the sending party until acknowledgment occurs. If there is no express condition, the sender may after a commercially reasonable time treat the message as no longer effective.

Acknowledgment is not acceptance, although an acceptance can be a sufficient recognition to also be treated as an acknowledgment. Acknowledgment confirms receipt. In modern electronic systems, this often occurs automatically on receipt of the electronic message in the recipient's system.

This section deals with functional acknowledgments. It does not create presumptions other than that an acknowledgment indicates that the message was received. Questions about accuracy of the received message and about time of receipt, and content are not treated here. Of course, by agreement the parties can extend the approach of this section to cover such issues.

PART 2

FORMATION AND TERMS

[A. General]

SECTION 2B-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, a contract requiring payment of $5,000 or more is not enforceable by way of action or defense unless:

(1) the party against which enforcement is sought authenticated a record sufficient

to indicate that a contract has been formed and that reasonably identifies the copy or subject matter to which the contract refers; or

(2) the contract is a license for an agreed duration of one year or less.

(b) A record is sufficient under subsection (a) even if it omits or incorrectly states a term, but the contract is not enforceable beyond the number of copies or subject matter shown in the record.

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

(1) a performance was tendered or the information was made available by one party and the tender was accepted or accessed by the other; or

(2) the party against which enforcement is sought admits in court, by pleading, testimony or otherwise that a contract had been formed, but the agreement is not enforceable under this paragraph beyond the number of copies or subject matter admitted.

(d) Between merchants, if within a reasonable time a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, the record satisfies the requirements of subsection (a) against the party receiving it unless notice of objection to its contents is given in a record within 10 days after the confirming record is received.

(e) An agreement that the requirements of this section need not be satisfied as to future transactions is effective if it is in a record that satisfies subsection (a).

(f) This section is the only statute of frauds applicable to transactions within this article.

Uniform Law Source: Section 2A-201. Revised.
Definitional Cross References:
"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Court": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Merchant": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Reason to know": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Reporter's Notes:

1. *General Policy.* This section provides important protections in commerce because of the character of the Article 2B subject matter, the threat of infringement, and the split of interests involved in a license with ownership of intellectual property rights in one party and rights or privileges to use or to possess a copy in the other. The section blends traditional U.C.C. concepts which focus on value issues with common law approaches that focus on duration of the contract in determining when a record is required.

2. *Basic Rule.* Subject to the stated exceptions, a contract is not enforceable by way of action or defense unless there is a record indicating that a contract was formed, if the contract calls for payments in excess of $5,000 and is a license for an agreed duration of one year or more. This dual standard reflects two traditional statute of frauds rules. The intent is to focus the formalities required by statute on transactions of significance, without requiring unnecessary formalities in the numerous small transactions that occur in ordinary commerce.

The $5,000 must be payments *required* under the contract. A royalty term that may ultimately yield millions of dollars would not come within this requirement unless there was a minimum payment that exceeds $5,000. Similarly, the existence of an option that might trigger an additional payment is not relevant unless the "option" payment is mandatory.

For licenses, as compared to other contracts, a record is required if the dollar amount is met and the license is for an agreed term of more than one year. A license for a perpetual duration, whether that exists because of an express term or through application of default rules, exceeds one year as would any license that states a term longer than a year even if the license may be terminated by a party before that time. On the other hand, a license for an indefinite term that is subject to termination at will does not exceed a one year term. The existence of an option to extend the duration of the license does not bring the contract within the statute unless the option is mandatory.

3. *Record Required.* The record, when required, must be sufficient to indicate that a contract was formed and must reasonably identify the copy or subject matter involved. No particular formalities are required. Only three invariable requirements are made by subsection (a). First, the record must evidence a contract within the scope of this article. Second, it must be authenticated. Third, it must specify the copy or subject matter involved.

The required record need not contain all material terms of the contract or even be designated by the parties as the contract. The record must, however, give a reasonable basis for believing that a contracts exists. Extrinsic evidence, including course of dealing and course of performance, along with the supplemental rules of this article may provide the remaining terms. Of course, the mere fact that a record exists which satisfies this section does not indicate that a contract was in fact formed. For example, while the record need not describe all elements of scope of a license, disputes about scope may indicate that no contract exists. See Section 2B-202.

There is no requirement that the record be retained. Obviously, retaining the record is good practice and may affect questions of proof, but this section merely requires that the record exist at a point in time. In electronic systems, a "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information must be in that form, but a record is not a mere ephemeral manifestation of information.

a. Authenticated.

The record must be authenticated by the party to be bound. A party can prove prior existence of an authenticated record by showing that a procedure existed 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 this article, "authentication" replaces the term "signature", but the concept is the same. In most cases, as under prior law on signatures, no real question will exist about the intended meaning of an (or signature) or it can be presumed that the authentication expresses agreement to a record and identifies the party. In the few cases in which doubt exists, since the concept of the rules in this section is that there must be some indication of the existence of a contract, the authentication must be made with intent to adopt or agree to the record or to identify the person as associated with the record which indicates the existence of the contract. Section 2B-119 states a presumption generally assumed to be true under prior law on signatures: unless the circumstances indicate to the contrary, an authentication encompasses an intent to identify the party, accept or adopt the record and its terms, and establish the integrity of the record's contents. The intent referred to pertains to the person making the authentication, not to the person receiving the authenticated record. See notes to Section 2B-102(4).

b. Subject Matter.

The record must describe the copy or subject matter covered by contract. "Subject matter" refers to defining to which information the contract refers. The section does not require description of the scope of the license. A reference to a film clip from the motion picture "Wise Choices" satisfies this section even though the

record does not describe what rights were granted. Filling out the details of scope and actual terms is a matter of parol evidence. A record is adequate for purposes of this section if it refers to one copy of the word processing software "Word Perfection." There is no requirement that the record describe the quantity or contract fee.

4. *Exception: Partial Performance.* Circumstances may render subsection (a) moot. One involves tender of performance by one party and acceptance by the other. These acts adequately document that a contract exists and the record required under subsection (a) is unnecessary. This section rejects the Article 2 rule that allows partial performance to validate the existence of a contract only to the extent of the performance itself. That rule is not consistent with the limited nature of the required record and splits transactions in an unacceptable manner. Parol evidence rules and ordinary contract interpretation principles protect against unfounded claims of extensive contract obligations. The exception requires tender and acceptance of performance. A party relying on the exception must show that the copy was tendered to it by the other party. Mere possession of a copy does not meet this exception, which depends on proving an authorized source for the copy. Similarly, the performance tendered and accepted must be sufficient to show a contract exists and cannot consist of minor acts of ambiguous nature.

Partial performance under this section only allows the party to prove the existence of the contract. It does not, of course, prove the existence of a contract or its terms, which terms must be established under other provisions of this article. It merely avoids the defense stated in subsection (a). For example, in a contract to develop and deliver three modules of a new program, tender and acceptance of one satisfies this section, but whether there is a contract covering three modules must be proven by the party claiming that to be the case.

5. *Exception: Judicial Admissions.* A record is not needed if the party charged with the contract obligations admits in judicial proceedings that a contract exists. The admission confirms the existence of the contract to the extent of the subject matter admitted.

6. *Exception: Confirming Memoranda.* Subsection (d) follows original Article 2. Between merchants, failure to answer a record that contains a confirmation of a contract within ten days of receipt is tantamount to an authenticated record under this section and is sufficient to satisfy this section with respect to both parties. This validates practice in many industries where the volume or nature of the transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum places the other party on notice that a contract has apparently been formed. Accordingly, it must object to the existence of a contract if one, in fact, does not exist.

The memorandum removes the statutory bar to enforcement. The only effect, however, is to take away from the party who fails to answer, the defense of this section. The burden of persuading the trier of fact that a contract was actually made prior to the confirmation is unaffected by this rule. Cf. Section 2B-203 (effect on contract terms). The confirming memorandum does not of itself establish the terms of the contract, which terms must be established under other provisions of this article such as general rules on manifesting assent to a record or agreeing to a modification.

7. *Other Agreements.* Subsection (f) confirms the enforceability of trading partner or similar agreements that alter the formal requirements of this section with respect to covered transactions. The parties can agree in a record to conduct business without additional authenticated writings. That agreement satisfies the statute and the policies of requiring minimal indication that a contract was formed.

8. *Other Laws.* Subsection (g) clarifies that the formalities required by this section supplant formalities required under any other laws relating to transactions within this article. This rule is applicable only with respect to state law. In many licenses, federal law requires more stringent formalities for effective conveyance. For example, the Copyright Act requires that an exclusive copyright license be in a writing and makes non-exclusive licenses that are not in a writing subject to subsequent transfers of the copyright.

9. *Estoppel.* This section does not address the relevance of equity theories such as estoppel in cases where the required record is not present. The law on the applicability of estoppel remains as it existed before the adoption of this article.

SECTION 2B-202. FORMATION IN GENERAL.

(a) A contract may be formed in any manner sufficient to show agreement, including by offer and acceptance, or by conduct of both parties or operations of electronic agents which

recognize the existence of a contract.

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

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

(d) In the absence of conduct or performance by both parties to the contrary, a contract is not formed if there is a material disagreement about a material term, including scope.

(e) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is so fixed, a contract is not formed if the parties subsequently do not agree to the term. 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, and return any contract fee paid for which performance has not been received. The parties remain bound by any contractual use restriction with respect to information or copies received or made under the contract and not returned or returnable to the other party.

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

Definitional Cross References:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Contract fee". Section 2B-102. "Contractual use restriction": Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Receive". Section 2B-102. "Remedy": Section 1-201. "Scope". Section 2B-102. "Term". Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section describes basic contract formation rules. With exceptions as noted, these rules come from original Article 2. The section is subject to the specific rules on offer and acceptance in 2B-203. Article 2B separates two issues. One is whether a contract was formed. The second is what are the terms of that contract. That latter issue is dealt with under general rules of interpretation, the parol evidence rule, and Sections 2B-207, 2B-208, and 2B-209. In many cases, of course, the same events create a contract and define its terms.

2. *Manner of Formation.* Subsection (a) continues the basic U.C.C. policy recognizing the effect of any manner of expressing agreement, oral, written or otherwise, including by conduct or inaction. This follows original Article 2. Cases interpreting original Article 2 may be applicable. Of course, no contract is formed without an intent to contract. This section and general law do not impose a contractual relationship where none has been assented to by the parties. In determining whether conduct or words establish a contract, courts should look to the entire circumstances, including usage of trade and course of dealing.

Subsection (a) also expressly recognizes that an agreement can be formed by operations of

electronic agents. This gives force to a choice made by the party to use an electronic agent. The agent's operations bind the user. In Article 2B, the operations of electronic agents are treated as having specified effects in law attributable to a party. Section 2B-116.

3. *Time of Formation.* Subsection (b) confirms that a contract can be formed even though the exact time of its formation is not known, if the actions or records of the parties or the operations of their electronic agents confirm the existence of a contract.

4. *Open Terms and Layered or Rolling Transactions.* As in common law, subsection (c) recognizes that if the parties intend to enter a binding agreement, that agreement is valid despite missing or otherwise open terms so long as there is any reasonably certain basis for granting a remedy. This rule does not apply if the parties do not intend to be bound unless or until the remaining terms are agreed to by the parties. This distinction, based on the intent of the parties states a basic principle applicable under both original Article 2 and general common law. *See Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.,* 145 F.3d 505 (2nd Cir. 1998) ("Under New York contract law, parties may enter into a contract orally even though they contemplate later memorializing their agreement in writing. If, however, the parties do not intend to be bound absent a writing, they will not be bound until a written agreement is executed."); *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2d Cir.1986).

If there is an intent to be bound, the test for enforceability is not certainty as to all terms about what the parties were to do, what obligations they assumed, or what damages are due in the event of breach. Rather, commercial standards are to be applied to answer these questions in light of the recognition that in many commercial arrangements, terms are defined over time, rather than at one specific time. The more terms the parties leave open, however, the less likely it is that they have intended to conclude a binding agreement, but their actions are frequently conclusive on the formation issue despite the omissions.

Subsection (c) follows common law and original Article 2 and distinguishes between preliminary negotiations or incomplete efforts to make a deal, and actions or statements with an intent to be bound even though terms are left open. Making the distinction requires consideration of all of the circumstances. If the parties intend a contract, it can be formed despite the existence of terms remaining to be agreed and terms left open. On the other hand, if there is no intent to contract, no contract exists and the default rules of this article do not create one.

This section provides a foundation for the layered contracting that typifies many areas of commerce and that is recognized in original Article 2 with respect to transactions in goods. The foundation begun in here is further developed in Section 2B-207, 2B-208 and 2B-305. The concept that all contracts arise at one single point in time and that this single event defines all the terms of agreement is not consistent with modern commercial practice. Contracts are often formed over a period of time, and contract terms are often developed during performance, rather than before performance occurs. In some cases, later adopted terms might be viewed as a modification of the agreement, but often the parties expect to adopt records later and that expectation itself is the agreement. Rather than a modification of an existing agreement, these terms fulfill prior expectations or normal practice. They are part of the agreement itself, rather than proposed changes. Treating later proposed terms as a proposed modification is appropriate only if the deal has in commercial understanding of both parties has been closed and recognized as a contract with no reason to expect new terms to be provided. If the parties do not intend to be bound unless later terms are agreed to, subsection (e) gives guidance for unwinding the relationship.

During the period of time in which the terms in layered contract are being developed or to be proposed, it is not appropriate to apply default rules of this article. The default rules are applicable only if the "agreement" of the parties does not deal with the subject matter of the default rule. Agreement may be found in express terms, or through application of usage of trade or course of dealing, or inferred from the circumstances of the transaction. In layered contracting, the agreement is that there are no terms on the undecided issues until the terms are made express by the parties. Applying a default rule there might in fact be a case of applying the rule <u>despite</u> contrary agreement. Of course, distinguishing such cases from cases in which the default rule should apply in the interim requires consideration of the circumstances of the transaction and, especially, usage of trade, course of dealing, and other indicia of the expectations of the parties.

5. *Disagreement on Material Terms and Scope.* A material disagreement about an important (material) term indicates that no intent to enter a contract exists. "Scope" of the license goes to the fundamentals of the transaction and what the licensor intends to transfer and what the licensee expects to receive. Indeed, in many respects, the contract scope provisions are the basic product description. Disagreements about this fundamental issue indicate fundamental disagreement about the contractual subject matter.

6. *Failure to Agree.* Subsection (e) derives from original Section 2-305(4) and indicates procedures that apply where the parties conditioned agreement on subsequent specification of terms, but that later determination did not occur. The basic principle is that the parties are to return to the status that would have prevailed in the

absence of any agreement.

SECTION 2B-203. OFFER AND ACCEPTANCE. Unless otherwise unambiguously indicated by the language of the offer or the circumstances, the following rules apply:

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

(2) An order or other offer for prompt or current delivery of a copy invites acceptance either by a prompt promise to ship or by the prompt or current shipment of a conforming or nonconforming copy. However, a shipment of nonconforming copies is not an acceptance if the party providing the shipment seasonably notifies the other party that the shipment is offered only as an accommodation to that party.

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

[**SECTION 2B-203A. ACCEPTANCE WITH VARYING TERMS.]**

(a) Except as otherwise provided in Section 2B-203B), a definite and seasonable expression of acceptance operates as an acceptance, even if the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially conflicts with a material term of the offer or materially varies from the terms of the offer.

(b) If the acceptance materially conflicts with or materially varies the offer, the following rules apply:

(1) A contract is not formed unless all the other circumstances, including the conduct of the parties, indicate that an agreement existed.

(2) If a contract is formed under paragraph (1), the terms of the contract are determined:

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

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

(c) If the offer and acceptance contain varying terms but the variation or conflict was not material, a contract is formed and the following rules apply:

(1) The terms of the contract are those of the offer.

(2) Nonmaterial additional terms contained in the acceptance are treated as proposals for additional terms.

(3) Between merchants, the proposed additional terms become part of the contract unless the offeror gives notice of objection before or within a reasonable time after it receives notice of the proposed terms.

[SECTION 2B-203B. CONDITIONAL OFFERS OR ACCEPTANCES.]

(a) Except as otherwise provided in subsection (b), an offer or acceptance that, because of the circumstances or the language is conditioned on agreement by the other party to the terms of the offer or acceptance, precludes formation of a contract unless the other party agrees to its terms, by manifesting assent or otherwise.

(b) If an offer and acceptance are in standard forms and one or both are conditioned on acceptance of their terms, the following rules apply:

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

(2) If a party agrees, by manifesting assent or otherwise, to a conditional offer effective under paragraph (1), it adopts the terms of that offer under Section 2B-207 or 2B-208, as applicable, except to the extent the terms of the conditional offer in a standard form conflict with the expressly agreed terms of the parties as to price and quantity.

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

Definitional Cross References.

"Agreement": Section 1-201. "Contract". Section 1-201. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Notice". Section 2B-102. "Notice": Section 1-201. "Notifies". Section 1-201. "Party". Section 1-201. "Receive": Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with offer and acceptance. It deals directly with acceptances that vary the offer and with conditional offers or acceptances. The basic principle is that a party has a right to control the terms of acceptance of its offer if it does so expressly, but that in the absence of control, any reasonable manner of acceptance suffices. In resolving issues about the so-called battle of forms, this section must be considered in connection with Section 2B-209. Note 4 to that section lists questions asked in such cases.

2. *Methods of Acceptance.* Subsection (a) deals with general rules of offer and acceptance. It follows Section 2-206(1). As under the *Restatement (Second) of Contracts* § 19, acceptance may be in any form, including a manifestation of assent pursuant to Section 2B-111.

a. Any Reasonable Manner. Any reasonable manner of acceptance is available unless the offeror has made it clear that a method is not acceptable or that acceptance requires a particular method. The offeror can control acceptance of its offer. Article 2 adopted this rule in the 1950's. This section follows original Article 2 in that acceptance may be in any manner or any medium reasonable under the circumstances. This standard accommodates new methods of communication as they develop.

b. Shipment or Promise to Ship. Either a shipment or a prompt promise to ship or transmit is a proper means of acceptance unless the offer otherwise provides. This follows Section 2-206(1)(b).

c. Beginning of Performance. The beginning of performance by an offeree can be effective as an acceptance to bind the offeror only if followed within a reasonable time by notice to the offeror. To be effective, the beginning of performance must unambiguously express the intent to be bound.

3. *Acceptance Varying the Offer.* Subsection (b) conforms to original Article 2. It allows contract formation even though the offer and acceptance contain varying terms that do not fully match. A term is a varying term if it conflicts with a term of the offer in whole or in part or if it covers an additional subject not dealt with in the offer. Article 2 altered the common law "mirror image" rule and common law in most states no longer consistently follows it. The mirror image rule precludes formation of a contract unless the terms completely match. However, there must be an acceptance; no contract is formed by a counteroffer. To resolve an issue not addressed in original Article 2, Article 2B provides a standard for determining when variations in terms does or does not yield an acceptance. This section presumes that varying terms do not create a contract if the variance is material.

In sales of goods and in traditional literature, this set of issues is often discussed in reference to the exchange of purchase order and acceptance forms. This is not routinely the context in information commerce. This section follows the premises in original Article 2, expanding on its principles and recognizing the fact of layered contracting. Where neither the offer nor the acceptance are expressly conditioned on acceptance of their own terms. there are two different cases. In one, the offer and acceptance materially conflict. In the other, the differences are not material.

a. Varying Terms: Material Variance. Subject to the rules dealing with conditional offers or acceptances, subsection [2B-203A(a)] provides that a material variance in a purported acceptance precludes contract formation based on the purported acceptance. What constitutes a material variation of the offer depends on the context, including what degree of acceptable variation the parties might reasonably expect in light of applicable trade use and course of dealing. However, an "acceptance" that purports to alter basic elements of the proposed bargain is not an acceptance and, in the absence of conduct creating a contract, no contract is formed by that "acceptance" unless the new terms are accepted by the other party.

An acceptance that materially varies the offer does not create a contract. However, this rule does not preclude formation of a contract by conduct. If a contract is formed by the circumstances, including conduct of the parties, the important issues center on what terms are applicable. In cases where the records exchanged materially conflict. Subsection [2B-203A(a)(1)] contemplates two approaches to determining the terms of the contract. The first arises if one party agreed to the terms of the other. In that case, the terms of the accepted record control subject to the limitations in Section 2B-207 and 2B-208. Agreement can be manifested in any manner except that it cannot be found solely in the "acceptance" that contains a materially varying term. The second is where the exchanged offer and acceptance materially conflict, but a contract is formed solely by conduct. This places the relationship under Section 2B-209 which instructs a court to consider the entire context in determining the terms of the contract.

b. Varying Terms: Non-Material Variance. If an offer and acceptance do not materially vary, they form a contract. The terms of the contract are the terms of the offer. Section 2B-209 does not apply because the contract is formed by offer and acceptance.

Subsection [2B-203A(a)(2)] allows for inclusion of non-material additional terms from the acceptance unless the offeror timely objects to those terms. This rule comes from existing Article 2 and follows the basic principle that the offeror controls the terms of its offer. If the acceptance gives conflicting treatment of a subject contained in the offer and the difference is not material, the offer controls. Standards of materiality in this context include whether the additional terms involve unreasonable surprise when measured against the commercial context, including usage of trade and course of dealing, or whether they so change the effect of the other terms of the offer and acceptance such as to significantly alter the bargain reached. In either context, the terms are not part of the agreement.

4. *Conditional Offers and Acceptances.* A person has a right to state and insist on preconditions for acceptance of its offer. Subsection [2B-203B(a)] recognizes that principle. In commercial practice, the most common conditional offer or acceptance limits its effect on the other party's adherence to all of its terms. No principle in contract law precludes a party from enforcing such conditions. However, conditional language in standard terms of a standard form creates special problems in "battle of forms" transactions where either or both parties make an acceptance or offer expressly conditional on its specific terms, but perform irrespective of acceptance of the condition. Subsection [2B-203B(b)] treats this as a question involving the effectiveness of the conditional language. In a standard form, the party desiring enforcement of its conditional language is entitled to that result only if its conduct corresponds to the condition. Conduct corresponds to the condition if the party insisting on the condition precludes further performance unless the other party assents to its terms.

Illustration 1. Licensee sends a standard order form indicating that its order is conditional on the Licensor's assent to the terms on the Licensee's form. Licensor ships with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. Here, neither party acted consistent with the language of condition. A contract exists based on conduct. The terms are governed by 2B-209.

Illustration 2. In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser that agreement to the Licensor's terms is a condition of shipment. It does not ship until Purchaser agrees to terms. Until that occurs, there is no contract. If it occurs, the contract exists based on the form agreed to.

Illustration 3. In Illustration 1, assume Licensor ships pursuant to a "conditional" form, but when the shipment arrives, Purchaser refuses it. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language. When agreement occurred, that agreement sets out terms of the contract.

SECTION 2B-204. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS. In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents. A contract is formed if the interaction results in the electronic agents' engaging in operations that confirm

or indicate the existence of a contract unless the operations resulted from electronic mistake, fraud or the like.

(2) A contract may be formed by the interaction of an electronic agent and an individual. A contract is formed if the individual takes actions or makes a statement that the individual has reason to know will:

(A) cause the electronic agent to perform, provide benefits, permit the use or access that is the subject of the contract, or instruct a person or an electronic agent to do so; or

(B) indicate acceptance or an offer, regardless of other expressions or actions by the individual to which the electronic agent cannot react.

(3) The terms of a contract formed under paragraph (2) are determined under Section 2B-207 or 2B-208, as applicable, but do not include terms provided by the individual if it had reason to know that the electronic agent could not react to the terms as provided.

Definitional Cross References

"Agreement": Section 1-201. "Automated transaction": Section 2B-102. "Contract": Section 1-201. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with two setting: 1) an interaction between two electronic agents and 2) an interaction between a human and an electronic agent. Both interactions can create a contract. In each case, however, contract formation rules take into account the fact that an electronic agent cannot react to terms outside the scope of its programming and, at least in most cases, that the party using the agent does not, by virtue of that use, accept the possibility of agreeing to other terms.

Modern systems enable the use of electronic contracting agents by consumers and other licensees as well as by licensors. Intelligent agents that search for information or other products within predefined purchase terms creates a significant new form of comparison shopping that is supported by the rules here.

2. *Interaction of Electronic Agents.* An interaction of two electronic agents can create a contract that bind the parties that used the agents to achieve that result if the operations of the electronic devices indicate that a contract exists. This rule follows the basic principle that conduct can create a contract. That would occur, for example, if the interaction results in information being sent by one and accepted in the system of the other. It might also occur if the agents' operations result in recording within their respective systems that a contract has been created. The terms of the contract that result from this interaction are determined under Section 2B-207 or 2B-208 as applicable.

3. *Electronic Mistake and Fraud.* Assent from the operations of the two electronic agents does not arise if the operations are induced by mistake, fraud or the like. Formation of a contract does not occur if one party or its electronic agent manipulates the programming or response of the other electronic agent in a manner akin to fraud. This, in essence, vitiates the inference of assent which would occur through the normal operations of the agent. Similarly, the inference is vitiated if because of aberrant programming or through an unexpected interaction of the two agents, operations indicating the existence of a contract occur in circumstances that are not within the reasonable contemplation of the person using either electronic agent. In such cases, the circumstances are

analogous to mutual mistake. In some cases, especially if the electronic agent is supplied by one party to the purported agreement, it would be appropriate for a court to avoid results that are clearly outside the reasonable expectations of the other party. The concept here is more akin to the law of unilateral mistakes except that it places the risk on the party that supplied the agent for and required its use in a particular transaction.

Subsection (1) makes clear that restrictions analogous to common law concepts of fraud and mistake are appropriate to prevent abuse or clearly unexpected results. Courts applying these concepts may refer to cases involving mistake or fraud doctrine even though, in the case of electronic agents, the electronic agent cannot actually be said to have been misled or mistaken. Of course, parties may agree to reallocate the risk of mistake or fraud in a separately formed agreement, such as an EDI agreement setting out a procedure for subsequent electronic ordering.

This section does not address the liability of a supplier of the electronic agent whose programming or lack of security causes loss. If such supply contract is within this article, allocation of liability is handled as in any other contractual relationship. Liability under other law is not dealt with in this article.

4. *Interaction of Human and Electronic Agent.* Contracts may be formed by an interaction of a human and an electronic agent. The electronic agent's ability to bind the party using it derives from the choice of that party to so use an automated system. A contract is formed if the human makes statements or engages in conduct that indicate assent. Consistent with the concept of manifesting assent, assent may be indicated by taking actions with reason to know that they indicate agreement. Here, that occurs if the acts or statements will cause the electronic agent to deliver benefits or permit the access that is the subject matter of the contract. Statements by the individual purporting to alter or vitiate agreement to which the electronic agent cannot react are ineffective.

Illustration 1. Tootie is an electronic system for placing orders with Home Shop. If a customer dials the number, a voice instructs the customer to indicate a credit card number, the item number, the quantity, the customer's location, and other data. Customer, after entering the data, verbally states that he will only accept the information if there is a 120 day "no questions" return right. Otherwise: "I don't want the damn things." Customer has reason to know that the electronic system cannot react to the verbal condition. Tootie automatically orders shipment.

There is a contract. The verbal condition is ineffective. Stating conditions beyond the capability of the agent to react does not vitiate agreement when there is reason to know that they cannot be dealt with by the electronic system. Agreement is indicated by the steps that initiate shipment.

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

User's "counter offer" is ineffective. The charge includes the additional $1.00.

SECTION 2B-205. FIRM OFFERS. An offer by a merchant to enter into a contract which is made in an authenticated record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term providing assurance that the offer will be held open which is contained in a standard form supplied by the party receiving the offer and used by the party making the offer is ineffective unless the party making the offer authenticates the term.

Uniform Law Source: Section 2A-205; Section 2-205.
Definitional Cross References.

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

Reporter's Note: This section follows original Article 2.

SECTION 2B-206. RELEASES. The following rules apply to releases of informational rights:

(1) A release in whole or in part is effective without consideration if it is:

(A) in a record to which the releasing party agrees, by manifesting assent or otherwise, and which identifies the informational rights released; or

(B) enforceable under estoppel, implied license, or other rules.

(2) A release continues for the duration of the informational rights released if the agreement does not specify its duration and does not require affirmative performance after the grant of the release:

(A) by the party granting the release; or

(B) by the party receiving the release, except for relatively insignificant acts.

(3) In cases not governed by subsection (2), the duration of a release is governed by Section 2B-308.

[**SECTION 2B-206A. SUBMISSION OF IDEAS.]**

(a) The following rules apply to submissions of information for the creation, development, or enhancement of information that is within the subject matter of this article and is not made pursuant to an existing agreement calling for the submission:

(1) a contract is not formed and is not implied from the mere receipt of an unsolicited submission;

(2) engaging in a business, trade, or industry that by custom or practice regularly acquires ideas is not in itself an express or implied solicitation of the information; and

(3) if the recipient seasonably notifies the person making the submission that it maintains a procedure to receive and review submissions, a contract is formed only if:

(A) the submission is made and accepted pursuant to that procedure; or

(B) the recipient expressly agrees to terms concerning the submission.

(b) An agreement to disclose an idea creates a contract enforceable against the receiving party only if the idea as disclosed is confidential, concrete, and novel to the business, trade, or industry or the party receiving the disclosure otherwise expressly agreed.

Definitional Cross References.

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

Reporter's Note:

1. *Releases: General Rationale.* A release is an agreement that the releasing party will not to object to, or exercise any remedies to limit, the use of information or informational rights. This is a license, but does not contain obligation by the releasing party to enable or support the other party's use of the information.

2. *Releases: Enforceability.* A release is enforceable without consideration if the release is by a record to which the releasing party agrees, by manifesting assent or otherwise. This clarifies the enforceability of releases in a record, but does not alter other law making releases enforceable, including law enforcing releases given without consideration. For this result, subsection [2B-206(1)] requires agreement to a record. This includes all modern means of recording assent and all forms of records, such as by filmed assent.

Releases are common in Internet "chat room" and "list service" systems. Participation often assumes permission to use comments or materials submitted. If the relationship is a contract supported by consideration (e.g., the operator grants the right to use the service in return for the release), the release is enforceable based on assent to a sign-on screen, regardless of whether consideration sufficient for a contract exists. The opposite is also true. If the service is a private service, dealing with information that persons view as confidential (e.g., a service dealing with the treatment of AIDS), a condition of participation that precludes use of the information associated with the names of the participants is also enforceable.

Illustration. X operates an on-line chat room and a monthly newsletter of selected comments. When an individual enters the chat room, the sign-on screen states: "By participating you grant X the right to use your comments in any medium." By joining, the participant releases its copyright in its comments. The on-screen condition is a record to which the participant's acts assent.

3. *Releases: Duration.* Absent contrary agreement, a release is for the duration of the released rights. Of course, the release is effective only with respect to its own terms. A release that allows use of a person's image in an Internet site does not release rights to other uses of that image.

4. *Idea Submissions: General Premise.* Subsections [2B-206A] deals in a limited way with an important issue in information industries: submissions of ideas. The subsections do not deal with 1) submissions of ideas for improving business operations or 2) with equity theories of liability. This leaves undisturbed the array of doctrines dealing with equitable remedies, but clarifies the effect of a submission in contract law. A distinction is stated between submissions pursuant to an agreement and unsolicited submissions.

5. *Idea Submissions: No Prior Agreement.* Subsection [2B-206A(a)] deals with submissions not pursuant to a prior agreement. Subsection (a)(1) states an obvious contract law principle that gives some courts difficulty. If the submission was not solicited, mere receipt of the submission does not create a contractual relationship. The receiving party may have an obligation to return copies in some cases, but the unilateral action of the other party cannot create obligations in contract on the recipient. This is true, as indicated in subsection (a)(2), even if the industry itself ordinarily relies on ideas. Contracts only arise in the event of agreement by the parties.

Subsection [2B-206A(a)(3)] acknowledges the common practice of establishing a method for

receiving and reacting to submissions as a means of controlling risk and giving guidance. Under this subsection, these procedures have impact in contract law if the submitting party is notified that they exist. Undisclosed procedures are not relevant to a contract analysis. If the submitting party is notified of the procedure, decisions about acceptance or rejection of the submission are funneled through that procedure or, in the case of acceptance, an express decision to accept. This protects both parties. The submitter and the recipient receive the benefit of a more specific set of choices about taking on a contract or rejecting it.

5. *Idea Submissions: Consideration* An agreement for submission of an idea carries with it, in the absence of contrary terms, the assumption that the idea has value or uniqueness. That value exists if the idea is concrete, confidential and novel. If, for example, a party agrees for a fee to submit an idea for enhancing the success of audiovisual works, the contract is not satisfied if the idea is "draw more attractive images." This adopts New York law and cases such as *Oasis Music Inc. v. 100 USA, Inc.*, 614 N.Y.S.2d 878 (N.Y. 1994)**.** A submission that does not meet this standard does not breach the contract, unless the agreement gave express assurances that the submission would be novel. The licensee cannot recover payments it already made. Rather, the default rule is that the provider of the non-novel submission cannot enforce any future obligations as to the submitted idea. The basic principle is that a non-novel idea is not adequate consideration for a contract and that a proponent of an idea implicitly represents that the idea has value. This is not met in a case of a non-novel idea.

This principle does not require that the idea rise to the level of novelty as that term is used in patent law. The information must not be something that is generally and widely known. Cases on combination secrets and other situations in trade secret law where information has sufficient uniqueness or secrecy to qualify as a trade secret should inform decisions under this standard.

Nothing in this section precludes an agreement that does not hinge on the uniqueness of the proposed submission. Whether such agreement exists must be judged based on the fundamental notion that a party does not implicitly contract away its rights, without a fee, to use publicly known information merely because it contracted for "disclosure" of such material.

[B. Terms of Records]

SECTION 2B-207. ADOPTING TERMS OF RECORDS.

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

(b) Adoption of the terms of a record between parties may occur after commencement of performance or use under their agreement if they had reason to know that their agreement would be represented in whole or in part by a later record to be agreed, but at the time performance or use commenced there was no opportunity to review the record or a copy of it or it had not been completed.

(c) If a party adopts the terms of a record, those terms become part of the contract without regard to the party's knowledge or understanding of individual terms in the record, except for a term that is unenforceable because it fails to satisfy another requirement of this article.

Definitional Cross Reference:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Manifest assent." Section 2B-111 "Opportunity to review." Section 2B-112. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* Article 2B deals separately with forming a contract and the terms of that contract. This section is the primary section on adoption of terms of a record as terms of a contract. Section 2B-208 limits the creation of terms in mass-market licenses and the time over which they can be presented. Section 2B-209 deals with cases when records do not create contract terms, but a contract exists because of conduct.

This section states basic principles about when and how terms of a record are adopted and also expressly recognizes that commercial deals often involve layered contracting, providing a standard for determining when this type of contract term formation exists. Subsection (b) rejects the idea that a contract and all terms must be formed at a single point in time. It permits layered contracting that reflects commercial practice in cases where the parties have reason to believe that terms will be proposed at some later time. The effect of a failure to agree depends on whether the agreement on terms was a condition to the existence of a contract. See Section 2B-202.

2. *Adopting Terms.* If a party agrees to a record, it adopts the terms of the record whether or not the record is a standard form. Standard forms are common in commercial practice because they provide efficiencies for both parties. Treating them in law as less than any other record of a contract would put commercial law in conflict with commercial practice and reduce the efficiencies such records provide. Because of the broad opportunities allowed in the Internet, standard forms will increasingly not be the province of only one party to the deal. This section rejects decisions which hold that a term that is not unconscionable or induced by fraud may still be invalidated because a court holds, after-the-fact, that a party could not have expected it to be in the contract. Absent unconscionability, fraud or similar conduct, commercial parties are bound by the records to which they assent.

a. *Knowledge of Terms.* It is not necessary that the adopting party actually read, understand, or negotiate the terms of a record. This rule follows virtually universal law in the United States. Assent to the record encompasses assent to its terms. Unconscionable terms remain unenforceable despite assent.

b. *Modes of Assent.* A party is bound by the terms of a record only if it agrees to the record, by manifesting assent or otherwise. The party may authenticate (sign) the record. The party's conduct may indicate assent to a record or a contract. Section 2B-111. The latter focuses on objective manifestations of assent. A party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. Finally, there are residual modes of assent that satisfy the idea that assent must be objectively expressed, even though they do not fit the precise standards of authentication or manifesting asset.

3. *Later Terms: Layered Contracting.* In ordinary commercial practice, while some contracts are formed and their terms fully defined at a single point in time, many commercial transactions involve a rolling or layering process. An agreement exists, but terms are clarified or created over time. That principle is acknowledged in various portions of original Article 2, for example in provisions allowing contracts formed with terms left open. Comments to original Section 2-207 note that later records presented to the other party are treated as proposed modifications or confirming memorandum only in cases of "a proposed deal which in commercial understanding has in fact been closed." Section 2-207, *comment* 2. Where that is not true, the later terms are part of the primary contracting process. Similarly, original Section 2-311 allows enforcement of agreements that permit one party to later specify the particulars of performance (e.g., terms of the contract) after the initial agreement is reached. Consistently, original Section 2-305 allows agreements in which one party later fixes the price.

Often, the commercial expectation is that terms will follow or be developed after performance begins. While some courts seem to hold that an initial agreement per se concludes the contracting as a single event notwithstanding ordinary practice and expectations that terms will follow, other courts recognize layered contract formation and term definition, correctly viewing contracting as a process, rather than a single event. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Often, performance commences with each party understanding that terms will be provided for later agreement, or otherwise used to define the contract. See *Brower v. Gateway 2000, Inc.*, -- N.Y.S.2d --, 1998 W.L. 481066 (N.Y.A.D. 1998). This section, along with the contract formation principles, explicitly accepts the layering principle and provides a standard for distinguishing when the intent or expectations is to conclude the contract at the initial point as contrasted to an expectation that terms will be provided for later agreement. In information commerce, the circumstances often indicate that initial general assent assumes that terms will be developed or presented later to fill out the details of the transaction. Such circumstances include customary practices in software licensing customs, but also will include use of electronic agents by licensees. For example, a

business or a consumer may instruct its electronic agent to search the Internet for car dealers willing to meet pre-set terms and offer prices within a pre-set range. While the business or consumer will expect to stand on the terms accepted by the dealer, both it and the dealer expect the contract to have more details, such as warranty, maintenance, and other standard provisions, without having to consider all such terms in the first interaction of the automated contracting system.

Section 2B-207(b) clarifies that contract terms can be proposed and agreed to as part of completing the initial contract even though proposed after the beginning of performance by one or both parties. Such terms are treated as part of the initial contracting process if at the time of initial agreement, the parties had reason to know and, thus, expected that this would occur and that terms of a record to be agreed would provide elaboration of their contract. If, instead, the parties considered their deal to be closed at the outset, then subsequently proposed terms from either party are treated as a proposed modification of the agreement, effective only under concepts applicable to such modifications. The third alternative, of course, is that the initial agreement leaves terms open and allows one part to specify what those terms are at some later date. The act of specifying the terms is, in effect, merely a performance of the contract.

In layered contracting terms are created over time. Thus, for example, where the parties reach an initial agreement about a multiple delivery contract and begin shipments before reducing that agreement to more elaborate written terms, the record when agreed to does not modify the original agreement, but reflects an expansion and elaboration as part of that contract. Similarly, the parties might begin performance on a software development agreement while terms are being developed and, ideally, agreed to by counsel and the representatives of the parties. When a final, fully elaborated record is completed and agreed to, it does not amend the contract, but simply becomes part of the now finalized contractual arrangement. Of there is no assent to the record, whether the parties have a contract hinges on whether they regarded assent to the record when developed as a condition to a contractual relationship. If so, and if there is no such agreement, there is no contract and equitable principles apply to avoid unjust enrichment and other effects of the beginning of performance.

The concept in subsection (b) differs from Section 2B-305 and original Section 2-311, both of which refer to agreements that give one party or its designate a contractual right to specify or particularize terms of performance. In cases governed by those sections, the party receiving the later terms is not presented with a right to agree to or reject the terms; the terms are in effect part of the original agreement. Where no further assent is required under the agreement, 2B-305 indicates that the terms must be proposed in good faith and in accordance with reasonable commercial standards.

Subsection (b) indicates that a layered contracting exists if the parties at the time of the initial agreement had reason to know that this would occur. The "reason to know" standard parallels the standard for determining when acts constitute assent to a contract. Reason to know does not require specific notice or specific language in an original agreement, although such factors may play a role in determining reason to know. It can also be inferred from the entire circumstances, including routine or ordinary practices of which a party is or should be aware. In some areas of commerce, such as many aspects of software contracting and many forms of mail order contracting, the circumstances of the agreement in ordinary commerce give reason to know that terms may be subsequently proposed. In Section 2B-207, the time over which the record can be proposed is referenced to the expectations of the parties under the reason to know standard. At some point, the deal has been closed, but specifying when this occurs in terms of a fixed time standard is impossible in general commerce. It requires an analysis focused on the context and circumstances.

