AGENDA
UCITA Standby Committee
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A. CERTAIN DEFAULT RULES

(A). SECTION 307(C): NUMBER OF USERS

a. Current Law:

Copyright case law holds that loading a program into a computer makes a copy and that moving that program from one part of computer memory to another makes another copy. See e.g., *MAI Sys.Corp. v. Peak Computer, Inc.*, 991 F2d 511 (9th Cir. 1993); *Stenograph v. Bossard,* 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998). These copies are infringements unless authorized by the copyright owner. Multiple, concurrent users entail multiple copies of a program that infringe unless permitted by license otherwise by operation of law. A license is a permission or a promise to not sue for acts that would otherwise infringe. Generally licenses are interpreted either to not grant rights or permissions beyond what is expressly granted or in a manner that reflects the commercial context and the rights involved. See e.g., *SOS, Inc. v. Payday, Inc.,* 886 F2d 1081, 1087 (9th Cir. 1989).

b. UCITA Rule

Section 307(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 the agreement.

c. Proposed Amendments

(1) Affect, Tab 1, page 44

(c) An agreement that does not specify the number of permitted users permits an unlimited number of users.

(2) Wolfson, Tab 4

Delete subsection (c).

d. Comment: Amendment (1) may be inconsistent with federal copyright law. Amendment (2) would place this area under common law. The UCITA rule is consistent with the Article 2 approach, which often phrases default rules in terms of a result that is reasonable in light of the actual commercial context including in this case the property rights involved.

(B). SECTION 308: DURATION OF INDEFINITE CONTRACT

a. Current law:

(1) Common law: Common law generally holds that an indefinite duration contract is enforceable for a reasonable time, but is subject to termination at will by either party. One case has held that copyright law preempts this rule for copyright licenses, but two subsequent appellate decisions reject that analysis. See *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993); *Korman v. HBC Florida, Inc.*, 182 F.3d 1291 (11th Cir. 1999); *Walthal v. Rusk*, 172 F.3d 481 (7th Cir. 1999); *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993). Compare *Lulirama Ltd. v. Axcess Broad. Servs., Inc.*, 128 F3d 872 (5th Cir.1997).

Some case law argues that the duration of a copyright or patent license may be the duration of the intellectual property right in the absence of contrary agreement, but is not perpetual. See e.g. P.C. Films Corp. v. MGM/UA Home Video, Inc., 45 U.S.P.Q.2d 1850 (2d Cir. 1998), *cert. denied*, 119 S.Ct. 542 (1998); Warner-Lambert Pharm.Co. v. John J. Reynolds, Inc., 178 F. Supp. 655, 664 (S.D.N.Y. 1959), *aff'd on other grounds*, 280 F.2d 197 (2nd Cir. 1960). Compare 3 DAVID NIMMER & MELVILLE NIMMER, NIMMER ON COPYRIGHT §11.01[B] (1999).

(2) Article 2: Some courts have held that UCC Article 2 today applies to some computer information transactions. To that extent, Section 2-309 provides that a contract that is indefinite in its duration is for a reasonable time, subject to termination at will by either party. UCC § 2-309(2) provides: "Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party."

(3) Agreement: An agreement that specifies the duration of a contract controls over the common law and the Article 2 default rule. See, e.g., *Wang Laboratories, Inc v. MA Laboratories, Inc*., 1995 WL 729298, No. 95-2274 SC (ND Cal. Dec. 1, 1995); *Gil Enterprises, Inc. v. Delvy*, 79 F.3d 241 (2d Cir. 1996); *Burger King Corp. v. Agad*, 911 F.Supp. 1499 (SD Fla 1995); *Lacoff v. Buena Vista Publishing, Inc.*, 2000 WL 202625 (N.Y. Sup. 2000).

b. UCITA Rule: UCITA follows the general approach of common law and Article 2, but allows a default rule that some licenses of indefinite duration are presumed to be perpetual unless otherwise agreed.

SECTION 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), the agreement is enforceable for a time reasonable in light of the licensed subject matter and commercial circumstances but may be terminated as to future performances at will by either party during that time on giving 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 terms if:

(A) the license is of a computer program that does not include source code and the license:

(i) transfers ownership of a copy; or

(ii) delivers 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 grants 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.

c. Proposed Amendments

(1) Affect, Tab 1, page 46
Delete Section 308 and replace with:

SECTION 308 - DURATION OF CONTRACT - If an agreement does not specify its duration, to the extent allowed by other law, and subject to cancellation for breach of contract, the agreement is enforceable indefinitely and the duration of any license to use licensed subject matter is perpetual as to the contractual rights and contractual use terms.

(2) DCC, Tab 2
Delete Section 308 and replace with:

Where a contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time.

(2) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

(3) The duration of a license is perpetual as to the contractual rights and contractual use terms if the license expressly grants 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.

(3) Wolfson, Tab 4
Delete section 308

d. Comments: UCITA deviates from Article 2 in a way that makes some licenses perpetual by default. The common law generally provides for termination at will in cases where the agreement does not indicate its duration. Deletion of the section will return the issue to common law, which also generally corresponds to the treatment of indefinite term agreements in Article 2. The DCC amendment would adopt the language in existing Article 2 but retain the default rule for combined works intended for public distribution. The Affect proposal would be a new rule not matched in any other state law; it may also be inconsistent with federal intellectual property laws.

(C). SECTION 503: TRANSFERABILITY OF CONTRACT.

a. Current Law:

(1) Restatement (Second) of Contracts enforces contract terms precluding transfer of a contract based on the idea that a person has a right to determine with whom the person will contract. Restatement (Second) of Contracts § 322, cmt. A ("In the absence of statute or other contrary public policy, the parties to a contract have power to limit the rights created by their agreement. The policy against restraints on the alienation of property has limited application to contractual rights."). Common law courts routinely enforce contract terms restricting transfer of a license without consent. The issue is not treated in the same manner that common law treats restrictions on the alienability of physical property (e.g., real estate).

(2) Federal Law. Intellectual property law precludes any rule giving rights to a bond fide purchaser as against an infringement claim; bona fide purchasers for value are generally not a relevant concept under federal law. Unwitting purchasers can be liable for infringement. *ISC-Bunker Ramo Corp. v. Altgech, Inc.* 765 F.Supp. 1310, 1331 (N.D.Ill.1990); *Microsoft v. Harmony Computers & Electronics,* 846 F. Supp. 208, 213 (E.D. N.Y. 1994); *Microsoft Corporation v. Software Wholesale Club, Inc.*, 129 F. Supp.2d 995 (S.D. TX, 2000).

Federal case law holds that federal policy preempts state law that would allow transfer by a licensee of a non-exclusive license involving a copyright or patent without the consent of the licensor. See *In re CFLC, Inc.,* 89 F.3d 673 (9th Cir. 1996); Stenograph Corp. v. Fulkerson, 972 F2d 726 (7th Cir.1992); PPG Industries, Inc. v. Guardian Industries Corp., 597 F.2d 1090 (6th Cir.), cert. denied, 444 U.S. 930, 100 S.Ct. 272, 62 L.Ed.2d 187 (1979); Unarco Industries,

Inc. v. Kelley Co., 465 F.2d 1303, 1306 (7th Cir.1972) cert. denied, 410 U.S. 929, 93 S.Ct. 1365, 35 L.Ed.2d 590 (1973); Harris v. Emus Records Corp., 734 F2d 1329 (9th Cir. 1984) (copyright); In re Patient Education Media, Inc., 210 BR 237 (Bankr. SDNY 1997); In re Alltech Plastics, Inc., 71 Bankr. 686 (Bankr. WD Tenn. 1987); *CMAX/Cleveland, Inc. v. UCR, Inc.*, 804 F. Supp. 337, 356, 359 (M.D. Ga. 1992) (assignee had no rights where assignment was breach of license; unlicensed use was infringement). See also In re Pioneer Ford Sales, 729 F2d 27 (1st Cir. 1984) (concerning franchise agreement); E.I. du Pont de Nemours & Co. v. Shell Oil Co., 498 A2d 1108 (Del. 1985).

(3) UCC. Some courts have held that UCC Article 2 today applies to some computer information transactions. To that extent, Section 2-210(2) permits a contract term to preclude transfer of a contractual interest, but otherwise allows transfers that do not materially harm the other party. It provides: "[Unless] otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance." Article 9 overrides some contractual provisions that bar transfer of some contract or contract rights related to financing transactions.

(4) Case law: Mergers etc. For software licenses and many other types of contract or asset (e.g., loans, contracts, insurance, leases, patents, trade secrets, trademarks), transferability rules do not change in merger, purchase, or acquisition contexts. Typically this is an important aspect of "due diligence." See *Data Products v. Reppart*, 3 CCH COMPUTER CASES 46, 462 (D. Kan. 1991) (acquisition of corporate subsidiary by parent company did not justify acquiring company's use of software licensed to the subsidiary for all other subsidiaries.); *Accusoft Corp. v. Mattel, Inc.*, 117 F.Supp.2d 99 (D. Mass. 2000) (software license precluded assignment without the prior consent of the licensor. After the license was created, the licensee was taken over by first one company and then another. In neither case was there a request for or consent to the transfer; the transfers were ineffective.); *New Paradigm Software Corp. v. New Era of Networks, Inc.*, 107 F.Supp.2d 325 (SD NY 2000); *TAP Publications, Inc. v. Chinese Yellow Pages (New York) Inc.*, 925 F.Supp. 212 (SD NY 1996).

b. UCITA rule:

SECTION 503. TRANSFER OF CONTRACTUAL INTEREST. The following rules apply to a transfer of a contractual interest:

(1) A party's contractual interest may be transferred unless the transfer:

(A) is prohibited by other law; or

(B) except as otherwise provided in paragraph (3), 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) and Section 508(a)(1)(B) , a term prohibiting transfer of a party's contractual interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ineffective to create contractual rights in the transferee against the nontransferring party, except to the extent that:

(A) the contract is a license 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; or

(B) the transfer is of a right to payment arising out of the transferor's due performance of less than its entire obligation and the transfer would be enforceable under paragraph (1) in the absence of the term prohibiting transfer.