The standard set out in subsection 2B-207(b) also carries forward into similar transactions in the mass market in Section 2B-208. Section 2B-208, however, places a time limit on when proposal of the terms must occur and precludes the terms from alter terms that are expressly agreed to by the parties to the license. In addition, of course, Section 2B-208 creates a right to a cost free refund if the proposed terms are unacceptable to the receiving party. See also Section 2B-617.

4. *Right to a Return.* In many cases governed by subsection (b) and in mass-market licenses, if assent is sought after the person paid or delivered or became obligated to pay or deliver, the manifestation of assent is not effective unless the person had a right to a return if it chooses to refuse the license. Section 2B-112. This return obligation applies in mass market contracts and in other contracts if the expectation is that the terms will be provided at or before the first use of the information, a typical format in certain types of software contracting. It does not apply in the more open-ended commercial arrangements where there is merely an expectation that terms will be agreed to (or rejected) at some point during performance, such as in the software development agreement mentioned in note 5. In these contexts, general principles of equity apply to deal with the circumstances where there is ultimately a failure to agree.

SECTION 2B-208. MASS-MARKET LICENSES.

(a) A party adopts the terms of a mass-market license for purposes of Section 2B-207 only if the party agrees to the license, by manifesting assent or otherwise, before or during the party's initial performance or use of or access to the information. A term is not part of the license:

(1) if the term is unconscionable under Section 2B-110 or is unenforceable under Section 2B-105(a) or (b); or

(2) subject to Section 2B-301, if the term conflicts with terms to which the parties to the license expressly agreed.

(b) If a party does not have an opportunity to review a mass-market license or a copy of it before the party delivered the information or became obligated to pay and the party does not agree, by manifesting assent or otherwise, to the license after having that opportunity, the following rules apply:

(1) The party is entitled to a return;

(2) The licensee is entitled to:

(A) reimbursement of any reasonable expenses incurred in complying with the licensor's instructions for return or destruction of the licensed subject matter and documentation or, in the absence of instructions, incurred for return postage or similar reasonable expense in returning them; and

(B) compensation for any reasonable and foreseeable costs of restoring an information processing system to reverse changes in the system caused by the installation, if:

(i) the installation occurs because information must be installed to enable review of the license; and

(ii) the installation alters the system or information in it but does not restore the system or information upon removal of the installed information because of rejection of the license.

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

Definitional Cross Reference:

"Contract": Section 1-201. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Manifest assent: Section 2B-111. "Mass-market license": Section 2B-102. "Party": Section 1-201. "Return": Section 2B-102. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with mass-market licenses, including consumer transactions. It defines the circumstances under which a party's assent to a mass-market license adopts the terms of that record. The section places limitations on the effectiveness of mass-market licenses. The section should be read in connection with Section 2B-207 and Section 2B-111. While most current mass-market licenses are presented by the licensor and accepted by the licensee, modern technology and contracting practices are not necessarily so limited and the section would also apply to a mass-market license presented by a licensee and accepted by a licensor in the mass market.

Many mass-market licenses are presented and agreed to at the outset of a transaction; some are presented afterwards. This section deals with both. The costs of return provided for in subsection (b) provide strong incentives for terms of the license to be presented at the outset of the transaction when practicable.

Some mass-market licenses are between two parties. Others involve two separate agreements and a three-party transaction. The two contracts in the three-party transaction are: 1) the mass-market license between the publisher and the end user, and 2) the retail agreement between the end user and the retailer. These agreements are not necessarily made at the same time. This section deals with both. The three-party arrangement is also addressed in Section 2B-617.

2. *General Mass-Market Rules.*

There are a number of ways in which the terms of a mass market or other contract can be specified. This can and does often occur by a general agreement of the parties unrelated to any record containing specific terms. In other cases, as described in Section 2B-305, the parties may agree that the terms or particulars of performance may be specified later by one party. See *TI Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y.A.D. 1998). Under Section 2B-305, the later supplied terms are enforceable without further agreement to them if the terms are proposed in good faith and within bounds of commercial reasonableness. This section deals with a third method of deriving the terms of a mass market agreement, obtaining assent to a record containing those terms – either at the outset of the transaction or shortly after it is initially formed.

Three limiting principles govern adoption of mass-market licenses regardless of when the license is presented and agreed to by the assenting party. In addition, as outlined in Section 2B-105, fundamental public policy limit enforceability of mass-market terms in some cases. See notes to Section 2B-105(b).

a. Assent and Agreement. A party adopts the terms of a record only if it agrees to the record by manifesting assent or otherwise indicating its agreement. A party cannot manifest assent unless it had an opportunity to review the record before that assent occurs. This means that the record must be available for review and called to the person's attention in a manner such that a reasonable person ought to have noticed it. Section 2B-112. A manifestation of assent requires conduct, including a failure to act, or its statements, indicate assent and that it has reason to know that, in the circumstances, this will be the case. Section 2B-111 and related notes.

Adopting the terms of a record for purposes of this section occurs pursuant to Section 2B-207. Under that section, if the terms of the record are proposed for assent by a party only after the party commences performance of the agreement between the parties, the terms become effective under these sections only if the party (e.g., the licensee) had reason to know that terms would be proposed after the initial agreement. Even if reason to know exists, this section requires that the terms be presented not later than the initial use of the information and that, if the mass-market license was not made available before the initial agreement, the person is given a right to a return should it refuse the license.

b. Unconscionability. Even if a party adopts the terms of a record, a court may invalidate

unconscionable terms pursuant to Section 2B-110. Unconscionability doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. For example, a term in a mass-market license that default on the mass-market contract for $50 software cross defaults all commercial licenses between the parties may be unconscionable if there was no reason for the licensee to anticipate that breach of the small license would constitute breach of an unrelated larger license negotiated between the parties. Similarly, a clause in a mass-market license that grants a license back of all trademarks or trade secrets of the licensee without any discussion of the issue between the parties would ordinarily be unconscionable. The principle is one of prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.

c. Conflict with Agreed Terms. In addition to unconscionability doctrine, this section provides that standard terms in a mass-market form cannot alter the terms expressly agreed between the parties to the license. A term is expressly agreed by the parties if they discuss and come to agreement regarding an issue and their agreement becomes part of their bargain. For example, in a consumer transaction where the consumer requests software compatible with a particular type of machine and the vendor agrees to provide such software, the standard terms of vendor's mass-market contract cannot alter the vendor's agreement with the consumer to provide compatible software. As is true with express warranties, this is subject to traditional parol evidence concepts which bear on the provability of extrinsic evidence that varies the terms of the writing. Additionally, of course, under Section 2B-617 the terms of any publisher's license cannot alter the agreement between the end user and the retailer unless expressly adopted by them as their own agreement.

Paragraph (a)(2) preserves the essential bargain of the parties to a mass-market transaction. For example, if a librarian acquires educational software for children from a publisher's retail outlet under an express agreement that the software may be used in its library network, a term in the publisher's license that limits use to a single user computer system conflicts with and is over-ridden by the agreement for a network license. This section does not adopt *Restatement (Second) of Contracts* § 211(c), which has been adopted in only a small minority of states. However, paragraph (a)(2) responds to some of the policy concerns on which that *Restatement* rule is based.

3. *Terms Prior to Payment.* If a mass-market license is presented before a price is paid, Article 2B follows general law that enforces a standard form contract if the party assents to it. *See, e.g., Storm Impact, Inc. v. Software of the Month Club*, 44 U.S.P.Q.2d 1441 (N.D. Ill. 1997) (on-screen license prevents waiver of copyright and precludes fair use claim).

The fact that license terms are non-negotiable or that the contract may constitute a "contract of adhesion" does not invalidate it under general contract law or this article. A conclusion that a contract is a contract of adhesion may, however, require that courts take a closer look at contract *terms* to prevent unconscionability. See, e.g., *Klos v. Polske Linie Lotnicze*, 133 F.3d 164 (2d Cir. 1998); *Fireman's Fund Insurance v. M.V. DSR Atlantic*, 131 F.3d 1336 (9th Cir. 1998); *Chan v. Adventurer Cruises, Inc.*, 123 F.3d 1287 (9th Cir. 1997). It should be recognized, however, that this article's concepts of manifest assent and opportunity to review address concerns often relevant to this review. Nevertheless, when applicable, the closer scrutiny followed in general commercial contract law may be appropriate here.

Many mass-market transactions involve three parties and two contracts. The publisher's license does not agree to license under terms other than those in the license and that choice should generally be enforced if manifesting assent after an opportunity to review occurs. In digital commerce, the license terms often define the product, for example, in distinguishing between single user and network use, consumer use and commercial use, ordinary private use or rights to public display or performance. *See ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Market choices of this type provide an important commerce in this field. Often, the license and its enforcement benefit the licensee, giving it rights that would not be present in the absence of an enforceable license. See, e.g., *Green Book International Corp. v. Inunity Corp.*, -- F. Supp. – (D. Mass. 1998) (shrink wrap granted right to distribute an element of the software).

While this section follows general law in enforcing standard form contracts, it adds a significant protection for the party presented with the form. As indicated in subsection (a)(2), the standard terms of the form cannot contradict terms expressly agreed to by the parties to the license and which are admissible in court under parol evidence rules.

4. *Terms after Initial Agreement.* In modern commerce, licenses are sometimes presented after initial general agreement between the ultimate licensee and either the retailer or the licensor-publisher. These transactions are a form of layered, or open-term, contracting recognized under original Article 2 and this article. In the software industry, such contracts are supported by both commercial expectations developed by standard practice over several decades and, frequently, by enforcement of copyright or other intellectual property rights held by the publisher. The contracting format allows contracts between end users and remote parties that control copyright or

other interest in the information. Enforceability of the license can be important to both parties because it allows a non-infringing exercise of licensed rights by the licensee and the licensor to tailor licensed rights to particular market demand. Such licenses are enforceable under this article, but to prevent abuse, in addition to the general protection created for all mass-market licenses, this section creates additional rights for the licensee.

a. Distribution Methods. Commercial distribution of copies of digital information does not necessarily parallel distribution involving sale of goods. The differences are grounded in the nature of the subject matter, the property rights involved, and the choices by the rights owner (publisher). In some cases, of course, the publisher sells copies to a distributor for resale. That choice does create a distribution sequence similar to the sale of goods. In other cases, the information is provided directly to the end user on-line and under an agreement directly between the rights owner and the end user. In many cases, however, the publisher distributes through third parties but does not simply sell copies to a distributor for re-distribution. *See, e.g., Microsoft Corp. v. DAK Indus., Inc.*, 66 F.3d 1091 (9th Cir. 1995).

This is a different distribution system than that used in the sale of goods because the distributor does not receive ownership, but merely a limited distribution license which allows distribution of the copies only if that occurs subject to an end user license with the rights owner or licensor. This method may be used to provide greater or lesser rights to eventual end users than would occur through simple sales of copies. For copyrighted works, the distribution format is based on the rights owner's exclusive right to *distribute* the work in copies. If the distributor does not comply with the license, an eventual transferee is not protected as a bona fide purchaser and is subject to an infringement claim. See *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995); *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994); *Marshall v. New Kids on the Block*, 780 F. Supp. 1005 (S.D.N.Y. 1991); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990).

In this latter distribution system, the license presented to the end user after it acquires a copy from a retailer is between the *rights owner* (or a distributor authorized to license to end users) and the end user, rather than between the end user and *the retailer*. This license creates, for the first time, a contractual relationship between the rights owner and the end user. In this three-party setting (end user, retailer, copyright owner or authorized licensor), the enforceability of the license is important to both parties. It is important to the end user because it is the first time it receives authorization to copy or otherwise use the work from the rights owner. It may also be important to the end user because many mass-market licenses give the end user rights that would not arise if it purchased a copy. A sale of a copy of a copyrighted work does not give the copy owner a number of rights that it may desire. It does not convey a right to make multiple copies, to publicly display the work, to make derivative works from the copy, or, in the case of computer programs, to rent the copy to others. The enforceability of the license is also important for the rights owner because the terms of use and other conditions of the license help define the product it transfers. There are also general marketplace benefits in that the licensing framework allows price and market differentiation that allows product priced for and tailored to market demands of various forms, such as in distinguishing pricing of a consumer as compared to a commercial or educational license.

b. Timing of Assent. Agreement to the mass-market record can occur before the initial use, but must occur no later than during the initial use of the information. This places an outside limit on layered contracting in the mass market and acknowledges customary practices in the software and other industries applicable to the mass market. The time limitation enacts a potentially significant protection of the licensee's expectations in this type of marketplace. Of course, this time limitation does not prevent subsequent modification of the license at any point in time or performance by a party that defines terms pursuant to agreement.

c. Cost Free Return Right. In mass-market licenses presented after an initial agreement, three issues are important. One involves preventing unconscionable terms; that issue is identical in all mass-market contracting. The second involves the relationship between the license terms and the express agreement of the parties to the license. This issue also does not change based on when the license is presented. The third issue involves assuring the licensee an opportunity to review and an effective choice to accept or reject a license presented after initial payment. Subsection (b) addresses this issue. It creates a return right that places the end user in a situation whereby it can exercise a meaningful choice regarding licenses presented after initial agreement. This article refers to a return right, rather than a right to a refund, because it recognizes that in the mass market, under developing technologies, the concept of requiring this right may apply to either the licensee or the licensor, whichever is asked to assent to a record presented after the initial agreement.

In cases where the form is presented to the licensee after it becomes initially obligated to pay, it must be given a cost free right to say no. This does not mean that the end user can reject the license and use the information. What is created is a right to return to a situation generally equivalent to that which would have existed

if the end user had reviewed and rejected the license at the time of the initial agreement. The return right does not apply if the licensee agrees to the license. It is not a means by which a party may rescind an agreement to which it has assented, but rather a method of ensuring that assent in this setting is real. Thus, if the licensee manifests assent to the license because it has reason to know that opening the packet holding the disk of the software constitutes assent to the license, the return right does not apply.

This return right also does not arise if there was an opportunity to review the license before making the initial agreement. In subsection (b) the exposure to potential liability for expenses of reinstating the system after review creates an incentive for licensors to make the license or a copy thereof available for review before the initial obligation is created. Subsection (b) does not apply to transactions involving software obtained on-line if the software provider makes available and obtains assent to the license as part of the ordering process. On the other hand, in a mail order transaction, if the license is first received along with the copy of the information that was ordered, subsection (b) applies. The return right under this section includes, but differs from the return right in Section 2B-112(b) as part of the opportunity to review. The return in Section 2B-208 is cost free in that the end user receives reimbursement for reasonable costs of return and, in a case where installation of the information was required to review the license and caused changes in the end user's system, to reasonable costs in returning the system to its initial condition. Of course, the fact that this section states an affirmative right in the mass market to a cost free refund does not affect whether under other law outside of this article, a similar right might exist in other contexts.

Subsection (b) contemplates that if a licensor chooses to seek assent to a license after the initial agreement, it has an obligation to reimburse the licensee's expenses incurred if it rejects the license. The expenses incurred in return of the subject matter of the rejected license must be reasonable and foreseeable. The costs of return do not include attorney fees or the cost of using an unreasonably expensive means of return or to airplane tickets, lost income or the like unless such expenses are required by instructions of the licensor. The expense reimbursement refer to ordinary expenses such as the cost of postage.

Similarly, in cases where expenses of restoring the system are incurred because the information was required to be installed in order to review the license, expenses chargeable to the licensor must be both reasonable and foreseeable. The reference here is to actual, out-of-pocket expenses and not to compensation for lost time or lost opportunity. The losses here do not encompass consequential damages. Moreover, they must be foreseeable. A party may be reasonably charged with ordinary requirements of a licensee that are consistent with others in the same general position, but cannot be held responsible for losses caused by the particular circumstances of the licensee of which it had no reason to know. A twenty dollar software license provided in the mass market should not expose the provider to significant loss unless the method of presenting the license can be said ordinarily to cause such loss. Similarly, it is ordinarily not reasonable to provide recovery of disproportionate expenses associated with eliminating minor and inconsequential changes in a system that do not affect its functionality. On the other hand, the provider is responsible to cover actual expenses that are foreseeable from the method used to obtain assent.

SECTION 2B-209. TERMS WHEN CONTRACT FORMED BY CONDUCT.

(a) Except as otherwise provided in subsections (b) and (c) and subject to Section 2B-301, if a contract is formed solely by conduct of the parties, in determining the terms of the contract, a court shall consider the terms and conditions to which the parties agreed, course of performance, course of dealing or usage of trade, the nature of the parties' conduct, the records exchanged, the information or informational rights involved, the supplementary terms of [the Uniform Commercial Code] which apply to the transaction, and all other relevant circumstances.

(b) If there is no agreement on, or if there is a material disagreement about, a material

element of scope, a contract is not formed by conduct.

(c) This section does not apply if the parties authenticate a record of the agreement, a party adopts the record of the other party, or there was an effective conditional offer under Section 2B-203 to which the party to be bound agreed, by manifesting assent or otherwise.

Uniform Law Source: Section 2-207. Substantially revised.

Definitional Cross References.

"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section deals with contracts formed by conduct and not by offer and acceptance in a record or records. Of course, in most cases, contracts created based on conduct also involve an exchange of letters or other writings. If these writings form the contract, this section does not apply. If the sole basis to conclude that a contract is formed lies in conduct, this section governs what are the terms of the contract. Under subsection (c), the section does apply if terms of the contract are in a record to which a party agreed by manifesting assent or otherwise.

Contracts formed by conduct arise in various settings. One is where the parties begin and complete performance without making an oral agreement and without reducing their agreement to writing. Another involves a "battle of forms" that, under Section 2B-203 did not result in an effective offer and acceptance and neither party agreed to a record signifying terms of agreement. This section rejects the so-called "knock-out" rule in Section 2-207(c) as too rigid for information transactions where contract terms may be essential to define the product being transferred and in a setting of convergence among diverse industries. The section requires that the court define the contract terms by considering all commercial circumstances, including the nature of the conduct, the informational rights involved, and applicable trade usage or course of dealing. Given the fluid nature of the context, usage of trade and course of dealing have special importance in defining the terms of the agreement and, as in any other context, when applicable, these elements of the agreement trump the supplemental default rules of this article in providing the content of the agreement.

2. *Interpret based on Context.* Subsection (a) directs the court's attention to the entire context including the terms of any records exchanged by the parties and the nature of the intellectual property rights involved. This requires a practical interpretation of the relationship. *Restatement (Second) of Contracts* § 202(1) (2) (1981); 2 *Farnsworth, Contracts* § 7.10 (1990). Where conduct, rather than offer and acceptance, creates the contract and there was no assent to a record defining terms of the contract, formalistic rules cannot account for the contextual nuances that exist in the rich environment of transactional practice in this area. Subsection (a) thus rejects a "knock-out" rule that would limit a court to a set formula for interpretation. Any such rigid rule prevents courts from more generally determining the actual intent of the parties in these cases. Since Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., this rule allows courts to continue existing practice of considering all factors when attempting to determine the terms of an agreement. This article does not impose an artificial or inappropriate legal regime on the contract interpretation process.

3. *Battle of Forms and Conduct.* As in transactions involving sales of goods, some information transactions involve exchanges of inconsistent standard forms coupled with conduct of both parties indicating the existence of a contract. In these cases, one of two results may occur. The first is that a contract is formed and the terms are defined with reference to the forms, either because they do not materially disagree or because a conditional offer or acceptance in a record of one party was agreed to or otherwise adopted by the other party. Those cases do not fall within this section. The second possibility is that the records do not establish a contract or its terms because, for example, they materially disagree and neither party agreed to the record of the other party. Such cases fall within this section. Subsection (a) directs the court to review the entire circumstances in such cases, regardless of which form was first received or sent, but including the terms of the exchanged records and established trade usage, course of dealing, and course of performance as relevant circumstances.

The overall treatment of battle of forms transactions requires consideration of this section and of Section 2B-203. There are two different scenarios:

a. Varying Terms. The first situation involves a case in which forms are exchanged purporting to be an offer and an acceptance, but neither form is made expressly conditional on acceptance of its terms in full. Under these conditions, the analysis involves answering several questions.

1) Did the terms of the offer and acceptance vary? If not, a contract is formed based on the exchanged records.

2) If there is a variance, is the variance material? Section 2B-203 permits a contract formed by an offer and acceptance with varying terms unless the variance is material. If the differences are not material, a contract is formed based on the offer and non-material additional terms in the acceptance.

3) If there is a material variance, a contract based on the records is still possible if one party agree to the terms of the other party's record.

4) If there is a material variance and no agreement to a record, but conduct forms a contract, Section 2B-209 applies, defining terms of the contract based multiple factors.

b. Conditional Offers. If the terms of the offer or acceptance vary and one or both are made conditional on acceptance by the other party of all the terms, the basic premise is that a party has a right to condition its offer or acceptance and that the conditional language is enforced unless waived. The analysis involves the following questions:

1) Are either or both records made conditional on assent to their own terms? If yes, apply Section 2B-203(c).

2) Were the conditions effective or have they been waived? Waiver can be inferred on any traditional basis, but in standard form settings, waiver is assumed if the party does not act in a manner that is consistent with its own conditions.

3) If the conditions were waived, the analysis reverts to the general analysis of conflicting terms indicated above. If the conditions are effective (e.g., not waived), did the one party assent to the conditional offer of the other? If yes, the contract is formed based on the conditional terms.

4) If there was no acceptance of the conditional offer, no contract is formed based on the records and Section 2B-209 applies.

4. *Contract Terms in Records.* If a party conditions its agreement to a contract on the other party's assent to its terms, that condition should be enforced. Contract law does not impose a contract on unwilling parties nor does it prevent a party from conditioning the terms on which it will do business. If an effective condition was asserted and the terms agreed to by the other party, the terms of that conditional offer or counter offer govern and this section does not apply. Simply stated, the contract was formed on one party's terms and courts should not disturb that result. This is also true in any case where a party adopts a record pursuant to Section 2B-207 or Section 2B-208. Similarly, under subsection (c) this section is inapplicable if a party agrees to terms in a record of the other.

This section applies only where the contract is based merely on conduct. Authenticated (signed) records supersede this section. In cases where there is an authenticated record of contract terms, or a record is presented by one party and agreed to by the other party but these leave some terms unresolved, the proper approach for a court does not involve use of this section, but resort to the general interpretation rules to define the terms of agreement and, in the absence of agreed terms, to the default rules of this article.

5. *Scope of License.* In information transactions, contract terms relating to scope define the product being licensed. The same subject matter (e.g., one copy of software) has entirely different value and substance depending on what rights are granted none of which are necessarily obvious from the copy itself (the same copy may be a single-user product or for network use). That being true, this article gives special deference to scope issues. Lack of an agreement as to a material element of scope, or a material disagreement, precludes the formation of a contract by conduct. In the absence of contrary agreement, the information provider can define what it is providing. The other party cannot ask a court to provide a product which a party failed to obtain by agreement. A vendor who offers a consumer version of software cannot be forced to have given a commercial license simply because a competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms define the product (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware of what can be granted (e.g., it may only hold rights to a screen play for use in television, a fact that a competing form seeking Internet use cannot change).

PART 3

CONSTRUCTION

[A. General]

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

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

(2) evidence of consistent additional terms unless the court finds the record to have been intended as a complete and exclusive statement of the terms of the agreement.

Uniform Law Source: Section 2A-202; Section 2-202.
Definitional Cross Reference:
"Agreement": Section 1-201. "Court": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.
Reporter's Notes:

1. *Scope of Section.* This section sets out the parol evidence rule taken directly from prior law in original Article 2.

2. *Practical Construction.* Paragraph (1) makes admissible evidence of course of dealing, usage of trade, and course of performance to explain or supplement the terms of any record stating the agreement of the parties. As in prior law, this rejects the rule that such evidence cannot be considered unless the court makes a determination that the language of the record is ambiguous. Instead, these sources of interpretation are allowed in all cases in order to reach a true understanding of the intent of the parties as to their agreement. Records of an agreement are to be read on the assumption that the course of prior dealings between the parties and the usage of trade were taken for granted when the record was drafted. Unless carefully negated by the record, they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties may be the best indication of what they intended the record to mean.

3. *Consistent Additional Terms.* Under paragraph (2), consistent additional terms not reduced to a record may be proved unless the court finds that the record was intended by both parties as a complete and exclusive statement of all the terms. This rejects the view that any record that is final on some terms should be, without more, taken as including all terms of the agreement. On the other hand, if alleged additional terms are such that given the circumstances of the transaction, if agreed upon, they would certainly have been included in the record of the agreement, evidence about the alleged terms must be kept from the trier of fact under this standard.

In many cases, evidence of the intent of the parties about the exclusive nature of the record of their agreement will be provided in the record itself. Particularly in commercial agreements, it is common practice to include a merger clause stating that the record is intended by both parties as a complete and exclusive expression of the terms of the contract. As a practical matter, a merger clause in a negotiated commercial contract creates a strong, nearly conclusive presumption that both parties intended the record to be the exclusive statement of terms of their agreement. The merger clause in such cases does not preclude a court from using course of dealing, usage of trade or course of performance to understand the meaning of contract terms, but does place a difficult burden on the

party seeking to establish that additional terms exist. Even in a commercial case, however, that presumption can be shown to be inappropriate if the record itself refers to terms contained in or documented by material extraneous to the purportedly exclusive record. Of course, however, records that contain a merger clause but refer to other documents may still reflect an intent to be exclusive if the agreed statement of what represents the aggregate exclusive statement of agreement includes all documents intended to be aggregated, including the referenced external documents.

4. *Contradictory Terms or Agreements.* This section follows original Article 2 and excludes evidence of alleged terms or agreements that contradict the terms of a record intended as a final expression of the agreement or the terms on which confirmatory memoranda agree. An alleged term or agreement is contradictory if its substance cannot reasonably co-exist with the substance of the terms of the record. Thus, an alleged term that calls for completion of a software project on July 1 contradicts a term of a record calling for completion on June 10. The two terms cannot reasonably co-exist as part of the same agreement. On the other hand, an alleged term that specifies the processing capacity of the software does not contradict the terms of a record that does not make reference that issue. Of course, the fact that the term does not contradict the record means only that evidence of it can be admitted. It does not indicate whether the alleged term was actually agreed to by the parties.

This rule does not preclude proof of modifications of the agreement expressed in the record. What is excluded is evidence of prior or contemporaneous agreements that are not in record. Modification may be shown by appropriate evidence. Of course, as indicated in Section 2B-303, terms of the original record may restrict what subsequent modification may be proven or effective, such as by requiring that all modifications be in an authenticated record.

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

(a) Where the contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(b) The express terms of an agreement and any course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other, but when such construction is unreasonable express terms control course of performance, course of dealing and usage of trade; course of performance controls both course of dealing and usage of trade; and course of dealing controls usage of trade.

(c) Subject to Section 2B-303 and 2B-605, course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

Uniform Law Source: Section 2A-207; Section 2-208; Section 1-205. Revised.
Definitional Cross References.
"Agreement": Section 1-201. "Contract": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section conforms to original Article 2-208. In interpreting an agreement a court should refer to relevant indicia of context in which the parties formed and performed their agreement. This section coordinates with Section 1-205 that deals with the use of course of dealing and usage of trade in interpreting an agreement.

2. *Construction based on Performance.* This section adopts the premise that the parties themselves know best what they have meant by the words of their agreement and that their actions under that agreement are the most important indication of that meaning. Course of performance as defined in subsection (a) thus provides an important component of the factors that determine the meaning of the "agreement" of the parties. In commercial law, an agreement may extend well beyond a record containing terms of the contract. Indeed, consistent with modern contract law, under this Article, course of performance (as well as usage of trade and course of dealing) are always relevant to determine the meaning and content of the agreement.

3. *Nature of Course of Performance.* A course of performance requires repeated performance by one party known to the other, an opportunity of the other to object, and a pattern of acceptance or acquiescence by that other party. Since it provides a basis for understanding the agreement of the two parties, the events creating it must have mutual elements. Unilateral conduct unknown to the other party, such as by making uses of information beyond the terms of a license, cannot establish a course of performance. Similarly, a single occasion of conduct does not fall within this concept, although a single event may affect the parties' rights in other respects.

4. *Relationship to Waiver.* If it is difficult to determine whether a particular pattern of action provides insight into the meaning of the agreement or represents a waiver of a term of an agreement. The preference is in favor of a "waiver" (if the elements of waiver are present) whenever this construction along with the rules on reinstatement of rights waived in Section 2B-605 preserves the flexible character of commercial contracts and prevents surprise or other hardship. A waiver by conduct may be retracted as to future conduct. An interpretation of the agreement based on a course of performance measures the meaning of the contract that is binding on both parties and cannot be retracted by one.

5. *Order of Interpretation.* Subsection (b) sets out the order of preference in interpreting an agreement among express terms, course of performance, course of dealing, and usage of trade. Express terms always govern. Course of performance and course of dealing are the next preferred, respectively, because each relates to the behavior of the particular parties. See Section 1-205.

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract within this article needs no consideration to be binding.

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

(c) The requirements of Section 2B-201(a) must be satisfied if the contract as modified is within its provisions.

(d) An attempt at modification or rescission which does not satisfy subsection (b) or (c) may operate as a waiver if Section 2B-605 is satisfied.

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

Definitional Cross References.

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

Reporter's Notes:

1. *Scope of the Section.* This section deals with the effectiveness of modifications of contracts and of agreed limitations on the ability to modify. This section is subject to Section 2B-304 on changes in terms of an on-going contract pursuant to contract terms allowing such changes. This section generally follows original Section 2-209 but provisions on the relationship between an attempted modification and an effective waiver are moved to Section 2B-605 on waiver.

2. *Role of Contract Modifications.* Subsection (a), as in original Article 2, seeks to protect and make effective modifications of contracts without regard to technicalities and complex issues of lack of consideration that existed under law prior to the enactment of Article 2. The *Restatement* is consistent. An agreement to modify a contract needs no consideration to be binding. Subject to the issues discussed in Section 2B-304, however, the modification must be in an agreement, indicating assent by both parties. As in original Article 2, this section does not specifically require that a modification be proposed in good faith to become binding. A court should not be asked to accept or invalidate an agreed modification based on its view of the validity and fairness of the commercial motivations of the party proposing the modification or whether agreement to the modification is fair to the other commercial party. However, there must be an agreement and courts have historically used this to protect against over-reaching and extortion-like demands in cases of abuse, applying a concept like that of good faith to prevent dishonesty in this setting. This article does not alter that existing case law.

3. *Contract Terms Prohibiting Oral Modification.* Subsection (b) conforms to prior law by generally allowing enforcement of a contract term that bars modification or rescission of an agreement except in an authenticated record. It also continues the policy that, because of the nature of consumer transactions, such terms should be enforceable only if the consumer assents to the term, but adopts the Article 2B concept of manifested assent to a term instead of the existing Article 2 language that the term be separately signed by the consumer. Both standards require specific indication of assent to the term, but the manifested assent requirement better fits modern electronic commerce.

A modification or rescission includes abandonment or other change of a term or contract by mutual consent. It does not include unilateral acts that terminate or cancel a contract.

In commercial practice, terms prohibiting modifications not contained in an authenticated record play an important role in preventing false allegations of oral modifications, difficulties of establishing the terms to which parties are bound, and avoiding circumvention of express agreements through later provision of new terms in a standard form that does not require or obtain an authorized authentication by the recipient. For example, such a clause should prevent modification of a basic agreement through a later provided mass-market license that is not authenticated by the party receiving the license. *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*, 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997). Such agreements are effective to preclude modifications not consistent with their requirements. This permits parties to make their own statute of frauds and to control their risk as regards any claims of modification after the agreement has been stated in a record.

A party whose language or conduct is inconsistent with a contract term requiring a signed record may place itself in a position from which it may no longer assert that term, but this is true only if the language or conduct induced the other party reasonably and in good faith to incur reliance costs. *See Autotrol Corp. v. Continental Water Systems,* 918 F.2d 689, 692 (7th Cir. 1990); *Wisconsin Knife Works v. National Metal Crafters,* 781 F.2d 1280 (7th Cir. 1986). Reasonableness of such behavior, of course, must be considered in light of the circumstances, including the fact of a no-oral waiver clause. Courts should be slow to find waiver of anti-waiver provisions. *See* 1 *White & Summers, Uniform Commercial Code* § 1-6, pp. 41-42 (4th Ed. 1995). It is more likely that the circumstances constitute a waiver of the substantive term for a particular performance, rather than of the "no-oral-modification" clause itself. That interpretation is consistent with Section 2B-302, preferring a waiver analysis over a modification analysis in close cases. In any event, a waiver can be retracted as to future performance by reasonable notice that the original terms of the agreement are to be complied with.

4. *Statute of Frauds.* Subsection (c) follows existing law and holds that the contract as allegedly modified must satisfy the statute of frauds to be enforceable. This places a barrier against unfounded claims of oral modification that alter the contract in a form that derogates Section 2B-201(a) requirements for an authenticated record. Thus, the alleged modification cannot, without an authenticated record, transform a two year license of

software into a perpetual license, nor can it alter the subject matter of a film clip license to include an entirely different clip outside the subject matter referenced in the original record. This rule does not allow validation by partial performance under the original agreement because partial performance in Article 2B validates the entire contract, rather than only that portion of the contract that relates to the performance already rendered and received. If the contract as modified does not satisfy the statute of frauds, the original agreement that did satisfy the statute of frauds constitutes the contract of the parties.

5. *Other Restrictions.* The modifications must, of course, also satisfy any other applicable rules limiting the effectiveness of agreed terms. Thus, disclaimers of warranties must conform to the disclaimer rules in Section 2B-406. Modifications of scope must comply with Section 2B-307(g).

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of a contract involving successive performances apply to all performances unless the terms are modified in accordance with this article or the contract, even if the terms are not displayed or otherwise brought to the attention of a party with respect to each successive performance.

(b) If a contract provides that it may be changed as to future performances by compliance with a described procedure, a change proposed in good faith pursuant to that procedure becomes part of the contract if:

(1) the procedure reasonably notifies the other party of the change; and

(2) in a mass-market transaction, the procedure permits the other party to terminate the contract as to future performance if the change alters a material term and the party in good faith determines that the modification is unacceptable.

(c) The parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light of the commercial circumstances.

Definitional Cross References.
"Agreement": Section 1-201. "Contract": Section 1-201. "Good faith": Section 2B-102. "Mass-market license": Section 2B-102. "Notice": Section 1-201. "Notifies": Section 1-201. "Party": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with contracts involving successive performances by one or both parties. Information contracts frequently contemplate long-term, ongoing relationships that need to be modified over time. This section clarifies the enforceability of agreed methods allowing changes in terms in on-going performance.

2. *Continuing Terms.* Subsection (a) states the simple principle that contract terms, if enforceable, cover all contractual performance. This principle applies in any case where subsequent performances are covered by

prior agreement. Thus, for example, a warranty disclaimer effectively created at the outset of a contract for use of a website applies to all subsequent performances and uses under that contract.

3. *Changes in Terms.* Subsection (b) addresses an important practice in online and other continuing contracts, such as outsourcing contracts. In long term contracts of this type, changes frequently occur in the terms of service. Separate notice or negotiation of each change is often not feasible or desired by the parties, especially in cases where the change affects large number of users of the on-line system. Commercial practice often accommodates the desire for an efficient method of making changes by providing in the original agreement for a right of one party to alter terms during the contract period. This is a common provision in on-line service agreements where the contracts of most access or information providers provide that terms of service may be altered by posting changes in a particular location or file and that posted changes are effective when posted or at a later point in time. Subsection (b) authorizes two contractual procedures that create effective changes. This does not preclude other methods or imply that other contractual arrangements are not enforceable. Section 2B-106.

This subsection deals with agreements that permit unilateral changes in terms. It does not deal with contracts that provide for periodic adjustment of terms based on some agreed standard, such as an applicable cost of living or price index. Stiles v. Home Cable Concepts, Inc., 994 F. Supp. 1410 (M.D. Ala. 1998).

Contract terms that allow unilateral changes in contract terms are in effect the converse of contractual provisions that restrict the ability of parties to modify a contract other than in a record authenticated by both. They are analogous to cases in which the agreement leaves the particulars of performance to be specified by one party. Section 2B-305(b); Section 2-311. The need for and enforceability of such changes is recognized in other areas of law. See FRB Regulation Z, 12 CFR § 226.5b. It is especially important in electronic commerce to recognize this right because this area of commerce is subject to evolving rules and circumstances that are not predictable, but may require adjustment of performance and other characteristics of the relationship. This would include, for example, changing regulations concerning rights of parental control over access by minors to particular types of information. As the regulations change, the provider of the information service must be able to make corresponding changes in its terms and conditions of service.

The interests of the other party are protected by the general obligation of good faith which restricts the actions of the party given the right to change contract terms, and by the fact that the change right was granted by a contract to which the affected party agreed. Also, in some cases, the contracts involving such provisions may be subject to termination at will or at brief intervals (e.g., monthly).

a. Relationship to Other Rules. The change procedures described in subsection (b) involve changes made pursuant to a contract term authorizing such changes. The terms of an on-going contract may, of course, be effectively altered in other ways. For example, the parties may *agree* to modify the contract. Article 2B allows such modifications without consideration. Similarly, general principles of waiver and rules on the effect of course of performance may affect the enforceable terms of the agreement. Section 2B-302; Section 2B-605.

b. Contractual Procedures: Commercial Contracts. Subsection (b)(1) provides that, in non-mass-market contracts, a unilateral change becomes part of the contract if it is made pursuant to a contractually authorized procedure that reasonably notifies the other party of the change. The change must be in good faith and must be commercially reasonable. In determining whether a change was in good faith, however, the mere fact that the change adversely affects the other party does not, in itself, indicate bad faith if the change is within general standards of commercial fair dealing or the reasonable expectations of the commercial context.

Subsection (b)(1) requires that the procedure reasonably notify the other party of the change, but does not create other limitations on what contract terms are appropriate. Commercial agreements cover a wide range of contexts and economic or other commercial considerations can properly yield different contractual procedures in different settings. Thus, for example, in an out-source contract, the provider may make significant investments in systems relying on the five year contractual term and pricing of the contract, but the circumstances may require reservation of the right to change terms as technology changes. In such contracts, notice is appropriate, but it would not be appropriate to require (absent a contrary agreement) that the change yield a right to withdraw from the contract.

What reasonably notifies the party of changes depends on the circumstances. Posting changes in a file used for that purpose ordinarily suffices even though individual changes are not separately singled out unless they are especially material, such as price. In many cases, reasonable notification requires action before the change is effective, but in some emergency situations, notice that coincides with the change or follows the change would be sufficient (e.g., blocking access to a virus infected site, or a change in access codes to prevent on-going third party intrusions). See 12 C.F.R. § 205.8(a)(2) as an example. A procedure that calls for posting changes in an accessible location of which the other party is aware will ordinarily satisfy this requirement. See, e.g., Federal Reserve

System, Interim Rule, 63 F. Reg. 14528 (March 25, 1998) (designation of an agreed electronic location for giving notice would ordinarily satisfy delivery requirement).

c. Mass-Market Transactions. Subsection (b)(2) deals with mass-market transactions. The standards of good faith and notification apply. In addition, to be authorized under this section, the procedure must not only have been contractually authorized, it must also permit the licensee in good faith to withdraw from the contract with respect to future performances. This additional element is not appropriate as a rule for general commercial contracts. The termination right extends only to changes that are material and adverse to the licensee. Price is a material term in all cases. Other changes may be material in an on-going relationship, such as a significant change in the agreed hours during which the on-line system is available. Of course, a reduction in price or other beneficial change does not require a right to terminate. Also, this section does not apply where a price or other change is based on an agreed standard to be used to periodically update contract terms, such as a cost of living index, market index or the like.

Withdrawal is without penalty, but the licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due at that time). In many mass-market licenses that entail continuing performance, the contract itself may be subject to termination at will under Section 2B-308. Subsection (b) does not alter that result.

4. *Changes in Content.* This section deals with changes in contract terms and does not cover changes in the content made available under an access contract, such as a contract providing access to multifaceted databases. In an access contract, the agreement grants rights to materials as changed by the licensor over time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete a database or a part of a database does not modify the contract, but merely constitutes performance by the licensor and is not within this subsection.

SECTION 2B-305. PERFORMANCE UNDER OPEN TERMS; TERMS TO BE SPECIFIED.

(a) A performance obligation of a party that cannot be determined from the agreement or from other provisions of this article requires the party to perform in a manner and in a time that is reasonable in light of the commercial circumstances existing at the time of agreement.

(b) An agreement that is otherwise sufficiently definite to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. If particulars of performance are to be specified by a party, the following rules apply:

(1) Specification must be made in good faith and within limits set by commercial reasonableness.

(2) If a specification 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 perform, suspend performance, or treat the failure to specify as a

breach of contract.

[**SECTION 2B-305A. PERFORMANCE TO PARTY'S SATISFACTION.]**

(a) Except as otherwise provided in subsection (b), an agreement that provides that the performance of one party is to be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied.

(b) Performance must be to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by stating that approval is in the "sole discretion" of the party, or words of similar import; or

(2) the agreement is for informational content to be evaluated in reference to aesthetics, market appeal, subjective quality, suitability to taste, or similar characteristics.