(3) A right to damages for breach of the whole contract or a right to payment arising out of the transferor's due performance of its entire obligation may be transferred notwithstanding an agreement otherwise.

(4) A term that prohibits transfer of a contractual interest under a mass-market license by the licensee must be conspicuous.

c. Proposed Amendments

(1). Klein, Tab 5, page 5:

Delete Subsection 503(2)(A)

(2). Affect, Tab 1, 56
Amend Section 503 as follows:

SECTION 503. The following rules apply to a transfer of a contractual interest:

(1) A party's contractual interest may be transferred unless the transfer:

(A) is prohibited by other law; or

(B) except as otherwise provided in paragraph (3) or (4), 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 paragraphs (3) and (4) and Section 508(a)(1)(B), a term prohibiting transfer of a party's contractual interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ~~ineffective to create contractual rights in the transferee against the nontransferring party~~, except to the extent that:

(A) the contract is a license 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; or

(B) the transfer is of a right to payment arising out of the transferor's due performance of less than its entire obligation and the transfer would be enforceable under paragraph (1) in the absence of the term prohibiting transfer; or

(C) the transfer occurs in connection with a merger, consolidation, reorganization, restructuring or other similar transaction with respect to the transferor, or a sale or transfer of all or substantially all the assets of the transferor. ……

(3) Wolfson, Tab 4:

Delete Section 503, moving any aspects needed for financing provisions to those provisions

(4) Virginia Amendment

Add: Section 503(2)(C):

the transfer is in connection with a merger or the acquisition or sale of a subsidiary or affiliate involving the licensing and another person and is made (i) to preserve the integrity of information and information processing systems used by the licensee, or (ii) to ensure compatibility of information and information processing systems among the parties involved in the merger, acquisition, or sale.

d. Comments

A rule permitting transfer without consent of rights owner may be preempted by the copyright and patent policy, subjecting parties to potential infringement liability if they rely on the state law "rule." The federal policy reflects the reality that, unlike with goods, information assets when transferred are identical to the original and do not depreciate. Allowing free transfer would make the licensee a competitor of its licensor. General common law and current practice make no special provision for mergers or acquisition, obtaining consents for such transfer are among the many due diligence efforts involved in any such transaction, involving leases, loans, contracts, insurance, licenses, patents, trade secrets, trademarks, etc. Article 9, however, overrides some contractual provisions that bar transfer of some contract or contract rights related to financing transactions.

The Wolfson amendment would eliminate the guidance that the section current provides, returning the issue to common law.

(D). SECTION 605: ELECTRONIC PASSIVE RESTRAINTS

a. Current law

(1) General Rule. Law does not allow a person to use property of another beyond the terms of its contract right to do so unless there is a pattern of conduct that establishes waiver or similar equitable changes.

(2) Digital Millennium Copyright Act (DMCA): Federal law assumes copyright owners may protect or control access to their works with technological measures and does not require contractual authorization to do so. It provides affirmative protection against attempts to circumvent such measures: 17 U.S.C. § 1201(a)(1)(A) -- "No person shall circumvent a technological measure that effectively controls access to a work protected under this title." 17 U.S.C. § 1201(a)(2): no person shall "manufacture, import, offer to the public, provide, or otherwise traffic in any technology, product, service, device, component, or part thereof," that is primarily designed or produced to circumvent a technological measure in a copyrighted work. There are exceptions, e.g., defense of fair use and free speech are not affected, and there are limited exemptions for nonprofit libraries, archives and educational institutions (when copy of a work is not reasonably available in another form, a nonprofit library does not violate act if it gains access to a commercially exploited copyrighted work solely in order to make a good faith determination of whether to acquire a copy, as long as it engages in permitted conduct and satisfies certain conditions regarding retention and use). *Id*. at (d). Certain law enforcement and encryption activities are exempted and reverse engineering is allowed in narrow noninfringing circumstances to achieve interoperability. *See Id.* at (e) and (f). A recent Library of Congress report on technological measures recommended only limited regulations to allow additional exemptions, but did not otherwise alter the DMCA effect.

b. UCITA rule

SECTION 605. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, “automatic restraint” means a program, code, device, or similar electronic or physical limitation the intended purpose of which is to prevent use of information contrary to the contract or applicable law.

(b) A party entitled to enforce a limitation on use of information may include an automatic 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 a use that is inconsistent with the agreement;

(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 after 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 an automatic 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 possession of the licensee or a third party and accessed without use of the licensor’s information or informational rights.

(d) A party that includes or uses an automatic restraint consistent with subsection (b) or (c) is not liable for any loss caused by the use of the restraint.

(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 to replace or disable the earlier copy by electronic means with an upgrade or other new information.

(f) This section does not authorize use of an automatic restraint to enforce remedies because of breach of contract or cancellation for breach. If a right to cancel for breach of contract and a right to exercise a restraint under subsection (b)(4) exist simultaneously, the affirmative acts constituting electronic self-help may only be taken under Section 816, including the prohibition on mass-market transactions, instead of this section. Affirmative acts under this subsection do not include:

(1) use of a program, code, device or similar electronic or physical limitation that operates automatically without regard to breach; or

(2) a refusal to prevent the operation of a restraint authorized by this section or to reverse its effect.

c. Proposed Amendment

(1). Affect, Tab1, page 58

Amend Section 605 as follows:

(b) A party entitled to enforce a limitation on use of information may include an automatic restraint in the information or a copy of it and use that
restraint only if:

(1) a conspicuous term of the agreement authorizes use of the restraint and

~~(2) the restraint prevents a use that is inconsistent with the agreement; or~~

~~(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 after 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 an automatic 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 possession of the licensee or a third party .

(d) A party that includes or uses an automatic restraint consistent with subsection (b) or (c) is not liable for any loss caused by the use of the restraint.

(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 to replace or disable the earlier copy by electronic means with an upgrade or other new information.

(f) This section does not authorize use of an automatic restraint to enforce remedies because of breach of contract or for cancellation for breach. ~~If a right to cancel for breach of contract and a right to exercise a restraint under subsection (b)(4) exist simultaneously, any affirmative acts constituting electronic self-help may only be taken under Section 816, including the prohibition on mass-market transactions, instead of this section. Affirmative acts under this subsection do not include:~~

(1) use of a program, code, device or similar electronic or physical limitation that operates automatically without regard to breach; or

(2) a refusal to prevent the operation of a restraint authorized by this section or to reverse its effect.

(g) If an automatic restraint malfunctions, or is activated accidentally, or is activated intentionally in a manner not consistent with ~~subsection (b) or (c) of~~ this section, and such malfunction or activation causes damages to, or deletion of, information or other property of the licensee, the licensor will be liable for the loss occasioned thereby not withstanding any limitation of a liability provision in the agreement. In addition, third persons harmed by wrongful discontinuation of access may recover damages from the licensee to the same extent as recoverable by the licensee.

d. **Comment**:

The Affect proposal restricts the ability of copyright owners to protect their works and access to them by technology and may be preempted by the DMCA. The requirement of conspicuousness apparent, if not met in a contract, would vitiate any technological restriction even if agreed to by the parties. Section 605 was the subject of extensive debate in the year-long Virginia JCOTS hearings and was modified at the 2001 Annual Meeting of NCCUSL pursuant to the efforts of Circuit City and Capital One to resolve objections and both were satisfied with the amendment that was made. Affect's new proposal may confuse the role of Section 816 (electronic self-help after breach) with the breach-prevention role of Section 605. The proposal may be inconsistent with ASP and other emerging forms of software distribution that often rely on controlled or limited time access or use.

(E). SECTION 702: WAIVER/ REASONABLE INSPECTION

a. Current Law:

Common law recognizes waiver of contract rights in various contexts where the one party fails to assert or notify the other party of an objection to its performance. Some courts hold that Article 2 applies to some computer information transactions. In this regard, the following applies:

UCC Article 2-605 (reasonable inspection):

(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

The Article 2 rule connects to UCC § 2-508 (UCITA § 703), which gives the seller a right to cure defects under certain circumstances. That right to cure cannot be exercised if the party is in the dark as to what the problem is.

b. UCITA Rule:

SECTION 702. 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 part without consideration by a waiver in a record to which the party making the waiver agrees after breach, such as by manifesting assent, or which the party making the waiver authenticates and delivers to the other party.

(b) A party that accepts a performance with knowledge that the performance constitutes a breach of contract and, within a reasonable time after acceptance, does not 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. However, a party that seasonably notifies the other party of a reservation of rights does not waive the rights reserved.

(c) A party that refuses a performance and fails to identify a particular defect that is ascertainable by reasonable inspection waives the right to rely on that defect to justify refusal only if:

(1) the other party could have cured the defect if it were identified seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final statement of all defects on which the refusing party relied.

…………….

c. Proposed Amendments:

(1) Affect Tab 1, page 60

Add to Section 702:

(g) (g) (1) For purposes of this section, "reasonable inspection" means reliance by the licensee on :

(A) (A) Exact technical specification provided by the licensor;

(B) (B) A sample, model or demonstration provided by the licensor; or

(C) (C) An express warranty made by the licensor.