Uniform Law Source: Section 2-305(1)(a); 2-309(1); 2-311(1)(2); Restatement 228. Revised.
Definitional Cross References.
"Agreement": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Informational content": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.
Reporter's Notes:

1. *Open Terms.* Section 2B-305(a) follows the emphasis of this article on construction of contracts based on the commercial context. If the agreement and this article do not provide content for a term left open by the parties, a court will use a standard of performance that it reasonable in light of the commercial circumstances. This rule, however, applies only if there is no agreement on the term. Agreement may be found in express language or in a term implied from the contractual circumstances, usage of trade or course of dealing.

If the dominant intent of the parties is to have an agreement, that agreement does not fail merely because some terms are not expressly dealt with. Section 2B-202. Of course, this does not create a contract where no contractual intent existed. If a term is left open because there was no agreement on the term and the intent of the parties precludes a contract unless or until that agreement occurs, subsection (a) does not apply. Section 2B-202(e).

What constitutes reasonable commercial conduct in such cases depends on the nature, purpose and circumstances of the action to be taken or avoided and on the entire commercial context of the agreement. If the reasonableness standard under subsection (a) applies, a party is not required to fix, at peril of breach, a time or performance that is in fact reasonable in the unforeseeable judgment of a later trier of fact. In such cases, under general requirements of good faith, effective communication by one party to the other of a proposed time limit or other interpretation of a reasonable performance calls for a response so that a failure to reply in a timely manner creates an inference of acquiescence to the proposal. If the recipient of the proposal objects to the proposal, however, or if no proposal is made, a demand for assurance on the ground of insecurity may be made under this article pending further negotiation. Only if a party insists on undue delay or unreasonably early performance or rejects the other party's reasonable proposal does a question of breach arise under this subsection.

2. *Terms Specified by a Party.* Subsection (b) deals with circumstances in which the contract gives one party the right to specify terms. This language, which comes from original Section 2-311, is an express recognition of one form of layered contracting in which terms are outlined after the initial agreement, rather than simultaneous with the initial agreement. If the other terms of the initial agreement are sufficiently definite to be a contract, this section allows parties to leave particulars of performance to be filled in by either of them without

running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible specifications is limited by what is commercially reasonable. This section is an application of some of the layered contracting themes adopted in this article.

The "agreement" which permits one party so to specify may be found in a course of dealing, usage of trade, implication from the circumstances or in explicit language used by the parties. Thus, acquisition of information through a telephone order where there is reason to know that a license provided by the other party will indicate the details of the contractual arrangement may fall within this section. The details thus supplied are bounded by trade use and commercial expectations, as well as by the terms actually agreed by the parties.

3. *Failure to Timely Specify*. Subsection (b)(2) applies when specification by one party is necessary to or materially affects the other party's performance, but is not seasonably made. The section excuses the other party's resulting delay in performance and the duty to perform. The hampered party may at its option perform in any reasonable manner, suspend its performance, or treat the other person's failure as a breach of contract. These rights are in addition to all other remedies available under the contract and this article. This includes the right to demand reasonable assurances of performance because the delay caused insecurity. The request for assurances may also be premised on the obligation of good faith established in this section which may imply the need for a reasonable indication of the time and manner of performance for which the other party is to hold itself ready.

4. *Performance to the Satisfaction of a Party*. Section 2B-305A(a) and (b) deal with cases where the contract provides that the required performance is to be to the satisfaction of the other party, a common arrangement in information industries. Subsection (a) follows the "preference" stated in *Restatement (Second) of Contracts* § 228. It assumes that such "to the satisfaction" clauses require satisfaction measured under an objective, reasonable man standard. This precludes entirely arbitrary demands and is supplemented by the obligation of good faith that applies to all contracts.

There are cases where a subjective standard of satisfaction is appropriate. The *Restatement* and general contract law recognize this. Subsection (b) provides guidance for determining when such a subjective standard applies. The most obvious is when the contract specifically so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard. Also, the section presumes a subjective standard if the contract involves informational content evaluated based on aesthetics and market appeal, rather than functional performance. A reasonable person standard in such cases lacks content since the nature of the required evaluation presumes personal judgment.

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

(a) A term that measures the quantity or amount of use by the output of the licensor or the requirements of the licensee means such actual output or requirements as may occur in good faith. No quantity or amount of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements may be tendered or demanded. However, this limitation does not apply if the party in good faith has no output or requirements.

(b) An agreement by a licensor to be the exclusive supplier of copies to a licensee imposes on the licensor an obligation to use good-faith efforts to supply the copies.

(c) An agreement by a licensee to be the exclusive distributor of information imposes on

the licensee an obligation to use good-faith efforts to promote the information commercially if the value received by the licensor substantially depends on that performance.

Uniform Statutory Source: Section 2-306.

Definitional Cross References.

"Agreement". Section 1-201."Good faith". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2-102. "Value": Section 2-102.

Reporter's Notes:

1. ***Scope of the Section.*** **This section deals with requirements and exclusive dealing contracts. Subsections (b) and (c) modify the original Article 2 rule for exclusive dealing arrangements to a requirement of a good faith effort to supply or promote the information. This brings together the diverse common law rules for such situations applicable to industries that have not been within the U.C.C. It avoids the uncertainty that comes from use of "best efforts" as a default rule, when courts have been unable to formulate a uniform meaning of that term..**

2. ***Out-put and Requirements.*** **Subsection (a) follows original Article 2. A contract for one party to accept the entire output of the other or for one party to meet or allow use that meets the requirements of the other is not too indefinite to be enforced because it is held to mean the actual good faith output or requirements of the particular party. This principle has become a part of basic common law. The agreements also do not lack mutuality of obligation since the party who will determine the obligation is required to operate in good faith so that its output or requirements will approximate a reasonably foreseeable figure. The section envisions and permits reasonable elasticity and good faith variations from prior requirements or output even though they may result in discontinuation. Results such as that in *Advent Sys., Ltd. v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991) are appropriate. A sudden expansion of demand based on an expansion of a facility or an unpredicted merger or acquisition would not be within the contract, but normal expansion undertaken in good faith would be within this section.**

If an estimate of output or requirements is included in the agreement, no quantity or level of use or demand unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement limits the intended elasticity. In the same manner, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur. If an enterprise is sold and the buyer obtains or is bound by the requirements contract, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

3. ***Exclusive Dealing.*** **Subsection (b) and (c) integrate the various bodies of law that pertain to exclusive dealing relationships in information and modify the original Article 2 rule for exclusive dealing arrangements to a requirement of a good faith effort to promote or supply the information. This standard brings together the diverse common law rules for such situations applicable to industries that have not been within the U.C.C. Some cases refer to "best efforts" obligations, while other refer to good faith efforts, but the outcome of the decision seldom hinges on the phraseology and the meaning of "best effort" in this and other contexts is not clear. Despite differing language, the basic thrust of the case law is consistent across all of the fields. The exclusive licensee in a distribution contract has an obligation to undertake commercially reasonable efforts to market the**

product, consistent with ordinary business standards and business judgment. See *Zilg v. Prentice-Hall, Inc.*, 717 F.2d 671 [2nd Cir. 1982], *cert. denied* 466 U.S. 938 (1984) (A promise to publish "implies a good faith effort to promote the book including a first printing and advertising budget adequate to give the book a reasonable chance of success in light of the subject matter and likely audience. [Once this obligation is fulfilled] a business decision by the publisher to limit the size of a printing or advertising budget is not subject to second guessing by a trier of fact as to whether it is sound or valid."); *Melville Nimmer & David Nimmer, Nimmer on Copyright* 10-96 (implied promise to "use reasonable efforts to make the work as productive as the circumstances warrant.").

This section adopts a good faith effort standard which requires honesty in fact and adherence to commercial standards of fair dealing. Under this article, the good faith concept is expanded from the original U.C.C. and common law concept that required mere "honesty in fact." The definition in this article also encompasses an obligation to act consistent with commercial standards of fair dealing. This additional concept creates a basis that allows courts to draw an appropriate balance in light of the commercial context and the existing traditions of that context if the contract is silent on the issue. What constitutes an effort that meets standards of commercial fair dealing, of course, must reflect the entire business context, including other obligations of each party and the extent to which efforts are necessary to give the other party a fair return on the contract..

Of course, the agreement of the parties may establish a higher standard. An agreement that does so may be found in the express terms of a record, or in usage of trade, course of dealing, or by implication from the circumstances of the transaction.

This section follows general law and creates this obligation only if the return to the licensee hinges primarily on the performance of the other party and the results of that performance in terms of royalties and other return. *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917). If the licensee receives substantial compensation independent of the results of the other's efforts, no special obligation arises, although of course, general concepts of good faith in performance apply. *See, e.g., Beraha v. Baxter Health Care Corp.*, 956 F.2d 1436 (7th Cir. 1992); *Permanence Corp. v. Kenmetal, Inc.*, 980 F.2d 98 (6th Cir. 1990)

[B. Interpretation]

SECTION 2B-307. INTERPRETATION OF GRANT.

(a) A license grants:

(1) the rights to use the information or informational rights that are expressly described; and

(2) all informational rights within the licensor's control at the time of contracting which are necessary in the ordinary course to exercise the expressly described rights.

(b) If a license expressly limits use of the information or informational rights, use in any other manner is a breach. In all other cases, a license contains an implied limitation that the licensee shall not use the information or informational rights other than as described in subsection (a). However, a use inconsistent with this implied limitation is not a breach if the use would be permitted under applicable law in the absence of the implied limitation.

(c) An agreement that does not specify the number of permitted users permits a number of users which is reasonable in light of the informational rights involved and the commercial circumstances existing at the time of agreement.

(d) Neither party is entitled to any rights in new versions, improvements or in modifications to information made by the other party after a license becomes enforceable. A licensor's agreement to provide new versions, improvements, or modifications after acceptance of the completed information requires that the licensor provide them as developed and made generally commercially available from time to time by the licensor.

(e) Neither party is entitled to receive copies of source code, object code, schematics, master copy, design material, or other information used by the other party in creating, developing, or implementing the information.

(f) Terms dealing with the scope of an agreement must be construed under ordinary principles of contract interpretation in light of the informational rights and the commercial context. In addition, the following rules apply:

(1) A grant of "all possible rights and for all media", "all rights and for all media now known or later developed", or a grant in similar terms, includes all rights then existing or later created by law, and all uses, media, and methods of distribution or exhibition whether then existing or developed in the future, and whether or not anticipated at the time of the grant.

(2) A grant of an "exclusive license", or a grant in similar terms, means that:

(A) for the duration of the license the licensor will not exercise, and will not grant to any other person, rights in the same information or informational rights within the scope of the exclusive grant; and

(B) the licensor affirms that it has not previously granted such rights in a contract in effect when the licensee's rights begin.

(g) The rules of this section may be varied only by a record that is:

(1) sufficient under Section 2B-201; and

(2) authenticated by the party against which enforcement is sought, or is prepared and delivered by one party and adopted by the party against which enforcement is sought.

Definitional Cross References.

"Agreement". Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party": Section 1-201. "Receive": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with a variety of significant interpretation issues, establishing a basic premise that a license is interpreted in a commercially reasonable manner, but providing specific interpretation rules that reflect commercial practice.

2. *License Grant Terms.* Subsection (a) recognizes that a license gives the contractual rights it expressly creates and, in appropriate cases, limited implied rights necessary to use the expressly granted rights. The reference in paragraph (a)(1) is to contractual rights relating to information or to grants of informational rights. Thus, for example, a license may expressly grant the right by contract to make copies of software, an informational right that otherwise remains within the exclusive control of the holder of the copyright in the software.

Subsection (a)(2) adopts the reasonable interpretation that an affirmative express grant implies a grant of all rights necessary to exercise that express grant to the extent these are within the control of the licensor. For example, a license to use a photograph in a digital product implies a right to transform that photograph into digital form to fit the media. A license of software to create visual presentations for public speaking implies a right to publicly display images from the software in such presentations because that right is necessary to the expressly granted right. The implied rights, however, relate only to rights in information and material provided to the licensee. They do not require that the licensor transfer additional materials (such as source code), unless that transfer was agreed to by the parties. Additionally, the implied rights must be necessary to the express grant and do not include rights merely because the rights are desired or even helpful, unless necessary to the expressly granted uses. Express terms of an agreement, of course, over-ride any implied rights. As in all cases, the terms of the agreement may be found in a record or inferred from the context, usage of trade, or course of dealing.

This subsection expresses a contract law rule. Some copyright license cases hold that federal policy requires interpretation of the scope of a license against the licensee and in a manner that withholds any use not expressly granted. *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989). The better view as adopted here is that applied in cases such as *Bourne v. Walt Disney Co.*, 68 F.3d 621 (2d Cir. 1995), which treat interpretation issues as ordinary commercial contract questions. Of course, to the extent a mandatory federal policy precludes different state law on this issue, that policy over-rides the standard in subsection (a).

3. *Exceeding the Grant.* Subsection (b) resolves what interpretation is given to a license that gives the licensee a right "to do X." It adopts the most commercially reasonable interpretation, i.e., that uses which exceed the grant or differ from the grant breach the contract. This, of course, refers to the grant as interpreted, including consideration of course of dealing, usage of trade and the implied rights under subsection (a).

The fact that uses differing from the grant are a breach of contract is clear under all case law if the licensed scope allows the licensee "only to do X" or otherwise precludes other uses. The first sentence of subsection (b) confirms this. Of course, if fundamental public policy or other restrictions on the enforceability of such terms apply, the contract limitation may not be enforceable. *See* Section 2B-105, comments.

If the word "only" or its equivalent does not appear, some patent license cases hold that uses not covered by the grant infringe the patent, but may not breach the license. These decisions deal with contract interpretation, rather than over-riding public policy. Independent of infringement issues with which the cases deal, as a matter of contract law, a rule that hinges on the use or failure to use the word "only" provides a true trap that is avoided in subsection (b) by adopting the ordinary commercial understanding that an affirmative grant implicitly excludes uses that exceed or are not otherwise within the grant.

The implied limitation, however, is not as strong as an express contract term of limitation. It does not yield a breach of contract if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a quotation from licensed material not subject to trade secrecy restraints, if a fair use under federal law allowing such use, would not conflict with the implied limitation. However, even if a license does not use the magic word "only" and gives a right to use software at a designated location, a licensee that makes multiple copies for sale infringes the copyright and breaches the contract. A grant to show a movie in Peoria implies the lack of a contract right to do so in Detroit.

> **Illustration 1:** LR licenses copyrighted software to LE. The license is silent on reverse engineering and consumer use, but grants the right to use the software in a 1,000 person network. LE reverse engineers the software to examine the code. The use is not a breach if it would be a fair use in the absence of the implied limit. Use in a 2,000 person network, however, breaches the express limitation.

4. *Number of Users.* A license can specify the number of permitted users or uses. In the absence of agreed terms, the contract authorizes a number that is reasonable in light of the informational rights and commercial circumstances involved. In some cases, especially in the mass market, a single user limitation would be assumed for a computer program. In other contexts, multi-use or network use concepts are more appropriate. Given the diversity of the modern marketplace, no single presumed number of users or uses would fairly meet all circumstances. Of course, as with all default rules in this article, this provision is subject to contrary agreement, which agreement may be found as well in express terms as in course of dealing, usage of trade and course of performance. In making the commercial determination required by the general rule, however, the nature of the underlying property rights must be considered. Contract interpretation rules should not be used to unfairly take away important property rights by inadvertence, nor should they deny the commercial realities and reasonable expectation that arise in the transaction in which the license grant occurs.

5. *Improvements and Design Material.* As a basic presumption, and unless the contract clearly indicates otherwise, neither party receives a contract right to receive subsequent modifications or improvements made by the other party, or a contract right of access to design and confidential material. Arrangements for contractual rights in modifications, improvements, source code or designs entail separate valuable relationships to be handled by express contract terms. In the absence of such express terms, the contract gives no right to the other party in an improvement subsequently developed by either the licensor or the licensee. This contract law principle does not, of course, supplant intellectual property rules on derivative works. Section 2B-105(a). The contract principle is independent of the implied license in subsection (a) which applies only to materials and information delivered to the licensee.

This section takes no position on what constitutes an improvement of an existing product and what constitutes a new product for purposes of applying contractual terms creating an obligation to provide improvements to the other party. That issue ultimately turns on the agreement of the parties as indicated by the commercial context and the actual language used.

6. *Grant Clauses.* Subsection (f) states that ordinary commercial contract principles apply to interpreting a grant. This resolves questions of whether, under state law, policy considerations require an interpretation that precludes a grant of rights unless express in the agreement. As a state law rule, of course, it is subject to contrary federal policy which, some courts hold, requires interpretation in favor of the licensor to protect intellectual property rights. Section 2B-105.

Subsections (f)(1) and (f)(2) provide guidance on interpreting common and important license terms. Subsection (f)(1) adopts the majority rule on whether a grant covers future technologies and all rights. This is ultimately a fact sensitive interpretation issue. But use of language that implies a broad scope for the grant without qualification should be sufficient to cover any and all rights (such as the right to copy, modify, publicly perform and the like) as well as present and future media (such as print, television, and other modes of distribution). This is subject to the other default rules in this article, 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. The point of this interpretation rule is not to encourage use of such broad grants, but to indicate what language achieves the indicated result. In many cases, the licensor will not be willing to grant such a broad conveyance. In such cases, the statutory language provides insight on what language should be avoided if a broad grant is not acceptable.

Subsection (f)(2) resolves a conflict in case law and treatise opinions among the various areas of commerce affected by Article 2B. It clarifies that an exclusive license that does not otherwise deal with the issue, conveys exclusive rights including rights of the licensor. Thus, the licensor may not license or use the information within the scope of the exclusive license, and affirms that it has not granted any other subsisting license covering

the same scope and will not grant any future license covering the same scope that takes effect during the duration of the original exclusive license. For example, a grant of exclusive right to distribute software in a stated geographical area means that the licensor itself will not engage in distribution within that same area during the term of the license, and that it has not previously conveyed similar rights that continue to exist during the term of the exclusive license.

SECTION 2B-308. DURATION OF CONTRACT. If an agreement does not specify its duration, to the extent allowed by other law, the following rules apply:

(1) Except as otherwise provided in paragraph (2) and Section 2B-206(a), the agreement is enforceable for a time reasonable in light of the commercial circumstances but may be terminated as to future performances at will by either party during that time on seasonable notice to the other party.

(2) The duration of contractual rights to use licensed subject matter is a time reasonable in light of the licensed informational rights and the commercial circumstances. However, subject to cancellation for breach of contract, the duration of the license is perpetual as to the contractual rights and contractual use restrictions if:

(A) the license is a software contract, other than for source code, that transfers ownership of a copy or delivery of a copy for a contract fee, the total amount of which is fixed at or before the time of delivery of the copy; or

(B) the license expressly granted the right to incorporate or use the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance

Uniform Law Source: Section 2-309(2).
Definitional Cross References.
"Agreement". Section 1-201. "Cancellation". Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Information". Section 2B-102. "Informational rights": Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Notice". Section 1-201. "Party". Section 1-201. "Rights". Section 1-201. . "Software contract". Section 2B-102.
Reporter's Note:

1. *Scope of the Section.* This section deals with the agreements that are indefinite in their duration. It follows common law and original Article 2 making such agreements subject to termination at will in most cases, but creating two exceptions that establish important licensee protection by presuming (as a default rule) a perpetual license. Notice of termination is required for at will termination under Section 2B-626.

2. *Reasonable Time.* Subsection (1) adopts a rule of commercial reasonableness to resolve issues

that arise in cases of contracts of indefinite duration. What time is reasonable for any given arrangement is defined by the circumstances. If the agreement is carried out over an extended period of time, the reasonable time can continue indefinitely while the parties continue to perform; the contract will not terminate until notice is given. The basic policy, however, is that a person making an open-ended commitment can be held to performance over a time that is reasonable, but cannot be placed in a position of perpetual servitude. The commercial circumstances that determine what is a reasonable time include consideration of licenses or third-party rights which constrict the licensor of the information. The licensor should not be presumed to have given a license that exceeds its own rights with respect to the information. As in common law and original Article 2, the contract is generally subject to termination at will.

In some cases, what constitutes a reasonable term can be determined by reference to other law. In this field, there are various federal policy considerations that affect the duration of licenses either by direct rule or indirectly by suggesting what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed to extend for the life of the patent. A similar premise exists for an indefinite copyright license. For a copyright license of an indefinite term, however, duration is subject to over-riding federal copyright law rules. *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993). An obligation to pay royalties for use of information for an indefinite period extends for a reasonable time which can often be measured by the term over which proprietary rights continue to exist in reference to the licensed information.

Parties to a contract under either subsection (1) or (2) are not required, in giving notice of termination, to fix at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response so that failure to reply will infer acquiescence. If objection is made, however, or if the demand is merely for information, demand for assurance on the ground of insecurity may be made under this article pending further negotiation. Only when a party insists on undue extension or unreasonably early termination or rejects the other party's reasonable proposal is there a question of breach under this section.

The section applies only if there is an agreement. In some cases, failure to agree on duration indicates that no contract exists.

3. *Termination at Will.* The general rule is that the indefinite term contract can be terminated at will by either party, except as provided in subsection (2) as to contractual rights of use under a license. This follows common law principles with respect to contracts generally. Under this standard, for example, a contract that grants a license and promises support services for an indefinite period can be terminated at will as to the support services. Treatment of the licensed rights is handled differently under subsection (2). At will termination enables a non-judicial method of ending the contract. Termination does not end all obligations or rights, including rights that vested based on prior performance. Which rights these include, of course, depends on the terms of the agreement.

4. *Termination.* Termination discharges executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. For example, if a single license fee paid grants a permanent right to use software, but the license also calls for an on-going obligation to deliver updates of the software for an indefinite term, termination does not affect the license rights, but does end the obligation to provide updates if that obligation was not earned by prior performance.

Justifiable cancellation for breach is a remedy for breach and is not the kind of ending of a contract covered under this section.

5. *Contracts for Definite Term.* The standards of this section do not apply if the agreement provides for a specific duration. Agreement to a definite duration may be found in express language or in a term implied from the contractual circumstances, usage of trade or course of dealing. A license for "the life of the edition" or "for so long as the work remains in print" defines a duration as well as does a contract for one year duration. On the other hand, commitments to "lifetime" service or "perpetual" maintenance are indefinite in duration.

6. *Perpetual Licenses.* Subsection (2) rejects in two specific instances the Article 2 and common law rule that a license that does not specify its duration is for a duration that is a reasonable time subject to termination at will. As in all other contracts, the presumed term is a reasonable time, but in two cases the default rule is that an indefinite term license is perpetual as to the licensed rights and use restrictions, subject to cancellation for breach or contrary agreement. As elsewhere, terms of agreement may be found in express terms, usage of trade, course of dealing or the circumstances of the transaction. In many cases, for example, these considerations would suggest an agreement for something other than a perpetual term where the transaction involves delivery of a copy of source code subject to confidentiality and other limitations on use. The perpetual term default rule does not apply to services, such as support obligations. These are within the general rule in subsection (1). There is no default rule about perpetual term if a party has an on-going obligation to deliver affirmative performances to the other party.

A perpetual term is set out as a default rule if a license transfers ownership of a copy or delivers a copy of software for a single fee, the total amount of which is determined at or before delivery. This does not contemplate royalty or other variable fees whose total dollar amount cannot be determined at the outset. This rule seeks to identify situations in the mass market and other similar settings where the transaction commercially conveys implicit long term rights to the licensee. The default rule is over-ridden in cases where the circumstances suggest that, despite a single fee or similar terms, there is no agreement to give perpetual rights. This may occur in cases where source code is delivered to a party subject to confidentiality or non-disclosure obligations. In such settings, the most likely construction of the agreement limits the transferee's rights in the confidential code. On the other hand, acquisition of a copy of a program under a license that is indefinite on duration and is acquired in the absence of confidentiality or similar obligations suggests a perpetual term if the remaining conditions of subsection (2) are met.

The second situation deals with cases where the licensed information is incorporated into a product for distribution to third parties, such as an art clip licensed for use in a digital multimedia encyclopedia. This recognizes the reliance interests that develop in such case and which would be disrupted by an at will termination right.

SECTION 2B-309. LIMITED RIGHTS TO INFORMATION GIVEN FOR STORAGE OR PROCESSING IN RECEIVING PARTY.

(a) Between merchants, this section applies if:

(1) one party, the recipient, is given confidential commercial, scientific, or technical information of the other party under an agreement that obligates it to store or process that information; and

(2) the recipient has reason to know that the information is confidential and that the delivering party does not authorize publication of it.

(b) The information and any summaries or tabulations based on it may be used by the recipient only in a manner and for purposes expressly authorized by agreement or reasonably necessary for performance of the agreement.

(c) The recipient shall:

(1) hold the information in confidence in a manner consistent with ordinary standards of its business, trade, or industry; and

(2) on termination, deliver all copies of the information to the other party or make the information available to be destroyed or delivered to the other party pursuant to the agreement or the reasonable instructions of that party or, in the absence of agreed terms or

instructions, in a commercially reasonable manner.

(d) This section does not apply to, or alter rights in, information made available to the recipient because the party providing the information was engaged in or intended to engage in a transaction with or to be facilitated by the recipient, and:

(1) the information was collected or created to effectuate, process, or make a record of the transaction; or

(2) the information describes the subject matter of the transaction, or reports, analyses or other information based on such information.

(e) Nothing in this section precludes or creates a claim for breach of confidentiality or invasion of privacy under other law by a person that is the subject of the information.

Definitional Cross References.

"Agreement": Section 1-201. "Information": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Termination". Section 2B-102.

Reporter's Notes:

1. *Scope of this Section.* This section describes default rules for transactions in which one merchant receives confidential information from another in a contract that requires the recipient to store or process that information. This covers modern outsourcing contracts and other arrangements where data storage or processing is provided to another party pursuant to agreement. Under subsection (d), the section does not apply to handling of data collected as an incident of processing transactions involving the other party. It does not deal with issues of data privacy or data protection and creates no inferences about the proper handling in other contexts in which confidential information is handled. The section limits the recipient to uses of information that are granted under the contract in cases where it had reason to know it was dealing with confidential material.

2. *Nature of the Transaction.* The limitations and obligations set out in this section arise only if a person receives, pursuant to contract, confidential commercial, scientific or technical information of the other party with reason to know that the information is confidential to the other party. This does not require that the information be a trade secret under applicable law. Between merchants, reason to know information is confidential creates contractual obligations in any transaction where the recipient is to process or store that information. Whether the same transaction gives rise to obligations under tort law is not addressed in this article.

The obligations of this section do not arise where under the agreement the party whose information is provided to the other authorizes its publication. The agreement that authorizes publication may be found in express terms of a record or in implication from the circumstances, usage of trade or course of dealing.

3. *Limitations on Use.* Subsection (b) states the premise that, unless it agrees otherwise, the party about whose business or technology the data relate maintains control. The recipient's right to use the data is limited to the purposes of the contract. This resolves an important issue in a manner consistent with the fact that the information is known to be confidential. The rule applies to cases involving information that has not been released to the public and which the recipient knows is unlikely to be released. The principle is that the information is received and to be held in a confidential manner; it remains the property or under the control of the party who provided it to the transferee. For example, if a data processing company contracts to receive and process a hospital's records on patient care and billing, the hospital is the dominant party in control of the information and, on termination of the contract, the data processing company must return all copies of the data to the hospital. *See Hospital Computer Systems, Inc. v. Staten Island Hospital,* 788 F. Supp. 1351 (D.N.J. 1992).

4. *Obligations to Maintain Confidentiality.* Paragraph (c)(1) provides that the recipient must exercise care consistent with ordinary standards of its trade or industry to maintain the information in a confidential manner. If the parties desire a higher standard of care, they can so specify in their agreement. However, a lesser standard cannot be specified. Section 1-102(3). A failure to exercise the required level of care breaches the contract.

5. *Return of Copies.* The information is to be returned to the providing party at the end of the contract. Subsection (c)(2) confirms this obligation, requiring compliance with contractual terms or reasonable instructions to return the information. Regardless of whether all copies are returned, the contractual limitations on use of copies of the information survive termination of the agreement. Section 2B-625. Failure to comply with this or the other obligations of this section and the agreement is a breach of the contract.

6. *Transactional Data.* Subsection (d) clarifies that section does not apply to data collected about others pursuant to processing or effectuating transactions. Thus, for example, this section would not apply to information collected by a credit card company as part of processing of credit transactions with respect to either the merchants or the card holders with which it deals. This information, collected as a by-product of ordinary transactions that have a different purpose than collecting or processing the information for its own sake, present significant questions about trade secrecy law and personal data privacy that are being debated in national and international venues. Those issues are outside the scope of this article. Of course, since this is a default rule, nothing here prevents development of contract terms regarding such information.

SECTION 2B-310. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, "restraint" means a program, code, device, or similar electronic or physical limitation that restricts use of information.

(b) A party entitled to enforce a limitation on use of information which does not depend on a breach of contract by the other party may include a restraint in the information or a copy of it and use that restraint if:

(1) a term of the agreement authorizes use of the restraint;

(2) the restraint prevents uses which are inconsistent with the agreement or with informational rights that were not granted to the licensee;

(3) the restraint prevents use after expiration of the stated duration of the contract or a stated number of uses; or

(4) the restraint prevents use when the contract terminates, other than on expiration of a stated duration or number of uses, and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) This section does not authorize or prohibit a restraint that affirmatively prevents or makes impracticable a licensee's access to its own information or information of a third party,

other than the licensor, if that information is in the licensee's possession and accessed without use of the licensor's information or informational rights.

(d) A party that includes or uses a restraint pursuant to subsection (b) or (c) is not liable for any loss caused by that use.

(e) This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy or version under an agreement electronically to replace or disable the earlier copy with an upgrade or other new information.

Definitional Cross References.
"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of Section.* This section deals with electronic or physical limitations on use of information that enforce contract terms by preventing breach or by implementing a contracted-for termination of rights to use the information. The section does not deal with devices used to enforce rights in the event of cancellation for a breach and cancellation or with enforcement concerning information that is outside the scope and subject matter of this article. The restraints here derive from contract terms and limit use consistent with the contract or the termination of a license at its natural end. The basic principle is that a contract can be enforced and that it is appropriate to do so through automated means. If the contract places enforceable time or other limits on use of information, electronic devices that enforce those limitations are appropriate and, in fact, are an important new capability created by digital information systems.

2. *Passive or Active Devices.* This section distinguishes between active and passive devices. An active device terminates the ability to make any further use of the licensed subject matter and the information it handles, while a passive device merely precludes acts that constitute a breach or a use of the licensed information after expiration of the contract. As specified in subsection (c), nothing in this section authorizes active devices that affirmatively limit the licensee's ability to access or use its own information through its own means other than by continued use of the licensed subject matter itself. Passive devices are mere automated contract parameter enforcement tools and are appropriately used to enforce contractual restrictions.

3. *Bases for Use.* Subsection (b) states alternative bases that permit use of automated restraints. The alternatives are co-equal; satisfying any one of the alternatives supports use of the restraint under this section. The list is not exclusive. Federal or other law (including other contract law) may also allow limiting devices (restraints).

a. Contract Authorization. The first option arises if the contract authorizes the party to use the restraint. Under this subsection, the contractual authorization must be in addition to the contract term that the restraint enforces.

b. Passive Restraints That Prevent Breach. Subsection (b)(2) provides that a passive restraint can be used without notice or express contract authorization if it merely prevents use inconsistent with contract terms or the intellectual property rights of the party using the restraint. All the restraint may do is prevent use; if it does more than that, it is not authorized by this subsection. For example, if a license restricts the licensee to only one back-up copy, this subsection authorizes a restraint to enforce that limitation so long as the restraint does not destroy or disable the licensed information. If the restraint does more (i.e., destroy information) than merely enforce the contract, it is not authorized under this section. Restraints here enforce contracts, but do not

impose a penalty for attempted breach. Similarly, if an enforceable contract term limits use of a copy of digital information to a single designated hardware systems, a restraint that precludes use on other systems is authorized under this subsection. A restraint that deletes the digital copy if the licensee attempts to use it on an unauthorized system is not authorized by this subsection. The agreement must support the electronic limitation. An agreement that limits use to a particular location does allow destruction of the information at the unauthorized location if that restriction is violated, or if a violation is attempted. The licensee still retains the right to use the information within contractual terms unless or until the contract is canceled. A restraint inconsistent with the contract is a breach of contract.

Illustration 1: The license provides that no more than five users may have access to and online database at any one time. If a sixth user attempts to sign on, that user is electronically denied access until another user discontinues use. This restraint is authorized under subsection (b)(2). A restraint that disables or deletes the database if a sixth user attempts access, it is not authorized.

c. Enforcing Property Rights. Subsection (b)(2) also allows use of passive devices that merely preclude infringing intellectual property rights. Merely preventing the act does not require a contract or other notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically although such may be precluded by intellectual property law absent fair use. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so, is authorized under (b)(2).

d. Enforcing Termination. The restraints authorized in subsections (b)(3) and (b)(4) enforce termination of a contract. Termination ends the contract for reasons other than breach. Subsection (b)(3) allows restraints that end use of the information upon expiration of a stated term or number of uses. At termination, the restraint may do more than merely prevent use since, at the end of the contract term, the party no longer has any rights in the information under the license. Thus, a card that allows thirty minutes of use can be disabled at the expiration of the contractual term and be made no longer operational. A machine allowing a single video game play can automatically discontinue use or delete the game when that game is completed. A license for a time limited use of downloaded software fragments allows erasure of those elements when the limited time for use expires. Consistent with rules on termination, no prior notice is required for such termination. In contrast, subsection (b)(4) requires prior notice if the restraint implements termination other than on the happening of an agreed event.

e. Cancellation. Cancellation means ending a contract because of breach. Nothing in this section authorizes or otherwise deals with electronic or other devices used to enforce rights in the event of breach and cancellation.

Illustration 2. A license requires monthly payments on the first of the month and runs for a one year term. Licensee makes one payment five days late. Licensor uses an electronic device to turn off the software before payment. That act is not authorized under this section since it enforces a remedy for breach of contract. If, however, the license reaches the end of the contractual duration, a restraint that turns off and deletes the software at that time is valid under this section.

4.

SECTION 2B-311. DELIVERY TERMS. Delivery terms such as "F.O.B." and "C.I.F." must be interpreted according to Article 2 and any applicable custom or usage of trade.

Definitional Cross Reference:

"Term". Section 1-201.

Reporter's Notes:

This section adopts the treatment of shipment terms found in original Article 2. These rules are default rules subject to contrary agreement. The agreement may be in express terms of a contract, or found in usage of trade, course or dealing or inferred from the circumstances of the contracting. An important factor in determining the actual agreement is the emergence of modern interpretations grounded in international understanding about the meaning of delivery terms.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) A licensor that is a merchant regularly dealing in information of the kind warrants that the information shall be delivered free of the rightful claim of any third person by way of infringement or misappropriation, but a licensee that furnishes detailed specifications to the licensor and the method required for meeting the specifications must hold the licensor harmless against any such claim caused by compliance with the specification or method except for a claim that results from the failure of the licensor to adopt a noninfringing alternative of which the licensor had reason to know.

(b) A licensor warrants:

(1) for the duration of the contract, that no person holds a claim to or interest in the information which arose from an act or omission of the licensor, other than a claim by way of infringement or misappropriation, which will interfere with the licensee's enjoyment of its interest; and

(2) as to rights granted exclusively to the licensee, that within the scope of the license the licensed informational rights are valid and exclusive for the information as a whole to the extent that exclusivity and validity are recognized under applicable law.

(c) The warranties in this section are subject to the following rules:

(1) If informational rights are subject to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) The obligations under subsections (a) and (b)(2) apply solely to informational rights arising under the laws of the United States or a State thereof unless the contract expressly provides that the obligations extend to rights under the laws of other countries. Language is

sufficient for this purpose if it states "The licensor warrants [exclusivity] [noninfringement] in [specified countries] [worldwide]," or words of similar import. In that case, the warranty extends to the specified country or, in the case of a general reference to "worldwide" or the like, to all countries within the description, but only to the extent that the rights are recognized under a treaty or international convention to which the country and the United States are parties.

(3) The warranties under subsections (a) and (b)(2) are not made by a party that merely permits use of its rights under a patent.

(d) Except as provided in subsection (e), a warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it may have. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states "There is no warranty against interference with your enjoyment of the information or against infringement", or words of similar import.

(e) Between merchants, a grant of a "quitclaim" or a grant in similar terms, grants the information or informational rights without an implied warranty as to infringement or misappropriation, or as to the rights actually possessed or transferred by the grantor.

Uniform Law Source: Section 2A-211; Section 2-312. Revised.

Definitional Cross References.

"Automated transaction": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Person": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section deals with implied warranties relating to non-infringement, exclusivity, and quiet enjoyment. These warranties, if they arise, cannot be disclaimed except as stated in this section.

2. *Non-Infringement Warranty.* Subsection (a) language comes from original Article 2. If the information is part of the licensor's normal stock and is provided in the normal course of its business, it is the licensor's duty to see that no claim of infringement of an intellectual property right by a third party will affect the information as delivered to the licensee. A transfer by a person other than a dealer in the particular type of

information, however, raises no implication of such a warranty. This section creates a warranty, when applicable; but it does not create an implied right of indemnity unless the parties expressly so agree.

a. Delivered Free of Infringement. Subsection (a) requires that the information be delivered free of any claim of infringement. This warranty refers to circumstances at the time of delivery. It expresses a fundamental undertaking in any transfer of information: transfer of a copy does not infringe rights of another person. It does not pertain to future events, such as a subsequently issued patent.

The warranty does not cover infringement claims that result from a licensee's decision to use the information in connection with other information or property, the composite of which infringes a third party right. The decisions in *Chemtron, Inc. v. Aqua Products, Inc.*, 830 F.Supp. 314 (E.D. Va. 1993) and *Motorolla v. Varo, Inc.*, 656 F.Supp. 716 (N.D. Tex. 1986) frame the issue correctly. That principle governs cases of computer software with multiple, generalized functions. For example, in a license of a spreadsheet program, the warranty is that the spreadsheet itself does not infringe another person's rights. If the licensee uses the capabilities of the software to implement an inventory control system that is covered by a patent held by a third party, the infringement comes from the licensee's use of the system and not from the software. No breach of an infringement warranty occurs and liability, if any, lies with the licensee. A licensor of software that can be adapted to may different functions at the option of the licensee does not warrant that none of the functions that might be implemented by the licensee infringe the rights of other parties.

b. Patent License. Under subsection (c)(3), the subsection (a) warranty does not apply to patent licenses. This means a party licensing a patent per se. While most patent licenses are not within Article 2B, a license of a software patent may be covered. For these cases, this article adopts the rule that prevails in patent licensing generally. A patent license does not warrant that the licensee can use the licensed technology. Instead, as referenced in the basic concept of patent rights, the license merely states that the licensor will not sue for use of its rights. There is no warranty that the license assures that there are no blocking patents which may prevent use of the licensed patented technology. This section thus recognizes the traditions of patent licensing. A patent does not create an affirmative right to use technology, but merely a right to prevent another person's use. Patent licenses are mere waivers of the right to sue and do not promise a right to non-infringing use of the patented technology unless the contract expressly so provides. Thus, if a party licenses software and the software is supported in part by patent rights, the warranty is breached if use of the software infringes a third party patent. On the other hand, if the software licensor also grants a license for the patent itself, that license does not create a warranty under subsection (a).

c. Specifications and Hold Harmless Duty. Nor is there an implication of a warranty by the licensor when the licensee orders information to be assembled prepared or manufactured on the licensee's specifications liability will run from the licensee to the licensor. In essence, if the project is defined by detailed specifications given by the licensee including the method for meeting those specifications or features, no warranty arises on behalf of the licensor and the licensee bears the obligation if, in such cases, the result of compliance infringes a third party right. See *Bonneau Co. v. AG Industries, inc.*, 116 F.3d 155 (5th Cir. 1997). There is, under such circumstances, a tacit representation on the part of the licensee that the licensor will be safe in creating the information according to specifications.

To establish this circumstance, the specifications must mandate acts that cause infringement, rather than allowing choices some of which may result in infringement. Thus, for example, a requirement that a product contain an image of a famous character specifies both the outcome (specification) and the method, triggering the hold harmless obligation unless that obligation does not arise because of other provisions of this section. The requirement design must be specific or detailed, rather than general. *See Bonneau Co. v. AG Industries, inc.*, 116 F.3d 155 (5th Cir. 1997) (design of "sufficient specificity for a competent manufacturer to construct the product and, thus, constitutes a specification"). The "hold harmless" obligation only exists if infringement is caused by compliance, not because of choices of the licensor in implementing goals of the licensee. This section goes beyond Article 2 in limiting when a licensee's obligation arises. A licensor receiving specifications with expertise in the field, cannot hold the licensee liable if the licensor failed to adopt a noninfringing alternative which it had reason to know existed.

d. Non-Infringement and Passive Transmission. The warranty in subsection (a) applies only to licensors of information. It does not apply to persons who merely provide communications or transmission services even if such service falls within this article. Service providers of this type do not, for purpose of contract law, engage in activities that reasonably create the inference that they assure the absence of infringing information. That obligation could be expressly undertaken, but if not, it is not created by law. Article 2B takes no position on and has no effect on federal questions about what constitutes infringement in such situations. This section follows a

contract law premise that commitments about the absence of infringing material between two parties to a contract are appropriate. Whether, a particular party is a "licensor of information" for contract law depends on the circumstances of the contract regarding its position with respect to affirmatively providing the information as part of its ordinary business, but that issue pertains to liability in reference to the licensee. It has no bearing on whether a passive transmission provider is liable for infringement to the owner of the intellectual property rights.

e. Limitations Period. The infringement warranty under this section does not extend to future performance. Nevertheless, Section 2B-705, establishes a limitations period for breach of non-infringement obligations that commences on the earliest of when the breach was or should have been discovered, rather than on delivery of the information.

2. *Quiet Enjoyment.* The warranty of quiet enjoyment was abolished in Article 2 for sales of goods and, thus, did not apply under prior law to software licenses. Paragraph (b)(1) reinstates that warranty for licenses and with respect to issues other than infringement. The licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. This "quiet enjoyment" warranty reflects the licensor's implied commitment to not act for the term of the license in a manner that detracts from the grant to the licensee by interfering with the licensee's use. If reflects the judgment that the nature of the limited interest transferred in a license – the right to use the information – results in a need of the licensee for protection greater than that afforded to a buyer of goods. The warranty is limited to claims or interests that arise from acts or omissions of the licensor.

3. *Exclusivity.* Subsection (b)(2) deals with obligations that arise when the transaction is an exclusive license in the sense that it assures the licensee that it is the only person able to exercise the rights granted within the scope of the grant. "Exclusivity" pertains to two issues not relevant in non-exclusive licenses. The first involves the validity of the intellectual property rights. Validity corresponds to whether the information is in the public domain, i.e., the information under property law can be used or recreated by anyone. Validity is important if a licensee relies on the "exclusive" rights to create a product for third parties. An exclusive licensor warrants that the rights conveyed are not in the public domain.

The second issue involves whether a portion of the rights may be vested in another person because co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In an exclusive license, the licensor warrants that this is not true. For non-exclusive licenses, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant because it does not alter the end user's ability to continue to use the licensed rights without challenge.

Exclusivity and validity are warranted only to the extent recognized in law. Thus, the licensor of a trade secret warrants that it has not granted rights to another person, but does not warrant that no other person independently holds or may discover the secret information. A trade secret gives no rights against independent discovery and, thus, the warranty does not purport to claim that no one else knows or uses the secret information.

Subsection (c)(1) further reinforces this theme. If, under applicable law, the rights are subject to compulsory licensing, public access or use, the license warranty is limited by the terms of these rights. Thus, for example, a license of rights in information which, under applicable law, must be licensed to any other party for a specified fee, does not warrant exclusivity as to such rights. These off-setting rights, however, must be embodied in law, rather than in another contract.

4. *International Issues.* Intellectual property rights are territorial in character. They extend only within the territory of the state that creates them, although some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) parallels this and provides that the obligations created about exclusivity and infringement extend only within this country and to a country specifically referenced in the license or warranty. Specification in the license of particular countries or "worldwide" in this sense refers only to specifications or representations made with express reference to the non-infringement warranty, such as "Licensor warrants non-infringement worldwide." Other references in a license may not be intended to create a warranty. For example, a grant of a license for worldwide use may in the circumstances be no more than a permission to use the information worldwide without risk of a lawsuit by the licensor, rather than a warranty that worldwide use will not infringe other rights. In the case of a "worldwide" warranty, the obligation extends only to countries that have property rights treaties with the United States. In the absence of such relationships, the rights created under United States law cannot create rights in the other country and, thus, the warranty cannot extend there.

5. *Disclaimer*. As with all other warranties, the warranties in the section can be disclaimed. This section provides for such disclaimer in language based on original Article 2. This requires specific language or circumstances indicating that the warranties are not given. Consistent with the general approach of contract law as a planning tool, illustrative language is provided. Subsection (d) limits the conditions under which the warranty of this section can be disclaimed or modified, it does not limit or preclude avoidance or modification of the hold

harmless obligation that might arise under subsection (a). If the circumstances or language indicate no intent to hold harmless, that agreement is enforceable and this subsection does not require proof that the language is conspicuous.

SECTION 2B-402. EXPRESS WARRANTY.

(a) Subject to subsection (c), an express warranty by a licensor is created as follows:

(1) An affirmation of fact or promise made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information to be furnished under the agreement shall conform to the affirmation or promise.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the information shall conform to the description.

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

(b) It is not necessary to the creation of an express warranty that the licensor use formal words such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, an express warranty is not created by an affirmation or prediction merely of the value of the information or informational rights; a display or description of a portion of the information to illustrate the aesthetics, market appeal, or the like, of informational content; or a statement purporting to be merely the licensor's opinion or commendation of the information or informational rights.

(c) This article does not alter or establish any standards under which an express

warranty or an express contractual obligation for published informational content is created or not created. If an express warranty or contractual obligation is created for published informational content and is breached, the remedies of the aggrieved party are pursuant to this article and the agreement.

Uniform Law Source: Section 2A-210. Section 2-313.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.

Reporter's Note:

1. *Scope and Basis of Section.* This section adopts original Article 2 law on express warranties, except with respect to published informational content, where it preserves current law. "Express" warranties rest on "dickered" aspects of the individual bargain and go so clearly to the essence of that bargain that, as indicated in Section 2B-406(a), words of disclaimer in a standard form cannot alter the dickered terms. "Implied" warranties, on the other hand, rest on a common factual situation or set of conditions so that no particular language is necessary to evidence them and they will exist unless disclaimed.

2. *Basis of the Bargain.* Subsection (a) adopts the "basis of the bargain" originally created in Article 2. This allows courts and parties to draw on a body of case law for distinguishing express warranties from puffing and other, unenforceable statements, representations or promises. While there are many factual issues, this standard provides better guidance than would an entirely new standard. The "basis of the bargain" concept is that express affirmations, promises and the like are enforceable as express warranties if they are within the matrix of elements that constitutes and defines the bargain of the parties, but that they are not express warranties if they are not part of that basis for the contract. The standard does not require that a licensee prove actual reliance on a particular statement, affirmation or promise in deciding to enter into the contract, but does require proof that the statement, affirmation or promise played a role in reaching or defining the bargain. This standard enables the creation of express obligations on the more general showing that statements about the information are part of the deal and basic to it. On the other hand, express warranty law deals with the elements of a bargain and is not a surrogate for regulation. It does not support imposing liability in contract for all statements of a licensor made about an information product, even if not brought to the attention of the licensee. This holds as well for advertising. If the licensee knows of the advertisement by the vendor and it became part of the basis of the bargain with the vendor, the advertisement may create an .

The question is whether statements of the licensor made to the licensee have in the circumstances and in objective judgment become part of the basic bargain. No specific intention to make a warranty is necessary. In actual practice affirmations of fact describing the information and made by the licensor about it during the bargain are ordinarily regarded as part of the description of the information unless they are mere puffing, predictions, or otherwise not an enforceable part of the bargain. No reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact. This is true also of the question of whether product documentation may create an express warranty. Whether the documentation is reviewed before or after the initial deal, the test is the same. If it contains affirmations of fact or promises that otherwise qualify and it became part of the basis of the bargain, an express warranty may arise.

The question is whether language, samples, or demonstrations are fairly to be regarded as part of the contract. If language is used after the closing of the deal, (as when the licensee on taking delivery asks for and receives an additional assurance), the assurance may become a modification of the contract and does not need to be supported by further consideration if it is otherwise reasonable. Section 2B-304. Alternatively, under the layered contract formulation established in Article 2 and employed here, that assurance may simply be treated as a further elaboration of the actual terms of the contract.

3. *Relation to Disclaimers.* The basic principle is that the purpose of the law of warranty is o determine what it is that the licensor has in essence agreed to provide. A contract is normally a contract for

something describable and described. These descriptions, if part of the bargain, are an express warranty. This article follows the general principle, as in original Article 2, that the obligations in a proven express warranty cannot other than in exceptional cases be materially deleted. A contract term generally disclaiming "all warranties, express or implied" cannot be given literal effect under Section 2B-406(a). This does not to mean that the parties, if they consciously desire, cannot make their own bargain as the desire, including a bargain that does not encompass the purported express warranty. But in determining what they have agreed upon consideration should be given to the fact that the probability is small that a real price is intended to be exchanges for a pseudo-obligation. Thus, for example, a contract for a "word-processing program" that contains the general disclaimer noted above is nevertheless a contract for an information product that meets the basic description of a "word-processing program."

4. *Puffing and Expressions of Opinion.* Subsection (b) retains current law to the effect that puffing or mere statements of opinion do not form an express warranty. The law on the distinction between an actionable representation and puffing is long and well-developed. The distinction requires a determination based on the circumstances of the particular transaction. It reflects that in common experience some statements and predictions cannot fairly be viewed as entering into the bargain. In transactions involving computer programs as with other commercial information, the closer the statement relates to describing the technical specifications, technical performance or product description of the information, the more likely it is to be an express warranty when communicated to the licensee, while the more the statement pertains to predictions about expected benefits that may result from use of the information, the more likely it will be found to be puffing. Of course, whether or not a statement is an express warranty does not affect whether the statement in context might yield a remedy under the law of fraud or misrepresentation.

Subsection (b) also refers to statements or demonstrations pertaining to aesthetics and market appeal. Aesthetics, as used here, refers to questions of the artistic character, tastefulness, beauty or pleasing character of the informational content, not to statements pertaining to how a person uses the information or to what is the essential nature of the information itself. Thus, for example, a statement that a clip art program contains easily useable images of "horses" or images of "working people," if it becomes part of the basis of the bargain, creates an assurance that the subject matter of the clip art program is horses or working people and that the images are usable. However, it does not purport to state that they are tasteful or artistically pleasing.

5. *Advertising as a Source of Express Warranty.* Paragraph (a)(1) provides that advertising may create an express warranty if the advertising statements otherwise conform to the standards for creation of an express warranty under this section. This expands the scope of express warranty law in some states. Statements made in advertising, of course, often reflect puffing or mere expressions of opinion and do not create an express warranty. As with other statements, a warranty arises only if the statement becomes part of the bargain and a bargain actually occurs. The affirmation of fact made in the advertising must be known by the licensee, influence and in fact become part of the basis of the bargain under which it acquired the information.

In the absence of that relationship, liability for false advertising, if any, would not be under contract law, but under tort or advertising law rules. This section does not create a false advertising claim under the guise of contract law.

6. *Descriptions.* Paragraph (a)(2) makes specific some of the principles described above about when a description of the information becomes an express warranty. The description need not be by words. Technical specifications, blueprints and the like can afford more exact descriptions that mere language and, if made part of the basis of the bargain, become express warranties. Of course, all descriptions by merchants must be read against the applicable trade usage and in light of the concepts of general rules as to merchantability resolving any doubts about the meaning of the description. The description requires a commercially reasonable interpretation.

7. *Samples and Models.* Subsection (a)(3) expands current Article 2 by expressly referring to express warranties created by demonstrations of information. In addition, subsection (a)(3) carries forward the Article 2 principle that express warranties may be created by descriptions, samples or models.

The basic treatment of samples, models and demonstrations is no different that the treatment of statements. Although the underlying principles are unchanged, the facts are often ambiguous when something is shown to be illustrative in nature. In merchantile experience, the mere exhibition of a "sample", a "model" or a "demonstration" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract.

Representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the demonstration, model, or sample. In the world of goods, showing a sample of a keg of raw beans by lifting out a cup-full communicates one inference, while a demonstration of a complex database program running ten files creates an entirely different inference if the ultimate

intended use of the system is to process ten million files. This difference also applies to beta models of software which are used on a test or a demonstration basis and may contain elements that are not carried forward into the ultimate product. In such cases, the parties ordinarily understand that what is being demonstrated on a small scale or what is being tested on a beta model basis is not necessarily representative of actual performance or of what will eventually be the product. The basic rule, as with any other purported express warranty, is that any affirmation model or demonstration must be interpreted in a reasonable fashion that reflects the circumstances of the test or demonstration. The court's discussion in *NMP Corp. v. Parametric Technology Corp.*, 958 F. Supp. 1536 (S.D. Okla. 1997) illustrates the issue in respect to software demonstrations.

8. *Published Informational Content.* Subsection (c) preserves current law for published informational content. This section does not create any express warranty for published informational content, but does not preclude the imposition of any liability under other law or the creation of an express contractual obligation. While there are many reported cases dealing with express warranties in goods and using the standards adopted here, no case law for published informational content uses Article 2 standards. See Joel R. Wolfson, *Express Warranties and Published Informational Content under Article 2B: Does the Shoe Fit?*, 16 John Marshal Journal of Computer & Info. Law 384 (1997). This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability pertaining to published informational content must balance contract themes with these more general social policies.

This section leaves undisturbed existing law dealing with how obligations are established with reference to published informational content. The cases tend to deal with obligations of this type as questions of express contractual obligation, rather than in language relating to warranties. Thus, a promise to provide an electronic encyclopedia obligates the party to deliver that type of work and is not fulfilled by delivery of a computerized work of fiction. In other cases where the issues focus on the quality of the content or the like, courts if inclined to find contract liability will do so under general contract law theory. Many, however, will conclude that the level of risk in the published informational content situation and the potentially stifling effect that contract liability might have on the dissemination of speech should lean toward limiting or excluding liability. See *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987). In some other cases, liability may arise under tort law theories, such as in *Hansberry v. Hearst*, 81 Cal. Rptr. 519 (Cal. App. 1968). However, this section rejects the seemingly simple, but ultimately inappropriate step of merely adopting Article 2 concepts from sales of goods to this much different context. That would risk a large and largely unknown change of law and over-reaching of liability in a sensitive area. It would create uncertainty that would in itself chill public dissemination informational content while courts grapple with adapting entire new standards of liability to this area.

Where there is a contract obligation that is breached, the remedies of this article apply and replace remedies under common law for breach of contract. This includes all provisions of Part 7 of this article, including standards that measure and exclude or limit damages.

9. *Third Parties.* This section deals with express warranties made by the licensor to its licensee. It does not deal with the enforceability under contract or tort theory of representations made by remote parties and relied on by an ultimate user of the information. The case law in tort dealing with such issues pertaining to information does not generally parallel cases dealing with the manufacture and sale of goods. Information providers have been held liable to third parties in only a few, atypical cases. This article does not expand or exclude such third party liability, however it may develop under tort law.

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

(a) Unless disclaimed or modified, a merchant licensor of a computer program warrants:

(1) to the end user that the computer program is reasonably fit for the ordinary purpose for which it is distributed;

(2) to a distributor that:

(A) the program is adequately packaged and labeled as the agreement or the circumstances may require; and

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

(3) that the program conforms to the promises or affirmations of fact made on the container or label, if any.

(b) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade.

(c) A warranty created under this section does not apply to informational content, including its aesthetics, market appeal, accuracy, or subjective quality, whether or not included in or created by a computer program.

Uniform Law Source: Section 2-314; 2A-212. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Computer program": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Informational content": Section 2B-102. "Licensor". Section 2B-102. "Merchant". Section 2B-102.

Reporter's Notes:

1. *Background and Policy.* This section generally applies the Article 2 warranty of merchantability to computer programs. Since it applies to all computer programs provided by a merchant, it creates a merchantability warranty for cases that under prior law are services contracts with no warranties or with obligations limited to making a reasonable effort and exercising ordinary care. The merchantability warranty does not depend on how the program is delivered, whether it be electronically or in a tangible copy. It flows from the presumed nature of a commercial undertaking in which the supplier of the program is a merchant dealing with that type of information. Disclaimer or modification of the warranty of merchantability or any part of the warranty is dealt with in Section 2B-406.

Article 2B warranties stem from a combining of three different legal traditions. **One** is from Article 2 and focuses on the quality of the product, creating an implied warranty that the result delivered will conform to ordinary standards for products of that type. The **second** is from common law dealing with licenses, services and information contracts, which in many states focuses on the process or performance effort, rather than the result. The **third** is from common law pertaining to services in some states and information contracts. It disallows implied obligations of accuracy in information transferred other than in a special relationship of reliance. In this and the following section, Article 2B distinctions are drawn between computer programs, on the one hand, and information or services, on the other hand.

The implied merchantability warranty and the warranty in Section 2B-404 pertaining to the accuracy of data may both apply to the same transaction and the same information product. The one applies to the program and its functions, while the other applies to the accuracy of data in an appropriate relationship.

2. *Merchantability.* **[Subsection (a) reflects a proposal adopted at the November meeting of the Committee, revising the traditional merchantability warranty. The proposal was supported by a consumer representative and a representative of a large software company as a way to define merchantability in a manner that focuses on the type of product involved in this article. Notes on this proposal have not yet been developed. The following are from the prior draft.]** The content of a merchantability obligation turns basically

on the meaning of the terms of the agreement as recognized in the applicable business, trade or industry. A computer program delivered under an agreement by a merchant must be of a quality fit for the purpose for which it was distributed. The implied warranty is made by all merchant-licensors. It does not apply to non-merchants. Non-merchants, however, like merchants, are obviously subject in appropriate cases to claims grounded in fraud or other theories premised on misrepresentation.

a. Concept of Merchantability. Merchantability does not require perfection, but the concept is that the subject matter of the warranty must fall generally within the average standards applicable in commerce for information of the type.

In 1998, a popular operating system program for small computers used by both consumers and commercial licensees contained over ten million lines of code or instructions. In the computer these instructions interact with each other and with code and operations of other programs. This contrasts with a commercial jet airliner popular in that year that contained approximately six million parts, many of which involved no interactive function. A typical consumer goods product contains fewer than one hundred parts. A typical book has fewer than one hundred fifty thousand words. In the software environment, it is virtually impossible to produce software of complexity that contains no errors in instructions that intermittently cause the program to malfunction, so-called "bugs." The presence of errors in general commercial products is fully within common commercial expectation. Indeed, in programs of complexity, the absence of errors would be unexpected. In this commercial environment, the contract law issue is whether the level of error exceeds the bounds of ordinary merchantability. This occurs only if the significance of the errors or their number lies outside ordinary commercial expectations for the particular type of program.

b. Fit for Ordinary Purposes. Under paragraph (a)(1) the program must be fit for the ordinary purpose for which it is distributed. Ordinary purposes focuses on expected end user applications of the type to which the product as distributed was addressed. To an extent greater than in reference to sales of goods, computer programs are often adapted to and employed in ways that go well beyond the uses expected when the distribution occurs. Use of ordinary, mass-market database programs in the context of highly sensitive or commercial applications does not change the warranty into one assuring fitness for ordinary purposes of such use. The focus is to the market and types of uses to which the program is directed. Ordinarily, of course, that also defines the ordinary actual use of the program. In any event, to be fit for ordinary purposes does not require that the program be the best fit or the perfect application for that use. If the transfer is to a person acquiring the program for re-distribution by sale, the program must be honestly resellable because it is what it purports to be.

3. *Aesthetics.* Subsection (c) makes clear a rule that would apply in any event. Merchantability does not apply to the aesthetics of a product under this article. Aesthetics, as used here, refer to questions of the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste, rather than elements of any standard of merchantability. On the other hand, merchantability standards are appropriately addressed to whether the information is what its description purports it to be and to whether it is or is not useable by the transferee. Thus, for example, if the complaint about the images created by a program is that they are not attractive, merchantability does not apply. If the complaint is that the commands and images are blurred and not useable, an issue of merchantability exists. A statement that a clip art program contains images of "horses" creates an assurance that the subject matter of the clip art program is horses or working people and that the images are usable. It does not purport to state that they are tasteful or artistically pleasing or whether they are brown, beige, white or green.

4. *Cause of Action for Breach.* In a cause of action for breach of warranty, as with all products, it is of course necessary to show not only the existence of the warranty, but that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action, in complex computer systems involving different hardware and software, the loss must be connected to defects in the computer program for which a breach of warranty is claimed. Proof that losses were caused by events after the program was installed and unconnected to it operate as a defense.

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

(a) Unless disclaimed or modified, a merchant that, in a special relationship of reliance with a licensee, collects, compiles, processes, provides, or transmits informational content,

warrants to its licensee that there is no inaccuracy in the informational content caused by the merchant's failure to perform with reasonable care.

(b) A warranty does not arise under subsection (a) with respect to a person that acts as a conduit or provides only editorial services in collecting, compiling, or distributing informational content identified as that of a third person.

(c) The warranty under this section does not come within Section 1-102(3).

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References.

"Informational content". Section 2B-102. "Licensee". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Published informational content". Section 2B-102.

Reporter's Notes:

1. *Scope and Effect.* This section recognizes a new implied warranty present in some informational content contracts, consulting, data processing or similar agreements. The warranty focuses on the accuracy of data, but does not create an absolute liability or absolute assurance of no inaccuracy. Instead, it creates a protected assurance in such contracts that no inaccuracies are caused by a failure of reasonable care. This section does not create a non-disclaimable duty of reasonable care.

2. *Accuracy.* A party that provides or processes information in a special relationship of reliance warrants that no inaccuracy exists due to the provider's lack of reasonable care in performing its obligations under the contract.

a. Ordinary Standards as Described. The presence of an inaccuracy relates to expectations gauged by ordinary standards of the relevant trade under the circumstances. In most large commercial databases, ordinary expectations assume that some data will be inaccurate. Variations or error rates within the range of commercial expectations of the business, trade or industry do not breach the warranty established in this section. If greater than ordinary accuracy is desired that desire must be expressed in the terms of the agreement and provide for greater than normal expectations of accuracy. For example, if in reference to a particular type of database the normal expected error rate is twenty percent, an error rate of fifteen percent does not create an inaccuracy within this section and does not breach the warranty. On the other hand, if in a database of thousands of medical treatments for various allergic reactions the commercial expectation is that the error rate should be no more than three percent, an error rate of ten percent may create an inaccuracy that results in breach of this implied warranty if caused by a failure to exercise reasonable care in compiling the information.

In addition, inaccuracy is gauged by reference to what the data purport to be under the agreement. This section follows cases such as *Lockwood v. Standard & Poor's Corp.*, 175 Ill.2d 529, 689 N.E.2d 1140, 228 Ill.Dec. 719 (Ill. App. 1997). A contract to estimate the number of users of a product in Houston does not imply an obligation to provide an accurate count, but merely requires an estimate. That estimate, if honestly made and given cannot breach this warranty.

b. Accuracy and Aesthetics. The warranty is that information is not inaccurate because of a lack of reasonable care. Informational content is accurate if, within applicable understandings of the level of permitted errors, the informational content correctly portrays the objective facts to which it relates. This warranty is not a warranty about the aesthetics, subjective quality, or marketability of informational content. These are subjective issues. Assurances on these issues require express agreement to give such assurances.

c. Adequate Results. One who hires an expert for purposes of consultation or data-related services relying on that expert's skills cannot expect infallibility. As under common law, reasonable efforts, not perfect results, provide the appropriate standard in the absence of express contract terms to the contrary. The analysis of the New York court in an analogous setting indicates the policy for the rule adopted here for those who collect, compile or process informational content. *Milau Associates v. North Avenue Development Corp.*, 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977).

3. *Merchants in a Reliance Relationship.* The implied warranty arises only if the licensor is a merchant with respect to the particular activity. In addition, the information must have been provided in a "special

relationship of reliance" between the licensor and the licensee. If the absence of such relationship, the mere fact that one person provides information to another creates no implied obligation beyond good faith.

a. Reliance Relationships. The requirement of a special relationship of reliance is fundamental to the implied obligation and to balancing the interest of protecting client expectations while not imposing excessive liability risk on informational content providers in a way that might chill their information-providing activities. This stems in part from cases applying *Restatement (Second) of Torts* § 552. The special element of reliance comes from the relationship itself, a relationship characterized by the provider's knowledge that the particular licensee plans to rely on the data in its own business and expects that the provider will tailor the information to its needs. The obligation arises only for those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the licensee such that reliance on the inaccurate information is justified and the party has a duty to act with care. See *Murphy v. Kuhn*, 90 N.Y.2d 266, 682 N.E.2d 972 (N.Y. 1997).

The relationship also requires that the provider make the information available as part of its own business in providing such information. The licensor must be in the business of providing that type of information. This adopts the rationale of cases holding that information provided as part of a differently focused commercial relationship, such as the sale or lease of goods, does not create protected expectations about accuracy except as might be created under warranty law. The court in *A.T. Kearney v. IBM*, 73 F.3d 238 (9th Cir. 1997) describes many of the relevant issues. See also *Picker International, Inc. v. Mayo Foundation*, 6 F. Supp.2d 685 (ND Ohio 1998).

An equally fundamental aspect of a special reliance relationship is that the information provider is specifically aware of and personally tailors information to the needs of the licensee. A special relationship does not arise for information made generally available to a group in standardized form even if those who receive the information subscribe to an information service they believe relevant to their commercial needs. The information must be personally tailored for the recipient. The transaction involves more than merely making information available. It does not require a fiduciary relationship, but does require indicia of special reliance.

b. Published Informational Content. The implied warranty does not apply to published informational content. By definition, published informational content is information transferred other than in a reliance relationship. Published informational content is informational content made available to the public as a whole or to a range of subscribers on a standardized, rather than personally tailored basis. This includes a wide variety of commercially important general distribution or subscription services providing informational content. It includes, for example, an Internet Website listing information of local restaurants, their prices and their quality, as well as services that provide data about current stock or monetary exchange prices to subscribers.

Published informational content is the subject matter of general commerce in ideas, political, economic, entertainment or the like, whose distribution entails fundamental public policy interests in supporting distribution and not chilling this process through liability risks. In the new technology era to which this article is addressed, many information systems analogous to newspapers, magazines, or books and are made available digitally or in on-line arrangements. Their traditional counterparts have never been exposed to contractual liability risks based on claims of mere inaccuracy and treating the new systems differently would reject the wisdom of prior law. A computerized database is the "functional equivalent of a traditional news service." These services have no contractual liability for mere inaccuracies in data in part because ordinary expectations anticipate the presence of errors and in part because of fundamental public policies supporting the free flow of information and free expression. Creating and applying a lower standard that creates greater liability for an electronic data provider than applies to a public library, book store, or newsstand would place an undue burden on the free flow of information. This policy underlies the results in *Cubby, Inc. v. CompuServ, Inc.*, 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991) and in *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987).

4. *Reasonable Care.* The primary obligation is that there is no inaccuracy in the data. An inaccuracy in informational content, however, creates no liability unless the inaccuracy results from a failure to exercise reasonable care. This corresponds to common law standards in many states for implied obligations in contracts involving services or information content. What constitutes reasonable care depends on the circumstances. Where the nature of the subject matter involves significant risks of personal injury if data are inaccurate, a higher degree of care can be expected than in situations in which the recipient reasonably should have other sources and judgments that will influence its decision, rather than mere reliance on the specific information provided in a transaction within this section.

5. *Conduits and Editing.*. The implied warranty applies only to information provided by the licensor. Subsection (b) clarifies that there is no warranty with respect to third party content where the provider identifies the information as coming from that third party. The implied warranty does not apply to parties engaged in editing informational content of another person. See *Doubleday & Co. v. Curtis*, 763 F.2d 495 (2d Cir.), cert.

dismissed, 474 U.S. 912 (1985); *Windt v. Shepard's McGraw-Hill, Inc.*, 1997 WL 698182 (ED Pa. Nov. 5, 1997)

A person collecting, summarizing or transmitting the third party data acting as a conduit does not create the same expectations about performance as does a direct information provider. Whatever expectations arise focus on the third party identified as the originator of the information. In these cases, however, that third party may not be contractually obligated to the licensee. Whether or not a contract exists, however, the conduit's obligation and the licensee's reasonable expectations with respect to it do not entail an obligation regarding the accuracy of the third party data. Concerning the policy issues in dealing with conduits, see *Zeran v. America On-Line, Inc.*, 129 F.3d 327 (4th Cir. 1997). Merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to the data provided by the third party. On the related issue of tort liability for publishers who are not also authors, *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991) (describes policy interests that also support subsection (b)).

6. *Relationship to Tort Law.* Since this section creates a new warranty analogous to the theory of negligent misrepresentation, disclaimer or non-existence of the implied warranty should have a strong bearing on potential existence of the tort claim in the same transaction. In cases involving economic loss, a disclaimer of this warranty in most cases forecloses a tort claim based on the same facts. However, this section does not foreclose development of other approaches to liability for information products under tort law. Most courts have held that published information products are not products for purposes of a product liability claim and that there is little or no duty of reasonable care owed to third parties in screening advertising or similar material for publication. See *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991). There are cases to the contrary on both points, however. Since these are issues under tort law, this article neither precludes nor encourages further exploration of the tort law questions.

7. *Disclaimer.* This warranty may be disclaimed pursuant to Section 2B-406. For an analogous case under common law, see *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993). The warranty is that there are no inaccuracies in the information caused by a lack of care. It is, therefore, not subject to the general rule that duties of reasonable care cannot be disclaimed by contract. Section 1-102. What is disclaimed is a warranty related to the accuracy of the content, not the exercise of reasonable care with respect to the information. That disclaimer is not affected by Section 1-102. No obligation of reasonable care is created under this section.

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless disclaimed or modified, if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, the following rules apply:

(1) Except as otherwise provided in paragraph (2), there is an implied warranty that the information is be fit for that purpose.

(2) If from all the circumstances, it appears that a licensor was to be paid for the amount of its time or effort regardless of the fitness of the resulting information, the implied warranty is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable care.

(b) There is no warranty under subsection (a) with regard to:

(1) the aesthetics, market appeal, or subjective quality of informational content; or

(2) published informational content, but there may be a warranty with regard to the licensor's selection among published informational content from different providers.

(c) If an agreement requires a licensor to provide or select a system consisting of computer programs and goods, and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components provided or selected will function together as a system.

(d) The warranty under this section does not come within Section 1-102(3).

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.

Definitional Cross References.

"Agreement": Section 1-201. "Computer program": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Published informational content": Section 2B-102. "Reason to know": Section 2B-102

Reporter's Note:

1. *General Approach.* This section reconciles diverse case law and, in subsection (c), recognizes a new implied warranty. Subsection (a)(1) states as a general rule that in some cases reliance creates an implied warranty of fitness for the licensee's particular purpose. Subsection (a)(2) applies the common law "efforts" standard in other cases. This bifurcation deals with the issue of whether the appropriate implied obligation is an obligation to produce a result (present in sales of goods) or an obligation to make an effort to achieve a result (common law). Under prior case law in software and other fields, the decision is based on whether a court views the transaction as a sale of goods (result) or a contract for services (effort). The reported decisions are split and often lack a principled basis for distinction.

2. *Warranty of Fitness.* Subsection (a)(1) follows original Section 2-315. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances at the time of contracting. A "particular purpose" differs from the ordinary purpose for which the information is used in that it envisages a specific use by the licensee which is peculiar to the nature of its business whereas the ordinary purposes for which information products are used are those envisaged in the concept of merchantability. Although normally this warranty arises only if the licensor is a merchant with appropriate "skill or judgment," if the circumstances justify the warranty it may be appropriate in the case of a non-merchant licensor.

The warranty does not exist if there is no reliance in fact or if the particular purposes are not made known to the licensor. This warranty requires particularization of the needs of the licensee in the context.

No express exclusion is made for cases where the information product is identified by a trade name. The designation of an item by a trade name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the licensee actually relied on the licensor, but it is not of itself decisive of the issue. However, if the licensee is insisting on a particular brand, it is not relying on the licensor's skill or judgment is making the selection and no warranty results. But the mere fact that the product acquired has a known trade name is not sufficient in itself to indicate nonreliance if it was recommended by the licensor. A similar principle is expressly stated in subsection (b)(2) relating to the selection from among various publishers.

The warranty obligates the licensor to meet known licensee needs if the circumstances indicate

that the licensee is relying on the provider's expertise to achieve this result. There are many development contract and other situations where no reliance exists, including cases where the licensee provides the contract performance standards, rather than relying on the provider to fill needs of the licensee. The express terms of the agreement require that the product meet the specifications, but no reliance exists on whether fulfilling the specifications will meet applicable needs.

3. *Services Warranty.* Subsection (a)(2) applies to cases that more closely resemble services contracts and carries forward the type of implied obligation most appropriate in such cases. The subsection recognizes that a skilled service provider does not guaranty a result suitable to the other party unless it expressly agrees to do so. *Milau Associates v. North Avenue Development Corp.,* 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977). Subsection (a)(2) provides a standard to determine when a contract calls for services and effort, rather than result. The test centers on whether the circumstances indicate that the service provider would be paid for time or effort, regardless of the fitness of the result. Such payment terms typify a services contract. Other standards evolved under general common law may also indicate that the parties intended a services obligation as delineated in subsection (a)(2). What constitutes reasonable care or effort depends on the project involved and other circumstances of the relationship. *Micro Manager, Inc. v. Gregory,* 147 Wisc.2d 500, 434 N.W.2d 97 (Wisc. App. 1988).

4. *Aesthetics and Published Information.* Subsection (b) makes clear that the warranty does not apply to published informational content or to aesthetics associated with the information. Aesthetics, as used here, refer to questions of the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste, rather than elements of any standard of implied warranty. On the other hand, warranty standards are appropriately addressed to whether the information is what its description purports it to be and to whether it is or is not useable by the transferee. Thus, for example, if the complaint about images created by a program is that they are not attractive, no implied warranty applies. If the complaint is that the commands and images are blurred and not useable, a warranty issue may exist.

5. *System Integration.* Subsection (c) creates a new implied warranty that requires systems performance in cases of systems integration contracts. While related to the implied fitness warranty, it expands that concept creating new protection for licensees. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a), will meet the licensee's needs. Neither does it mean that use of the system does not or may not infringe third party rights. This warranty simply creates an assurance that the parts will functionally operate as a system. This is an additional assurance beyond the fact that each component must be separately functional.

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

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

(b) Except as otherwise provided in subsections (c), (d), and (e), to disclaim or modify an implied warranty or any part of it, but not the warranty in Section 2B-401, the following rules apply:

(1) To disclaim or modify an implied warranty arising under Section 2B-403

language must mention “merchantability”, “quality”, or use words of similar import. To disclaim or modify an implied warranty arising under Section 2B-404, language must mention “accuracy”, or use words of similar import.

(2) Language to disclaim or modify an implied warranty arising under Section 2B-405 must be in a record. It is sufficient to state “There is no warranty that this information or efforts will fulfill any of your particular purposes or needs”, or words of similar import.

(3) Language is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or, except for the warranty in Section 2B-401, 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.

(4) Language sufficient under Article 2 or 2A to disclaim or modify an implied warranty of merchantability is sufficient to disclaim or modify the warranties under Sections 2B-403 and 2B-404. Language sufficient under Article 2 or 2A to disclaim or modify an implied warranty of fitness for a particular purpose is sufficient to disclaim or modify the warranties under Section 2B-405.

(5) In a mass-market transaction, language in a record that disclaims or modifies an implied warranty must be conspicuous.

(c) Unless the circumstances indicate otherwise, all implied warranties, but not the warranty in Section 2B-401, are disclaimed by expressions like “as is” or “with all faults” or other language that in common understanding call the licensee's attention to the disclaimer of warranties and makes plain that there are no implied warranties.

(d) When the licensee before entering into the contract has examined the information or the sample or model as fully as it desired or it has refused to examine the information, there is no

implied warranty with regard to defects which an examination ought in the circumstances to have revealed to the licensee.

(e) An implied warranty can also be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(f) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer or modification which complies with this section is effective with respect to all performances under the contract.

(g) Remedies for breach of warranty may be limited in accordance with this article.

Uniform Law Source: Section 2A-214. Revised.

Definitional Cross References.

"Computer program": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Mass-market license": Section 2B-102. "Record": Section 2B-102.

Reporter's Note:

1. *General Structure and Policy.* This section brings together various rules relating to the disclaimer of warranties, except for the statutory warranties under Section 2B-401. The general approach corresponds to existing Article 2 and Article 2A. This article does not alter consumer protection statutes which in some states preclude disclaimer of warranties in consumer cases. See Section 2B-105. With respect to implied warranties, this section follows fundamental policies of U.S. law which recognize that parties may disclaim or limit warranties. Implied warranties are default rules whose contractual disclaimer and limitation is integral to the contract choice paradigm under which commerce occurs and to the ability of a party to control the risk it elects to undertake.

2. *Express Warranties.* Subsection (a) restates original Article 2. It uses modern language of "disclaimer" and "modification," rather than prior Article 2 language, without substantive change. General language of disclaimer cannot alter or avoid express warranties. While courts should construe contract terms of disclaimer and language of express warranty as consistent with each other whenever reasonable, in cases of inconsistency, the express warranty language controls. In effect, express warranties cannot be disclaimed, but as always, the parties' agreement controls. For example, the language of the agreement, including language styled as a disclaimer, may indicate that a purported warranty did not in fact become part of the basis of the bargain and is not, therefore, an express warranty.

Express warranties arise in various ways, including by description of the information itself. Since they cannot be disclaimed, express product descriptions are an important balance in contracts that comprehensively disclaim all implied warranties. The information must conform to its express description. A word processing system for a particular computer system that is delivered with a disclaimer of all implied warranties, must still meet the express warranty describing it as a "word processing" program for a particular type of hardware. However, that goes less to quality of the program than to the fact of the program if without content being a program.

While express warranties survive general disclaimers, the licensor is protected against unfounded claims of oral express warranties by the provisions of this article on parol and extrinsic evidence and the terms of its contract, and against unauthorized representations by the law of agency. Remedies for breach of an express warranty are dealt with in other sections of this article and may be modified in accordance with this article.

3. *Disclaimers and Fraud.* This article does not alter the law of fraud. In some cases, liability for fraud may arise despite the presence of a general disclaimer of warranties. Thus, if the licensor makes an intentional misrepresentation of an existing material fact on which the licensee reasonably relied, it may be liable for fraud even though such disclaimer eliminates contractual warranty liability. A failure to disclose known material problems in a product being provided pursuant to a license may constitute fraud if an obligation to disclose arises under that law.

The court's discussion in *Strand v. Librascope, Inc.*, 197 F. Supp. 743 (E.D. Mich. 1961) illustrates one such circumstance. While general disclaimers do not foreclose liability for intentional fraud in most states, disclaimers or other denials of obligation specific to the particular facts may foreclose a claim in fraud because they eliminate the element of fraud that requires reasonable reliance on a material misrepresentation.

4. *Disclaimer of Implied Warranties in a Record.* Subsection (b) brings together various provisions on disclaimer of implied warranties. These rules are subject to the provisions of subsections (c), (d) and (e).

a. When a Record is Required. This article follows original Article 2. Disclaimer of the implied warranty of merchantability is not required to be in a record, nor is a disclaimer of a warranty in Section 2B-404 required to be in a record. However, as in original Article 2, the rule is different for disclaimer of the "fitness" warranty. This must be in a record, except in cases governed by subsections (c), (d) or (e).

b. Merchantability and Accuracy Warranties. Under subsection (b)(1), to disclaim the warranty of merchantability or accuracy of data, the disclaimer must mention merchantability or accuracy, or use words of similar import. Use of the specific term "merchantability" is allowed, but not required. The use of alternative words, of course, must in fact communicate the nature of the disclaimer. The other language suffices if it reasonably achieves the purpose of clearly indicating that the warranty is not given in the particular case.

c. Conspicuousness. Subsection (b)(5) requires that if language of disclaimer is in a record, that language must be conspicuous in cases involving a mass-market license. This provides additional protection against surprise in such retail market environments. Article 2B does not require that the language be conspicuous in other types of transaction. Outside the mass market, benefits of requiring conspicuous language are off-set by the trap created for persons drafting contracts and the difficulty of reliably meeting this requirement in electronic commerce. Also, unlike what might have been expected when original Article 2 developed, implied warranties are routinely disclaimed in modern commercial transactions. Original Article 2 requires a conspicuous disclaimer only if the disclaimer is in writing.

d. Fitness Warranty. Subsection (b)(2) provides language adequate to disclaim the warranty under Section 2B-405. The language is more explicit than under Article 2, but use of the specific language is not mandatory. This language works, but other language may also be sufficient if it reasonably achieves the purpose of indicating that the warranty is not given.

e. Disclaimer of All Warranties. Subsection (b)(3) recognizes that in some cases all implied warranties are disclaimed. The subsection sets out language sufficient for this purpose. The disclaimer of all warranties using this language is, of course, subject to the requirement of a record and, in the case of mass-market transactions, the requirement that the disclaimer be conspicuous.

f. Article 2 and 2A Disclaimers. Subsection (b)(4) provides for cross-article validity of disclaimer language. The intent is to avoid requiring parties to make a priori determinations about Article 2B or Article 2 (or 2A) coverage particularly when "mixed" transactions will be increasingly common. Language adequate to disclaim a warranty under one of these articles is adequate to disclaim the equivalent warranty under Article 2B.