(2) "Reasonable inspection" does not require the licensee to install or operate the computer program or information product in a manner that may endanger the licensee's information processing system or the informational content residing in the information processing system

(2) Klein, Tab 5:

Add to Section 702:

(g) NO WAIVER OF REMEDY SHALL BE ENFORCEABLE IF ASSENT TO THE WAIVER IS A PRECONDITION TO A PROCEDURE THAT PURPORTEDLY CORRECTS A DEFECT AND THE DEFECT IS NOT CORRECTED BY THE PROCEDURE.

d. Comments:

The UCITA rule follows UCC § 2-605 but alters that rule to benefit licensees by adding the phrase "only if." In the years since the adoption of Article 2, the waiver rule has produced no significant litigation or The meaning of the Affect proposal relating to subsection (g) is not clear. There is no corollary in Article 2 or the common law for the Klein proposal. Under some circumstances, applying ordinary concepts of consideration and breach, the indicated result might occur; under other circumstances, it would not be appropriate.

(F). SECTION 703/ 704: CONFORMING TENDER

a. Current Law:

The so-called "perfect-tender" rule is actually a rule that, in limited circumstances, a party may reject the other party's performance if it fails to conform to the contract, in theory even if the flaw is minor. The rule is not followed in common law, in international contract law, or even in the UCC for cases involving more than a single delivery. In each of these other contexts, law follows a form of material breach concept (e.g., you can refuse the performance only if the breach is significant). The rule only applies to a right to reject and does not pertain to when or whether a right of action in damages exists.

Even when it applies in Article 2, the "conforming tender" rule is hemmed in by considerations of what the agreement means, what standards of merchantability apply, a right to cure, and usage of trade and course of dealing. It is further limited by principles of waiver. As one leading treatise dealing with Article 2 comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ." *White, James and Summers, Robert, Uniform Commercial Code* (Fourth Edition) at 440-441 (West Publishing Co., 1995).

(1) UCC §§ 2-601/ 612

<u>§ 2-601. Buyer's Rights on Improper Delivery.</u>

Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or
(b) accept the whole; or
(c) accept any commercial unit or units and reject the rest.

<u>§ 2-612. "Installment Contract" ; Breach.</u>

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

(2). Restatement (Second) § 237 states the material breach concept in the following terms: "Except as stated in s 240, it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time."

b. UCITA Rule:

UCITA adopts the conforming tender rule for cases involving issues about tender of a single delivery of a tangible copy in the mass market, but otherwise follows the generally applicable material breach rule.

SECTION 601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) If an uncured material breach of contract by one party precedes the aggrieved party's performance, the aggrieved party need not perform except with respect to restrictions in contractual use terms, but the contractual use terms do not apply to information or copies properly received or obtained from another source.

§ 703 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 and the party in breach seasonably notifies the aggrieved party of its intent to cure and, within the time for performance, makes a conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without monetary 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 a case not governed by paragraph (1) or (2), the party in breach seasonably notifies the aggrieved party of its intent to cure and promptly provides a conforming performance before cancellation by the aggrieved party.

(b) In a license other than in a mass-market transaction, 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 the specific nonconformity and a demand for cure of it; 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 of contract that has been seasonably cured under subsection (a). However, notice of intent to cure does not preclude refusal or cancellation for the uncured breach.

§ 704 COPY: REFUSAL OF DEFECTIVE TENDER

(a) Subject to subsection (b) and Section 705, tender of a copy that is a material breach of contract permits the party to which tender is made to:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market transaction that calls for only a single tender of a copy, a licensee may refuse the tender if the tender does not conform to the contract.

(c) Refusal of a tender is ineffective unless:

(1) it is made before acceptance;

(2) it is made within a reasonable time after tender or completion of any permitted effort to cure; and

(3) the refusing party seasonably notifies the tendering party of the refusal.

(d) Except in a case governed by subsection (b), a party that rightfully refuses tender of a copy may cancel the contract only if the tender was a material breach of the whole contract or the agreement so provides.

c. Proposed Amendment:

(1) Affect, Tab 1, page 62:

Amend Sections 703 and 704 as follows:

SECTION 703:

(a) A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not expired and the party in breach seasonably notifies the aggrieved party of its intent to cure and, within the time for performance, makes a conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without monetary 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 a case not governed by paragraph (1) or (2), the party in breach seasonably notifies the aggrieved party of its intent to cure and promptly provides a conforming performance before cancellation by the aggrieved party.

(b) A party may not cancel a contract or refuse a performance because of a breach of contract that has been seasonably cured under subsection (a). However, notice of intent to cure does not preclude refusal or cancellation for the uncured breach.

SECTION 704 - COPY: REFUSAL OF DEFECTIVE TENDER

(a) Subject to ~~and~~ Section 705, if the tender of a copy fails in any respect to conform to the contract, the licensee may:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) . Refusal of a tender is ineffective unless:

(1) it is made before acceptance;

(2) it is made within a reasonable time after tender or completion of any permitted effort to cure; and

(3) the refusing party seasonably notifies the tendering party of the refusal.

(c) ~~()~~ A party that rightfully refuses tender of a copy may cancel the contract. .

(2) Wolfson, Tab 4

Delete subsection 704(b)

d. Comment:

The proposed change in (1) deviates from common law, which requires a material breach in order to allow a party to refuse to perform its own obligation (e.g., accept the other party's performance). It also deviates from modern international sales of goods law, which likewise requires a material breach. The proposal also deviates from existing Article 2, which uses the conforming tender rule only as to single delivery contracts, not installment contracts; for installment contracts cancellation of the entire contract is only allowed if the defects in one delivery substantially impair the value of the entire contract. Proposed revisions to Article 2 appear to expand and clarify the seller's right to cure, further reducing the practical import of the conforming tender rule.

Any replacement of the material conformance rule with the perfect tender rule in UCITA (other than for mass-market licenses) must include elimination of all provisions not consistent with perfect tender rule. Affect proposal eliminates one, § 703(b) which requires licensors to attempt cure when acceptance of tender was required. But other provisions would require reconsideration, and new provisions may be required. See, e.g., § 705(1) (providing that a party may refuse a tender of a copy which is a material breach as to that copy, but refusal of that tender does not cancel the contract); UCITA rules on revocation of acceptance; Article 2 rules on installment contracts.

(G). SECTION 216: IDEA SUBMISSION

a. Current law: UCITA deals only with contract law rules, not tort. Although there is a split of authority, many courts dealing with payment for ideas hold that an idea must be confidential, concrete, and novel to the business, trade, or industry in order to invoke legal protection under contract or tort law. *See e.g., Nadel v. Play-by-Play Toys & Novelties, Inc.*, 208 F.3d 368 (2nd Cir. 1999); *Brandwynne v. Combe International, Ltd.* 1999 WL 946680 (S.D.N.Y); *Brady v. Orion TV Productions Inc.* 15 USPQ2d1385, 1389(1990); *Ed Graham Productions v. National Broadcasting Co.,* 180 USPQ 93 (1973); *Murray v. National Broadcasting Company, In.,* 844 F.2d 988 (2nd Cir., 1988); *Tate v. Scanlan International, Inc.,* 403 N.W.2d 666 (1987); *Smith v. Recrion Corporation,* 91 Nev. 666, 541 P.2d 663(1975).

b. UCITA Rule:

SECTION 216. IDEA OR INFORMATION SUBMISSION.

(a) The following rules apply to a submission of an idea or information for the creation, development, or enhancement of computer information which is not made pursuant to an existing agreement requiring 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.

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

(A) the submission is made and a contract 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.

c. Proposed Amendment:

Klein, Tab 5, page 5

In Section 216 (b) insert after “AN AGREEMENT TO DISCLOSE AN IDEA” the words “FOR A MOTION PICTURE OR OTHER AUDIO OR VISUAL PROGRAMMING”

d. Comment:

Current law makes no distinction between idea and information submissions related to motion picture or other industries. Software publishers receive ideas for games and software applications, features and functionality; online content providers receive ideas for content. UCITA adopts what has been the New York rule as to these issues, which has been applied to a range of idea submissions, including submissions related to software and other digital products as well as goods such as ideas for avoiding airplane tire blow-out upon landing. UCITA does not affect tort liability issues under misappropriation or similar doctrine.

(H). New Section: Return of Information

a. Current Law:

There is no case law directly on this issue, although UCITA, Article 2 and the common law each supports enforcement of contracts requiring one party to return information belonging to the other and principles of conversion could apply to inappropriate retention of property. Outsourcing and data processing contracts routinely deal with return of information. But when the contract is silent, a default rule may be helpful and some commercial licensees have requested one in recent months. UCITA deals with return of information upon termination (ending a contract without breach) and upon cancellation (ending for breach). The suggested default rule pertains to additional situations.

b. UCITA Rule:

§ 618 Termination: Enforcement

(a) On termination of a license, a party in possession or control of information, 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 all right under the license for the licensee 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 of contract 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 605 or by judicial process, including 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 make them available to the other party at a place designated by that party which is reasonably convenient to both parties. ……..

SECTION 802. CANCELLATION.

… (c) On cancellation, the following rules apply:

(1) If a party is in possession or control of licensed information, documentation, materials, or copies of licensed information, the following rules apply: ….

(B) A party in breach of contract which would be subject to an obligation to deliver under Section 618, shall deliver all information, 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 of contract shall follow any reasonable instructions received from the other party.

(C) Except as otherwise provided in subparagraphs (A) and (B), the party shall comply with Section 618.

(2) All obligations that are executory on both sides at the time of cancellation are discharged, but the following survive:

(A) any right based on previous breach or performance; and

(B) the rights, duties, and remedies described in Section 616(b).

(3) Cancellation of a license by the licensor ends any contractual right of the licensee to use the information, informational rights, copies, or other materials.

(4) Cancellation of a license by the licensee ends any contractual right to use the information, informational rights, copies, or other materials, but the licensee may use the information for a limited time after the license has been canceled if the use:

(A) is within contractual use terms;

(B) is not for distribution and is solely part of measures reasonable under the circumstances to avoid or reduce loss; and

(C) is not contrary to instructions received from the party in breach concerning disposition of them.