4. *Disclaimers of Implied Warranties By the Circumstances.* Subsections (c), (d) and (e) deal with common factual situations in which the circumstances of the transaction are in themselves sufficient to call the licensee's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

a. "As is" Disclaimers. This provision follows original Article 2. Terms such as "as is" and "with all faults" in ordinary commercial usage are understood to mean that the licensee takes the entire risk as to the quality of the information involved. The terms here are in fact merely a particular application of subsection (e) which provides for exclusion of modification of implied warranties by usage of trade. They provide an important means of conducting business in many areas of commerce. They also accommodate electronic commerce which may require in many contexts "short" or summary terms defining the contract because of limited space in records. The language need not be in a record.

b. Excluding Warranties by Inspection. Subsection (d) also follows original Article 2. Implied warranties may be excluded or modified by the circumstances where the licensee examines the information or a sample or model of it before entering into the contract. "Examination" as used in subsection (d) is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the licensor at the time of the making of the contract. Of course if the buyer discovers the defect and uses the information anyway, of if it unreasonably fails to examine the information before using it, resulting damages may be found to result from his own action rather than from a breach of warranty. It goes to the nature of the obligation undertaken by the licensor at the time of the transaction.

In order to bring the transaction within the scope of the "refused to examine" language of this subsection, it is not sufficient that the information merely be available for inspection. There must in addition be a demand or offer by the licensor that the licensee examine the information. This puts the licensee on notice that it is assuming the risk of defects which the examination ought to reveal.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they may give rise to an "express" warranty. In such case the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (a).

The particular licensee's skill and the normal method of examining information in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the licensee. However, an examination under circumstances which do not permit extensive testing would not exclude defects that could be ascertained only by such testing. A merchant licensee examining a product in its own field will be held to have assumed the risk as to all defects which a merchant in the field ought to observe, while a non-merchant licensee will be held to have assumed the risk only for such defects as an ordinary person might be expected to observe.

c. Course of Dealing, etc. Subsection (e) is from original Article 2. It permits disclaimer or other elimination of implied warranties by course of performance, course of dealing or usage of trade. It is consistent with the U.C.C. concept of practical construction of contracts established under Article 2 and continued in this article.

d. Detailed Specifications. If a licensee gives precise and complete specifications, this is a frequent circumstances by which the implied performance warranties may be excluded. The warranty of fitness will not normally apply because there is usually no reliance on the licensor. The warranty of merchantability in such a transaction must be considered in connection with Section 2B-408 on cumulation and conflict of warranties. As in Article 2, in the case of an inconsistency, the implied warranty of merchantability is displaced by any express warranty that the information will conform to the specifications. Thus, if the licensee gives detailed specification as to the information, neither the implied warranty of fitness nor the implied warranty of merchantability normally will apply unless consistent with the specifications.

SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM. A licensee that modifies a copy of a computer program, other than by using a capability of the program intended for that purpose in the ordinary course, does not invalidate any warranty regarding performance of an unmodified copy, but does invalidate any warranties, express or implied, regarding performance of the modified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to the computer program.

Definitional Cross References.
"Computer program". Section 2B-102. "Copy". Section 2B-102. "Licensee". Section 2B-102.

Reporter's Notes:

1. *Scope of Section.* This section deals with the effect of modifications in computer program code on the continued existence of performance warranties that might extend to the modified program. The rule applies only to the modified copy. If the defect existed in the unmodified copy, the modifications have no effect. Modifications other than changes made using an aspect of the program intended for that purpose eliminate any performance warranties extending to the modified copy. This applies only to warranties related to the performance of software. It does not apply to title and non-infringement warranties.

The basis for the rule in this section lies in the fact that because of the complexity of software systems, changes may cause unanticipated and uncertain results. The complexity of software means that it will often

not be possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

2. *Application.* The section voids the warranties unless the agreement indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes that are not part of the program options. 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, 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 any performance warranties as to the altered copy.

This section does not apply where the parties jointly work on development of a program, with each being authorized by the agreement to change code created by the other or created by both parties. Who constitutes the licensor in such cases is not clear, but the joint project characteristic takes the case out of this section. What warranties arise in the joint development context is determined by whose is the licensor and by the agreement of the parties, which agreement is defined and construed in light of the circumstances of the transaction, including the course of dealing and usage of trade.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if this construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(2) A sample displaces inconsistent general language of description.

(3) Express warranties displace inconsistent implied warranties other than an implied warranty under Section 2B-405(a).

Uniform Law Source: § 2-317.
Definitional Cross Reference.
"Party". Section 1-102.
Reporter's Note: This section follows original Article 2.

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

(a) Except for published informational content, a warranty to a licensee extends to persons for whose benefit the licensor intends to supply the information or informational rights and which rightfully use the information in a transaction or application of a kind in which the licensor intends the information to be used.

(b) A warranty to a consumer extends to each individual consumer in the licensee's

immediate family or household if the individual's use was reasonably expected by the licensor.

(c) A contractual term that excludes or limits third-party beneficiaries is effective to exclude or limit a contractual obligation or contract liability to third persons except individuals described in subsection (b).

(d) A disclaimer or modification of a warranty or remedy which is effective against the licensee is also effective against a third person under this section.

Definitional Cross References.

"Consumer transaction". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Published informational content". Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section utilizes third-party beneficiary concepts based on the contract law theory of "intended beneficiary" and on the *Restatement (Second) of Torts* § 552 dealing with the scope of liability to third parties for a provider of information. It expands both where they apply to uses within the household of the licensee. The section does not address products liability law, leaving that law and other forms of tort law for development by the courts.

2. *Liability to Third Parties.* Dealing with an informational content product, the California Supreme Court in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

> **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 have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.**

To impose liability under contract-related theories, the information provider must have known of and clearly intended to have an effect on third parties. This is a third party beneficiary concept and requires a conscious assumption of risk or responsibility for particular third parties. Even within that standard, courts should not be aggressive in finding the requisite intent.

All of this relates to the unique role of information in our culture and to the uniquely difficult nature of proving a causal connection between a release of information and harmful effects. The cases and this section also reflect sensitivity to the risk that placing excessive liability exposure on information providers without their express undertaking may chill the willingness of those providers to disseminate information.

3. *Product Liability Law.* This Section does not deal with products liability issues. It neither expands nor restricts tort concepts that might apply for third party risk. Article 2B leaves development or non-development of any appropriate liability doctrine to common law courts. Indeed, few courts impose third party tort liability in transactions involving information. The *Restatement (Third) on Products Liability*, recognizing this, notes that informational content is not a product for that law. The only reported cases that impose product liability on information involve air flight charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in other contexts. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. *Winter v. G. P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990).

While there may be a different policy for software embedded in tangible products, this article does not deal with embedded software. Section 2B-104. Contract issues regarding the software that operates the brakes in an automobile sold to a consumer fall within Article 2.

4. *Intended Effect Required.* 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, liability is restricted to intended third parties and those in a special relationship with the information provider. Intention requires more than that the person be within a general category of those who may use the information (.e.g., all readers). There must be a closer and more clearly known connection to the particular third party. The liability covers use in transactions that the provider of information intended to influence. The section also must be considered in light of the scope of warranties under this article which create no implied warranty of accuracy pertaining to published informational content.

Illustration: LR contracts for publication of a text on chemical interactions. Publisher obtains an express warranty that LR exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published information), nor LR (excluded under (a)) makes a warranty to a general buyer of the book.

5. *Household and Family Use.* Subsection (b) modifies intended beneficiary concepts to per se include the family of an individual, consumer licensee. This covers both personal injury and economic losses and applies to consumer use by the indicated persons. To apply, the use by the family members must be authorized under the license and the licensee must be an individual (with a family), not a corporation. The section assumes that the licensor had some reason to anticipate that the information would be used in the licensee's household. Thus, the mere fact that a household member in fact uses a commercial data compression system licensed to a professional does not extend the warranty to the individual consumer in that person's household. On the other hand, the provider of mass-market word processing software might reasonably expect acquisition of it for use of the software at home. Ordinarily, for this rule to apply, the software must be provided in a consumer transaction or be such as is commonly used for consumer purposes.

6. *Limitation by Contract.* The policy adopted here focuses on the information provider's original intent with respect to third parties. Subsections (c) and (d) flow from the fact that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. This follows current law. *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993) applied a variation of this rule in the case of an information product.

PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF INFORMATIONAL RIGHTS AND TITLE TO COPIES.

(a) If an agreement provides for conveyance of ownership of informational rights in software, ownership passes at the time and place specified by the agreement. In the absence of such specification ownership passes when the information and the informational rights are in existence and identified to the contract.

(b) The following rules apply to copies:

(1) Transfer of a copy does not transfer ownership of informational rights.

(2) In a license:

(A) title to a copy is determined by the license;

(B) a licensee's right under the license to possession or control of a copy is governed by the license and does not depend on title to the copy; and

(C) if a licensor reserves title to a copy, the licensor retains title to that copy and has title to any copies made of it, unless the license grants the licensee a right to make and transfer copies to others, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(c) If an agreement provides for transfer of title to a copy, title passes:

(1) at the time and place specified in the contract; or

(2) in the absence of such specification:

(A) at the time and place the licensor completed its obligations with respect to delivery of a copy on a tangible medium; and

(B) at the time and place at which the licensor completed its obligations with respect to electronic delivery of a copy if a first sale occurs under federal copyright law.

(d) If the party to which ownership or title passes under the contract refuses delivery of the copy or rejects the terms of the contract, ownership and title revest in the licensor.

Uniform Law Source: Section 2-401; Section 2A-302. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Identified": Section 2-501. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Sale": Section 2B-102. "Transfer". Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with both transfers of ownership of intellectual property rights and transfers of title to a copy. As a general rule, most transfers of ownership of rights are not within this article. The treatment of the issue here deals primarily with transfers of ownership under a software contract.

2. *Copy vs. Rights Ownership.* This section distinguishes title to the copy from ownership of the intellectual property rights. The distinction is fundamental in all intellectual property law and flows from the Copyright Act and other law. It is acknowledged in paragraph (b)(1). While ownership of a copy may transfer some rights with respect to that copy, it does not convey underlying property rights to the work of authorship or patented invention. The media is merely the conduit. Subsection (a) deals with the timing of a transfer of ownership of

informational rights. The remaining subsections of this section deal with ownership of copies.

3. *Rights Ownership.* 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 informational rights (as compared to title to a copy). If federal law requires a writing for this, state law is subject to that rule. Section 2B-105. The subsection reverses the rule in *In re Amica,* 135 Bankr. 534 (Bankr. N.D. Ill. 1992) which delayed transfer of rights ownership until actual delivery of the completed work..

The agreement of the parties controls when ownership of rights pass to the other party. That agreement may be found in express terms of the contract or be inferred from usage of trade, course of dealing, or the circumstances of the particular transaction. In the absence of terms of that agreement, transfer of ownership does not hinge on delivery of a copy. Rather, it occurs on identification to the contract of the information and the rights involved. This includes both completion to a sufficient level that separates the transferred property from other property of the transferor and designation by the transferor that the particular property is that which is transferred under the contract. This does not include early drafts or working copies. *In re Bedford Computer,* 62 Bankr. 555 (D.N.H. 1986) provides guidance on identifying information to a contract. More generally, the concept of identification to the contract is used here as in Article 2 on sale of goods.

While identification to the contract controls when ownership of rights passes in the absence of contrary agreement, when that transfer is effective between the parties ultimately depends on their agreement. In many cases, the agreement is that title does not vest until the transferee performs all of its obligations due at or before that time. In such cases, a transferee's material failure to perform an obligation to pay or provide other consideration due precludes the transfer until those obligations are met. In other cases, performance is reasonably viewed as an agreed condition precedent to the vesting of title in the transferee. If payment or other consideration is deferred until after title vests, however, a court may conclude that it was not a condition precedent to the transfer of title under the agreement.

4. *Ownership of a Copy.* Paragraph (b)(2) applies only to licenses. In a license, title to the copy depends on the terms of the agreement. As in Article 2A, this article does not presume a transfer of title on delivery. The license controls. If the license is silent, determination of intent on whether title to a copy passes to the licensee may require consideration of the entire terms and context of the transaction. *Applied Information Management, Inc. v. Icart*, 976 F. Supp. 147 (E.D.N.Y. March 3, 1997); *DSC Communications Corp. v. Pulse Communications, Inc.*, 976 F. Supp. 359 (E.D. Va. 1997).

Under subsection (b)(2)(C), a reservation of title in a copy extends that reservation to all copies made by the licensee. That presumption is altered if the transaction contemplates that the licensee will make copies for sale or other distribution. Thus, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all of the books. This concept does not apply where the expectation is that the licensee will transfer copies to others subject to a license.

5. *When Title to a Copy Passes.* Subsection (c) deals only with contracts where the parties agreed to transfer title to a copy, whether in a license or a simple sale of a copy. The subsection states presumptions relating to when title passes to copies. The contract controls. Absent contract terms, the section distinguishes between tangible and electronic transfers. The rule for tangible transfers of a physical copy parallels original Article 2. Title transfers when the licensor completes its obligations regarding delivery, which obligation are spelled out in Section 2B-607 and 2B-60A which define the time and place of tender of delivery. The electronic transfer rule defers to federal law. Some argue that 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. Under subsection (c), state law will coordinate with the resolution of that issue in federal law. Article 2B takes a neutral position.

If there was no intent to transfer title to a copy, title remains in the transferor. While the focus of the transaction is the information and its use, the transaction then resembles a lease as to the tangible property. Under subsection (b), however, the location of title to the copy has only limited significance for contract law purposes if a license controls the use of the information and the copy.

SECTION 2B-502. TRANSFERS OF CONTRACTUAL INTERESTS. The following rules apply to transfers of contractual interests:

(1) A party's interest in a contract may be transferred unless the transfer:

(A) is prohibited under other applicable law; or

(B) would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.

(2) Except as otherwise provided in paragraph (3), a term prohibiting transfer of a party's interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ineffective except to the extent that the contract is a license granted for incorporation or use of the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance and the transfer is of the completed combined work.

(3) A contractual term prohibiting transfer of the right to payment is unenforceable unless the transfer would be prohibited under paragraph (1). A prohibited transfer is a breach of contract and ineffective.

Uniform Law Source: Section 2-210; Section 2A-303.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Transfer". Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section deals with transfers of contractual interests. It relates both to transferability in the absence of a contract term and the effect of a contract term prohibiting or limiting transfer of the contract rights. Transfer issues pertaining to security interests and finance leases is considered in Section 2B-503. In this section, and other sections of Part 5, the word "transfer" refers to what in many contexts is described as an "assignment of a contract." The term here does not refer to a "transfer of a copyright" or similar intellectual property interest. It does not refer to delegation of performance under a license. Delegation occurs when a third party performs the duties or rights of the licensee, while transfer (assignment) involves conveying those contract rights to the third party.

2. *Transferability in the Absence of Contract Restrictions.* In contracts for information, transferability involves different background policy and property considerations than with contracts for the sale of goods. While the general state law rule is that a contract right can be transferred, in reference to licenses, transfer is often not permitted in the absence of the consent of the other party to the contract. The reasons lie in the fact that much of the information involved has elements of confidentiality that foreclose non-consensual transfers because the transfer jeopardizes the other party's interests. Additionally, the nature of the property involved and the ease of its reproduction may lead to a similar conclusion even in the absence of truly confidential information. More generally, given the intangible nature of the property, allowing free transferability may in effect place a licensee in

direct competition with the licensor as a source of the information.

a. Federal Policy and Other Law. Paragraph (1) recognizes two limitations on the rule that, when the agreement is silent, transfer of contract rights may be made without consent of the other party to the contract. The first is when other law prevents transfer. In licensing, the other source of law often comes from a federal intellectual property policy that precludes transfer of a non-exclusive copyright or patent license without the consent of the licensor. *Everex Systems, Inc. v. Cadtrak Corp.,* 89 F.3d 673 (9th Cir. 1996); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984); *Unarco Indus., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303 (7th Cir. 1972); *In re Patient Education Media, Inc.,* 210 B.R. 237 (Bankr. S.D.N.Y. 1997); *In re Alltech Plastics, Inc.,* 71 Bankr. 686 (Bankr. W. D. Tenn. 1987).

This federal policy on non-exclusive licenses preempts contrary state law. Section 2B-105. This policy flows in part from the fact that a nonexclusive license is a personal contractual privilege that does not create a property interest. It is also embedded in federal policies of encouraging innovation. The Ninth Circuit explained this in the following terms:

> Allowing 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.… As a practical matter, [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.

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

b. Material Harm to Other Party. The second restriction on transferability in the absence of a contractual restriction holds that the contract cannot be transferred without consent if the transfer would significantly affect the other party's position in the contract or expectation of performance. This result is often associated with cases in which the transfer occurs by a party owing executory or on-going performance obligations and the transfer either purports to shift that performance obligation to a third party or otherwise undermines its occurrence. For example, a transfer of contractual rights under which the transferee holds and has use of trade secret information of the other party will ordinarily be barred because it would place that information in the hands of another person to which the licensor never agreed. Similarly, a transfer that places the information in the hands of a person who will engage in far greater commercial or other use may be precluded if a license for such greater use would ordinarily have required additional terms or additional consideration.

Material harm should be interpreted here in light of the commercial context and the original expectations of the contracting parties. The issue is not only whether there will be actual harm to the other party, but whether there is a material impairment of its expectation of return performance. The federal policies noted above are also relevant. Also, as noted in Article 2A, "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Section 2A-303, *Comment* 3. Licensors similarly have residual interests in the information they have licensed to a third party.

In addition to the preclusion of transfers that cause material harm, a transfer may be cause for insecurity and a demand for assurance of future performance. Section 2B-504.

3. *Contractual Restrictions.* Subsection (2) validates contractual restrictions on transfer of a contractual interest. This is consistent with both the underlying theme of this article recognizing contractual choice and with the importance of the retained interest of the licensor in a license arrangement. A transfer in violation of the contract restriction is ineffective. This rule parallels that for unauthorized transfers in copyright and patent law. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994); *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).

The rule renders a transfer ineffective, rather than merely a breach, because of the important interests involved in the licensor's position in a license. "Ineffective" means that it creates no contractual rights or privileges in respect to the relationship of the third party and the party to the original license. If the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), there would be a significant period of time in which the transferee would be protected by the license before it could be canceled in litigation against the licensee. For example, assume a license for $5,000 that allows licensee (ABC, a small company) to make as many copies as needed for use in the licensee's enterprise for employees. ABC has ten employees and the license is expressly not transferable. ABC transfers the license to AT&T, a much larger company with 50,000 employees. If

it had requested an enterprise license, the fee would have been $10,000,000. If the transfer is merely a breach, ATT may be licensed to make as many copies as it needs for its (as licensee) employees. Until licensor sues and obtains cancellation of the license against ABC, all copies made are non-infringing. In contrast, a rule making the prohibited transfer ineffective preserves the original bargain of the parties and precludes the licensee from going into competition with its licensor, having obtained a license based on the lower use promise associated with the original licensee. See Section 2B-306(a).

Illustration N licenses its copyrighted software to various licensees, but refuses to license to M, its chief competitor. One license is from N to LE. After the license, M acquires all of the assets of LE. If the transfer of the license is effective, M has indirectly obtained access to potentially valuable technology of its competitor, which it can use until a contract breach remedy precludes use. If the transfer is ineffective, as in this article, M obtains no greater rights in this license than are allowed under informational rights law.

If information is not protected under copyright, trademark, or patent law, the fact that the transfer is ineffective does not expose the transferee to greater liability. Thus, in trade secret law, a good faith transferee without notice may have a right to use information it receives in violation of trust. That rule is not changed by the contract rule stated here. The rule making the transfer ineffective merely indicates that the transferee does not receive contractual rights because of the transfer.

4. *Financing party Interests.* As provided in Section 2B-503, a contract restriction on transfer is not fully enforceable with respect to creation of some financing arrangements.

5. *Payment Streams.* Subsection (3) allows transfer of payment streams despite a contrary contractual provision unless the transfer of the payment stream would make a material change of the other party's position and therefor be precluded under subsection (1). In cases where Article 9 applies, this leaves unaffected the Article 9 rule that, in itself, the contract term cannot preclude such transfer, while also preserving the underlying rule of law that precludes transfers that materially harm the other party.

SECTION 2B-503. [deleted – 11/98]

SECTION 2B-504. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

(a) A transfer of "the contract" or of "all my rights under the contract", or a transfer in similar general terms, is a transfer of all contractual rights. Whether the transfer is effective is determined under Section 2B-502.

(b) The following rules apply to a transfer of a party's contractual rights:

(1) The transferee is subject to all contractual use restrictions.

(2) Unless the language or circumstances otherwise indicate, as in a transfer as security, the transfer delegates the duties of the transferor and transfers its rights, subject to Section 2B-505.

(3) Acceptance of the transfer constitutes a promise by the transferee to perform the delegated duties. The promise is enforceable by the transferor and any other party to the original contract.

(4) The transfer does not relieve the transferor of any duty to perform, or of liability for breach of contract, unless the other party to the original contract agrees that the transfer has that effect.

(c) A party to the original contract other than the transferor may treat a transfer that delegates performance without its consent as creating reasonable grounds for insecurity and, without prejudice to the party's rights against the transferor, may demand assurances from the transferee pursuant to Section 2B-620.

Uniform Law Source: 2-210; 2A-303.

Definitional Cross References.

"Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Transfer": Section 2B-102. "Term". Section 1-201.

Reporter's Note:

1. *Scope and Effect of Section.* This section conforms to original Section 2-210(4) and Article 2A. It outlines the effect of a transfer of contract rights. This section is not a complete statement of the law on assignment and delegation. Issues not addressed here are dealt with under other law.

2. *Subject to Contract Terms.* The transferee of a contract is bound by the terms of the original contract and that obligation can be enforced either by the transferor or the other party to the original contract. An effective transfer of contractual rights constitutes a transfer of those rights and, unless the agreement or the circumstances otherwise indicate, a delegation of duties. The transferee, by accepting the transfer, promises to perform any delegated duties.

3. *Transfers in General and for Security.* Subsection (b)(2) states a general rule of construction distinguishing between a commercial assignment of a contract, which substitutes the transferee for the assignor both as to rights and duties, and a financing assignment in which only the transferor's rights are conveyed. When the latter occurs and is effective, Article 9 deals with questions about the on-going ability of the original contracting parties to make ordinary adjustments in the original contract without consent of the financing entity.

4. *Assurances.* Subsection (c) recognizes that the non-transferring party has a stake in the reliability of the person to whom the contract is transferred. In part, that stake is protected under Section 2B-502. Subsection (c) also gives the non-transferring party a right to demand adequate assurances of future performance and to proceed under Section 2B-620 to protect its interest in performance of the contract.

5. *Effect on Transferor's Obligations.* Paragraph (b)(4) follows current law providing that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent by that party to a novation.

SECTION 2B-505. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may perform its contractual duties through a delegate or pursuant to a subcontract unless:

(1) the contract prohibits delegation or subcontracting; or

(2) the other party has a substantial interest in having the original promissor

perform or control the performance.

(b) Delegating or subcontracting performance does not relieve the party delegating or subcontracting the performance of a duty to perform or of liability for breach.

Uniform Law Source: Section 2-210; Section 2A-303.
Definitional Cross References.
"Contract": Section 1-201. "Party": Section 2B-102.
Reporter's Notes:

1. *Nature of Delegation.* Delegation or subcontracting of performance exists when a party to the original contract uses a third party to make an affirmative performance under a contract. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. *Effect of Contract.* The ability to delegate is subject to contrary agreement. A contract that permits use or creation of licensed information only by a named person or entity controls and precludes delegation.

3. *Delegation in the Absence of a Contract Restriction.* In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original party perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions in 2B-502, but may also have such an interest in other cases. Delegation is permitted, however, where no substantial reasons exist to believe that the delegated performance will not be as satisfactory as performance by the original party.

SECTION 2B-506. PRIORITY OF TRANSFER BY LICENSOR.

A licensor's transfer of ownership of informational rights is subject to any enforceable nonexclusive license that is made prior to the transfer.

Uniform Law Source: Section 2A-304. Revised.
Definitional Cross References:
"Authenticate": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Record": Section 2B-102. "Transfer": Section 2B-102.
Reporter's Note:

1. *Background.* This area is heavily influenced by federal copyright law as to copyright interests. This section traces that influence while providing maximum state law recognition for traditional U.C.C. priorities. As to transfers of ownership of copyrights or patents by assignment or exclusive license, federal law controls. Federal law may also control the priority between security interests and ownership transfers or the priority among security interests in intellectual property under copyright or patent law. There is no preemption with respect to transfers of data, trade secrets and other non-federal property rights. This Section deals with general priorities.

2. *Prior Oral Licenses.* This Section gives priority to a prior license that is enforceable, including enforceability under the statute of frauds in 2B-201. This parallels copyright law but is not an exact match to the policies in that federal law, which require a signed writing to give priority to an non-exclusive license over a subsequent transfer of the copyright. This creates a state law priority system with reference to the coverage allowed to state law. The rule governs as to data, access contracts, trade secrets and other information not within the Copyright Act. The Copyright Act gives priority only if a license is in a signed writing. To the extent inconsistent with this section, that rule governs with respect to copyright interests. Section 2B-105. There are currently no decisions on whether an electronic record or authentication qualify under the copyright standard. However, the copyright rule should be applied in light of modern technology treating an electronic record as being sufficient to be a writing.

3. *Preemption Issues.* For rights not created under federal law, priority issues are questions of state law. The same is true for non-ownership rights in patent licenses. The situation is different in copyright law. Section 205(f) of the Copyright Act provides that a non-exclusive license prevails "over a conflicting transfer of

copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights" and was taken before the transfer of ownership or in good faith before recordation of the transfer and without notice of it. 17 U.S.C. § 205(f). There is no case law on this provision.

This provision of the Copyright Act can be viewed either as a comprehensive rule of priority (e.g., non-exclusive license that is not in a signed writing is never superior to transfer of ownership; priority of a written license entirely controlled by Section 205(f)), or as a minimum condition for a particular result (e.g., that a nonexclusive license in a signed writing has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This Article adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, a nonexclusive license prevails in the listed situations, but the priority of a nonexclusive license in cases not covered by Section 205 is not controlled by federal law.

SECTION 2B-507. TRANSFER BY LICENSEE.

(a) If all or any part of a licensee's interest in a license is transferred, voluntarily or involuntarily, the transferee acquires no interest in information, copies, or the contractual or informational rights of the licensee unless the transfer is permitted under Section 2B-502. If the transfer is effective, the transferee takes subject to the terms of the license.

(b) Except as otherwise provided under trade secret law, a transferee that acquires information or informational rights that are subject to the informational rights and contractual use restrictions of a third party acquires no more than the contractual or other rights its transferor was authorized to transfer.

Uniform Law Source: Section 2A-305

Definitional Cross References.

"Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2B-102. "Transfer". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

1. *Transferee Interests.* Subsection (a) provides that a transferee of the license acquires only the rights that the license and this article allow. This reflects the simple fact that what is transferred is the contract and that the transfer cannot change contractual rights. This principle holds true even if the transfer includes the tangible manifestations of the information that is subject to the license.

2. *Transfers and Underlying Property Rights.* Subsection (b) provides that the transferee of a licensee acquires only those rights that the licensee was authorized to transfer. This is an important principle under intellectual property law which differs from transactions involving sales of goods. It comes from the fact that one of the property rights created under copyright law is the exclusive right to distribute a work in copies. A transferee who receives a transfer not authorized by the rights holder does not acquire greater rights than its transferor was authorized to transfer, even if the acquisition was in good faith and without knowledge. The basic fact is that, as regards property rights, the transfer if unauthorized was itself a violation of the property rights of the copyright owner. Ideas of entrustment and bona fide purchase, which play a role in dealing with title to goods, have no similar role in intellectual property law. Neither copyright nor patent recognize concepts of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred. Copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, but the first sale must be authorized.

Section 2B-503 creates a limited exception to this rule with respect to the creation and perfection of a security interest. But, as described in that section, this exception does not permit taking possession or

enforcement of the interest. Also, the interest created is subject to the license terms.

Transfers that exceed or are otherwise unlicensed 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 and its use is likely to constitute infringement. See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994); *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).

3. *Trade Secret and Unprotected Information.* Subsection (b) allows a bona fide purchaser in reference to trade secret claims. These are state law property rights. A trade secret enforces confidentiality. If a party takes without notice of such restrictions, it is not bound by them; it is in effect a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

PART 6

PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) Except as otherwise provided in subsection (c), tender of performance by a party entitles that party to acceptance of that performance. In addition, the following rules apply:

(1) A tender of performance occurs when the party, with manifest present ability and willingness to perform, offers to complete the performance.

(2) If a performance by the other party is due at the time of the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete its tendered performance.

(3) A party shall pay or render the consideration required by the agreement for a performance it accepts. A party that accepts a performance has the burden of proving a breach with respect to the accepted performance.

(c) If there is an uncured material breach of contract one party which precedes the aggrieved party's performance, the aggrieved party does not have a duty to perform other than with respect to contractual use restrictions. In addition, the following rules apply:

(1) An aggrieved party may refuse a performance that is a material breach as to

that performance or that may be refused under Section 2B-609(b).

(2) The aggrieved party may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides.

(d) Except as otherwise provided in Sections 2B-603 and 2B-604, in the case of a performance with respect to a copy, Sections 2B-606 through 2B-614 prevail over this section.

Uniform Law Source: Restatement (Second) of Contracts § 237. Substantially revised.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Party": Section 2B-102.

Reporter's Notes:

1. *General Approach.* This section brings together several general principles pertaining to performance of a contract. The provisions of this section are supplanted by more specific sections on tender and acceptance (or refusal) of copies as indicated in subsection (d). The general approach follows the *Restatement (Second) of Contracts* and common law using the concept of material breach to determine what remedies arise for an aggrieved party other than in the mass market where a standard of conforming tender applies. The characteristics of this particular subject matter often involves a continuing performance, rather than a single delivery and the nature of the product is such that the advancement of the state of the technology involves continuingly pushing the edge.

A program for small computers may contain over ten million lines of code or instructions. These instructions interact with each other and with code and operations of other programs. This contrasts with a commercial jet airliner popular with approximately six million parts and typical consumer goods with fewer than one hundred parts. A typical book has fewer than one hundred fifty thousand words. In the software environment, it is virtually impossible to produce software of complexity that contains no errors in instructions that intermittently cause the program to malfunction.

2. *Duty to Conform: Material Breach.* A party must conform to its contract. Any failure to conform gives the aggrieved party a right to a remedy subject to concepts of waiver and the agreement. What remedies are available depends on the agreement and, in absence of agreement, on whether the breach was material. Subsection (c) adopts the common law doctrine of material breach. A party's duty to perform is contingent on the absence of a prior material failure of performance by the other party. See *Restatement (Second) of Contracts* § 237.

The material breach concept is simple: a minor defect in performance does not warrant rejection or cancellation of a contract. While minor problems constitute a breach, the remedy lies in recovery or recoupment of damages. The policy avoids forfeiture for small errors. Especially if performance involves ongoing activity, perfect performance cannot be expected as a default rule. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. The material breach standard applies to the performance of both the licensor and the licensee. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem, nor can the licensee that receives less than perfect performance from the licensor.

The contingent relationship described in subsection (c) does not refer to contractual use restrictions. A breach by one party does not allow the other party to ignore contract restrictions on use. This is true even if the aggrieved party has a duty to mitigate loss. Contractual use restrictions limit any duty to mitigate; they define what the party can do in use of the information. A breach by the licensor does not give the licensee unfettered rights to act in derogation of use restrictions that are often buttressed by intellectual property rights.

3. *Material Breach: Mass Market.* As described in Section 2B-609(b), Article 2B does not apply the material breach standard to mass-market transactions involving tender of delivery of a copy other than in an installment contract setting. This follows Article 2 and Article 2A. Article 2 and Article 2A stand alone in modern contract law in not using the material breach concept for all contracts that they cover. Article 2 requires so-called "perfect tender", but does so in only a single fact situation: a single delivery of goods not part of an installment contract. Article 2B creates a parallel rule for single delivery mass-market transactions. As in Article 2, the rule applies only to tender of a copy that is the vendor's sole performance. Additionally, the "perfect tender" rule is a misnomer even in Article 2. It is better described as a "conforming tender" rule. What constitutes a conforming

tender even in a single delivery context is hemmed in by legal considerations regarding merchantability, and interpretation principles including usage of trade and course of performance. It is further limited by principles of waiver and a right to cure. As one leading treatise comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ."

4. *Duty to Accept and Tender.* Subsection (b) brings together general rules from the Restatement and current Article 2 regarding the presumed sequence of performance. It is subject to the more specific rules on tender and acceptance of copies in sections 2B-606 through 2B-614. The primary principle is that tender of performance entitles the tendering party to acceptance of that performance. The rule is stated in general terms here. Of course, if the tendered performance is a material breach, the party receiving the tender is not required to perform.

5. *Refusing a Performance and Cancellation.* An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. That distinction is more central in Article 2B than in Article 2 because of the nature of the contracts involved.

A party may refuse a performance if the performance fails to conform to the contract and consists of a material breach as to that performance. Whether that breach also allows the party to cancel the entire contract depends on whether the breach is material to the entire contractual relationship. In contracts where the entire performance is delivery of a single copy, a right to refuse the copy corresponds to the right to cancel the contract. In more complex situations, a single breach may not be material to the whole agreement. Thus, for example, a payment that is one-half the required amount is a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the agreement.

SECTION 2B-602. LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) In this section, "enable use" means to grant a contractual right or permission with respect to information or informational rights and to complete the acts, if any, required under the agreement to make the information available to a party.

(b) A licensor shall enable use by the licensee pursuant to the contract. The following rules apply to enabling use:

(1) If nothing other than the grant of a contractual right or permission is required to enable use, the licensor enables use when the contract becomes enforceable.

(2) If the agreement requires delivery of a copy, enabling use occurs when the copy is delivered. If the agreement requires delivery of a copy and steps authorizing the licensee's use, enabling use occurs when the last of those occurs.

(3) In an access contract, to enable use requires providing all access material necessary to obtain the agreed access.

(4) If the agreement requires a transfer of ownership of informational rights and a filing or recording is allowed by law to establish priority of the transferred ownership, on request

by the licensee, the licensor shall execute and deliver a record for that purpose.

Definitional Cross Reference:
"Access contract": Section 2B-102. "Access material": Section 2B-102. "Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102.

Reporter's Notes:

1. *Scope of Section.* This section defines the licensor's obligation to enable use of the information or access that it provides to the licensee. The term, "enable use," replaces the Article 2 idea of tender of delivery of goods. In information contracts, the licensor may or may not be required to deliver anything. In some cases, it suffices to authorize use of information the licensee obtained from other sources. The licensor's obligation depends on the agreement, but in most commercial cases it consists of two elements: making the information available (if necessary) and giving authority or permission to use the information. The alternatives in subsection (b) conform to that dual requirement.

2. *No Acts Required.* Paragraph (b)(1) recognizes that in many cases mere authorization of a right to use or access information suffices to enable use. Such cases include, for example, circumstances in which a publisher is already in possession of a photograph that it desires to use in a digital multi-media work, but must obtain permission to do so from the photographer who holds the copyright. Similar circumstances frequently arise throughout the information industries. In such cases, the creation of an effective license contract suffices to enable use.

3. *Recording Information.* If the agreement involves a transfer of ownership of informational property rights and a filing or other recording is needed to complete that transfer so as to have priority over other transfers, subsection (b)(4) indicates that the licensor must cooperate in completing that recording.

SECTION 2B-603. SUBMISSIONS OF INFORMATION TO THE SATISFACTION OF A PARTY. If a party submits information pursuant to an agreement that requires that the information be to the satisfaction of the recipient, the following rules apply:

(1) Sections 2B-606 through 2B-614 do not apply to the submission.

(2) If the information is not satisfactory to the recipient and the parties engage in efforts to correct the deficiencies in a manner and over a time consistent with the ordinary standards of the business, trade, or industry, the efforts or the passage of time required for the effort are neither an acceptance nor refusal of the submission.

(3) Except as provided in paragraph (4). neither refusal nor acceptance occurs unless the recipient expressly refuses or accepts the submission, but the recipient is not entitled to use the submission before acceptance.

(4) Silence and a failure to act in reference to a submission beyond a commercially reasonable time to respond entitles the submitting party to demand in a record delivered to the

recipient a decision on the submission. If the recipient fails to respond within a reasonable time after receipt of the demand, the submission is treated as having been refused.

Definitional Cross References.
"Agreement": Section 1-201. "Party": Section 2B-102.

Reporter's Notes:

1. *General Purpose.* This section deals with situations where Article 2 rules on tender, acceptance and rejection of goods are not appropriate because the agreement calls for submissions of informational content to the satisfaction of the receiving party. Section 2B-305. The section excludes sale of goods standards in such cases, and focuses on practices of industry.

2. *Tender-acceptance of Copy Not Applicable.* Paragraph (1) indicates that rules related to the tender and acceptance of copies do not apply where the information is submitted under terms that provide for approval to the satisfaction of the licensee or other person. In goods-related transactions, the focus is on making decisions about the particular item presented. In information transactions of the type described here, the submission triggers a process that centers around the fact that the recipient has the right to refuse if the submission does not satisfy its expectations, but that immediate acceptance or rejection is often not expected. A process of revision and tailoring occurs. This corresponds to ordinary commercial expectations in these fields, which includes handling of submitted book manuscripts, games, and similar materials.

3. *Express Choices.* In cases involving information submitted to the recipient's satisfaction, acceptance or rejection is not implied from delay and silence alone. Consistent with ordinary practices, subsection (3) makes it clear that only an explicit refusal or acceptance satisfies the standard of acceptance or refusal in this setting since the circumstances are keyed to the subjective satisfaction of the receiving party. The paragraph also makes clear that, until acceptance, the recipient cannot "use" the submitted information. This refers to commercial or other exploitation and does not, of course, prevent use for the purpose of reviewed, correcting, or otherwise adjusting the information to meet the recipient's satisfaction.

4. *Demand for Decision.* Generally, under paragraph 3, express choices supplant rules that might operate from silence in not refusing or from delays in submitting changes. However, paragraph (4) recognizes that in some cases and extraordinary delay in responding in any manner creates rights in the submitting party to obtain a firm answer. What constitutes sufficient delay for this purpose must, of course, be judged in reference to ordinary commercial standards associated with the applicable context.

5. *Other Remedies.* This section deals with contract issues only. If the person receiving a submission does not enter a contract for that information, but misuses the submission, other law provides remedies when appropriate. These include liability under concepts of quantum meruit, fraud, conversion and the like as appropriate to the circumstances. The continued development of law under these non-contractual theories is not affected by this article.

SECTION 2B-604. IMMEDIATELY COMPLETED PERFORMANCES. If a performance involves delivery of information or services covered by this article that , because of their nature, may immediately provide a licensee with substantially all the benefit of the performance or with other significant benefit on performance or delivery that cannot be returned after received, the following rules apply:

(1) Sections 2B-607 through 2B-614 do not apply.

(2) The rights of the parties are determined under Section 2B-601 and the ordinary standards of the business, trade, or industry.

(3) Before tender of the performance, a party may inspect the media, labels or packaging but may not view the information or otherwise receive the performance before completing any performance of its own that is then due.

Definitional Cross Reference:
"Agreement": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2B-102.

Reporter's Notes:

1. *Scope of Section.* This section deals with subject matter that is, in effect, fully received when made available to, viewed by, or read by the transferee. In reference to this subject matter, concepts of inspection, rejection and return from the law of the sale of goods cannot apply. The section leaves the parties to the general rules of Section 2B-601 which incorporate common law. This section applies, for example, in a case where the licensed subject matter is a short song licensed for a single performance. Once performed, the subject matter cannot be returned; inspection prior to acceptance is not a relevant standard. This is true, for example, in a disclosure of a valuable fact known to one party, but not to the other. The subject matter of the contract involves informational content that, once seen, has in effect communicated significant value.

2. *Inspection not Permitted.* In these transactions merely viewing or receiving the information transfers significant value to the licensee which cannot be returned. Given that fact, subsection (3) clarifies that inspection rights are limited to media and packaging. A person that joins a fee-based celebrity chat room cannot participate before deciding whether to accept or not accept it. The participation itself transfers the value and that value cannot be returned. A person licensing the formula for Coca Cola cannot read and potentially memorize the formula before being bound to the contract and its performance under the contract.

SECTION 2B-605. WAIVER OF REMEDY FOR BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record to which the party agrees after breach, by manifesting assent or otherwise.

(b) A party that accepts a performance with knowledge that the performance constitutes a breach and that fails within a reasonable time after acceptance to notify the other party of the breach, waives all remedies for the breach unless acceptance was made on the reasonable assumption that the breach would be cured and it has not been seasonably cured.

(c) Except for performance that are to be to its satisfaction, a party that refuses a performance and fails to identify in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on that defect to justify refusal if:

(1) the other party could have cured the defect if it had been identified seasonably; or

(2) between merchants, the other party after refusal 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) Waiver of a remedy for breach of contract in one performance does not waive any remedy for the same or a similar breach in future performances unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance will be required in the future, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by that party.

Definitional Cross Reference:
"Contract": Section 1-201. "Manifest assent": Section 2B-111. "Merchant": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 1-201. "Receive": Section 2B-102. "Record": Section 2B-102. "Term". Section 1-201. "Seasonable": Section 1-204.
Uniform Law Sources: Section 2A-107; Section 2-605
Reporter's Notes:

1. *Scope of the Section.* "Waiver" is the voluntary relinquishment of a known right. Conduct or words may create a waiver. This section brings together rules from various sections of original Article 2 dealing with waiver issues and recasts those rules to fit the variety of performances in Article 2B transactions. The section also adopts principles from common law.

2 *Waivers in a Record.* Subsection (a) follows Section 2A-107. Waivers in a record are enforceable without consideration. See *Restatement (Second) of Contracts* § 277. Subsection (a) does not preclude other forms of waiver, but confirms that waivers within its provisions are effective. For example, an oral waiver, if effective under common law, remains effective under Article 2B. This subsection does not require delivery of the record to the party that receives the benefit of the waiver.

3. *Waiver by Accepting a Performance.* Subsection (b) and (c) deal with waivers that result from accepting a performance without objecting to known defects. Waiver is implied from the combination of knowledge of the defect and silence beyond a reasonable time after accepting the performance. This rule does not apply if the party merely knows that a performance is not consistent with the contract unless the performance was tendered to, and accepted by, the party that waives its rights. Thus, failure to object to a pattern of behavior that violates a license but pertains to performance not delivered to the other party cannot create a waiver. In some cases, of course, such a pattern may result in an estoppel.

> **Illustration:** LE is to pay royalties of 2% of the sale price of products it licensed for distribution; payment is due on the first of each month. A 5% late fee is imposed for delays of more than five days. LE 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 the breach is material. If it accepts a tender that it knows to be a breach without objecting in a reasonable time, it cannot cancel the contract for that breach and may waive its right to the late fee or other damages, if any.

4. *Waiver by Failure to Particularize.* Subsection (c) provides that a waiver may result from a failure

to particularize the reason for a refusal of a performance only in a limited number of circumstances. Failure to particularize is a waiver only if the other party could have cured the problem had it known of the basis for refusal. Additionally, between merchants, waiver occurs when the breaching party asks for a specification in writing of the reasons for refusal and a basis for that refusal is not listed among the given reasons. This generalizes the language of original Section 2-605.

5. *Executory and Waived Performances.* Under Subsection (d), unless the intent is express or the circumstances clearly indicate to the contrary, a waiver applies only to the specific breach waived. This principle does not alter estoppel concepts; a waiver may create justifiable reliance as to future conduct in an appropriate case.

6. *Retracting a Waiver.* A waiver cannot be retracted with respect to past events. Similarly, a waiver enforceable as to future events because supported by consideration cannot be unilaterally retracted. It constitutes a bilateral agreement. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* § 84, comment f.

SECTION 2B-606. CURE OF BREACH OF CONTRACT.

(a) A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not expired, the party seasonably notifies the aggrieved party of its intention to cure, and, within the time for performance, the party makes a conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without money allowance, seasonably notifies the aggrieved party of its intent to cure, and provides a conforming performance within a further reasonable time after performance was due; or

(3) in cases not governed by paragraph (1) or (2), the party seasonably notifies the aggrieved party of its intention to provide a conforming performance and promptly does so before cancellation by the aggrieved party.

(b) In a license other than a mass-market license, if the agreement required a single delivery of a copy and the party receiving tender of delivery was required to accept a nonconforming copy because the nonconformity was not a material breach of contract, the party in breach shall promptly and in good faith make an effort to cure if:

(1) the party in breach receives seasonable notice of a specified nonconformity and a demand for cure of the nonconforming copy; and

(2) the cost of the effort to cure does not disproportionately exceed the direct damages caused by the nonconformity to the aggrieved party.

(c) A party may not cancel a contract or refuse a performance because of a breach that has been seasonably cured. However, notice of intent to cure does not preclude refusal of the performance or cancellation.

Uniform Law Source: Sections 2-508; 2A-513

Definitional Cross References.

"Aggrieved party": Section 1-201. "Cancellation": Section2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Direct damages": Section 2B-102. "Enable use": Section 2B-602. "Good faith": Section 2B-102. "License": Section 2B-102. "Mass-market license": Section 2B-102. "Material breach": Section 2B-109. "Notice": Section 1-201. "Notifies: Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Seasonable": Section 1-204.

Reporter's Notes:

1. *Scope of the Section.* This section recognizes that the licensor or the licensee (whichever is in breach) may have an opportunity to cure the breach and retain the contractual relationship. For licensees, cure will often relate to missed or delayed payments, failure to give a required accounting or other report, and misuse of information. For licensors, the issues often focus on timeliness of performance, adequacy of product, and the like. The section places limits on the opportunity to cure that reflect a balance between the goal of preserving contract relationships and the goal of giving the injured party the full benefit of its contractual expectations. Subsection (b) creates a limited obligation to cure in cases where the injured party was required to accept the tender of a copy because the performance was not a material breach as to that copy.

2. *General Law on Cure.* The idea that a breaching party may, if it acts promptly to eliminate the effect of its breach and preserve the contract is embedded in modern law. See, e.g., *Restatement (Second) of Contracts* § 237. However, there is significant disagreement about the scope of allowed cure, reflecting different balances drawn between the policy of allowing a party to preserve a contractual relationship and policies that protect the valid expectations of the party that received the performance constituting a breach. Compare UNIDROIT *International Principles of Commercial Contract Law* art. 7.1.4; U.N. *Sales Convention on the International Sale of Goods* art. 48. This section draws primarily from original Section 2-508, but adapts the provisions of that section to reflect the unique context of information transactions.

3. *Right to Cure.* This section generally allows cure if it is prompt and the circumstances indicate that the cure will avoid harm to the other party. The ability to cure is not an excuse for performance that fails to conform to the contract, but is rather an opportunity to avoid loss and retain the benefits of the contract for both parties.

This section creates a right to cure if the cure occurs before the contractual time for performance expires under paragraph (a)(1). This gives a party whose early actions created a breach an opportunity to make a good tender within the contract time. What is the agreed time for performance is determined not only by the original agreement, but also by any subsequent modifications agreed by the parties. If, despite the prompt and timely cure, there are damages incurred by the aggrieved party, these remain recoverable, but the prompt cure precludes cancellation for that breach.

Cure requires seasonable notice to the other party of an intent to cure. The closer that the time of the breach is to the contractual time for performance, the greater is the necessity for promptness in giving notice and completing the cure. In addition, what constitutes seasonable notice depends on the context, including the importance of the expected performance and the timing and difficulty of obtaining substitutes. The notice does not constitute cure. Cure only occurs when a conforming performance is tendered.

4. *Permissive Cure.* If the time for original performance expires before cure, cure is permissive, rather than available as a matter of right. There are two different circumstances in which cure is permitted.

a. Expectation that initial performance would be acceptable. Paragraph (a)(2) creates a rule that seeks to avoid injustice by reason of a surprise refusal of a performance by the other party. The party in breach has an opportunity to cure only if had "reasonable grounds to believe" that the original tender would be

acceptable. Thus, tender of payment of eighty percent of the amount due would not create an opportunity to cure unless from the course of performance the tendering party had reason to believe that the tender would be acceptable to the other party. Reasonable grounds for believing that a tender would be acceptable can arise from prior course of dealing, course of performance or usage of trade, as well as the particular circumstances surrounding the contract. The party is charged with commercial knowledge of any factors in a particular transaction which in common commercial understanding require strict compliance with contractual obligations, but can also rely on any reasonable expectations and usage of trade regarding variation of performance unless these have been clearly refuted by the circumstances of the particular transaction, including the terms of the agreement. If the other party gives notice either implicitly, through a clear course of dealing, or through terms of the agreement that strict performance is required, those indications control application of this section. Requirements in a standard form that are not consistent with trade usage or the prior course of dealing and are not called to the other party's attention may be inadequate to show that expectations consistent with the trade usage or course of dealing are unreasonable.

b. Cure subject to other person's actions. Outside of the settings described in paragraphs (a)1) and (a)(2), the opportunity to cure is limited by the aggrieved party's right to insist on performance. Paragraph (a)(3) allows cure, but is restricted by the limitation that the cure must occur before the aggrieved party cancels the contract. This places control in the aggrieved party affected by a material breach. In the mass market and in other cases of contracts involving rights in a copy of information, refusal of the copy may be cancellation because the entire transaction focused on providing rights associated with a copy. In such cases, no special notice or words of cancellation are required. As indicated in subsection (c), the aggrieved party is not required to withhold cancellation because of a notice of intent to cure received from the other party.

5. *What Constitutes Cure* Cure requires the completion of acts that put the aggrieved party in essentially the position that would have ensued on full conforming performance. A completed cure requires a party to fully perform the obligation that was breached, fully compensate for loss, timely perform all assurances of cure, and provide adequate assurance of future performance. Monetary compensation may be required, but constitutes a cure only if provided in addition to tendering full conforming performance, such as tender of a conforming copy or tender of a late payment with any required late payment charges. Cure does not occur merely because one party announces its intention to cure, even if that intention is held in good faith. Cure only occurs when or if the proposed compensatory and conforming actions are completed.

Some contract breaches cannot be cured. This is true, for example, if a party breaches a contract by publicly disclosing licensed trade secret information. In such cases, the damage done by breach cannot be reversed and the provisions for cure under this section are inapplicable. A similar condition may arise where the agreement demands performance on a specific date or hour, but the performing party materially fails to meet the deadline. Cure is to be regarded as offering an opportunity to avoid ending a contract relationship by bringing the performance into line with the other party's rightful expectations. It is not a rule that allows a breaching party to avoid consequences of breaches that have clear and irreversible effects.

6. *Effect of Cure.* Cure of a breach does not mean that the aggrieved party is bound to accept without a remedy less than conforming conduct. The main effect is that a contract cannot be canceled if the breach was cured before cancellation occurs. The aggrieved party retains, after cure, a right to any remedies appropriate under the agreement or this article.

7. *Obligation to Cure.* Subsection (b) applies to cases where the licensee is required to accept a performance because the material breach standard is not met even though some defect exists. It creates an obligation to attempt a cure. Failure to undertake the effort is a breach, but if the effort occurs and fails, there is no additional breach of contract. The obligation is limited by a concept of proportionality. No obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five non-material names reducing the value of the list by a small amount, it has no obligation to cure if obtaining those additional names would be disproportionate to the damages. In such case, the proper remedy is the difference in value (if any) of the copy rendered and the performance promised.

[B. Performance in Delivery of Copies]

SECTION 2B-607. COPY: DELIVERY; TENDER OF DELIVERY.

(a) Delivery of a copy must be at the location designated by agreement, but in the

absence of such designation, the following rules apply:

(1) The place for delivery of a copy on a physical medium is the tendering party's place of business or, if it has none, its residence. However, if the parties know at the time of contracting that the copy is located in some other place, that place is the place for delivery.

(2) The place for delivery of a copy electronically is an information processing system designated by the licensor.

(3) Documents of title may be delivered through customary banking channels.

(b) Tender of delivery of a copy requires the tendering party to put and hold a conforming copy at the other party's disposition and give the other party any notice reasonably necessary to enable it to obtain access, control, or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires the tender of access material and other documents required by the agreement. The party receiving tender shall furnish facilities reasonably suited to receive tender. In addition, the following rules apply:

(1) If the contract requires delivery of a copy held by a third person without being moved, the tendering party shall tender access material or documents required by the agreement.

(2) If the tendering party is required or authorized to send a copy to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, the following rules apply:

(A) In tendering delivery of a copy on a physical medium, the tendering party shall put the copy in the possession of a carrier and make a reasonable contract for its transportation having regard to the nature of the information and other circumstances, with expenses of transportation to be borne by the receiving party.

(B) In tendering electronic delivery of a copy, the tendering party shall

initiate a transmission that is reasonable having regard to the nature of the information and other circumstances, with expenses of transmission to be borne by the receiving party.

(3) If the tendering party is required to deliver a copy at a particular destination, the party shall make a copy available at that destination and bear the expenses of transportation or transmission.

[**SECTION 2B-607A. COPY: PERFORMANCE RELATED TO DELIVERY; PAYMENT.]** If performance requires delivery of a copy:

(1) The party required to deliver need not complete a tendered delivery until the receiving party tenders any performance then due.

(2) Tender of delivery is a condition of the other party's duty to accept the copy.

(3) Tender entitles the tendering party to acceptance of the copy.

(4) If payment is due on delivery of a copy, the following rules apply:

(A) Tender of delivery is a condition of the receiving party's duty to pay.

(B) Tender entitles the tendering party to payment according to the contract.

(C) All copies a contract required by the must be tendered in a single delivery and payment is due only on tender.

(5) If the circumstances give either party the right to make or demand delivery in lots, the contract fee, if it can be apportioned, may be demanded for each lot.

(6) If payment is due and demanded on delivery of a copy or on delivery of a document of title, the right of the party receiving tender to retain or dispose of the copy or document, as against the tendering party, is conditional on making the payment due.

Definitional Cross References.
"Agreement": Section 1-201. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Information processing

system": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Send". Section 2B-102. "Term". Section 1-201.

Reporter's Notes:

This composite section corresponds to Article 2 with changes that reflect information as the subject matter. This section maintains the traditional distinction between shipment and destination contracts as that rule exists under original Article 2 and also the underlying doctrine as to determining when a contract is a shipment or a destination contract. As under Article 2, the presumption is that the licensor is not required to deliver to a particular destination unless the agreement so provides. This, the obligation in the absence of agreement is to make the copies available at the licensor's site or, if shipment is expected, to tender them to a carrier making appropriate arrangements for their transport with fees paid by the recipient. Merely designating a place to which shipment is made does not in itself alter the presumption that a "shipment contract" is intended. The presumption can be altered or confirmed, of course, by the shipment terms (e.g., FOB, CIF) the parties require in their agreement. The proposed new sections reflect suggestions that shortening the section would aid in interpretation.

SECTION 2B-608. COPY: RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as otherwise provided in Sections 2B-603 and 2B-604, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, the party receiving the copy has a right before payment or acceptance to inspect at a reasonable place and time and in a reasonable manner to determine conformance to the contract.

(2) Expenses of inspection must be borne by the party making the inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method, or standard does not postpone identification to the contract or shift the place for delivery, passage of title or the risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was an indispensable condition the failure of which avoids the contract.

(4) A party's right to inspect is subject to existing obligations of confidentiality.

(b) If a right to inspect exists under subsection (a), but the agreement is inconsistent with an opportunity to inspect before payment, the party does not have a right to inspect before payment.

(c) If the contract requires payment before inspection of a copy, nonconformity in the tender does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-609; or

(2) despite tender of the required documents, the circumstances would justify an injunction against honor of a letter of credit under Article 5.

(d) Payment made under the circumstances described in subsection (b) or (c) is not an acceptance of the copy and does not impair a party's right to inspect or preclude any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Section 2-512; 513. Revised.
Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Party": Section 2B-102.
Reporter's Notes:
This section generally conforms to original Article 2 with changes that reflect information as the subject matter.

SECTION 2B-609. COPY: REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Sections 2B-610 and 2B-611, if a tender of a copy constitutes a material breach of contract, the party to which tender is made may:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market license, a licensee may refuse a tender of a copy if the contract calls only for a single tender and the copy or tender fail in any respect to conform to the contract. The refusal cancels the contract.

(c) Refusal is ineffective unless it is made before acceptance and within a reasonable time after tender or completion of any permitted effort to cure and the refusing party seasonably notifies the tendering party.

(d) Except as otherwise provided in subsection (b), a that refuses tender of a copy may cancel the contract only if there has been a material breach of the entire contract or the agreement so provides.

Uniform Law Source: Combines 2-601, 2-602, 2A-509. Revised.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-602. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Licensee". Section 2B-102. "Mass-market license": Section 2B-102. "Notifies": Section 1-201. "Party": Section 2B-102.

Reporter's Notes:

1. *Scope of Section.* This section deals with refusal of copies. It is a specific application of the rule in Section 2B-601. In general, the right to refuse a performance hinges on there being a material nonconformity or an uncured, prior material breach by the tendering party. The right to refuse is subject to Sections 2B-610 and 2B-611. This section applies a different rule for mass-market transactions.

2. *Acceptance of the Tender.* A party may accept or reject all of tendered multiple copies, but may also accept some commercial units and reject the rest. This rule comes from Article 2 where the commercial units are separable and clearly identifiable. It should be interpreted in reference to that context. If the vendor tenders thirty copies of a software product and ten are defective, the licensee can accept the twenty and reject the remainder.

In general, acceptance of a performance does not waive the party's rights to a remedy for breach unless it occurs in a setting in which the acceptance constitutes a waiver. Under subsection (a), this principle carries forward to cover circumstances of acceptance of part of the tendered performance. The primary limits on partial acceptance are that it must occur in good faith and that commercial reasonableness must be considered to avoid impairment of the value of the items that were rejected due to breach.

This does not permit a party to disassemble an integrated or composite product, keeping what it desires and rejecting the rest. The part accepted (or rejected) must be a reasonable commercial unit. Reasonableness reflects the overall tender. It is not reasonable to reject parts of a tender provided as an integrated whole. The issue is not whether some of the composite product could have been provided separately, but whether as provided pursuant to the agreement, it was a separable element and whether it is reasonable to treat it as separate and apart from the remaining, rejected units.

3. *Conforming Tender Rule.* Subsection (b) adopts the "conforming tender" rule for mass-market transactions that fit the circumstances under which that rule exists under original Article 2 - transactions where the only obligation of the transferor entails providing a copy in a single delivery. In more complex transactions, neither original Article 2, nor this article require conforming tender as a precondition to the recipient's obligation to accept.

While often described as a "perfect tender" rule, the "conforming tender" rule does not require tender of a "perfect" copy or "perfect" product. The rule displaces general law concepts based on the material breach (or substantial performance) standard. What performance conforms to the agreement depends on what the agreement entails, including the express terms as interpreted in light of usage of trade, course of dealing and concepts of merchantability. In addition, refusal of a tender may yield a right or opportunity to cure. Section 2B-606.

4. *Effective Refusal.* Under subsection (c), refusal of a tender is ineffective if the refusing party does not timely notify the other party of its refusal. This corresponds to waiver rules under common law and this article. It precludes arguments that silent "refusal" can be coupled with active use of the information.

5. *Refusal and Cancellation.* Many transactions involve contractual commitments that go beyond the obligation to deliver a particular copy. Subsection (d) confirms that an aggrieved party that refuses tender of a copy may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides. Cancellation of the entire contract requires breach that is material as to the entire agreement, or a contract term that allows cancellation.

SECTION 2B-610. COPY: INSTALLMENT CONTRACTS; REFUSAL AND DEFAULT.

(a) In this section, "installment contract" means a contract in which the terms require or authorize delivery of copies of the same information with the same informational rights in lots to be separately accepted, even if the contract contains a term that states "each delivery is a separate contract" or its equivalent.

(b) In an installment contract, the party receiving tender may refuse a nonconforming installment if the nonconformity is a material breach as to that installment and cannot be cured or if the nonconformity is a defect in any required documents. However, if the nonconformity is not within subsection (c) and the tendering party gives adequate assurance of its cure, the aggrieved party must accept that installment and may not cancel the contract unless the tendering party fails seasonably to complete the cure.

(c) If a nonconformity or breach with respect to one or more installments is material as to the entire contract, there is a breach as to the entire contract. However, the aggrieved party reinstates the contract if it accepts a nonconforming installment without seasonably notifying the party in breach of cancellation or if the aggrieved party brings an action with respect only to past installments or demands performance as to future installments.

Definitional Cross Reference:
"Aggrieved party": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102. "Seasonably": Section 1-204. "Term". Section 1-201.

Reporter's Note:
This section generally conforms to original Article 2 with changes that reflect information as the subject matter.

SECTION 2B-611. COPY: CONTRACTS WITH A PREVIOUS VESTED GRANT OF RIGHTS. If an agreement grants rights in or permissions to use informational rights which precede or are otherwise independent of the delivery of a copy, the following rules apply:

(1) A party may refuse a tender of a copy which is a material breach as to that copy, but refusing that tender does not cancel the contract.

(2) In a case governed by paragraph (1), the tendering party may cure by

seasonably providing a conforming copy before breach becomes material as to the entire contract.

(3) A breach that is material with respect to a copy allows cancellation of the contract only if the breach cannot be seasonably cured and is a material breach of the entire contract.

Definitional Cross Reference:
"Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Seasonably": Section 1-204.

Reporter's Notes:

1. *Scope and Purpose.* This section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts. The similarity lies in that more than one performance by the licensor occurs. The difference is that the performances involve a grant of informational rights followed by delivery of a copy, while installment contracts deal with serial deliveries of copies.

The section follows commercial practice and distinguishes between (1) agreements where a grant to use informational rights vests independent of any copy, and (2) agreements where the purpose is to obtain informational or other rights associated with a copy. It describes the relationship in the former situation between a tender of a copy and cancellation of the entire contract or cure of the tender. Refusal of the copy does not necessarily permit cancellation of the contract. The grant of rights (already vested) is an independent, performed part of the agreement and any particular copy used to implement that grant is a mere conduit. If the copy does not materially breach the entire contract, the tendering party has a right to cure. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement.

2. *Nature of the Transaction.* The section applies only if the contract vests the right or permission to use informational rights without the transferee's receipt of a copy. Whether this circumstance exists depends on the agreement. It is, however, a routine transaction in information industries, especially in distribution agreements and performance rights.

When a vested rights transaction occurs, the parties view a copy as a mere conduit to complete an already vested grant. In such cases, a defect in a copy is not necessarily material to the entire contract. In contrast, if the agreement does not create a prior vesting of rights and the transaction is not an installment contract, a material defect in the copy tendered is more often material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the informational rights vest by agreement independent of a copy, the licensee can refuse the copy and still expect and insist on performance and exercise rights under the contract.

Illustration 1. IBM grants LE the right to distribute up to twenty thousand copies of its Fast-Pace Internet software in the United States during one year. Several weeks later, IBM delivers a master disk of the software for LE. The master disk contains a manufacturing flaw. The contract is within this section. LE can refuse the copy if the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. IBM can cure by timely tendering a conforming copy. LE can recover damages for the delay, if any.

Illustration 2. LE orders a 100 person site license from Micro for its operating system software. Micro ships a copy of the software, but the copy is warped and defective and arrives several weeks late. This contract is not within this section since there was no vested right to use informational rights independent of the copy to be delivered.

Illustration 3. Prince D's estate grants LE an exclusive license to show a still photographs of Prince D on an Internet Website for one week during June, 1999, the anniversary of Prince D's death also giving LE the right to advertise the exhibit. A copy of the photographs is to be delivered one week before the first showing. The copy is delivered several days late and the copy is technically defective and cannot be used.

LE refuses the copy. The contract is within this section because the grant of rights is independent of the copy. Refusal does not cancel the contract. LE can continue to advertise. Prince D can cure in a reasonable time unless it delays to the point that it creates a material breach of the entire contract.

SECTION 2B-612. COPY: DUTIES UPON RIGHTFUL REFUSAL.

(a) After rightful refusal of a copy, if the refusing party rightfully cancels the contract, Section 2B-702 applies, but if the contract is not canceled, the parties remain bound by all contractual obligations.

(b) The following rules apply to a copy that was rightfully refused and to any copies of it that are within the possession or control of the refusing party to the extent that the rules are consistent with Section 2B-702 if that section also applies:

(1) Any use, sale or other transfer of the refused copy or the information it contains, or any failure to comply with a contractual use restriction is a breach unless authorized by this section or by the tendering party. However, use for a limited time within contractual use restrictions is not a breach and does not constitute acceptance under Section 2B-613(a)(5) if the use:

(A) occurs after the tendering party is seasonably notified of refusal;

(B) is not for distribution and is solely to mitigate loss; and

(C) is not contrary to instructions concerning disposition of the copy received from the party in breach.

(2) The refusing party shall:

(A) deliver all copies, access materials, and documentation pertaining to the refused copy to the tendering party or hold them with reasonable care for a reasonable time for disposal at that party's instructions; and

(B) follow reasonable instructions of the tendering party for returning or delivering the copies, access material and documentation. Instructions are not reasonable if the

tendering party does not arrange for payment of or reimbursement for reasonable expenses of complying with the instructions.

(3) If the tendering party gives no instructions within a reasonable time after being notified of refusal, the refusing party may, in a reasonable manner to avoid or mitigate loss, store the copies, access material, and documentation for the tendering party's account or ship them to the tendering party and is entitled to reimbursement for reasonable costs of storage and shipment.

(4) The refusing party has no contractual obligations other than those stated in this section or the contract with respect to the copy, access material, and documentation that were refused. Both parties remain bound by any contractual use restrictions that would have been enforceable had the performance not been refused.

(5) In complying with this section, the refusing party shall act in good faith and with care that is reasonable in the circumstances. Reasonable conduct in good faith under this section is not acceptance or conversion and is not the basis for an action for damages under the contract.

Uniform Law Source: Section 2-602(2), 2-603, 2-604.

Definitional Cross Reference:

"Access material": Section 2B-607. "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section deals with the rights and obligations of a party that rightfully refuses tender of a copy and remains in possession or control of that copy or copies made from it. The section coordinates with Section 2B-702 in the event of cancellation of the contract. If it applies, Section 2B-702 controls to the extent of any conflict. This includes, of course, the various terms provided as surviving cancellation.

2. *Cancellation and Refusal.* Refusal of a copy may or may not permit cancellation or result in a decision to cancel the entire contract. If it does result in cancellation, Section 2B-702 governs the handling of copies to the extent it is inconsistent with this section. If the contract is not canceled, this section applies in full, and the parties remain bound by all contractual obligations, except of course, as altered by the breach itself and the remedies thus made available.

The difference lies in the fact that cancellation requires both parties promptly to disengage from the entire contract, returning any material previously received and refraining from any use of the information that would be allowed under the license. Cancellation ends the license. On the other hand, refusal without cancellation presumes that the contract continues to govern the rights and obligations of the parties, although the refused copy

and related material will be returned to the tendering party, or any defect cured.

3. *No Right to Use.* In general, under paragraph (b)(1), a refusing party has no right to use the refused copies or any copies made from them. Uses inconsistent with this section or the contract constitute a breach by the party engaging in or allowing the misuse and may, in appropriate cases, be treated as acceptance of the tendered copies.

Despite this general principle, the paragraph permits limited, short-term uses for purposes of mitigating loss. The uses must be solely for the purposes of mitigation and cannot extend to disclosure of confidential information, violation of a contractual use restriction, or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to reach the balance discussed in *Can-Key Industries v. Industrial Leasing Corp.*, 593 P.2d 1125 (Or. 1979) and *Harrington v. Holiday Rambler Corp.*, 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved.

4. *Handling Copies.* This section does not give the refusing party a right to sell goods, documentation or copies under any circumstance. The materials may be confidential and may be subject to the overriding influence and limitations of the proprietary rights held and retained by the other party. In the case of a refusal of a copy, there is no commercial necessity to sell that copy to a third party to avoid commercial loss. More important, in many cases, sale would be clearly inconsistent with protecting the interests of the tendering party which are often focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

5. *Confidentiality.* Both parties remain bound by contractual use restrictions, including confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The contractual use restrictions, of course, relate only to the information acquired under and subject to the license. This does not restrict the party's ability to obtain the same information from alternative lawful sources independent of the contract restrictions.

SECTION 2B-613. COPY: ACCEPTANCE; EFFECT.

(a) Acceptance of a copy occurs when the party to which the copy is tendered:

(1) signifies, or acts with respect to the copy in a manner that signifies, that the tender was conforming or that the party will take or retain the copy in spite of a nonconformity;

(2) fails to make an effective refusal;

(3) commingles the copy or the information in a manner that makes compliance with the party's duties after refusal impossible;

(4) substantially obtains the benefit from the copy and cannot return that benefit; or

(5) acts in a manner inconsistent with the licensor's ownership, but any such act is an acceptance only if the licensor elects to treat it as an acceptance and ratifies the act to the extent it was within contractual use restrictions.

(b) Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect

under Section 2B-608 or the agreement, acceptance of a copy occurs only after the party has had a reasonable opportunity to inspect.

(c) If an agreement requires delivery in stages involving separate portions which taken together comprise the whole of the information, acceptance of any stage is conditional until acceptance of the whole.

[**SECTION 2B-613A. EFFECT OF ACCEPTANCE OF A COPY.]**

(a) Acceptance of a copy precludes refusal and, if made with knowledge of a nonconformity in the tender, may not be revoked because of it unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not in itself impair any other remedy for nonconformity.

(b) The party accepting a copy has the burden of proving a breach of contract with respect to the copy.

(c) If a copy has been accepted, the accepting party shall:

(1) within a reasonable time after it discovers or should have discovered any breach, notify the other party of a breach or be barred from any remedy for that breach; and

(2) if the claim is for breach of an obligation regarding noninfringement and the accepting party the copy is sued by a third party because of such breach, notify the other party within a reasonable time after receiving notice of the litigation or be barred from any remedy over for the liability established by the litigation.

Uniform Law Source: Section 2-606; 2-607(2); Section 2A-515. Revised.
Definitional Cross Reference:
"Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201.
Reporter's Notes:

1. *Scope of the Section.* This section deals with the effect of acceptance of a copy. It derives largely from existing Article 2 and Article 2A provisions on the similar subject matter, but makes some changes in those rules to reflect the nature of information as the primary focus of the transaction, rather than the copies themselves.

2. *Nature of Acceptance.* Acceptance of a copy is the opposite of refusal. Under subsection (d), acceptance precludes refusal and, if made with knowledge of any nonconformity, may not be revoked because of it

unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. In the case of a transaction in which payment is due on delivery of the copy, acceptance entitles the licensor to payment. More broadly, unless revoked, acceptance of a copy entitles the licensor to whatever consideration is to be given for copy. In contrast, of course, rightful refusal of the copy does not create an obligation to pay or give other consideration unless the licensor cures. Acceptance puts the burden on the party accepting the copy to prove any breach with respect to that copy. See also Section 2B-601.

While acceptance of a copy precludes refusal of the copy unless acceptance is revoked, acceptance does not in itself impair any other remedy for nonconformity. Except in cases of waiver under Section 2B-605, for example, the accepting party retains the right to recover damages for breach where the copy is defective.

3. *What constitutes Acceptance.* Subsection (a) provides guidance on what constitutes acceptance of a copy. Paragraphs (a)(1) and (a)(2) conform to Section 2-606 and to Article 2A. They clarify that acts as well as communications may signify acceptance. These paragraphs must be read in connection with subsection (b) which retains existing Article 2 rules by indicating that the referenced acts or communications are not acceptance if the party had a right to inspect the information or copy under the agreement or the default rules of this article, unless they occur after there has been a reasonable opportunity to inspect.

a. Commingling Paragraphs (a)(3) and (a)(4) focus on two circumstances significant in reference to information and that raise issues different from cases involving goods. In paragraph (a)(3), the rule reflects that it is inequitable or impossible to reject data or information having commingled the material. The party that commingles the information retains the right to its remedies for breach, but the concept of a refusal of the tendered copy is not a helpful paradigm in working through the rights of the parties. To refuse a tendered copy (or revoke an acceptance of the copy), the refusing party must return or keep available the information for return to the other party. Commingling precludes this. Commingling refers to blending the information into a common mass in which it is indistinguishable. It also refers to software integrated into a complex system in a way that renders removal and return impossible or information integrated into a database or knowledge base from which it cannot be separated.

b. Non-returnable Benefits. Subsection (a)(4) involves use or exploitation of the value of the material by the licensee. In information transactions, in many instances merely being exposed to the factual or other material transfers the significant value. Often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient 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.

c. Ownership. Paragraph (a)(5) adopts the Article 2 rule that, even though the buyer did not explicitly accept the goods, its acts inconsistent with the vendor's ownership constitute acceptance if ratified by the seller. This gives the seller an option to either treat the acts as acceptance, or to treat the situation as a rejection of the goods followed by acts of conversion or the like. In information transactions, the options are less clear, since a licensee can avoid explicit acceptance of the information, but then act in a manner that is outside the contract terms, even had it accepted the tender. The language of paragraph (a)(5) gives the licensor a right to elect where the inconsistent acts are within contractual use restrictions. Paragraph (a)(5) modifies the Article 2 rule and recognizes that if the licensor decides to treat the acts as acceptance, it need not also ratify actions of a licensee's that would, in any event, be outside the contract terms. For example, if a licensor provides a conforming copy of educational software pursuant to a license for use in a single school district and the district, while not communicating acceptance of the copy, distributes the software throughout the country, the licensor can either: 1) treat silence as refusal of the tender and sue for breach and infringement, or 2) treat the actions as acceptance and sue for the price, ratifying uses within the designated district, but also sue for infringement as to uses or distribution outside the contract terms.

SECTION 2B-614. COPY: REVOCATION OF ACCEPTANCE.

(a) A party that has accepted a copy may revoke acceptance only if a nonconformity is a material breach and the party accepted the copy:

(1) on the reasonable assumption that the nonconformity would be cured, and it

has not been seasonably cured;

(2) during a period of continuing efforts by the party in breach at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the nonconformity, if the acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party notifies the other party of the revocation.

(c) Revocation is barred if:

(1) it does not occur within a reasonable time after the party attempting to revoke discovers or should have discovered the ground for it;

(2) it occurs after a substantial change in condition or identifiability not caused by defects in the information, such as after the party commingles the information in a manner that makes its return impossible; or

(3) the party attempting to revoke received a substantial benefit from the information, which benefit cannot be returned.

(d) A party that rightfully revokes has the same duties and is under the same restrictions as if the party had refused the copy.

Uniform Law Source: Section 2A-516; 2-608**.** Revised.
Definitional Cross Reference:
"Copy": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Notifies: Section 1-201. "Party": Section 2B-102. "Seasonable": Section 1-204.
Reporter's Note:

1. *Scope of the Section.* This section sets out rules for determining whether a party may revoke acceptance of a copy. Revocation, when effective, returns the parties to the same position as if the copy had been refused. In effect, the revoking party is no longer liable for the purchase price and, in appropriate circumstances, can obtain a refund. This section deals only with revocation of acceptance of a copy.

2. *Conditions for Revocation.* Revocation is appropriate only if the breach is a material breach. This is true even in cases involving mass market licenses which may involve application of the "conforming tender" rule with respect to the initial right to refuse the tender of delivery. Acceptance ordinarily establishes a closure of the transaction with respect to the accepted copy. That expectation cannot be altered based on mere minor defects. For this purpose, the general standards of material breach apply. Section 2B-109. This follows law under original Article 2 and Article 2A. Under subsection (b), revocation requires notice to the other party and is not effective

until the other party is so notified.

Revocation is inappropriate if based on a defect in the copy or the information of which the accepting party was aware when it accepted the copy. This follows law under original Article 2. Acceptance with knowledge of a defect does not eliminate other remedies of the party unless it creates a waiver, but does bar revocation based on the defect unless conditions mentioned in subsection (a) are present. These deal with two different circumstances:

a. Expectation of Cure. In the first, revocation may be permitted if the acceptance was on the assumption that the defect would be cured. This is dealt with in both paragraph (a)(1) and paragraph (a)(2). It allows the parties to proceed on a course involving a mutual effort to resolve problems within the contract, rather than by ending it. Paragraph (a)(2) adds a provision not found in Article 2 to deal with an issue often encountered in software litigation. In cases of continuing efforts to modify and adjust the software to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both parties know that problems exist and this would allow revocation if the effort fails within a seasonable time and the other conditions barring revocation do not arise.

b. Latent Defects. Paragraph (a)(3) follows original Article 2 and allows revocation if the defect was not discovered before acceptance because of the difficulty of discovery or assurances from the other party that had the effect of delaying discovery.

[C. Special Types of Contracts]

SECTION 2B-615. ACCESS CONTRACTS.

(a) If an access contract provides for access over a period of time, the licensee's rights of access are to the information as modified and made commercially available by the licensor from time to time during that period. In addition, the following rules apply:

(1) A change in the content of the information is a breach of contract only if the change conflicts with an express term of the agreement.

(2) Unless it is subject to a contractual use restriction, information obtained by the licensee is free of any use restriction other than restrictions resulting from the informational rights of another person or other applicable law.

(3) Access must be available at times and in a manner:

(A) conforming to the express terms of the agreement; and

(B) to the extent not expressly dealt with by the contract, at times and in a manner that is reasonable for the particular type of contract in light of the ordinary standards of the business, trade, or industry.

(b) In an access contract that gives the licensee a right of access at times substantially of

its own choosing during agreed periods of time, an intermittent and occasional failure to have access available during those times is not a breach of contract if it is:

(1) consistent with the express terms of the contract;

(2) consistent with ordinary standards of the business, trade, or industry for the particular type of contract; or

(3) caused by scheduled downtime; reasonable needs for maintenance; reasonable periods of equipment, software, or communications failure; or events reasonably beyond the licensor's control and the licensor exercises such commercially reasonable efforts as the circumstances require.

Definitional Cross Reference:
"Access contract": Section 2B-102. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Software". Section 2B-102. "Term". Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section provides default rules dealing for basic attributes of an access contract concerning availability of access and treatment of information obtained as a result of that access.

2. *Nature of an Access Contract.* There are two types of access contract. In one, the access and the contract occur at the same time and there is no on-going relationship between the parties. In the other, a continuous access contract, the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This relationship is illustrated by on-line services which operate on a subscription or membership basis. The agreement is not only that the transferee receives the access or the information, but that the subject matter be accessible on a continuing basis. A continuous access contract is unlike installment contracts under Article 2 which are segmented into tender-acceptance sequences. Often, the licensor here merely keeps the system on-line and available for the licensee to access when it chooses.

Access contracts are licenses in the pure sense that they grant a right to have use of a facility or resource controlled by the licensor. This is not an intellectual property license, but a modern application of traditional concepts of licensed use of physical resources applied to electronic. They do not fall within Article 2.

3. *Basic Obligation.* The obligation in a continuous access contract is to make and keep the system available in a manner consistent with contract terms or industry.

a. General Standards of Availability. As indicated in subsection (a)(3), availability is subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a 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).

b. Content Changes. The access agreement does not bind the provider of access to making available particular information unless the express contract terms require this. Access is granted to the information or other resources provided as they exist at the time of the particular access. Databases may be added, modified or deleted consistent with this core obligation.

4. *Use of Received Information.* The access contract may or may not contain provisions that restrict use of information obtained through the access. If there are no restrictions provided in the agreement, subsection (a)(2) indicates that the information is received on an unrestricted basis, subject only to intellectual property rights

and any separate agreement concerning that information. For example, if an access contract merely enables access to news articles, but does not limit their use by the licensee, no limitation exists other than under copyright law.

In contrast, if a transaction allowing access or a separate agreement establish conditions or limitations on the use of the information obtained through the access, those license terms would be governed under Article 2B. They are interpreted and enforced pursuant to other provisions of this article and, of course, the terms of the agreement itself. Once the information is received by the licensee, however, it is ordinarily no longer appropriate to construe the relationship as an access contract, but rather, it is simply a license. For example, if licensee uses the access provided by its contract with ABC Corporation to acquire a copy of a spreadsheet program, when the program is received by the licensee, the rights and remedies of the parties with respect to use of the program are governed by the agreement with respect to that program and, in the absence of agreed terms, by the default rules of this article regarding software licenses. As to the software, the relationship ceased to be an access contract when the software was received by the licensee. Of course, the terms of the license may be found in the agreement establishing the access contract or in a separate agreement concerning the licensed information.

The restrictions that might arise are not necessarily based on creation of a license. In some cases, a mere copyright notice may adequately restrict the right to use the information obtained through the on-line access. *Storm Impact, Inc. v. Software of the Month Club*, 1998 WL 456572 (N.D. Ill. 1998) (On-screen limitation precluding commercial use of software enforced and resulting use infringed; court did not clarify whether the notice was a license or merely limited permission granted by posting the software on the Internet).

SECTION 2B-616. CORRECTION AND SUPPORT AGREEMENTS.

(a) If a person agrees to correct performance problems or provide similar services with respect to information other than as an effort to cure its own breach of contract, the following rules apply:

(1) Except as otherwise provided in paragraph (2), the person:

(A) shall perform at a time, place and in a manner consistent with the express terms of the agreement and, to the extent not dealt with by the express terms, at a time, place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry; and

(B) does not undertake that its services will correct all performance problems unless the agreement expressly so provides.

(2) If the services are provided by a licensor of the information as part of a limited remedy, the licensor undertakes that its performance will provide the licensee with information that conforms to the agreement to which the limited remedy applies.

(b) A licensor is not required to provide instruction or other support for the licensee's use of information or access. A person that agrees to provide support shall make the support

available in a manner and with a quality consistent with the express terms of the support agreement and, to the extent not dealt with by express terms, at a time, place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry.

Uniform Law Source: Restatement (Second) of Torts § 299A.
Definitional Cross Reference:
"Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.
Reporter's Notes:

1. *Scope of the Section.* This section provides default rules regarding contracts to correct errors or to provide support in use of information. A support agreement is an agreement to make available advisory or consulting services relating to the use of the information. The default rules do not apply if the parties have otherwise agreed. Agreement altering these terms does not depend on express terms of a record, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trades, in course of dealing and the like.