(5) The licensee shall pay the licensor the reasonable value of any use after cancellation permitted under paragraph (4).

(6) The obligations under this subsection apply to all information, informational rights, documentation, materials, and copies received by the party and any copies made therefrom. …

c. Proposed Amendment

(1) Suggested Alternatives, Tab 7

Section 619. Obligation to Return Information [new]

(a) In this section, “returnable information” means information, copies, or other materials that are in possession or control of a party and are the property of the other party, or are subject to a contractual obligation to be delivered to the other party on termination.

(b) In the case of a termination, information must be returned in accordance with Section 618.

(c) In the case of a cancellation, information must be returned in accordance with Section 802(c).

(d) In addition to Sections 618 and 802(c) as applicable, if a party: discontinues all rights of access pursuant to Section 814; repossesses under Section 816 licensed information; or, in a transfer that would not be effective under Section 503, refuses consent to a transfer of the licensee’s contractual interest to another person in a merger or a sale of substantially all assets of the licensee;, the following rules apply:

(1) Subject to subsection (2), on seasonable request of the other party in a record, the party exercising rights to discontinue, repossess or refuse consent shall take commercially reasonable steps to deliver to the other party copies of that party’s returnable information that cannot be accessed, used or obtained by the requesting party without use of the information or resources of the delivering party.

(2) The party requesting the delivery shall reimburse the other party for commercially reasonable costs of delivery including a reasonable fee for any continued use of the delivering party’s information or resources to effect the delivery.

(e) If pursuant to Section 605 an automatic restraint, other than one which merely prevents use after expiration of a trial period involving use at no or nominal cost, prevents use of returnable information, on a seasonable request by either party in a record, the other party shall take commercially reasonable steps to facilitate deliver to the requesting party copies of the returnable information that cannot be accessed, used or obtained by the requesting party without use of the information or resources of the delivering party. The party requesting the delivery shall reimburse the other party for commercially reasonable costs of delivery including a reasonable fee for any continued use of the delivering party’s information or resources to effect the delivery.

(f) In all cases governed by Subsection (d) or (e), both parties remain bound by any obligations of confidentiality under their agreement or imposed by law.

B. OPEN SOURCE SOFTWARE

a. Current Law:

There are no relevant reported cases dealing with “open source” or “free” software. Presumably, the applicable law would be the same as that for software generally, which consists of some cases that apply Article 2 and its warranty and

other provisions, and some cases that apply common law rules. Some argue that the licensing model used by providers in this setting does not depend on contracts, but operates by merely withholding copyright consents. That premise is highly questionable given the ruling of the Federal Circuit Court of Appeals in *Jazz Photo Corp v ITC &Fuji*, 2001 US App LEXIS 18798 (Fed. Cir. 2001) (notice restricting uses not enforceable under patent law unless contractual elements established with respect to it), and general contract law rules (Article 2 or common law). In cases where warranties or consumer protections are imposed by law, neither Article 2 nor current common law exempts products distributed with open plans so that they can be fully examined by other merchants, developers or consumers.

b. UCITA Rule:

UCITA makes no distinction among software types and thus treats this type of software in the same manner that it treats other software with which "open-source" or "free" software compete.

c. Proposed Amendments

(1) Affect, Tab 1, page 37:

Text Deleted and Inserted in Section 102(a):

Section 102(a)(16) "Consumer contract" means a contract between a merchant licensor and a consumer. However, a contract to provide free software is not a consumer contract.

Section 102(a) (32) "Free software" means computer information that is available to the public at no charge beyond the cost of media and delivery, that may be redistributed at no charge, and that is distributed without contractual use terms. If the computer information includes a computer program, the source code is available for that program at no charge beyond the cost of media and delivery.

Section 102(a)(46) "Mass-market transaction" means a transaction that is: ... (B) any other transaction with an end-user licensee if: ... (iii) the transaction is not: (V) a contract to provide free software.

(2) Klein, Tab 5, page 3:

Add to Section 406:

(k) The provisions of Sections 403 and 405 of this subtitle do not apply to:

(1) computer information or a computer program provided for no fee, unless the computer information or computer program is provided in conjunction with the sale or lease of goods, services, other computer information, or another computer program; or

(2) computer information or a computer program provided as a beta test or similar experimental version of the computer information or computer program.

(l) The provisions of section 403 of this subtitle do not apply to a computer program provided under a license that does not impose a license fee for the right to the source code, to make copies, to modify, and to distribute the computer program.

(3) Kunze, Tab 3, pages 12:

NEW SECTION 401(c)(4):

The warranty under Section 401(a) does not apply to a computer program if there is no charge for (1) the source code, (2) making copies, or for use of those copies, (3) modifying, and (4) distributing the computer program.

NEW SECTION 403(d):

The warranty under Section 403(a) does not apply to computer program if there is no charge for (1) the source code, (2) making copies, or for use of those copies, (3) modifying, and (4) distributing the computer program.

(4) **Kunze, Tab 3, page 13:**
Add new subsection 103(g)

This Act does not apply to a non-contractual copyright permission notice.

(5) Suggested Alternatives, Tab 7:
Add the following new section:

(a) Except as provided in subsection (b), the warranties under Sections 401, and 403 do not apply to a computer program if the licensor makes a copy of the source code available to the licensee in the transaction without charge and there is no contract fee for the right to use, make copies of, modify, or distribute copies of the program or source code.

(b) Subsection (a) does not apply if the copy of the computer program is contained in and sold or leased as part of goods.

d. Comment: The amendments create a potential market imbalance in which competing products in the same market have different contractual obligations. Many of the amendments remove consumer protections with respect to the subject matter software. The Affect proposal would remove all consumer protections from open source contracts with consumers even though end users of such software include individuals who are not developers and thus cannot read or review software code. Among the rules that would be excluded are the statutory deference to consumer protection laws (Section 105) and the rule that precludes disclaimer of liability for personal injury claims in consumer cases (Section 803).

C. SECTION 805: STATUTE OF LIMITATIONS

a. Current law:
UCC Article 2:

§ 2-725(1). Statute of Limitations in Contracts for Sale.

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

b. UCITA Rule:

Section 805 (b) If the original agreement of the parties alters the period of limitations, the following rules apply:

(1) The parties may reduce the period of limitation to not less than one year after the right of action accrues but may not extend it.

(2) In a consumer contract, the period of limitation may not be reduced.

c. Proposed Amendment:

(1) Affect, Tab 1, page 76:

(b) If the original agreement of the parties alters the period of limitations, the following rules apply:

(1) The parties may reduce the period of limitation to not less than one year after the right of action accrues but may not extend it.

(2) In a ~~consumer contract~~ mass-market transaction, the period of limitation may not be reduced.

(2) Maryland and Virginia:
Enacted the same amendment

d. Comment: Existing Article 2 contains no consumer rule and allows the statute of limitations to be reduced to one year in both consumer and commercial transactions. UCITA changes this rule for consumers by preventing any reduction. The Affect proposal seeks to expand the protection to businesses engaged in a mass-market transaction. There is no corollary in Article 2 or the common law. The mass-market transaction concept was rejected in revisions to Article 2.

D. SECTION 105: CONSUMER PROTECTION STATUTES PRESERVATION

a. Current Law: Consumer protection laws ordinarily define their own scope and coverage. UCC Article 2 provides:

§ 2-102. Scope; Certain Security and Other Transactions Excluded From This Article.

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

b. UCITA Rule:

SECTION 105. RELATION TO FEDERAL LAW; FUNDAMENTAL PUBLIC POLICY; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

…

(c) Except as otherwise provided in subsection (d), if this [Act] or a term of a contract under this [Act] conflicts with a consumer protection statute [or administrative rule], the consumer protection statute [or rule] governs.

(d) If a law of this State in effect on the effective date of this [Act] applies to a transaction governed by this [Act], 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 record, writing, or 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 under this [Act].

(4) A requirement of consent or agreement to a term is satisfied by a manifestation of assent to the term in accordance with this [Act].

[(e) The following laws govern in the case of a conflict between this [Act] and the other law: [List laws establishing a digital signature and similar form of attribution procedure.]]

Legislative Note: The purpose of subsection (c) is to make clear that this Act does not alter the application to computer information transactions of the substantive provisions of a State's consumer protection statutes or rules (including rules about the timing and content of required disclosures) and does not alter application of the State's statutes giving regulatory authority to a state agency such as the Office of the Attorney General. It may be appropriate, for purposes of clarity, in subsection (c) to cross reference particular statutes such as the State's Unfair and Deceptive Practices Act by inserting "including [cite the statute]." Subject to the federal Electronic Signatures Global and National Commerce Act, if certain consumer protection laws should be

appropriately excepted from the electronic commerce rules in subsection (d), those laws should be excluded from the operation of subsection (d).

c. Proposed Amendments:

(1) AG Draft, Tab 6, page 1: Delete subsection 105 (c) and replace with:

(c) Nothing in this Act is intended to limit, modify or supercede consumer protection law. In this section, “consumer protection law” means consumer protection statutes, rules or regulations, and other state action having the effect of law, as well as applicable judicial or administrative decisions interpreting those statutes, rules, regulations, and actions. To the extent a consumer protection law provides greater protection to consumers than is provided herein, the more protective consumer protection law shall apply. (1) In the event a consumer protection law requires a term to be conspicuous, the consumer protection law’s standard of conspicuousness shall apply. However, no such requirement shall preclude such terms from being presented electronically. (2) In the event a consumer protection law addresses assent, consent or manifestation of assent, the consumer protection law's standard of assent, consent or manifestation of assent shall apply. However, nothing in the consumer protection law requiring assent, consent or manifestation of assent shall preclude such assent or consent or manifestation of assent from being accomplished electronically.

(2) Affect, Tab 1, page 1: SECTION 105.

(c)<u>(1) For the purposes of this subsection the term “law which protects consumers" includes, without limitation:</u>

<u>[Here list state consumer protection statutes]</u>

<u>(2) Law which protects consumers applies to a licensee or recipient of computer information or computer programs under a consumer contract in the same manner in that law which protects consumers applies to consumer goods.</u>

<u>(3)</u> Except as otherwise provided in subsection (d), if this [Act] or a term of a contract under this [Act] conflicts with a consumer protection statute [or administrative rule], the consumer protection statute [or rule] governs.

(3) Suggested Alternatives, Tab 7: Delete (c) and replace with:

(c) Nothing in this Act is intended to limit, modify or supercede consumer protection law applicable to the subject matter of this Act. In this section, “consumer protection law” means consumer protection statutes, rules or regulations, and other state action by the executive, legislative or administrative branch of government that has the effect of law, as well as applicable judicial or administrative decisions interpreting those statutes, rules, regulations, and actions. To the extent a consumer protection law provides greater protection to consumers than is provided herein, the more protective consumer protection law shall apply:

(1) In the event a consumer protection law requires a term to be conspicuous, the consumer protection law’s standard of conspicuousness shall apply. However, no such requirement shall preclude such terms from being presented electronically.

(2) In the event a consumer protection law addresses assent, consent or manifestation of assent, the consumer protection law's standard of assent, consent or manifestation of assent shall apply. However, nothing in the consumer protection law requiring assent, consent or manifestation of assent shall preclude such assent or consent or manifestation of assent from being accomplished electronically.

d. Comment:

What is dealt with here is the relationship between UCITA and ***prior*** consumer protection laws in a state. ***Subsequent*** consumer protection laws will, of course, contain their own scope and preemptive terms.

Proposed amendments (1) and (3) clarify what is already true in UCITA, i.e., consumer protection statutes and regulations trump UCITA in cases of conflict. UCITA supersedes common law but not consumer statutes or regulations. Both amendments also include state actions such as executive orders as measures that control over UCITA.

The legislative note in UCITA alerts legislatures of the need to examine state consumer protection statutes applicable to goods to determine whether they ought to be amended to apply to computer information. Both Virginia and Maryland engaged in close analysis of their own consumer protection rules, amending those laws to cover information transactions when appropriate. This type of examination is needed for appropriate results since some consumer law requirements would make no sense if applied to information transactions (e.g., a consumer statute requiring a label to appear on outside packaging for goods cannot automatically be applied to downloaded software or to the right to access a database; there is no "outside" in either case). The debate regarding open source software is also illustrative of the need to tailor coverage. If a policy decision is made but a consumer protection statute imposes warranties on goods, the separate statute should be amended not to impose them on open source software. The Affect amendment eliminates this nuanced approach.

E. PUBLIC CRITICISM AND COMMENT

a. Current Law.

Federal law preempts state law where there is a conflict and state statutes typically do not bother to state this basic rule. UCC Article 2 contains no such statement although various federal laws (including copyright and the Magnuson Moss Warranty Act) may preempt it. For copyrighted works, federal law preempts state laws granting rights equivalent to the intellectual property rights in the Copyright Act. See *Rosciszewski v. Arte Associates, Inc.*, 1 F.3d 225 (4th Cir. 1993). This rule does not ordinarily preempt state law that enforces contracts, since the agreement of the parties is the core of such relationships and is not equivalent to copyright law. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *National Car Rental System, Inc. v. Computer Assoc. Int'l, Inc.*, 991 F2d 426 (8th Cir. 1993).

The *Restatement (Second) of Contracts* § 178 et. seq. recognizes that, in some cases, courts may invalidate a contract term if it violates over-riding public policy. This principle is applied sparingly and on a non-uniform basis; it is not stated in UCC Article 2. Under existing law, the "public policy" principle is applied only in cases in which the public interest would be injured to a degree that private rights should yield to the public interest. *See e.g., Livingston v. Tapscott*, 585 So. 2d 839 (Ala. 1991); *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 293 N.W.2d 843 (Neb. 1980).

The relationship between public comments and contract law under current law is not clear and varies. For example, a trade secret license that precludes public comment about the licensed product would be enforceable. No free speech policy issue arises since the transaction itself is contractual in nature and requires non-disclosure to protect property rights of the transferor. The mere fact that a contract limits the right to public disclosure or comment does not render it invalid under fundamental public information policy. *See e.g., National A-1 Advertising Inc. v. Network Solutions Inc.*, 2000 WL 1513791, 121 F.Supp.2d 156 (2000). Reasons to contractually restrict a contracting party's disclosure of or discussion about a transaction or subject matter speech are many, varied and themselves involve rights to speak or not speak: software publishers seek to improve their products through "beta" testing under contracts precluding comment until the final product is released; owners of trade secrets attempt to protect those secrets or other confidential information; consumer reporting agencies restrict publication and comment about speech in credit reports; one competitor may require permission for other competitors to publish benchmark test results in order to ensure that the tests are fair; Consumers' Union's contract for Consumers Report restricts this speech notwithstanding the consequent decrease in public debate: "Neither the Ratings nor the reports nor any other information, nor the name of Consumers Union or any of its publications, may be used in advertising or for any other commercial purpose, including any use on the Internet."

Under current law, laws regarding defamation, intentional interference with contract, commercial disparagement and the like can influence the scope and character of public debate and private contract. Such laws tend not to prohibit speech but impose liability for certain kinds of speech.

b. UCITA Rule:

UCITA § 105(a) expressly states that federal law preemption applies when appropriate, a statutory provision not found in other uniform law that was adopted in response to concerns of some that UCITA might somehow displace federal law. UCITA § 105(b) states a fundamental public policy invalidation rule designed to provide courts with a framework to resolve cases where enforcement of a particular contract term in a particular case would violate a fundamental public policy whose strength overrides the fundamental public policy of enforcing contracts. This provision, along with comments that refer to public commentary, reverse engineering and some other potentially fundamental policy issues, sets a flexible standard rather than attempting to state a fixed rule whose application would likely not be appropriate in all cases, regardless of its content.

§ 105 Relation to Federal Law; Fundamental Public Policy

(a) A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption.

(b) If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a 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 the term. …

c. Proposed Amendments:

(1) Affect, Tab 1, page 18:

Add subsection (d):

(d) In a mass-market transaction, a license may not include a term that has the effect of forbidding or restricting the rights or abilities of licensees of computer information or others to engage in public disclosure of a description, criticism, comparison, or evaluation of the computer information or its license, and any such term included is unenforceable to the extent these rights or abilities are not prohibited by other law.

(2) Affect, Tab 1, page 39:

Section 105(f); add

(II) A term in a license is unenforceable if it restricts the licensee from publishing benchmark studies, product reviews or other descriptions of the product that will assist the reader to achieve interoperability or to discover, prove, repair, or mitigate the effects of software errors or security-related risks.

(3) Suggested Alternatives, Tab 7:

Add: Section 209(d)

(d) In a transaction in which computer information is offered in its final form to the general public including consumers, a term of a contract for it is unenforceable to the extent that the term restricts a licensee from engaging in otherwise lawful public discussion of the quality of performance of the computer information; however, such a term is enforceable to the extent that it prevents the misleading use of comparative information or trade names and identification by competitors. Nothing in this section displaces other laws, including laws governing defamation or commercial disparagement.

(4). AG Draft, Tab 6, page 1-2

Add section 105(f):

No licensor shall include a term in a mass-market license that prevents a critical review of the quality of computer information product that has been released in final form to the mass market, but a licensor may include a term in a mass market license that prevents the misleading use of comparative information by competitors.

(5). Virginia Adopted Amendment:

Section 209(d)

(d) In a mass-market transaction, a term of that has the effect of forbidding or restricting the rights or abilities of licensees of computer information to engage in public disclosure or description criticism, comparison or evaluation of the computer information or its license terms is unenforceable to the extent these rights or abilities are not prohibited by other law.

(6) Affect, Tab 1, page 78

Amend Section 105 as follows:

(a) A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption.

~~(b) If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a 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 the term.~~

(b) (1) If a term of a standard form contract favors the drafting party and violates a public policy, including policies embodied in the copyright law, the court shall refuse to enforce the

contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a result contrary to public policy.

(2) If a term of a negotiated contract violates a fundamental public policy, the court may refuse to enforce the contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a 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 the term.

d. Comment:

Affect proposal (1) and (2), the AG Draft and the VA amendment may be inconsistent with laws regarding defamation and the like and the right of a party to make contractual terms that deal with unfair or misuse of information. They also do not distinguish between beta test products and final products, the difference between which may affect the proper enforceability of terms limiting comment. No rules of the type proposed here apply to goods transactions under Article 2 or proposed revisions of article 2, a setting in which similar concerns might arise. The proposals depend on the meaning of mass-market transactions and become less sustainable to the extent that this term extends into business-business transactions. Affect proposal (6) would dramatically change existing law by giving courts the apparent right to invalidate contract terms based on their sense of public policy without the balancing of fundamental interests contemplated by the *Restatement* and UCITA Section 105.

F. WARRANTIES

(A). SECTION 401: INFRINGEMENT, TITLE, NONINTERFERENCE.

a. Current Law.

(1). Common Law and Intellectual Property Law

As a general rule, common law and intellectual property traditions treat a license as a mere covenant to not sue the other party for doing what the license permits, but do not treat the contract as an affirmative promise that using the intellectual property will not infringe other rights of other parties. This tradition is especially well-established in patent licensing law. In effect, there is no implied warranty that use of the information will not infringe the rights of others. There may be variations from this concept in some common law settings, such as in publishing or motion picture licenses, but these are established if at all by limited case law that is not clearly decisive.