2. *Nature of the Error Correction Obligation.* Obligations to correct performance problems are different from an obligation to provide updates or new versions of software to remedy warranty breaches. In modern practice, contracts to provide updates are a source of revenue for software providers. The reference to error correction covers contracts where, for example, a vendor agrees to be available to come on site and correct or attempt to correct problems in the software for a fee. This is a services contract. An agreement to provide updates or new versions, on the other hand, is more in the nature of an installment contract calling for deliveries as new versions of the software are developed and made available for general distribution. While the new versions often cure problems in earlier versions and the two types of contracts overlap, the update arrangement deals with new products. This article makes no attempt to set standards by which this distinction can be made in fact, but courts faced with the issue must necessarily refer to the terms of the agreement of the parties and general industry standards.

3. *Services Obligation.* Most agreements to correct problems are services contracts. In most cases, the obligation is as stated in subsection (a)(1). The obligation parallels the obligation that any services provider undertakes: a duty to act consistent with the standards of the business to complete the task. A services provider does not guaranty that its services yield a perfect result. The standard measures a party's performance by reference to standards of the relevant trade or industry.

4. *Services in Lieu of Warranty.* Subsection (a)(2) recognizes an alternative formulation of the provider's obligations in contracts where the promissor agrees to a particular outcome. This obligation arises if the repair obligation is part of a limited remedy in lieu of a warranty. The prototype is the "replace or repair" warranty. The obligation to correct errors in that context is to complete a product that conforms to the contract. What performance conforms to the contract, of court, hinges on the terms of that agreement as interpreted in light of usage of trade, course of performance and the like. If the services performance fails to yield a conforming product, what remedy is available depends on other rules in this article, such as the conditions for cancellation and rules on perfect tender or substantial performance.

5. *Support Agreements.* Subsection (b) provides a default rule regarding support agreements. As a form of services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

SECTION 2B-617. CONTRACTS INVOLVING PUBLISHERS, DEALERS, AND END USERS.

(a) In this section:

(1) "Dealer" means a merchant licensee that receives information directly or

indirectly from a licensor for sale or license to end users.

(2) “End user” means a licensee that acquires a copy of the information from a dealer by delivery on a physical medium for the licensee’s own use and not for sale, license, transmission to third parties or for public display or performance for a fee.

(3) “Publisher” means a licensor, other than a dealer, that offers a license to an end user with respect to information distributed to the end user by a dealer.

(b) In a contract between a dealer and an end user, if the end user’s right to use the information or informational rights is subject to a license from the publisher and there was no opportunity to review the license before the end user became obligated to pay the dealer, the following rules apply:

(1) The contract between the end user and the dealer is conditioned on the end user’s agreement to the publisher’s license.

(2) If the end user does not agree, by manifesting assent or otherwise, to the terms of the publisher’s license, the end user has a right to a refund on return of the information to the dealer. A right to a refund under this paragraph is a return for purposes of Sections 2B-112 and 2B-208.

(3) The dealer is not bound by the terms, and does not receive the benefits, of an agreement between the publisher and the end user unless the dealer and end user adopt those terms as part of their agreement.

(c) If an agreement provides for distribution of copies on a physical medium or in packaging provided by the publisher or authorized third party, a dealer shall only distribute those copies and documentation:

(1) in the form as received; and

(2) subject to any contractual terms of the publisher that the publisher provides

for end users.

(d) A dealer that enters into a license or software contract with an end user is a licensor of the end user under this article.

Definitional Cross References. "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Receive": Section 2B-102. "Return": Section 2B-102. "Term". Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section deals with a three party relationship in which a retail transaction involves a publisher, dealer, and end user. This section describes the relationship among the contracts of these parties. The section only applies to distribution of tangible copies.

2. *Dealer and End User.* Subsection (b) deals with the three-party relationship from the perspective of the dealer's contract with the end user. While the end user acquires the copy from the dealer, whether the dealer has authority to convey a right to use the work is determined by its contract with the publisher. That contract permits distribution only under specified conditions. In such cases, the end user's right to "use" (e.g., copy) arises by a separate agreement between the end user and the publisher. See *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994).

a. Contracts are Separable. The basic principle is that a dealer is not bound by nor does it benefit from any contract created by the publisher with the end user. This mirrors case law on manufacturer warranties and warranty limitations under Article 2 which do not bind the dealer, but also do not benefit that dealer although that rule has been over-ridden in some states. See Cal. Civ. Code § 1791 ("as is" disclaimer disclaims warranties for manufacturer, distributor and retailer-dealer). The agreements are separate unless the dealer and end user adopt the publisher's license as defining their own relationship. Of course, the dealer remains bound by its contract with the publisher or other party from whom it received the information.

b. Dealer is a Licensor. Subsection (d) confirms that warranties exist on the part of the dealer by stating that the dealer is a licensor with respect to its end user transferee. In effect, the end user licensee has separate recourse from two different licensors (the dealer and, if it agrees to the license, the publisher).

c. Conditional Rights. Under subsection (b)(1) and (b)(2) performance of the dealer's relationship with the end user hinges on the end user's ability to make use of the information supplied by the dealer. This depends on the license between the publisher and the end user. If the end user declines that license, it has a right to obtain a refund from, or to cancel payment to the dealer. This creates a return *right*, rather than merely an option. If the end user assents to the publisher's license, the publisher's license in effect replaces the dealer-end user contract except as to obligations expressly created and earmarked as continuing on the part of the dealer (such as a services or support obligation). Of course, if the information breaches a warranty, the right to recover from the dealer remains unless disclaimed by the dealer.

An alternative view of the relationship, which is appropriate in some cases, treats the publisher's license as part of the dealer's contract which the end user and dealer understood from the outset would be provided to complete the entire terms of the relationship. This is a variation of the right, long recognized in commercial law, of parties to conclude a contract leaving it to one party to supply particulars of performance after the initial agreement, with the specifications here coming in the form of a publisher's license. Where the arrangement is that assent to these later particulars is required and the end user rejects the terms, it in effect is also rejecting the contract with the dealer and is entitled to return the copy and receive a refund. Agreement on this issue, as in other respects, does not depend on express terms of the contract, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trade, in course of dealing and the like.

Illustration: User acquires a program from Dealer for $1,000 each. User is aware that each software program comes subject to a publisher license. When it reviews one license, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the dealer's contract is conditioned on the user's consent to the publisher's terms.

3. *Dealer and Publisher.* Often the publisher's arrangement with the dealer is a license that retains ownership of copies in the publisher and permits distribution only subject to an end user 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).

SECTION 2B-618. [deleted 11/98]

SECTION 2B-619. [deleted 11/98]

[D. Performance Problems]

SECTION 2B-620. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. If reasonable grounds for insecurity arise with respect to the performance of either party, the aggrieved party may demand in a record adequate assurance of due performance and, until the demanding party receives that assurance, may if commercially reasonable suspend any performance, other than with respect to contractual use restrictions, for which the party has not already received the agreed return.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to reasonable commercial standards.

(c) Acceptance of any 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.

Uniform Law Source: 2-609.
Definitional Cross References.
"Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102.
Reporter's Note: Corresponds to original Article 2.

SECTION 2B-621. ANTICIPATORY REPUDIATION. If either party repudiates a contract with respect to a performance not yet due the loss of which will substantially impair the

value of the contract to the other, the aggrieved party may:

(1) for a commercially reasonable time await performance by the repudiating party; or

(2) resort to any remedy for breach of contract, even if it has notified the repudiating party that it would await its performance and has urged retraction; and

(3) in either case, suspend its own performance or proceed in accordance with Sections 2B-712 or 2B-713, as applicable.

Uniform Law Source: 2-610.
Definitional Cross References.
"Aggrieved party": Section 1-201. "Contract": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.
Reporter's Note: Corresponds to original Article 2..

SECTION 2B-622. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) Until a repudiating party's next performance is due, it may retract its repudiation unless the aggrieved party has since the repudiation canceled or materially changed its position in reliance on the repudiation or otherwise indicated that it considers the repudiation final.

(b) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform but must include any assurance justifiably demanded under Section 2B-620.

(c) Retraction reinstates a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

Uniform Law Source: Section 2-611.
Definitional Cross References.
"Aggrieved party": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Party": Section 2B-102.
Reporter's Note: Corresponds to original Article 2.

[E. Loss and Impossibility]

SECTION 2B-623. RISK OF LOSS OF COPIES.

(a) Except as otherwise provided in this section, the risk of loss as to a copy, including a

copy delivered electronically, passes to the licensee upon its receipt of the copy.

(b) If a contract requires or authorizes a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require the licensor to deliver the copy at a particular destination, the risk of loss passes to the licensee when the copy is duly delivered to the carrier, even if the shipment is under reservation.

(2) If the contract requires the licensor to deliver the copy at a particular destination and the copy is duly tendered there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered at that destination.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains with the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, or a copy is to be delivered by making access available to a physical resource containing a tangible copy, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing the third party, pursuant to an agreement between the licensor and the third party, to make delivery or authorizing the third party to allow access.

Uniform Law Source: Section 2-509. Revised.
Definitional Cross Reference:
"Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Document of title": Section 1-201. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102. "Receive": Section 2B-102. "Send". Section 2B-102.
Reporter's Notes:
1. *Scope of the Section.* This section applies to risk of loss with respect to copies. It does not deal with other risks of loss, such as risks associated with loss of the information itself, a master copy that contains the

sole information, or of informational rights.

2. *Basic Approach.* As in Article 2, who bears the risk of loss is determined by the agreement and, in the absence of agreement on the issue, by standards that focus on the transaction, rather than on questions of title with respect to the copies. The basic rule is that risk rests with the person in possession or control of the copy. It passes from one party to another on receipt of the copy, unless another rule applies under this section or the agreement. Such agreement is to be found not only in the express terms of the contract, but in the circumstances surrounding the contract, in trade usage, in course of dealing and the like.

3. *Shipment or Electronic Communication.* This section deals specifically with when risk of loss transfers in cases where a copy is to be shipped or transmitted to the other party. Subsection (b) deals with transactions in which the transfer occurs in the form of tangible copies to be shipped by a carrier. The rules applied are taken from original Article 2 and also correspond, in this context, to when and how a tender of delivery occurs. They distinguish between a shipment contract (ship, but no requirement to deliver at the particular destination) and a destination contract. In ordinary commerce, most transactions involving shipment of tangible copies are shipment contracts. But in any particular case, the agreement controls. Duly delivered in the case of a shipment contract requires that the sender tender the copy to the shipper pursuant to an appropriate contract.

Where a copy is to be transferred electronically, risk of loss transfers to the recipient when the copy is received. This rule also applies to access contracts. In each case, the assumption is that the recipient should have no risk regarding the loss of a copy that has not yet been received where electronic transmissions are, in effect, virtually instantaneous. This rule applies if loss occurs during transmission. The risk of loss issue here should be distinguished from issues about when tender of delivery occurs which, in many electronic cases, entails making available for access by the licensee. Risk of loss assumes that the transferor who is to send the copy electronically retains a copy for retransmission. The rule, of course, is a default rule subject to variation by agreement. The agreement may be found in express terms, course of dealing, usage of trade or inferred from the circumstances of the contracting.

4. *Delivery without Moving the Copy.* Subsection (c) states rules regarding transfers accomplished without moving a tangible copy. It transfers risk of loss when the transferee receives the ability to control or access the copy. These rules correspond to existing law under Article 2.

SECTION 2B-624. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Unless a party has assumed a greater obligation, delay in performance or nonperformance in whole or in part by a party other than an obligation to make payments or to conform to contractual use restrictions, is not a breach of contract if the delay or nonperformance is of a performance that has been made impracticable by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or

(2) compliance in good faith with any foreign or domestic governmental regulation or order, whether or not it later proves to be invalid.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance.

(c) If the claimed excuse affects only a part of the party's capacity to perform an

obligation for delivery of copies, the party claiming excuse shall allocate performance among its customers in any manner that is fair and reasonable and notify the other party of the estimated quota to be made available. The party claiming excuse may include the requirements of regular customers not then under contract and its own requirements in making the allocation.

(d) A party that receives notice in a record pursuant to subsection (b) of a material or indefinite delay in delivery of copies or of an allocation under subsection (c), may by notice in a record:

(1) terminate and thereby discharge any executory portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(e) If, after receipt of notice under subsection (b), a party fails to modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.

Definitional Cross Reference:

"Contract": Section 1-201. "Good faith": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section states the ordinary U.C.C. formulation of impossibility doctrine. Unlike in original Article 2, however, the doctrine here is expressly applicable to both parties, except with respect to obligations to pay and use restrictions. In cases of substituted performance of the type described in original Section 2-614, the excuse provisions of this section will ordinarily apply. To the extent that they do not, courts should follow the principles in original Section 2-614 as appropriate.

2. *Nature of the Excuse.* Subsection (a) conforms to original Article 2 and intends to adopt the decisions and policy perspectives reflected under original Section 2-615. It excuses a party from timely performance where that performance has become commercially impracticable because of unforeseen supervening events not within the contemplation of the parties at the time of contracting. The excuse does not apply to an obligation to pay or to conform to use restrictions.

As under original Article 2, increased cost alone does not excuse a performance unless due to some unforeseen contingency which alters the essential nature of the performance. A rise or a collapse in the market also is not in itself a justification. Market and cost fluctuations are exactly the type of business risk which commercial contracts are intended to cover. Similarly, where the contract calls for the development of technology, no excuse of performance occurs if the proposed development itself proves ultimately to be technologically impossible. That risk is ordinarily inherent in a development agreement. Of course, however, a different allocation of risk may be agreed to, such as where both parties proceed on the assumption that a third party technology will be completed in a different development project, but that does not occur and renders the completion of the first project impossible. In such cases, the agreement may have been based on an assumed fact or occurrence that did not ensue and an excuse may be appropriate.

The excuse does not apply if, under the agreement of the parties, the person seeking to claim an excuse agreed to assume the risk of the contingency that in fact occurred. Such agreement is to be found not only in

the express terms of the contract, but in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like. Thus, the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the contract terms, either consciously or as a matter of reasonable commercial interpretation from the circumstances.

3. *Allocation Rules.* Subsections (c) and (d) are limited to cases involving a contractual obligation to deliver copies. They follow original Article 2. Subsection (c) gives the licensor a right to make an allocation of the copies available for delivery among its customers and its own requirements. This adds needed flexibility to cope with exigencies caused by unexpected contingencies.

A licensor that has a partial excuse under this section must fulfill its contract to the extent that the over-riding contingency permits. If the events affect its ability to supply its customers generally, this section allows the licensor to take into account the needs of all customers and of itself when fulfilling its obligation to one customer as far as possible. This may include customers not then under contract. However, good faith requires that the licensor exercise real care in making its allocations and, in cases of doubt, current contract customers should generally be favored. Except for such considerations, however, the standard here is intended to leave open every reasonable business leeway to the licensor.

4. *Rights of Other Party.* The interests of the individual licensee in the face of an indefinite delay or a proposed allocation are protected in subsection (d). The licensee may either accept the proposed allocation or treat the contract as terminated as to executory obligations. This latter option does not allow treating the case as involving a breach, but merely permits termination.

[F. Termination]

SECTION 2B-625. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination all obligations that are still executory on both sides are discharged.

(b) Unless the agreement otherwise provides, the following survive termination:

(1) a right based on previous breach or performance of the contract;

(2) a contractual use restriction applicable to any licensed copy or information received from the other party, or copies made of it, that are not returned or returnable to the other party;

(3) an obligation to return, deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party, or the right to obtain information from an escrow agent;

(4) a term establishing a choice of law or forum;

(5) an obligation to arbitrate or otherwise resolve disputes by alternative dispute resolution procedures;

(6) a term limiting the time for commencing an action or for providing notice;

(7) a term of indemnity;

(8) a limitation of remedy or disclaimer of warranty;

(9) an obligation to provide an accounting and make any payment due under the accounting; and

(10) any right, remedy, or obligation stated in the agreement as surviving to the extent enforceable under other law.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201. "Termination". Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* Termination means ending a contract other than for the occurrence of a breach. Additional provisions on termination are in Section 2B-626 and Section 2B-627. This section sets out the general effect of termination and provides a partial list of the obligations that survive termination unless the agreement otherwise provides. The agreement here, of course, may be in express terms of a record or as well in the inferences provided by course of dealing, usage of trade, or the circumstances of the contracting.

2. *Effect of Termination.* Termination discharges *executory* obligations. It does not terminate vested rights or remedies. This rule follows current law and commercial practice. The discharged obligations are those that are executory, i.e., not fully performed on both sides. If performance of one party pursuant to the contract has earned a reciprocal performance (e.g., payment, delivery) from the other, the discharge on termination does not affect that earned obligation. In cases where the obligations of one or both parties are partly completed, but not fully completed, in determining when obligations are executory the basic rule is that an obligation is executory for purposes of this section if the obligation is not fully performed and the unperformed part is such that a failure to perform it would be a material breach that excuses the other party's obligation to perform under the contract. Minor remaining acts would typically not leave an obligation executory, but material remaining performance does.

3. *Survival Rules.* Subsection (b) lists provisions and rights that survive termination. The list presumes that the obligation was created in the agreement and indicates terms that parties ordinarily would designate as surviving in a commercial contract. The intent is to provide background rules, reducing the need for specification in the contract with resulting risk of error. Of course, additional surviving terms can be added and the terms provided here can be made non-surviving by the agreement of the parties. Such agreement is to be found not only in the express terms of the contract, but in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like.

SECTION 2B-626. NOTICE OF TERMINATION.

(a) Except as otherwise provided in subsection (b), a party may not terminate a contract except on the happening of an agreed event, such as the expiration of the stated duration, unless the party gives reasonable notice of termination to the other party.

(b) An access contract may be terminated without notice. However, other than on the

happening of an agreed event, termination requires reasonable notice to the licensee if the access contract pertains to information owned and provided by the licensee to the licensor.

(c) A term dispensing with notification required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for giving notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)

Definitional Cross References.

"Access contract": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Term". Section 1-201. "Termination". Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with when notice of termination is required. Termination involves an end to the contract for reasons other than breach. The rules stated here do not apply to cancellation for breach.

2. *Termination on the Happening of an Event.* No notice is required for termination based on an agreed event (e.g., the end of the stated license term). This corresponds to current Article 2 and common law. The parties to the agreement are charged with awareness of its terms and, in cases covered by this rule, have agreed that the contract expires on the occurrence of an objectively ascertainable event. No notice of termination is needed. This contrasts with cases where termination occurs at the option of a party.

3. *Notice in Other Cases.* If termination can occur based on a judgment or discretion of one party (such as an "at will termination") notice must be given of the termination. The notice must be reasonable. What is reasonable varies with the circumstances. Thus, for example, where the reason for termination involves unlawful conduct or a desire to prevent harmful acts by the other party, notice at or immediately after termination may suffice. In other, less exigent or harmful circumstances, prior notice will ordinarily be required. One function of the notice requirement is to give the other party a reasonable opportunity to make other arrangements in lieu of the terminated contract and to avoid use of the information after termination in a way that may result in breach of contract or infringement of intellectual property rights.

This section requires "giving" notice. A requirement that notice be received would create uncertainty even though the party is merely exercising a contractual right. The uncertainty is especially great in online or Internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

4. *Access Contracts.* Under subsection (b), termination of access contracts does not require notice even when this is based on the exercise of discretion by the party terminating the contract. Of course, the termination must be justifiable under the terms of the contract.

In reference to access contracts, the contractual rights granted to the licensee are to access a resource owned or controlled by the licensor. When the contract terminates, the access privilege also terminates. This is consistent with current law for licenses of this type. In fact, in many cases, a license to use resources or property of the licensor is subject to termination at will without notice. This section provides a limited exception to the common law rule in cases where the access contract involves information provided to the licensor and owned by the licensee. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

5. *Contract Modification.* As indicated in subsection (c), the notice requirement may be waived or the terms, timing and other aspects of the notice specified by agreement. Use of such provisions is restrained by two rules. The first is that exercise of rights under such a contract term is not permitted if unconscionable. Note that the focus is not on the term in this context, but on its operation. The second is that any agreed standards for notice are effective unless they are manifestly unreasonable. This latter rule is taken from Article 9 and permits significant flexibility in an agreement, but allows a court to reject clearly abusive terms regarding notice.

SECTION 2B-627. TERMINATION ENFORCEMENT.

(a) On termination of a license, a party in possession or control of information, documentation, copies, or other materials that are the property of the other party or are subject to a contractual obligation to be delivered to that party on termination, shall use commercially reasonable efforts to deliver or hold them for disposal on instructions of that party. If any materials are jointly owned, the party in possession or control shall make them available to the joint owners.

(b) Termination of a license ends any contractual right to use or access the licensed information, informational rights, or copies. Continued use of the licensed copies or exercise of terminated rights is a breach unless authorized by a term that survives termination.

(c) Each party may enforce its rights under subsections (a) and (b) by acting pursuant to Section 2B-310 or by judicial process, including by obtaining an order that the party or an officer of the court take the following actions with respect to any licensed information, documentation, copies or other materials to be delivered:

(1) deliver or take possession of them;

(2) without removal, render unusable or eliminate the capability to exercise contractual rights in or use of them;

(3) destroy or prevent access to them; and

(4) require that the party or any other person in possession or control of them and make them available to the other party at a place designated by that party which is reasonably convenient to both parties.

(d) In an appropriate case, injunctive relief may be granted to enforce the parties' rights under this section.

Definitional Cross References. "Contract": Section 1-201. "Court": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Term". Section 1-201. "Termination". Section 2B-102.

Reporter's Notes:

1. *Scope of the Section.* This section deals with what obligations arise on termination of a license, providing guidance on the procedure for winding down an existing relationship. The section does not deal with rights in the event of cancellation for breach or with transactions other than a license. Sections 2B-702 and 2B-715 deal with cancellation.

2. *Obligation to Return.* Subsection (a) states the unexceptional principle that on expiration of the contract, the party is entitled to materials held by the other party that it owns or that the contract provides are to be returned at the end of the relationship. The obligation is conditioned by a reference to commercially reasonable efforts to deliver because of the difficulties that may be involved in modern systems with multiple back-up systems. A reasonable effort, however, does not condone any intentional or knowing retention of copies and is subject to subsection (b) which defines any use of the information after termination as a breach of the contract.

3. *Termination of Rights of Use.* Under subsection (b), termination ends rights of use unless some rights are stated to survive or are otherwise irrevocable. This is a by-product of the conditional nature of a license. Continued use that is not authorized by the terminated license constitutes a breach of contract. Where intellectual property rights are involved, that use will often also constitute an infringement of those rights. Since termination does not involve actions taken in response to a breach of contract, no provision is made for limited use in order to mitigate damages. Compare Section 2B-702.

4. *Enforcement.* In most cases, parties voluntarily comply with the obligations that arise on termination. Subsection (c) provides for judicial enforcement if there is not timely compliance. The enforcement rights outlined in this subsection do not depend on the occurrence of a breach. They state a remedy that allows enforcement of the terms of the agreement. That remedy may be exercised by either party, of course, as applicable.

PART 7

REMEDIES

[A. In General]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same loss.

(b) A court may deny or limit a remedy other than for liquidated damages if, under the circumstances, the remedy would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) Except as otherwise provided in Sections 2B-703 and 2B-704, if a party is in breach of contract, whether or not the breach is material, the aggrieved party has the rights provided in the agreement or this article, but the aggrieved party shall continue to comply with any contractual use restrictions with respect to information or copies that have not been returned or

are not returnable to the other party..

Uniform Law Source: Section 2A-523.

Definitional Cross References.

"Agreement": Section 1-201. "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Court": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201.

Reporter's Note:

1. *General Scope.* This section states general rules of over-riding relevance regarding contract remedies.

2. *Cumulative Remedies.* Contract remedies aim to put an aggrieved party in the position that would result if performance had occurred as agreed. Section 1-106(1). As in current law, the remedies in this article are cumulative to the extent consistent with the general goal. Article 2B rejects any concept of election of remedies.

3. *Aggrieved Party Choice.* Article 2B allows the aggrieved party to choose the remedy, subject to the substantive limitations applicable under this article or the agreement of the parties. Beyond the express limits, the court should not control the choice. However, to prevent extreme cases of abuse, subsection (b) conditions the basic principle of choice by giving a court a limited right to deny a remedy if the remedy would place the injured party in a *substantially* better position than performance would have. This creates a general review power, applicable only to prevent extreme abuse. It does not justify close scrutiny of the remedies chosen by an injured party. The basic model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation limit as a safeguard. That limit should be cautiously employed.

4. *Remedies Retained.* Section 1-103 indicates that this article, including the remedy provisions, is supplemented by various general sources of law. Included are equitable and similar remedies. These are not displaced by Article 2B. Thus, for example, a right or remedy for breach under Article 2B does not displace a right of action or a remedy under intellectual property law. Damage awards are limited, of course, by the principle that prohibits double recovery for the same wrong, but often the two forms of recovery refer to different damages and are not a double recovery.

SECTION 2B-702. CANCELLATION.

(a) A party may cancel a contract if:

(1) cancellation is permitted by Section 2B-609(b);

(2) there is a material breach which has not been cured or waived; or

(3) the agreement allows cancellation for the breach.

(b) On cancellation, the following rules apply:

(1) A party in possession or control of licensed information, documentation, materials, or copies of licensed information shall take the following actions:

(A) A party that rightfully refused a copy shall comply with Section 2B-612(b) as to the refused copy in possession or control of that party. If there is any inconsistency between Section 2B-612(b) and this section, this section controls.

(B) A party in breach of contract that is in possession or control of

licensed information, documentation, materials or copies of them that would be subject to an obligation to return under Section 2B-627, shall deliver all documentation, materials and copies to the other party or hold them with reasonable care for a reasonable time for disposal at that party's instructions. The party in breach shall follow any reasonable instructions received from the other party.

(C) Except as provided in subparagraphs (A) and (B), the party shall comply with Section 2B-627 as to all information, documentation, materials, or copies.

(2) All obligations that are executory on both sides at the time of cancellation are discharged except that the rights, duties, and remedies described in Section 2B-625(b) survive.

(3) Cancellation of a license ends any right of the licensee to use the information, informational rights, copies or other materials under the license. However, the party that is not in breach may use them for a limited time after cancellation if the use:

(A) is within contractual use restrictions;

(B) occurs after the party in breach is notified of cancellation;

(C) is solely to mitigate loss; and

(D) is not contrary to instructions received from the party in breach concerning disposition of them.

(4) The obligations under this subsection and any section referred to herein apply to all information, documentation, materials, and copies received by the party and any copies made therefrom.

(c) A term providing that a contract may not be canceled precludes cancellation but does not limit other rights and remedies.

(d) Unless a contrary intention clearly appears, an expression such as "cancellation" or "rescission" or the like shall not be construed as a renunciation or discharge of a claim

in damages for an antecedent breach.

Uniform Law Source: 2A-505; 2-106(3)(4), 2-720.

Definitional Cross Reference:

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Term": Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section describes when cancellation of a contract can occur and what rights ensue from rightful cancellation. Cancellation means that one party ends the contract for breach. It terminates executory obligations but does not alter rights earned by prior performance or fixed due to prior breach. Cancellation is a remedy available for either the licensee or licensor.

2. *When Cancellation is Permitted.* Subsection (a) states three separate circumstances under which cancellation is permitted. Paragraph (a)(1) allows cancellation in a mass market transaction involving a single delivery of a copy if the copy can properly be refused under Section 2B-609. This rule protects consumers and other individuals who refuse a copy. Paragraph (a)(3) recognizes the general principle of contract choice, allowing cancellation if the agreement provides that cancellation is an appropriate remedy for a particular type of breach. Paragraph (a)(2) allows cancellation in the event of a material breach.

3. *Material Breach of Entire Contract.* Cancellation is a remedy for breach. A right to cancel exists if the breaching party's conduct constitutes a material breach of the entire contract or if the contract gives a right to cancel under the circumstances. What is a material breach of the entire contract depends on the terms of the agreement and the nature or effect of the breach. In the absence of contract terms Courts should draw on Section 2B-109 and general case law to determine what constitutes a material breach. A material breach does not require that the aggrieved party cancel. The aggrieved party may continue to perform, demand reciprocal performance, and collect damages. However, if the injured party does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach. Section 2B-6--.

4. *Effect on Use Rights.* A license grants permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If the license is canceled, that "defense" dissolves. A licensee who continues to act in a manner inconsistent with underlying intellectual property rights of the licensor exposes itself to an infringement claim. See *Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992); *Expediters International of Washington, Inc. v. Direct Line Cargo Management Services, Inc.*, -- F. Supp. -, 1998 WL 67532 (DNJ 1998) (use of software after license expired is infringement). Of course, in many cases, especially those involving access contracts, information obtained under the contract is not subject to contractual use restrictions after received. The cancellation of rights described here does not alter the recipient's rights with respect to such information or copies thereof.

5. *"No cancellation" clause.* Especially in transactions where the information is licensed for inclusion in another product, a common form of remedy limitation is to provide that the licensor cannot cancel for breach, but is limited to other remedies. The clause is effective as a remedy limitation, but does not alter other remedies. Thus, a party that acquires software under an agreement requiring five years of fixed payments and that agreed to such a clause, could not cancel, but remedies of recoupment, off-set, or damages remain intact. The party is not required to pay for information that it did not receive.

SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages or a party's other remedies, as by:

(1) precluding a party's right to cancel for breach;

(2) limiting remedies to return or delivery of copies and refund of the contract fee;

or

(3) limiting the remedies to repair or replacement.

(b) Resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. If performance of the exclusive remedy by the party in breach causes the remedy to fail of its essential purpose, the exclusive remedy fails. If the exclusive remedy fails, subject to subsection (c), the aggrieved party is entitled to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of terms disclaiming or limiting consequential or incidental damages if the contract expressly makes those terms independent of the agreed remedy.

(d) Consequential damages and incidental damages may be disclaimed or limited by agreement unless the disclaimer or limitation is unconscionable. Limitation or disclaimer of consequential damages for injury to the person in a consumer transaction for a computer program that is subject to this article and is contained in consumer goods is prima facie unconscionable, but limitation or disclaimer of damages where the loss is commercial is not.

Uniform Law Source: Section 2-719.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Computer program": Section 2B-102. "Consequential damages": Section 2B-102. "Consumer": Section 2B-102. "Consumer transaction": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Delivery": Section 2B-102. "Incidental damages": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.

Reporter's Note:

1. ***Scope of this Section.*** **This section deals with contract limitations on what remedies are available in the event of breach. It applies the dominant principle of freedom of contract, but limits the effect of contract choices to protect a licensee. Terms modifying remedies are also subject to Section 2B-704 and 2B-705.**

2. ***Agreement Controls.*** **Under subsection (a) parties may shape their remedies to their particular requirements. Agreements limiting or modifying remedies are generally given effect. However, the contract must clearly indicate that agreed remedies are exclusive. This is stated in subsection (b) which is consistent with original Article 2. The right to control remedies by agreement and thus to define risks is a fundamental facet of contract practice defining the cost of a transaction.**

3. ***Listed Illustrations.*** **Subsection (a) lists some remedy limitations that are common in commercial practice. The illustrations are not an exclusive list. They include:**

a. Replacement, Repair and Refund. **Limited remedy terms that refer to replacement, repair or refund are used in some information industries. These terms refer to a limited remedy. In transactions involving single copies of information for an end user, the reference to refund ordinarily refers to refund of the single license fee payment. The three terms however indicate entirely different agreed remedies: replacement refers to supplying another copy of the same product, while repair obligates the party to revise the product to eliminate defects and refund obligates it to return money already paid. The purpose of a "replacement" or a "repair" obligation is to limit remedies, but still provide the licensee with an information product that meets contract obligations. The purpose of the "refund" remedy is to return moneys paid by the licensee for the product and to limit damages.**

While many transactions involve contract fees based on a single payment, other cases entail a contract fee that includes royalties or other fees to be paid in the future. In such cases, the reference to refund in this section does not restrict the ability of the parties to agree to return of a fixed maximum amount or any other portion of the expected fee, excluding all or part of anticipated royalties. Refund contemplates return of payments made, not coverage of all value that might have been received under the agreement. Another example of a situation where less than all payments may be covered under a refund remedy is an on-going or other services-like contract where a breach occurs in the third or fourth year of a five year relationship. A limited remedy may provide any adequate agreed remedy.

***b. No Cancellation*. Subsection (a) lists a remedy (barring cancellation) relevant in information transactions important to the licensee when the licensee commits resources to develop and exploit information licensed to it. The contractual ability to bar the right to cancel is important in that environment. It has no adverse effect in consumer transactions since, even though a consumer may not cancel if it agrees to such term, the other remedies (refusal, recoupment, damages) allow it to fully protect its interest.**

4. *Exclusive Remedies.* A contractual remedy is not an exclusive remedy unless the contract expressly so provides. The second sentence of subsection (b) follows original Article 2. It makes no change in the application of this rule to cases where there is a design flaw and performance of the remedy leaves the licensee without what it expected under the contract – a fully functioning product. This section preserves the core of Article 2 cases on this point. In situations where the defect cannot be corrected because, for example, it lies in the design of the product, a "repair" remedy fails.

The circumstances are different if the remedy requires or permits refund. In such case, the purpose of the remedy is to either provide a functioning product or return the other party's money. Performance of the refund meets this purpose even though the licensee did not receive a functioning product. Especially when dealing with on-going contracts or royalty-based contract fees, if the agreed exclusive remedy does not contemplate payment of all fees that might have been earned, whether performance of the remedy meets its essential purpose depends on whether the amount agreed to was actually provided. If performance of the remedy is not accomplished, the party has a right to all remedies under this article subject to subsection (c).

5. *Limited Remedy Related to Consequential Damage Limits.* Article 2B assumes that the consequential damages limitation covers all aspects of the obligations and remedies under that agreement. Some commentators characterize the obligation to replace or repair in a limited remedy as a promise and a separate contractual obligation, breach of which creates a damages claim. Whether that is correct or whether the remedy clauses are better treated as an overall transaction, is not clear since it should depend on the actual expectations of the parties. Article 2B treats such remedy clauses as part of an overall transaction and sets out a presumption that a consequential damages limitation to apply to all consequential loss. A failure of the remedy results in failure of that limitation unless the agreement expressly provides that the consequential damages limitation is independent of the

remedy limitation. In that case, the consequential damage limit continues to apply to any and all consequential damages incurred in the overall transaction.

Subsection (c) resolves a frequently litigated issue under Article 2. It deals with the effect of failure of a limited remedy on a contract limitation or exclusion of consequential damages. This is a contract interpretation issue that asks whether one term (exclusion of consequential damages) is dependent on, or independent of, the other (limited remedy).

The interpretation question concerns whether failure (or breach) of the one (the limited remedy) affects the other (consequential damage limitation). Cases under Article 2 split, but most hold that in commercial contracts, failure of one remedy does not exclude enforceability of the other. Article 2B rejects this, enacting the assumption more favorable to licensees that a consequential damage limit fails if the limited remedy fails, unless the contract makes the consequential damages limit clearly independent of the limited remedy. This favors the party against whom the limitation of damages applies, treating the two terms as a package unless the agreement indicates otherwise. If the agreement expressly states that the two are independent, both parties are bound by the agreement.

6. *Minimum Adequate Remedy.* This article does not give a court the right to invalidate a remedy limitation because it believes that the imitation does not afford a "minimum adequate remedy" for the aggrieved party. On this issue, Article 2B follows original Article 2. Standards of unconscionability and standards for formation of a binding contract adequately set floors on what agreed terms are binding with respect to remedies. The essence of a contract is that parties accept the legal consequences of their deal and that there be at least a fair quantum of remedy in the event of breach. Contracts that do not do so may fail for lack of consideration or mutuality. This does not mean that a court can, after the fact, rewrite the contract in reference to remedies rules. If there is a remedy provided and made exclusive, the fact that it does not fully compensate the aggrieved party is not a reason to allow that party to avoid the consequences of its contract. For example, a contract that limits recovery for defects is software used in a satellite system to the price of the software (e.g., $10,000) is not rendered unenforceable because the licensee used the software and a defect caused loss of a $1 million satellite. The decision to set the contract limit affected pricing and risk and cannot be set aside because the risk assumed eventually fell on one party. On the other hand, a contract that states "licensee will have no responsibility for any harm to licensor caused by licensee's breach f the agreement" may raise a question of whether the agreement itself had sufficient mutuality to establish a contract.

7. *Consequential Damage Limits.* Commercial disclaimer or limitation of consequential damages are ordinarily enforceable and are routine aspects of commercial practice. In consumer transactions, the issues may be difference. Original Article 2 made disclaimer of personal injury damages in sales of consumer goods prima facie unconscionable. Article 2B follows that rule for computer programs contained in consumer goods. In other information contracts, however, including cases of computer programs, most modern cases do not rely on contract law to create liability for personal injury in situations where this may be appropriate. More generally, most cases reject personal injury claims against information providers even under tort law. This pattern reflects a belief that goods and information products are not the same. In reference to information products, courts must balance public interests in encouraging distribution of information against interests in creating new sources of recovery. This article adopts the sales law presumption only in cases where that rule is relevant and established, but does not extend that rule to publishers of computer encyclopedias, interactive games and other contexts. It does not preclude courts using general theories of tort law to do so, if contrary to the prior development of such law, they conclude that such risk allocation is appropriate.

SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages caused by a breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of the loss anticipated at the time of

contracting, the actual loss, or the actual or anticipated difficulties of proving loss in the event of breach. A term fixing unreasonably large liquidated damages is void as a penalty.

(b) If a party justifiably withholds delivery of copies because of the other party's breach, the party in breach is entitled to restitution of any amount by which the sum of the payments it made for the copies exceeds the amount of the liquidated damages payable to the aggrieved party in accordance with subsection (a). The right to restitution is subject to offset to the extent that the aggrieved party establishes:

(1) a right to recover damages under this article other than subsection (a); and

(2) the amount or value of any benefits received by the party in breach, directly or indirectly, by reason of the contract.

Uniform Law Source: 2-718.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Party": Section 2B-102. "Term": Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section deals with the enforceability of liquidated damages clauses in an agreement. The basic approach is that such terms of an agreement are enforceable unless unreasonable. The section derives from, but expands on original Section 2-718. A liquidated damages term differs from other remedy modifications in that it sets both a minimum and maximum recovery, while for example, a damage limitation caps the remedy at a particular amount, but does not guaranty that recovery if facts to support it do not exist.

2. *General Standard.* Under subsection (a), liquidated damages terms are enforced if the amount is reasonable in light of the circumstances and commercial context of the transaction. An agreed term liquidating damages in the event of breach is, in concept, no different than any other term of an agreement. The presumption is that courts should enforce the terms agreed by the parties. This section sets out the standards that allow a court to take a different approach to liquidated damages terms and invalidate them in some cases.

This section follows common law and expands on conditions that sustain enforceability of damage liquidation clauses. The clause is sustainable if it is reasonable in light of before-the–fact or after-the-fact estimates of the amount of damages or the difficulty of proof. This includes all damages terms that are reasonable in light of the actual loss, the loss anticipated at the time of contracting, or the actual or anticipated difficulties of proving loss in the event of breach. Basically, the term is enforceable unless there is no reasonable basis on which to sustain it.

If the liquidated damage term chosen by the parties is based on their assessment of risk 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. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to the enforceability of the term.

3. *Penalties and Small Damages.* A term fixing unreasonably large liquidated damages is unenforceable as a penalty. No position is taken with respect to terms that fix unreasonably low damages. Such terms are to be reviewed in reference to basic standards of unconscionability when applicable.

4. *Restitution.* Subsection (b) carries forward original Article 2 concepts.

SECTION 2B-705. STATUTE OF LIMITATIONS.

(a) An action for breach of contract must be commenced:

(1) 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

(2) no later than five years after the right of action accrues.

(b) By the original agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues but may not extend it.

(c) Except as otherwise provided in subsection (d), a right of action accrues when the act or omission constituting a breach of contract occurs even if the aggrieved party did not know of the breach. A right of action for breach of warranty accrues when tender of delivery of a copy pursuant to Section 2B-607, or when access to the information occurs. However, if the warranty expressly extends to future performance of the information or a copy, the right of action accrues when the performance fails to conform to the warranty, but not later than the date the warranty expires.

(d) In the following cases, a right of action accrues on the later of the date the act or omission constituting the breach occurred or the date on which it was or should have been discovered by the aggrieved party, but not earlier than the date for delivery of a copy if the claim relates to information in the copy:

(1) a breach of warranty against third-party claims for

(A) infringement or misappropriation; or

(B) libel, defamation, or the like;

(2) a breach of contract involving a party's disclosure or misuse of confidential information; or

(3) a failure to provide an indemnity.

(e) If an action commenced within the period of limitation is so terminated as to leave

available a remedy by another action for the same breach or indemnity, the other action may be commenced after expiration of the period of limitation if the action is commenced within six months after termination of the first action, unless the termination resulted from voluntary discontinuance or dismissal for failure or neglect to prosecute.

Uniform Law Source: Section 2A-506; 2-725.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Termination": Section 2B-102.

Reporter's Note:

1. *Scope and Purpose.* This section introduces a uniform statute of limitations for information transactions, providing an important reconciliation of competing state law rules applicable to industries that engage in nationwide business activities. The section removes these transactions from otherwise applicable, non-uniform state law rules. The terms of the section blend concepts of time of the event and discovery rule applicable to information contracts.