To the extent that assurances about non-infringement and the existence of rights are present in any transaction, they typically reflect the fact that copyright and patent laws are territorial, i.e., the rights do not extend beyond the country adopting the law except by treaty. There are no treaties that are adopted worldwide for all intellectual property.

(2) UCC Rules.

To the extent that some courts have held that Article 2 applies to some computer information transactions, Article 2 creates a limited warranty of non-

infringement. Article 2 also expressly rejects any implied warranty that the transferor will not interfere with the transferee's use of the property (e.g., "quiet enjoyment"), but UCC Article 2A does establish such a warranty. Article 2 in reference to infringement and title provides in Section 2-312:

(1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

(a) the title conveyed shall be good, and its transfer rightful; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

b. UCITA Rule:

UCITA generally adopts the Article 2 rule, but includes a warranty of non-interferences and a specific treatment of the territorial nature of intellectual property rights.

SECTION 401. WARRANTY AND OBLIGATIONS CONCERNING NONINTERFERENCE AND NONINFRINGEMENT.

(a) A licensor of information that is a merchant regularly dealing in information of the kind warrants that the information will 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 holds the licensor harmless against any such claim that arises out of compliance with either the required specification or the required method except for a claim that results from the failure of the licensor to adopt, or notify the licensee of, a noninfringing alternative of which the licensor had reason to know.

(b) A licensor warrants:

(1) for the duration of the license, that no person holds a rightful 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:

(A) to the knowledge of the licensor, any licensed patent rights are valid and exclusive to the extent exclusivity and validity are recognized by the law under which the patent rights were created; and

(B) in all other cases, the licensed informational rights are valid and exclusive for the information as a whole to the extent exclusivity and validity are recognized by the law applicable to the licensed rights in a jurisdiction to which the license applies.

(c) The warranties in this section are subject to the following rules:

(1) If the licensed informational rights are subject to a right of privileged use, collective administration, or compulsory licensing, the warranty is not made with respect 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, unless the contract expressly provides that the warranty 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 reference to "worldwide" or the like, to all countries within the description, but only to the extent the rights are recognized under a treaty or international convention to which the country and the United States are signatories.

(3) The warranties under subsections (a) and (b)(2) are not made by a license that merely permits use, or covenants not to claim infringement because of the use, of rights under a licensed patent.

(d) Except as otherwise 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 licensor.

c. Proposed Amendments.

(1) Affect, Tab 1, page 48
Amend Section 401 as follows:

(a) A licensor of information that is a merchant regularly dealing in information of the kind warrants that the information will 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 warrants to the licensor that compliance with the specifications and the required method will not result in a rightful claim of infringement or misappropriation by a third person.

.....

(c) The warranties in this section are subject to the following rules:

(1) If the licensed informational rights are subject to a right of privileged use, collective administration, or compulsory licensing, the warranty is not made with respect to those rights.

(2) The obligations under subsections (a) and (b)(2) apply to informational rights arising under the laws of the ~~United States or any state and under the laws of any other country, to the extent the rights are recognized under a treaty or international convention to which the country and the United States are signatories~~, any country, unless the contract expressly provides that the warranty obligations extend only to rights under the laws of — the United States or any State. ……..

(2) Wolfson, Tab 4

Add disclaimer language for the licensee hold-harmless obligation in Section 401.

d. Comments: UCITA improves the position of a transferee vis a vis common law and UCC § 2-312. It restricts the conditions under which the transferee's indemnification obligation is triggered as compared to Article 2 (i.e., requiring detailed specifications and providing no indemnity if the transferor had reason to know of the infringement and an alternative). UCITA also creates a warranty of non-interference. The Affect proposal retains some of the UCITA variations but eliminates the indemnity obligation and replaces it with a warranty by the licensee to the licensor. The Affect proposal narrows the protection provided by the licensee: the licensee only warrants that compliance with the specifications *and* the methods will be safe, as opposed to *either* of them. It returns more to Article 2 by eliminating the exception for infringement of which the seller had reason to know.

The Affect proposed change to subsection (c) is not consistent with intellectual property laws, which are territorial in character. The proposal may affect small business licensors that cannot comply with the warranty and may not have the commercial resources to retain legal counsel or commercial power to disclaim it.

(B). SECTION 402: EXPRESS WARRANTIES.

a. Current Law:

Express warranty law grew out of the law of fraud and, when moved into Article 2, essentially took on the task of dealing with the enforceability of express promises in a transaction. UCC § 2-313 provides:

(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

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

b. UCITA Rule:

The UCITA rule generally corresponds to the Article 2 rule, but expressly indicates that advertising may create and express warranty and also deals with warranties with respect to published informational content in a manner that protects the First Amendment values present for such information.

SECTION 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, including by 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 will conform to the affirmation or promise.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the information will conform to the description.

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will reasonably conform to the performance of the sample, model, or demonstration, taking into account differences that 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 “warranty” or “guaranty”, or state a specific intention to make a warranty. However, an express warranty is not created by:

(1) an affirmation or prediction merely of the value of the information or informational rights;

(2) a display or description of a portion of the information to illustrate the aesthetics, appeal, suitability to taste, subjective quality, or the like of informational content; or

(3) a statement purporting to be merely opinion or commendation of the information or informational rights.

(c) An express warranty or similar express contractual obligation, if any, exists with respect to published informational content covered by this [Act] to the same extent that it would exist if the published informational content had been published in a form that placed it outside this [Act]. However, if the warranty or similar express contractual obligation is breached, the remedies of the aggrieved party are those under this [Act] and the agreement.

c. Proposed Amendment:

(1) Affect, Tab 1, page 50:
Amend Section 402(a)(3) as follows:

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will ~~reasonably~~ conform to the performance of the sample, model, or demonstration, taking into account differences that 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.

d. Comment: The Affect amendment conforms subsection (3) to Article 2. The UCITA rule reflects a difference between goods and information which is that goods can often run on their own (e.g., a washing machine may be demonstrated by plugging it into an outlet) whereas computer information needs hardware that typically is not manufactured, configured or controlled by the information provider, and will often be asked to work with other software provided by third parties. Thus, a demonstration of a data processing application will work differently with 2,000 records as opposed to 100,000 and/or with computer X configured Y way vs. computer Y configured X way; a washing machine will generally work the same wherever plugged in. Cases recognize the distinction by focusing on the reasonable conformance rule stated in UCITA. *See, e.g., NMP Corporation v. Parametric Technology Corporation*, 958 F. Supp. 1536 (N.D. Okla., 1997).

(C). SECTION 406: EXCLUSION OF WARRANTIES.

a. Current Law:

By their nature, implied warranties are default rules that can be disclaimed by an agreement. While consumer protection laws in a few states preclude disclaimers in *consumer* transactions, Article 2 and 2A both expressly permit disclaimer of all implied warranties. In contrast, the general assumption is that an express warranty, as part of the basis of the actual bargain, cannot be disclaimed and controls over inconsistent language of disclaimer, but that contract terms can prevent the creation of an express warranty by in effect making the promise not part of the basis of the bargain.

Article 2 provides:

§ 2-316. Exclusion or Modification of Warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is

unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

b. UCITA Rule:

UCITA adopts the approach of Article 2 on disclaimer, modifying language to reflect the different warranties involved and to provide for more meaningful disclaimer language.

SECTION 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 301 with regard to parol or extrinsic evidence, the disclaimer or modification is inoperative to the extent that such 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 401, the following rules apply:

(1) Except as otherwise provided in this subsection:

(A) To disclaim or modify the implied warranty arising under Section 403, language must mention “merchantability” or “quality” or use words of similar import and, if in a record, must be conspicuous.

(B) To disclaim or modify the implied warranty arising under Section 404, language in a record must mention “accuracy” or use words of similar import.

(2) Language to disclaim or modify the implied warranty arising under Section 405 must be in a record and be conspicuous. It is sufficient to state “There is no warranty that this information, our efforts, or the system will fulfill any of your particular purposes or needs”, or words of similar import.

(3) Language in a record is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or, except for the warranty in Section 401, if it is conspicuous and states “Except for express warranties stated in this contract, if any, this ‘information’ ‘computer program’ is 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) A disclaimer or modification sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of merchantability is sufficient to disclaim or modify the warranties under Sections 403 and 404. A disclaimer or modification sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of fitness for a particular purpose is sufficient to disclaim or modify the warranties under Section 405.

(c) Unless the circumstances indicate otherwise, all implied warranties, but not the warranty under Section 401, are disclaimed by expressions like “as is” or “with all faults” or other language that in common understanding calls the licensee’s attention to the disclaimer of warranties and makes plain that there are no implied warranties.

(d) If a licensee before entering into a contract has examined the information or the sample or model as fully as it desired or has refused to examine the information, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed to the licensee.

(e) An implied warranty may 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 [Act] with respect to liquidation or limitation of damages and contractual modification of remedy.

c. Proposed Amendments:

(1) Affect, Tab 1, page 53: Amend Section 406 as follows:

(d)

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

~~(f)~~ (e) 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)~~(f) Remedies for breach of warranty may be limited in accordance with this [Act] with respect to liquidation or limitation of damages and contractual modification of remedy.

(g) Notwithstanding the provisions of subsection (a) through (f) if this section, oral language or language in a record used in a consumer contract which attempts to exclude or modify any implied warranties of merchantability of a computer program created under section 403 of this Act, or exclude or modify the consumer’s remedies for a breach of those warranties, is unenforceable.

(2) Affect, Tab 1, page 14: Add to Section 406:

(h) Notwithstanding the provisions of subsections (a) through (f) of this section, oral language or language in a record used in a mass-market transaction will be ineffective to exclude or modify any implied warranty of merchantability of a computer program under section 403 of this Act or any implied warranty of fitness for a particular purpose or that components will function together under section 405 of this Act or to exclude or modify the remedies for a breach of those warranties, is unenforceable. The provisions of this subsection do not apply to computer information that is available for the public at no charge beyond the cost of media and delivery and that may be redistributed at no charge beyond the cost of media and delivery, or to computer information provided as a bona fide beta test or similar experimental version of the computer information or computer program that is not generally distributed.

d. Comment:

Affect proposal (1) eliminates the rule in UCC Article 2-316(b)(3) which is repeated in UCITA § 406(d). These rules reflect the underlying public policy that buyers should not expect to obtain a warranty on defects of which they are aware or ought to be aware. In Article 2 and UCITA, the legitimate fear that not all

defects can be discovered is accommodated by the statute and the comments (see UCITA Comment No. 5(b)).

Affect proposals (1) and (2) eliminate standard Article 2 rules allowing disclaimer of warranties by agreement. Under federal law, warrantors who provide express, written warranties on tangible consumer products that are sold may not disclaim implied warranties. Under UCITA when express warranties are provided and the federal act applies, that rule governs (UCITA § 105(a)). Otherwise, federal law has no policy of preventing sellers from disclaiming warranties. The Affect proposals do not reflect Article 2, existing or revised, and also do not reflect the common law.

Affect proposal in its subsection (g) limits the ability of licensors to limit remedies for breach, which limitations are expressly allowed by Article 2-316(4) as a balance against imposition by law of implied warranties. The UCITA rule is the same as in Article 2.

(D). VIRUSES

a. Current Law

No statute or case law deals directly with the allocation of loss in the event that an information product contains a virus or other harmful code. Such cases would presumably be handled under ordinary contract warranty law (e.g., a product containing harmful code may not be merchantable). Various criminal laws make it a criminal offense to knowingly include harmful code in a manner intended to or likely to harm the information or system of another person.

b. UCITA Rule:

After extensive discussion over several public meetings of various proposals dealing with viruses and the like, the Committee elected to leave the issue to be developed by judicial and other action. No consensus could be reached nor could a fair allocation of risk be stated given numerous issues such as these: (1) both licensors and licensees are victims of viruses, i.e., sabotage or terrorism by third parties; (2) viruses can be inserted even after extensive testing by licensors and testing cannot discover all viruses; (3) the person in the best position to check for viruses and latest iterations is the licensee; (4) numerous companies provide virus detection assistance and free "cures;" and (5) neither UCC Article 2 nor the common law imposes any similar rule or any similar liability on one of the victims of sabotage (e.g., such as when aspirin is contaminated at the store or anthrax is dusted on packages).

c. Proposed Amendment

(1) Affect, Tab 1, page 77:
Add Section 410 [new]:

SECTION 410 [new] EXPRESS WARRANTY OF CONTAMINANT-FREE INFORMATION -

(a) (1) A licensor warrants that computer information that it provides is, to the best of its knowledge, free of any virus or any other contaminant, or disabling devices including, but not limited to, codes, commands or instructions that may have the effect or be used to access, alter, delete, damage or disable the information, or other software, information or

property, other than code, commands or instructions specifically disclosed in the license agreement; and further warrants that it has not and will not introduce into and the software does not contain any such virus or other contaminants or disabling devices.

(2) A merchant licensor warrants that it has made reasonable efforts to discover whether computer information that it provides is free of viruses, worms, or other such contaminants.

(3) This warranty may not be disclaimed except in a contract with the specific purpose of providing access to the licensee of code that has been contaminated with viruses, worms, or other such contaminants.

(b) Notwithstanding any provision to the contrary in a license agreement, a licensor shall be liable for incidental and consequential losses that are caused by any breach of security of the licensee's information by a third party where the breach of security was facilitated by the licensor's breach of the warranty set forth in subsection (a) of this section.

d. Comment.

The Affect proposal has no counterpart in Article 2 or the common law. The proposal raises the issue of "viruses" which was extensively debated during the UCITA hearings. The issue was left to criminal laws and federal and state laws regarding unauthorized access and trespass. The issue may also be affected by new laws regarding terrorism (e.g., insurance companies providing property insurance are seeking allocation of the risk of terrorism to other parties).

G. SECTION 109: CHOICE OF LAW

a. Current Law:

(1) Contract Choice:

Common law generally enforces contractual choices of law unless they are unconscionable or violate fundamental public policy of a state. *See Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir. 1984); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993). Compare *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App.4th 881, 72 Cal. Rptr.2d 73 (Cal. App. 1998) (California fundamental policy invalidates choice of law that would be enforceable under Maryland law, where the contract was made). The *Restatement (Second) of Conflicts of Law*188 provides:

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

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

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

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

For funds transfer and letters of credit, the UCC provides for open choice of law by agreement without any limitations and, for letters of credit, also provides for choice of forum without limitation. UCC §§ 4A-507; 5-116.

UCC Article 2A, which deals with leases of goods and has not been applied to computer information transactions provides a special rule for

consumers, which rule has not been adopted in proposed revisions of Article 2. Section 2A-106 provides: "If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the lime the lease agreement becomes enforceable or within thirty days thereafter or in which the goods are to be used, the choice is not enforceable."

Recent proposed revisions to UCC Article 1 provide:

(b) … Except as otherwise provided in this section:

(1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated …

(c) In the absence of an agreement … and except as provided in subsections (d) and (f), the rights and obligations of the parties are determined by the law that would be selected by application of this State's conflict of laws principles.

(d) If one of the parties to a transaction is a consumer, the following rules apply:

(1) An agreement referred to in subsection (b) is not effective unless the transaction bears a reasonable relation to the State or country designated.

(2) Application of the law of the State or country determined pursuant to subsection (b) or (c) may not deprive the consumer of the protection any rule of law governing a matter within the scope of this section, which both is protective of consumers and may not be varied by agreement of the state or country;

(A) in which the consumer principally arises, unless subparagraph (A) applies; or

(B) if the transaction is a sale of goods, in which the consumer makes the contract and takes delivery of those goods, if such State or country is not the State or country in which the consumer principally resides.

(e) An agreement otherwise effective under subsection (b) is not effective to the extent that application of the law of the State or country designated would be contrary to a fundamental policy of the State or country whose law would govern in the absence of agreement under subsection (c).

(2) No Contract Choice:

In the absence of contractual choices of law, various often conflicting approaches are followed. One Treatise says: "[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. Four or five theories are in vogue among the various states, with many decisions using - openly or covertly - more than one theory." *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992).

UCC Article 1 deals with choice of law in a general provision applicable to transactions falling with the scope of the UCC. Section 1-105(1) states that: "this Act applies to transactions bearing an <u>appropriate relation</u> to this state." This places the choice of law in the forum state if that state has sufficient contact with the particular problem being litigated.

b. UCITA Rule:

SECTION 109. CHOICE OF LAW.

(a) The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract 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 under subsections (b) and (c) in the absence of the agreement.

(b) In the absence of an enforceable agreement on choice of law, the following rules determine which jurisdiction's law governs in all respects for purposes of contract law:

(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 was located when the agreement was entered into.

(2) A consumer contract that requires delivery of a copy on a tangible 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 having the most significant relationship to the transaction.

(c) In cases governed by subsection (b), if the jurisdiction whose law governs 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 [Act]. Otherwise, the law of the State that 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.

c. Proposed Amendments: Affect, Tab 1, page 32: Amend Section 109 as follows:

(a) Except as provided in subsection (e), t~~T~~he parties in their agreement may choose the applicable law. ~~However, the choice is not enforceable in a consumer contract 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 under subsections (b) and (c) in the absence of the agreement.~~

(b) In the absence of an enforceable agreement on choice of law, the following rules determine which jurisdiction's law governs in all respects for purposes of contract law:

(1) Except for consumer contracts, a ~~A~~n access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor was located when the agreement was entered into.

(2) A consumer contract

(i) that requires delivery of a copy on a tangible medium is governed by the law of the jurisdiction in which the copy is or should have been delivered to the consumer, or

(ii) otherwise is governed by the law of the jurisdiction in which the licensee resides at the time the license becomes enforceable

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

(e) In a consumer contract, the choice of law is enforceable only if

(a) the law chosen by the parties is that of a jurisdiction in which the licensee resides at the time the license becomes enforceable, or within 30 days thereafter, or

(b) where the contract requires delivery of a copy on a tangible medium, the law chosen by the parties is that of a jurisdiction in which the copy of computer information is or should have been delivered.

(2) Affect, Tab 1, page 42: Add the following to Section 109:

Section 109(e) If a computer program, including a program embedded in a device, is the cause of an injury to a person or of damage to tangible property, a term of the license should not be enforced if it (i) selects the law of a state that is neither the state in which the injured party or property owner lives or the state in which the injury or property damage took place, or (ii) requires an injured person or owner of damaged property to travel to another state, or (iii) limits damages available to the injured person or property owner below those that would normally be available in a products liability suit.

d. Comment. Current UCITA rule is more protective of consumer issues than current law, including common law and UCC Article 1 in most cases. The terms of proposal (1), while similar to Article 2A on leases, were not adopted in

revisions of UCC Article 1 or Article 2 and resemble proposals that the U.S. Commerce Department has opposed in international negotiations.

H. SECTION 110: CHOICE OF FORUM

a. Current Law:

Current case law treats choice of exclusive forum clauses, whether in a form contract or otherwise, as presumptively enforceable and precludes them only if the clause is unreasonable and unjust. See *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); *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998); *Caspi v. The Microsoft Network, L.L.C. et. al.*, 732 A.2d 528 (N.J. A.D. 1999); *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991); *America Online, Inc. v. Booker*, 2001 WL 98614 (Fla. App. 2001); *Koch v. America Online, Inc.*, 139 F.Supp.2d 690 (D Md. 2001) (Court enforces forum selection clause in AOL online contract); *Kilgallen d/b/a LJK Software, Inc. v. Network Solutions, Inc.*, 99 F.Supp.2d 125 (D. Mass. 2000); *Barnet v. Network Solutions, Inc.*, 38 S.W.3d 200 (Tex. App. 2001) (Court enforces the forum selection clause in the NSI contract.).