2. *Limitations Period.* Subsections (a) and (b) combine a rule that accrues the cause of action when the breach occurs with a discovery rule and a rule of repose. The primary rule in original Article 2 is that limitations bar the cause of action four years after the breach occurs. This section follows that primary rule and requires the action to be brought within four years of the time that the claim accrues. However, it also enacts a limited "discovery rule," which expands the time for bringing a cause of action in most states beyond that applicable under current U.C.C. law for sales of goods. This discovery rule may extend the time for bringing the lawsuit to up to five years from the time of breach.

The basic rule in subsection (a) refers to the time that the right of action accrues. Subsection (c) sets out a rule for deciding when that occurs. Subsection (d) contains rules that, in stated contexts, alter the time of breach rule to a time of discovery rule.

3. *Effect of Agreement.* Subsection (b) limits the role that agreements may play in modifying the limitations period. The theory is that statute of limitations rules reflect public policy about how long of a period may be permitted before one concludes that no action may be brought for an alleged breach. The subsection follows original Article 2 and precludes agreements that permit a period of limitations longer than the term stated in the statute. This does not preclude "tolling agreements" arranged between the parties during negotiation or other discussions about contract disputes. It only precludes extensions in the *original* agreement of the parties. The section also does not preclude other applications of tolling doctrine under general state law.

Subsection (b) also follows original Article 2 in precluding agreements that shorten the statute of limitations to less than one year. This rule does not preclude contracts that "limit" a warranty to a stated period of less than one year (e.g., ninety days). Such agreements typically define a term during which discovery of a breach and its effect must occur. Unless the agreement so states, it does not purport to limit the time in which a lawsuit may be brought. Thus, for example, a ninety day warranty term means that there is no breach unless the defect appears within ninety days after delivery, but if such occurs, the agreement does not restrict how long the aggrieved party may wait before bringing the lawsuit. That is determined by this section.

4. *Accrual of Cause of Action: Time of Performance.* The primary four year term of the statute refers to four years from when the right of action accrues. Article 2B applies two different rules for determining when the cause of action accrues. The primary rule for most cases is in subsection (c). The cause of action accrues when the conduct constituting a breach occurs or should have been discovered. In reference to an alleged breach of warranty generally, this occurs on delivery of the information or service, even if the performance defect does not become apparent until much later. Warranties are breached or not on delivery of the warranted subject matter.

In some cases, a warranty "extends to future conduct." This occurs, for example, if a warranty is that there are no defects that affect performance during the first ninety days after delivery. This section requires a court to apply this language according to its terms. Breach of this warranty occurs if a defect appears within that ninety day period. Subsection (c) confirms this result. It rejects the Article 2 rule which has been interpreted to

mean that such a warranty per se changes the basic limitations rule to a pure "discovery" rule, i.e., the cause of action does not accrue until the defect is or should have been discovered. That approach subverts the intent of the extended warranty. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

5. *Discovery Rule.* Subsection (d) describes selected cases in which the time of occurrence rule is replaced entirely by a time of discovery rule. Each of the listed situations concerns circumstances in which it would be inappropriate to define breach as occurring when performance is delivered because the breach is never manifested until later and because the assurances involved in the contract obligation go to events beyond the time of delivery.

SECTION 2B-706. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach of contract. Neither rescission nor a claim for rescission of the contract nor refusal or return of the information bars or is inconsistent with a claim for damages or other remedy.

Definitional Cross References.
"Contract": Section 1-201. "Information": Section 2B-102. "Remedy": Section 1-201.
Reporter's Note: Conforms to original Article 2.

[B. Damages]

SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) Except as otherwise provided in the agreement, 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. The burden of establishing a failure of the aggrieved party to take measures reasonable under the circumstances is on the party in breach.

(b) Neither party is entitled to recover:

(1) consequential damages for losses caused by the content of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative.

(c) The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality includes as consequential damages compensation for the benefit obtained as a result of the breach.

(d) For purposes of this article, market value is determined as of the date of breach and

the place for performance.

(e) Damages or expenses that relate to events that may occur after the date of judgment, must be reduced to their present value as of the date of judgment.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Consequential damages": "Contract": Section 1-201. Section 2B-102. "Direct damages": Section 2B-102. "Information": Section 2B-102."Informational content": Section 2B-102. "Party": Section 2B-102. "Present value": Section 2B-102. "Published informational content": Section 2B-102. "Remedy": Section 1-201.

Reporter's Notes:

1. *Scope of the Section.* This section brings together a number of general rules regarding computation of damages. Specific approaches to measuring licensor damages are contained in Section 2B-708. Specific approaches to measuring licensee damages are contained in Section 2B-709. Both of those sections are subject to the general principles stated here.

2. *Mitigation.* Subsection (a) 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 and is included under Section 1-103. The basic principle is that contract remedies are not punitive but compensatory. The injured party cannot act in a manner that enhances the loss and expect to have that loss compensated in the form of damages recoverable from the other party.

This general duty does not create an obligation of an aggrieved party to cover. The damages formulae in Section 2B-708 and 2B-709 contain various means of accommodating an adjustment of the damages recoverable by reference to statutory damages measures that are in effect a surrogate for actual mitigation. This is true, for example, in statutory formulae based on market value of the performance. If that formula is used, whether there was an actual cover or other mitigation is often not relevant. The market value reference limits direct damages in a manner consistent with principles of mitigation. However, this Article also allows recovery of consequential as compared to direct damages and mitigation issues are highly relevant to such claims.

The burden of establishing that there was a failure to mitigate lies on the party claiming this as a defense against recovery of damages.

The reference to "except as otherwise provided" by agreement includes contractual liquidation of damages. An enforceable liquidated damages provision creates an agreed measure of damages. A court may not reduce or alter that contractual measure based on its determination about whether actual damages were adequately mitigated or not.

3. *Published Content.* Subsection (b) excludes consequential damages for "published informational content." Published informational content invokes many fundamental and important values of our society. Whether characterized as a First Amendment analysis or treated as a question of simple social policy, our culture has a substantial interest in promoting the dissemination of information. This article takes a position that supports and encourages distribution of informational content to the public. This conforms to modern U.S. law. 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.

The requirement is that the agreement expressly provide for consequential damages as a remedy. This is not achieved where the agreement merely includes an express warranty as to the quality of the information that is enforceable under Section 2B-402. The agreement must specifically contemplate a risk of liability for consequential damages.

As indicated in the definition of published informational content, the context is one in which the content provider does not deal directly with the data recipient in a special reliance setting. The information is compiled and published. Information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the liability limitations even under tort law. The *Restatement of Torts*, for example, limits exposure for negligent error in data to intended recipients and to "pecuniary loss" which corresponds to direct damages.

Illustration 1: D distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. C reviews the on-line information and trades 1 million shares of Acme at a price that causes a $10 million loss because the data were incorrect. If C were in a relationship of

reliance with Dow, consequential loss is recoverable. But this is published informational content, and C cannot recover alleged consequential loss.

Illustration 2: Internet-Games.com allows players to play a grisly 3-D game. One player who pays five dollars is shocked by the violence and spends a sleepless week. That customer should have no recovery at all, but if it can show a breach, the individual could not recover consequential loss since this is published informational content.

4. *Speculative Damages.* The article does not require proof with absolute certainty or mathematical precision. Consistent with the underlying principle of Article 1 that there be a liberal administration of the remedies of the Code, the remedies must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See *Restatement (Second) of Contracts* 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974).

5. *Confidential Information.* Subsection (c) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party to whom the confidentiality obligation is owed has an expectation of the information not being misused and that expectation is entitled to protection. Lost value does not easily fit into the idea of damages resulting from breach. Yet, compensation for such loss is important. Where the breach of confidence gives benefits to a third party that are not realized directly or indirectly by the party to the contract, recovery, if any, occurs under other law. The principle stated here, of course, is subject to the general ability of a court to exclude recovery that would put a party into a substantially better position than would have been true in the absence of breach and the basic principle that double recovery is not allowed. Section 2B-701.

6. *Market Value.* If market value is part of a damages computation, subsection (d) requires that market value be determined at the time and place for performance. Where performance is delivery of a copy, the place is as indicated in the agreement or in the Article 2B rules on tender. In other cases, such as an Internet transaction that provides access to an information system, the nature of the subject matter makes geographic touchstones difficult to determine or inappropriate. In such cases, courts may refer to Article 2B rules on choice of law, which provide a stable reference point relevant to and protective of both parties.

In determining market value, due weight must be given to any substitute transaction actually entered into by a party taking into account the extent to which the transaction involved terms, performance, information, and informational rights similar in terms, quality, and character to the agreed performance.

7. *Present Value.* Subsection (e) provides that damages as to future events are awarded based on present value as of the date of judgment. "Present value", a defined term, provides for discounting the value of future payments or losses as measured at a particular point in time. This requires that, *as to damages awarded for eventualities that are in the future*, courts do so based on a present value standard. As to losses and expenses that have already occurred, the present value measurement does not apply. No change in the law on pre-judgment interest is intended.

SECTION 2B-708. LICENSOR'S DAMAGES.

(a) For purposes of this section, a "substitute transaction" is a transaction by the licensor which would not have been possible in the absence of the licensee's breach and which is in the same information or informational rights with the same contractual use restrictions as the transaction to which the licensee's breach applies.

(b) Subject to Section 2B-707, if there is a breach of contract by a licensee, the licensor may recover the following as compensation for the loss resulting in the ordinary course from the

particular breach or, if appropriate, as to the entire contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and the market value of other consideration required under the contract for the performance that was the subject of the breach:

(A) the amount of accrued and unpaid contract fees and the market value of other consideration earned but not received for:

(i) any performance accepted by the licensee; and

(ii) any performance to which Section 2B-604 applies;

(B) for performances not governed by subparagraph (A), if the licensee repudiated or wrongfully refused the performance or the licensor rightfully canceled and the breach makes possible a substitute transaction, the amount of loss as determined by the following:

(i) contract fees and the market value of other consideration required under the contract for the performance less the contract fees and market value of other consideration received from an actual and commercially reasonable substitute transaction entered into by the licensor in good faith and without unreasonable delay; or

(ii) contract fees and the market value of other consideration required under the contract for the performance less the market value of a commercially reasonable hypothetical substitute transaction.

(C) for performances not covered by paragraph (1)(A), if the breach does not make possible a substitute transaction, lost profit, including in the calculation reasonable overhead, that the licensor would have realized on acceptance and full payment for performance that was not delivered to the licensee because of the licensee's breach; or

(D) damages calculated in any reasonable manner; and

(2) any consequential and incidental damages.

Uniform Law Source: Section 2A-528; Section 2-708.

Definitional Cross References. "Consequential damages": Section 2B-102; "Contract": Section 1-201. "Contract fee": Section 2B-102. "Direct damages": Section 2B-102; "Incidental damages": Section 2B-102; "Information": Section 2B-102; "Informational rights": Section 2B-102. "Licensee": Section 2B-102; "Licensor": Section 2B-102; Material Breach": Section 2B-109. "Market value": Section 2B-707. "Present value": Section 2B-102.

Reporter's Note:

1. *Scope and General Structure of the Section.* This section allows the licensor to choose among alternatives to fit its circumstances. The choice is subject only to the prohibition on double recovery and to the court's right to prevent excessive recovery under Section 2B-701. Because of the diverse issues involved in breach of a license, Article 2B rejects the hierarchy in original Article 2 making some remedies available only if others are inadequate. It nevertheless retains much of the conceptual framework from Article 2. Section 2B-707 provides that damages related to events in the future at the time of the award are to be set based on their present value. It also provides for when and where "market value" is to be determined.

2. *General Approach.* This section gives the licensor a right to elect damages under measures described in (b). The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice substantially over-compensates or enables double recovery. No order of preference is stated for the options. The formulas in subsection (b) measure "direct damages" in terms of the difference in value between performance promised and received, not counting any lost expected benefits beyond the performance itself. The measure also includes reimbursement of value already given to the other party when appropriate. Direct damages are capped by the contract fee for the breached performance and the market value of other consideration to be received. This does not include the loss of expected benefits from use of the expected performance in other contexts. If recoverable, those are consequential, not direct damages.

3. *Intangible Subject Matter: Substitute Transactions.* Licensor remedies differ from remedies for sellers under Article 2. The most significant differences result from recognition of the intangible character of information. Article 2 focuses damages calculation on an assumption that the seller's loss lies in the disposition of the particular item (goods). For information, the particular copy (item) is not the focus. Given their ability to be recreated easily and rapidly, with little cost, information assets are prime candidates for damage computation focusing on profit lost, a scenario that in Article 2 is associated with so-called lost volume sellers. The basic principle, however, as applied to Article 2B transactions is not a matter of lost volume, but of whether the breach enables a substitute transaction that could not otherwise have occurred and the returns from which are properly considered in determining direct damages.

Given this structure, the term "substitute transaction" is highly important to properly administering the damages system to understand when the substitute transaction is made possible by the breach. A transaction is not a substitute simply because the transferor used a diskette or other media that might have been used to deliver the same information to the licensee in breach. The focus in Article 2B transactions is on the information, not the tangible media, and on the contractual use restrictions associated with the transaction. To be a substitute transaction, the transaction must involve the same information under the same contractual use restrictions applicable to the transaction in breach.

The substitute transaction must have been made possible by the breach. This has two effects. First, a substitute transaction must be possible. If there is no market and no alternative licensee for the same information under the same terms, then no substitute is possible. Second, even if similar transactions are possible, the licensor's ability to engage in the similar transaction must be due to the breach and not simply because these other transactions would have been possible in any event. Thus, in a breach of a non-exclusive access contract by a licensee, ordinarily there would not be a substitute transaction as meant here even though another transaction in fact occurred because the licensor has effectively unlimited capability to make access available to others. While a new access contract may occur after breach, it was not made possible by breach – the new license would have occurred with or without the breach. In most non-exclusive licenses, breach does not enable a new transaction in the sense intended in this section. This is consistent with common law and explicitly recognizes that in effect, the information assets are available in relatively infinite supply. On the other hand, breach and cancellation of a licensed exclusive right to show a work in a particular geographic area may enable a substitute license for that area that could not have been

made because of the exclusive nature of the breached license.

4. *Computation Approaches.* The basic damages formulae describe direct damages and are capped in total recovery by the contract fee and the market value of other consideration to be received by the licensor. They yield the following results:

a. *Accrued Fees and Consideration.* Paragraph (b)(1)(A) recognizes that the aggrieved licensor is entitled to recover any accrued and unpaid fees or the value of other consideration owed for information or services actually delivered. The fees are direct damages.

b. *Measuring other Direct Damages.* This Section outlines several approaches to direct damages in addition to unpaid fees.

(i). Recovery Measured by Contract Fee: Substitute Transaction Enabled. Paragraph (b)(1)(B) describes recovery measured by unaccrued contract fees and other consideration less the value of an actual or hypothetical substitute transaction made possible by the breach. Section 2B-707 requires computation at present value for losses associated with events occurring after judgment. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. Speculative damages are not recoverable. The reasonable certainty principle is recognized in the *Restatement* and throughout common law. *Restatement (Second) of Contracts* § 352. See Section 2B-707.

The recovery is reduced by due allowance for the proceeds of a substitute transaction made possible by the breach as measured either by an actual substitute transaction or the market value of a commercially reasonable hypothetical transaction that could have been made. The substitute transaction must have been made possible by the breach. If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery is reduced by the market value (if any) of the hypothetical substitute. As with actual transactions, market value of a hypothetical substitute must utilize a market for the same use restrictions for the same information.

(ii). *Recovery Measured by Lost Profits.* Paragraph (b)(1)(C) provides as an alternative that losses may be measured by lost profits caused by a failure to accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts should refer to common law cases on licenses and to cases under the lost profit concept in Article 2. Unlike in Article 2, however, use of this standard does not require proof that the alternative standards are inadequate to compensate the licensor. The injured party chooses the method of computation.

As with contract fees, lost profits must be proven with reasonable certainty and may not be merely speculative. *Restatement (Second) of Contracts* § 352. Similarly, recovery is subject to the general duty to mitigate. See *Krafsur v. UOP, (In re El Paso Refinery)*, 196 BR 58 (Bankr. WD Tex. 1996).

(iii). Measurement in any Reasonable Manner. Subsection (b)(1)(D) recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases. Direct damages ordinarily refer to the value of the performance received or expected as measured by contract terms, while consequential loss refers to reasonably foreseeable loss resulting from the inability to use the performance.

c. *Consequential and Incidental Damages.* The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. See discussion in Section 2B-102 on the measurement and application of the concept of consequential damages. The damage recovery is also subject to the general provisions of Section 2B-701 and Section 2B-702.

5. *Illustrative Situations.*

Illustration 1: LR licenses a master disk of its software to LE and allows LE to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. LE wrongfully refuses the disk and repudiates the contract. Under (a)(1)(B), LR would recover $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach and (2) by any other failure to mitigate. However, (a)(1)(B) would not apply since the second 10,000 copy license is not a substitute if the license was not made possible by the breach. Recovery under subsection (a)(1)(C) is computed by assessing lost profit including reasonably attributable overhead.

Illustration 2: Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, LR makes an identical license with Second for a fee of $900,000. This transaction was possible because the first exclusive license was canceled. LR recovery is $100,000 less any net

cost savings not accounted for in the second transaction. If there was no actual second license, but the market value for such a license was $800,000, the recovery is $200,000 less any net cost savings not accounted for in the hypothetical market value.

Illustration 3: LR grants an exclusive U.S. license to LE to distribute copies of LR's copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, LE breaches and LR cancels. Recovery is the present value of the remaining contract fees with due allowance for any actual or hypothetical substitute transaction made possible by the breach.

6. *Remedies under Other Law.* The licensor may have remedies under other law. The primary source is intellectual property law. Breach 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 breach consists of acting outside the scope of the license and in violation of the intellectual property right. Intellectual property remedies do not displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general rule is that all remedies are cumulative, except that double recovery is not permitted.

SECTION 2B-709. LICENSEE'S DAMAGES.

(a) Subject to Section 2B-707 and subsection (b), if there is a breach by a licensor, the licensee may recover the following as compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways, but not to exceed the contract fee for the performance that was the subject of the breach plus restitution of any amounts paid for performance not received and not accounted for within the indicated recovery: (A) with respect to performance that has been accepted and the acceptance has not been rightfully revoked, the value of the performance required less the value of the performance accepted as of the time and place of acceptance;

(B) with respect to performance that has not been rendered or that was rightfully refused or acceptance of which was rightfully revoked:

(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;

(ii) the market value of the performance less the contract fee for

that performance; or

(iii) the cost of a commercially reasonable substitute transaction less the contract fee under the breached contract, if the substitute transaction was actually entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use restrictions,; or

(C) damages calculated in any reasonable manner; and

(2) incidental and consequential damages.

(b) The amount of damages must be reduced by any unpaid contract fees for performance by the licensor which has been accepted by the licensee and as to which the acceptance has not been rightfully revoked.

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2).
Definitional Cross Reference: "Consequential damages": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Direct damages": Section 2B-102. "Incidental damages": Section 2B-102. "Information": Section 2B-102. "Informational rights"" Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Material breach": Section 2B-109. "Market value": Section 2B-707. "Present value": Section 2B-102. "Term". Section 1-201. "Value": Section 1-201.
Reporter's Notes:

1. *Scope and General Structure of the Section.* As with licensor remedies, this section allows the licensee to choose among alternatives to fit its circumstances. The licensee's choice is subject only to the prohibition on double recovery and to the court's right to prevent excessive recovery under Section 2B-701. Because of the diverse issues involved in breach of a license, Article 2B rejects the hierarchy in original Article 2 making some remedies available only if others are inadequate. It nevertheless retains much of the conceptual framework from Article 2, preserving both market value and cover approaches to computing damages. Section 2B-707 provides that damages related to events in the future at the time of the award are to be set based on their present value. It also provides for when and where "market value" is to be determined.

2. *Direct Damages.* The formulae in subsection (a)(1) measure direct damages. They are capped by the market value of the performance that was breached plus restitution of fees paid for which performance was not received. Market value refers to what would be charged in a similar transaction for the performance that was the subject of the breach. "Direct damages" are the difference in market value between performance promised and performance received, not counting lost expected benefits from anticipated use of the expected performance. If recoverable, these latter losses are consequential, not direct damages. This section rejects cases such as *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 1982) which, under a standard referring simply to "value", incorporate in direct damages an assessment of how valuable to the aggrieved party the use of the expected performance would have been

3. *Computational Approaches.*

Subsection (a) provides for recovery under the formulae stated in that section less expenses saved as a result of the breach, to the extent these are not reflected in the formula recovery. In addition to recovery of direct damages under the stated measures, subsection (a)(2) allows recovery of incidental and consequential damages. All of the damages recoverable under this section are subject to the general standards for damage computation in Section 2B-707 which, among other things, excludes recovery of consequential damages for published informational content and recovery of claimed damages that are speculative in nature.

a. Lost Value in Accepted Performance. Paragraph (a)(1)(A) provides for recovery of the difference in the expected value for performance accepted or performance that cannot be returned and the actual value as received. Thus, for example, if software with a value of $10,000 was to be delivered, but because of a defect, the value was $9,000, this paragraph yields a recovery of $1,000 if the licensee accepted the software. As indicated by the general cap on direct damages stated in subsection (a)(1), the expected value is generally measured by the contract fee for the performance if it had been as expected. Recovery of any loss that exceeds that amount is in the nature of consequential damages.

The expected value of the performance in the absence of a defect will often equal the agreed price for that performance. This article rejects the approach of courts that compute direct damages in terms of potential benefits expected from use, a concept more appropriately entailed in computation of consequential damages. The section, however, allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality if those costs are commercially reasonable and incurred in good faith.

b. Performance not Received or Accepted. In contrast to paragraph (a)(1)(A), paragraph (a)(1)(B) deals with recovery of damages in reference to performance that has not been accepted by the licensee.

(i). Recovery of Fees. Paragraph (a)(1)(B)(i) confirms that the licensee is entitled to recover any fees paid for which performance was not received. Performance has not been provided if the licensor fails to make a required delivery or repudiates, or if the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled. This provision allows restitution of amounts paid for such undelivered performance.

(ii). Market and Cover. Paragraphs (a)(1)(B)(ii) and (B)(iii) parallel Article 2 by comparing contract price to either the market value of the performance not received or the cost of cover replacing that performance with a reasonable substitute. In each case, as in general throughout this section, the recovery is reduced by the amount of any expenses saved as a result of the breach. Section 2B-707 requires that market value be determined as of the time and place for the performance that is in breach.

Paragraph (B)(iii) recognizes the right to cover as a means of fixing the amount of damages and avoiding further loss due to breach. This rule provides that recovery can be computed based on a commercially reasonable cover containing the same contractual use restrictions as the original contract. In administering claims for damages based on cover, courts must recognize the differences between the application of this remedy in context of goods transactions and its application in the area of information commerce. Where the information that was not delivered is of a mass-market character obtainable from numerous sources, the similarities between goods and information is strong. On the other hand, in most commercial contexts, the information to be delivered may not be available from any other source (e.g., a proprietary software product available solely from the copyright owner). In such cases, "cover" requires a different product. It is to be treated as cover for purposes of damages computation only if the similarities are close and are such as would not in themselves result in differences in cost. This section allows cover through commercially reasonable substitutes. It does not, however, allow cover with information products obtained under different contractual use restrictions than in the original contract. Use restrictions are important to defining the product itself and its price. They are sufficiently material that differences in such terms means that a different product is involved. Recovery when this occurs is better left to "market value" determinations. For example, while a licensee can cover for a breach in delivery of a word processing program by obtaining a different program as a commercially reasonable substitute, that version cannot be obtained under a perpetual license, where the original program was under a one year license.

c. Measured in any Reasonable Manner. Subsection (a)(1)(C) authorizes the licensee to compute damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance and instructs the parties and the courts to rely on reasonable standards. The measurement, while open-ended in computation technique, is limited to the type of damages discussed here and by the cap on recovery of direct damages expressed in subsection (a)(1).

3. *Consequential and Incidental Damages.* The licensee may also recover incidental and consequential damages in an appropriate case. If proven with reasonable certainty, damages can include lost profits.

4. *Illustrative Cases.*

Illustration 1: LE contracts for a 1,000 person site license for database software from LR. The contract fee is $500,000 in initial payment and $10,000 for each month of use. The term is two years. LE makes the first payment, but LR fails to deliver. LE cancels and obtains a substitute system under a three year contract for $500,000 and $11,000 per month. It is entitled to return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court should consider to what extent this second transaction defines the market value in light

of differences in the terms of the license and the nature of the software and other relevant variables. The replacement does not qualify as cover because of the differences in the contract terms on duration of the license.

Illustration 2: Same facts as in Illustration 1, but after breach LE obtains a license for LR software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the LR contract. Since the new contract is for the same information under the same terms, LE has recovery of its initial payment, the $100,000 price difference, and any recoverable incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While LE could reject the software, it elects to accept the license. It sues for damages. The issue is establishing the difference in value between a proper system and the one delivered. Assume that the difference is $150,000. LE recovers that amount as direct damages, along with any recoverable incidental or consequential damages.

SECTION 2B-710. RECOUPMENT.

(a) Except as otherwise provided in subsection (b), an aggrieved party, upon notifying the party in breach of contract of its intention to do so, may deduct all or any part of the damages resulting from the breach from any payments still due under the same contract.

(b) If a breach of contract is not material with reference to the particular performance, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Section 2-717.

Definitional Cross References. "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Material breach": Section 2B-109. "Party": Section 2B-102.

Reporter's Note:

1. *Scope of the Section.* This section codifies in modified form the general right of recoupment. Recoupment, as contrasted to set-off, allows a party to exercise self-help by recovering money owed through withholding, in full or in part, payments due under the same contract. The section derives from original Section 2-717, but expands the concept to deal with recoupment by either party.

2. *Basic Standard.* Subsection (a) permits either party to deduct from payments owed to the other damages resulting from the other party's breach. To bring this right into application, the breach must be of the same contract under which the payment in question is being withheld. The concept applies equally to withholding royalties due or withholding from a license fee owed. This is a form of self-help. Exercise of the right requires notice to the other party of the intent to withhold payments. In conformity to the general approach of this Article, no formality of notice is required and any language that reasonably indicates the party's reason for holding up payment is sufficient. In the absence of adequate notice, withholding of payments is a breach and may also provide cause for insecurity and a right to demand assurances of future performance under Section 2B-620.

3. *Non-material Breaches.* Subsection (b) limits the right to recoup in the case of a nonmaterial breach in an ongoing performance contract. This limit applies only if the breach was non-material as to both the particular performance and the entire contract. Thus, a complete failure to deliver a shipment of copies is outside the limit since it is material as to that particular performance. On the other hand, if only a minor problem exists in reference to one performance, the balance of interests shifts in a contract requiring on-going performance by the other party. In such contracts, allowing self-help reduction of payments creates a risk of over-reaching by the party withholding payment by creating a pattern of partial non-performance without a clear justification for doing so.

[C. Performance Remedies]

SECTION 2B-711. SPECIFIC PERFORMANCE.

(a) Specific performance may be ordered, if:

(1) the agreement expressly provides for that remedy, other than for an obligation for the payment of money;

(2) the contract was not for personal services and the agreed performance is unique; or

(3) in other proper circumstances.

(b) An order for specific performance may contain any terms and conditions considered just and must provide adequate safeguards consistent with the contract to protect confidential information, information, and informational rights of both parties.

Uniform Law Source: 2A-521. Section 2-716. Revised.
Definitional Cross References. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.
Reporter's Notes:

1. *Scope of this Section.* This section adapts and expands on existing U.C.C. law regarding the remedy of specific performance. It allows this as a contracted for remedy, but also expressly refers to a judicial obligation to condition an award on protection of the confidential information and informational rights of the party order to perform.

2. *Contracted For Remedy.* Subsection (a) allows the parties to contract for specific performance, so long as a court can administer that remedy. This right excludes the obligation to pay a fee, however, since collection of a fee is essentially a monetary judgment and not appropriate for specific performance themes. Authorization of a contracted-for specific performance remedy provides an efficient means of circumventing losses that are inevitable where a contract obligation can be, in effect, converted into an obligation to pay rather than perform.

3. *Judicial Remedy.* Subsection (a)(2) states the substantive standard for specific performance. It follows Article 2. The standards cited here are from original Article 2 and differ somewhat from general common law principles. *Restatement (Second) of Contracts* § 357, *Introductory note.*

a. Personal Services. Specific performance cannot be ordered for a "personal services contract." This reflects the standard principle that an individual cannot be forced to perform a contract or other obligation against the individual's will. Determining what constitutes a personal services contract for purposes of this rule requires a court to look closely at the nature of the agreement and at what was to be provided pursuant to the agreement. A contract for a named individual of superior skill or artistry to perform a particular task is a personal services contract. Breach of such agreement creates a right to damages, but does not allow an award of specific performance enforceable by the contempt powers of the court against the individual. The case of a corporation that agrees to provide services pursuant to an agreement is less clear. In many cases, the corporation's contractual obligation does not fall within the realm of personal services because any person in the corporation can perform. The general obligation is that someone or something will deliver the relevant services.

Applying this standard in context of development contracts requires that the court carefully

scrutinize what is the bargained for performance. Was the agreement premised on an expectation that an identified individual would develop the program, or was the contract primarily one requiring development of the program, regardless of the identity of the person ultimately responsible.

Of course, even though the contract does not involve personal services, this does not require or even necessarily permit an award of specific performance. This is justified only if the performance is unique or the circumstances are otherwise appropriate.

b. Unique Subject Matter. This section adopts the rule of original Article 2. Specific performance under that rule is not limited to cases where the subject matter of the contract is already identified to the contract at the time of the contract. The test of uniqueness requires that a court examine the total situation that characterizes the contract. It incorporates a commercially realistic interpretation of the importance or uniqueness of the particular source. Despite the often unique character of information provided by a particular source, however, respect for a licensor's property and confidentiality interests often precludes specific performance of an obligation to create or a right to continue use of the property unless the need is compelling. See *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). Specific performance may be appropriate to prevent misuse or wrongful disclosure of confidential material because the performance (non-disclosure) is commercially significant and cannot be adequately protected through an award of damages. Such an award is one potential illustration of the "other proper circumstances" referred to in this section and in current law.

4. *Conditioning the Order.* The terms of any order of specific performance are, of course, determined within the discretion of the court. Subsection (b) recognizes this, but provides an important protection for confidential information relevant for both the licensor and the licensee where performance would jeopardize interests in confidential information of a party. Confidentiality and intellectual property interests must be adequately dealt with and protected in any specific performance award. Those interests, of course, focus on the interests of the party claiming confidentiality, which may either the party ordered to perform or the party receiving the specific performance.

SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, a licensor remains bound by all contractual use restrictions on information of the licensee, but the licensor may:

(1) identify to the contract any conforming copy not already identified if, at the time it learned of the breach, the copy was in its possession;

(2) in the exercise of reasonable commercial judgment for purposes of avoiding loss and effective realization on effort or investment, complete the information and identify it to the contract, cease work on it, relicense or dispose of it consistent with Sections 2B-502, or proceed in any other commercially reasonable manner;

(3) pursue any remedy for breach that has not been waived.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.
Definitional Cross References. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102.
Reporter's Notes:

1. *Scope of the Section.* This section parallels original Section 2-704. It provides options to the licensor in proceeding after breach by the licensee. The choices referred to here and elsewhere, of course, are constrained by the general duty to mitigate damages.

2. *Right to Identify Copies to the Contract.* The right to identify conforming copies to the contract is applicable primarily to situations where the licensor intends to rely on the measure of damages that involves comparison of the contract fee with the fee received in a substitute transaction for the same information. It will be less commonly used in Article 2B transactions because the nature of licensing ordinarily does not fall within this type of damages computation. See Section 2B-708.

3. *Right to Complete Unfinished Information.* The licensor is given express power to complete information for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time the licensor learns of the breach make it clear that such action will result in a material increase in damages. The burden is on the licensee to show the commercially unreasonable nature of the licensor's action just as it would be under Section 2B-707 if the licensor elected not to complete and the allegation is that the licensor failed to mitigate loss.

SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, a licensee that has not canceled the contract may continue to use the information and informational rights under the contract. If the licensee continues to use the information or informational rights, the licensee is bound by all terms of the contract, including contractual use restrictions or obligations not to compete and any obligation to pay contract fees. In addition, the following rules apply:

(1) The licensee may pursue any remedy for breach that has not been waived.

(2) The licensor's rights remain in effect as if the licensor had not been in breach but are subject to the licensee's remedy for breach, including any right of recoupment or setoff.

Definitional Cross References. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.

Reporter's Note:

1. *Scope of the Section.* This section deals with the conditions under which the licensee may continue use of the information after breach by the licensor. It allows the licensee, in an appropriate case, to elect between canceling the license or retaining the license rights and obligations, while pursuing other remedies.

2. *Right to Continue Use.* This section allows a licensee after breach to continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. This remedy is not available if the licensee cancels the contract. Cancellation eliminates all rights of use under the license. Section 2B-702.

3. *License Remains in Force.* If the licensee elects to continue use, it remains bound by the contract terms as if no breach occurred, except, of course, for its right to a remedy for breach. Among the remedies that might be appropriate is the remedy of recoupment or a lawsuit for damages.

SECTION 2B-714. RIGHT TO DISCONTINUE ACCESS. On material breach of an access contract or if the agreement so provides, a party may discontinue all contractual rights of access of the party in breach and direct any person that is assisting the performance of the

contract to discontinue its performance.

Definitional Cross References. "Access contract": Section 2B-102. "Agreement": Section 1-201. "Party": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201.

Reporter's Notes:

1. *Scope of Section.* This section deals with the right of a party in an access contract to stop performance by denying further access to the other party in the event of material breach or if the contract so provides.

2. *Right to Deny Access.* The access provider may discontinue access without judicial authorization or prior notice in the event of material breach or, if the contract so provides, after other breach. This right flows from the nature of the agreement which allows electronic access to a facility owned or controlled by the licensor. The ability quickly to terminate access is a potentially important element of a party's ability to avoid on-going liability or continuing to provide benefits to the other party despite material breach of the agreement. The on-going liability risk might occur, for example, if the breach includes misuse of the access system to distribute infringing, libelous, or otherwise damaging material.

The right to discontinue corresponds to common law principles regarding contracts for access to facilities. At common law, these are treated as agreements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides even in absence of any breach. *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993).

3. *Relationship to Cancellation.* This section does not require the access provider to cancel the contract although, in most cases, discontinuing access may be equivalent to cancellation. As with cancellation, however, the right to discontinue requires a material breach or a breach allowing cancellation or discontinuation under the agreement. If the breach does not rise to this level, or if the access provider so chooses, it may proceed under the right to suspend performance and demand adequate assurance of future performance pursuant to Section 2B-620.

4. *Not Retaking Transfers.* This section does not give the licensor a right to retake transfers already made without judicial action, but merely to stop future performance. Rights with respect to information already in possession or control of the licensee at the time of breach are dealt with in Section 2B-715 and elsewhere.

SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) Upon cancellation of a license, the licensor has the right:

(1) to possession of all copies of the licensed information in the possession or control of the licensee and any other materials pertaining to that information which by contract were to be returned or delivered by the licensee to the licensor; and

(2) to prevent the continued exercise of contractual and informational rights in the licensed information under the license.

(b) Except as otherwise provided in Section 2B-714, a licensor may exercise its rights under subsection (a) without judicial process only if this can be done:

(1) without a breach of the peace; and

(2) without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

(c) In a judicial proceeding, a court may enjoin a licensee in breach of contract from continued use of the information and informational rights and may order that the licensor or a judicial officer take the steps described in Section 2B-627.

(d) A party has a right to an expedited judicial hearing on prejudgment relief to enforce or protect its rights under this section.

(e) The right to possession under this section is not available to the extent that the information, before breach of the license and in the ordinary course of performance under the license, was so altered or commingled that the information is no longer identifiable or separable.

(f) A licensee that provides information to a licensor subject to contractual use restrictions has the rights and is subject to the limitations of a licensor under this section with respect to the information it provides.

(g) This section neither authorizes nor precludes the exercise of rights under subsection (b) by electronic means.

Uniform Law Source: Section 2A-525, 526; Section 9-503. Revised.
Definitional Cross References. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.
Reporter's Notes:

1. *Scope of the Section.* This section applies only to licenses and only if the license is canceled for breach. In such cases, the aggrieved party has a right to recover the information and prevent use by the breaching party. The remedies are analogous to those in Article 2A. The rights, which may be exercised by either the licensor or the licensee, reflect the nature of a license, which grants conditional, rather than comprehensive rights in the transferee.

2. *Rights Recognized.* Subsection (a) recognizes two rights. The aggrieved party can obtain (1) possession of all copies of the information, and (2) when appropriate, an injunction against further use of the information. The combination implements the intent that, on cancellation of the license, the injured party has a full right to preclude any further benefits to the breaching party resulting from the licensed information. In many cases involving informational content, merely returning all copies does not achieve that result. The rights of possession and injunction, of course, apply only to information or copies provided under the license or copies made from licensed material. In a license, by definition, the licensor retains over-riding rights to control use of and access to the information. A breach that allows cancellation of the license triggers an immediate right to prevent further use and to retake the property conditionally conveyed to the licensee.

3. *Self-help.* Subsection (b) provides a right of self-help under standards consistent with Article 2A (for lessors) and Article 9 (for secured parties). The right to use self-help is constrained by the requirement in this section that there be a breach and cancellation of the license and by the requirement that the use of self-help not cause a "breach of the peace" or a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information. Article 9 decisions regarding breach of the peace may be relevant

under this section. Self-help that occurs in situations that do not meet these standards ordinarily constitutes a breach of contract. It may also violate other law, such as law pertaining to conversion.

4. *Expedited Hearing.* Subsection (d) creates a right to an expedited hearing to enforce rights or possession and restrictions on use. This allows early review to reduce what may be significant risks for the licensee and the licensor, e.g., the risk to the licensee that a slow judicial process may cause an increased risk of harm because it induces the licensor to resort to self-help means to enforce rights and the risk to the licensor that the delay may cause serious economic or other harm. The section does not define the what timing is required. This is left to state procedural law.

7. *Identifiability.* Under subsection (e) there must be some physically identifiable thing with reference to which the possessory rights can be applied. The right to possession cannot exist if the copies have been so commingled as to have become unidentifiable. This includes, for example, cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible because of the expected performance of the parties under the contract.

This limitation does not apply to the right to prevent use. For example, if trade secrets were provided to the licensee under contractual use restrictions, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is inseparable from other property of the party in breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license of an image which results in use of that image in a software game by the party in breach does not prevent the other party from barring continued use of the image in commerce after breach even if the image is inseparable from the game.

SECTION 2B-716. ELECTRONIC SELF HELP.

(a) Except as otherwise provided in subsection (b), on cancellation of a license the use of electronic means to exercise a licensor's rights under Section 2B-715(b) ("electronic self-help") is not permitted unless:

(1) the licensee manifests assent to a term in the license that authorizes use of electronic self-help;

(2) prior to the exercise of electronic self-help the licensor gives notice to the licensee that states:

(A) that the licensor intends to exercise electronic self-help as a remedy on or after 15 days from the receipt by the licensee of the notice;

(B) the nature of the breach which entitles the licensor to exercise self-help; and

(C) the name, title and address of a person with whom the licensee may communicate concerning the alleged breach.

(b) Electronic self-help is also permitted if:

(1) the licensor obtains possession of a copy without a breach of the peace and the electronic self-help is used solely with respect to that copy; or

(2) the licensed information is informational content licensed for public display or performance for entertainment or educational purposes.

(c) The licensee may recover damages caused by wrongful exercise of electronic self-help by the licensor, including consequential damages whether or not excluded by the terms of the license, if:

(1) the licensor fails to give notice as required by subsection (a) or acts before expiration of the time specified in the notice; or

(2) having received the notice described in subsection (a), the licensee gives notice describing in good faith the general nature and magnitude of damages, which notice is received by ~~to~~ the person designated under subsection (a)(2)(B) within 15 days of receipt by the licensee of the licensor's notice, but damages are not recoverable beyond the amount stated in the licensee's notice.

(d) A party has a right to an expedited hearing to contest or affirm the licensor's right to proceed under subsection (a).

(e) Rights or obligations under this section may not be waived by an agreement made prior to breach, but the parties by such agreement may specify the timing, method, and manner of giving notice under subsections (a) and (c) unless the terms are manifestly unreasonable.

Reporter's Note: This section is a modified version of a proposal adopted in principle at the November meeting to provide a basis for a resolution of the electronic self-help issue based on concepts of prior notice. The prior Draft of the article provided that it took no position authorizing or prohibiting electronic self-help.

PART 8
MISCELLANEOUS PROVISIONS

SECTION 2B-801. EFFECTIVE DATE. This [Act] takes effect on [ ].

SECTION 2B-802. TRANSACTIONS COVERED.

(a) This article applies to all transactions within its scope that become enforceable after its effective date.

(b) Contracts enforceable before the effective date of this article are governed by the law then in effect unless the parties agree to be governed by this article.