The *Restatement* contains a similar rule.

UCC Article 2A, which deals with leases of goods and has not been applied to information transactions provides in Section 2A-106: If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable." This provision was not adopted in revisions of UCC Article 1 or Article 2.

b. UCITA Rule:

SECTION 110. 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 judicial forum specified in an agreement is not exclusive unless the agreement expressly so provides.

c. Proposed Amendments

(1) Affect, Tab 1, page 30
Amend as follows:

…….

<u>(c) In a consumer transaction a term that provides for a judicial forum that would not otherwise have jurisdiction over the licensee is unenforceable</u>

(2) AG Draft, Tab 6, page 2
Delete the section.

d. Comment:

The UCITA rule codifies the rule of common law and the Restatement. Proposal (1) recommends an approach that has not been adopted outside Article 2A,

which law involves transactions that are different from the online and other transactions involved in UCITA subject matter.

I. SECTION 110: UNCONSCIONABILITY

a. Current Law. The doctrine of unconscionability was created in UCC Article 2 and has subsequently been incorporated into the common law of most states. It provides a means for a court to invalidate over-reaching terms where there has been gross abuse. The doctrine of reasonable expectations was articulated in 1971 in the *Restatement*, but has been adopted in very few states since then largely because it provides for too-large of a judicial intrusion in the content of an agreement. See James J. White, *Form Contracts Under Revised Article 2,* 75 Wash. U. L.Q. 315 (1997). It would allow a court to invalidate a contract term that does not meet the reasonable expectations of a party even if the term is not unconscionable. This test was considered and rejected in proposed revisions of Article 2. The Article 2 rule is as follows:

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

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

b. UCITA Rule: UCITA adopts the Article 2 rule virtually verbatim, except for minor styling changes. Section 111 provides:

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

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

c. Proposed Amendments

(1) Affect, Tab 1, page 34:
Amend as follows:

(a) If a court as a matter of law finds a contract or a term thereof to have been unconscionable <u>or to have frustrated the reasonable expectations of the non-drafting party</u> at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable <u>or the unreasonable</u> term, or limit the application of the unconscionable <u>or unreasonable</u> term so as to avoid an unconscionable <u>or unreasonable</u> result.

(b) If it is claimed or appears to the court that a contract or term thereof may be unconscionable <u>or unreasonable</u>, the parties must be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

(2) Affect, Tab 1, page 80:
Amend as follows:

(a) If a court as a matter of law finds a contract or a term thereof to have been unconscionable or to have frustrated the reasonable expectations of the non-drafting party at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable or unexpected term, or limit the application of the unconscionable or unexpected term so as to avoid an unconscionable or unexpected result.

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

d. Comment: The proposed amendments recommend adoption of a rule that has been expressly rejected in all of the uniform contract law debates, including Article 2, 2A and UCITA after extended discussion in each context. Indeed, Revised Article 9 does not even accept the basic concept of unconscionability as to transactions covered by it.

J. KNOWN DEFECTS

a. Current Law:

Current contract law, both in common law and in the UCC, does not give special treatment under contract law rules to defects that are known to a party making a transfer. The issue is covered within whatever warranties are made and in whether the product or service provided meets ordinary expectations consistent with the ordinary meaning of its description.

Knowledge of an important defect that is not disclosed is, beyond general contract warranties of merchantability, etc., handled under the law of fraud, misrepresentation or unfair trade practices. In the computer information industries, consistent with general law of fraud, courts have held that a failure to disclose a known, material defect in circumstances where a duty to disclose exists, may constitute fraud where it entails an intent to defraud the other party. See *Strand v. Librascope*, 197 F. Supp. 743 (E.D. Mich. 1961); *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658 (9th Cir. 1982); *Invacare v. Sperry Corp.,* 612 F. Supp. 448 (N.D. Ohio 1984). Statements that are rendered fraudulent because they conceal important known defects may also be actionable under the law of fraud.

No general contract law requires disclosure of known defects that are not material or imposes liability for nondisclosure when the transferred subject matter still corresponds to the ordinary meaning of its description under the contract.

b. UCITA Rule:

UCITA follows traditional commercial contract law by providing for implied warranties and express warranties, but not dealing with questions about fraudulent nondisclosure. Section 114 states that other law, including the law of fraud, is not altered by UCITA.

c. Proposed Amendments

(1) Suggested Alternatives, Tab 7

Amend Section 114 as follows:

SECTION 114. SUPPLEMENTAL PRINCIPLES ….

(a) Unless displaced by this [Act], principles of law and equity, including the law merchant and the common law of this State relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, and other validating or invalidating cause, supplement this [Act]. Among the laws supplementing and not displaced by this [Act] are trade secret laws, unfair competition laws and the law of fraud, misrepresentation and unfair and deceptive practices regarding failure to disclose material defects in a product, and remedy may be had under this Act or other law pursuant to Section 806.

(2) Affect, Tab 1, page 40
Add to Section 403 (merchantability warranty):

(d) A licensor that is a merchant with respect to computer programs of the kind:

(1) Warrants that, as of the time of transaction, the licensed computer program has no known defects other than those which have been disclosed to the licensee at or before the time of the transaction. A defect has been disclosed to the licensee if it was made available to the licensee at no cost, for example by publication on the licensor's website, and the licensee was advised how to access the licensor's disclosure of this defect, and the disclosure is reasonably calculated to be informative to the typical licensee of a product of this kind, including a description of the errors or problems that the licensee would be expected to encounter as a consequence of this defect and the steps recommended to avoid or mitigate losses caused by the defect.

(2) Will be liable for incidental and consequential losses of the licensee that were caused by a defect that was known to the licensor at time of transacting but were not disclosed to the license. However a mass-market license may limit the remedy to reimbursement of not more than $500 for incidental losses and consequential losses that involved actual out-of-pocket expenses of the licensee. Unless the contract specifies otherwise, the licensor will not be liable for incidental and consequential losses of the licensee that were caused by a defect that was unknown to the licensor at the time of transacting or that was known and disclosed.

(3) May not disclaim this warranty in a mass-market license or a license for a computer program that will be embedded in goods and whose failure could cause a personal injury or damage to tangible property.

(3) Affect, Tab 1, page 52:
Amend Section 403 (merchantability warranty):

SECTION 403 - IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM

(a) Unless the warranty is disclaimed or modified, a licensor that is a merchant with respect to computer programs of the kind warrants:

(1) to the end user that the computer program is fit for the ordinary purposes for which such computer programs are used;

(2) to the distributor that:

(A) the program is adequately packaged and labeled as the agreement requires; 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;

(3) that the program conforms to any promises or affirmations of fact made on the container or label; and

(4) that the program is free of defects or programming errors known to the licensor.

(4) Affect, Tab 1, page 14:
Amend Section 406 (disclaimer) as follows:

(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 401, the following rules apply:

(1) Except as otherwise provided in this subsection:

(A) To disclaim or modify the implied ~~warranty~~ warranties arising under Section 403, language must mention "merchantability" ~~or~~ and "quality" and "known defects" or use words of similar import and, if in a record, must be conspicuous. …

(5) Wolfson, Tab 4
Add a new section:

"Principles of law and equity related to fraud, including fraud in the inducement, are not displaced by this Act."

d. Comment: The proposals stated in proposed amendments (2) thru (4) would enact rules that are not applied elsewhere in general contract law and that, in general, are also not adopted in the common law of fraud. Proposals (1) and (5) clarify that the law of fraud is not displaced and provides a potential remedy for fraudulent practices.

K. ELECTRONIC SELF-HELP

a. Current Law:

There are few cases dealing with electronic measures that are used to enforce rights in the event of breach by another party. The few cases generally hold that such use is appropriate if there was agreement in the contract that it could be used or if other law permits it. *See, e.g., American Computer Trust Leasing v. Jack Farrell Implement Co.*, 763 F. Supp. 1473, 1991 (D. Minn. 1991).

Article 9 (security interests) and Article 2A (leases of goods) permit a secured party (which can be any party reserving a security interest or making a lease) to disable the goods in place or otherwise engage in self-help so long as its actions entails no breach of the peace. No prior notice of, or express agreement to, the availability of the right is requires. No prior notice of its exercise is required.

Federal law, in the DMCA, assumes the rights of an owner of a copyright to use technological means to control access to (use of) its work and, with exceptions not relevant here, prohibits acts that circumvent such technological controls. 17 USC § 1201, et. seq.

b. UCITA Rule:

UCITA precludes electronic self-help unless the parties expressly agree to allow it and elaborate procedures are in place before it can be exercised. These ensure that no hidden or unforeseen use of this remedy is possible. UCITA also bars electronic self-help entirely in mass-market transactions.

SECTION 815. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) On 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 are 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 814, 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;

(2) without a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information; and

(3) in accordance with Section 816.

SECTION 816. LIMITATIONS ON ELECTRONIC SELF-HELP.

(a) In this section:

(1) "Electronic self-help" means the use of electronic means to exercise a licensor=s rights under Section 815(b).

(2) "Wrongful use of electronic self-help" means use of electronic self-help other than in compliance with this section.

(b) On cancellation of a license, electronic self-help is not permitted, except as provided in this section. Electronic self-help is prohibited in mass-market transactions.

(c) If the parties agree to permit electronic self-help, the licensee shall separately manifest assent to a term authorizing use of electronic self-help. In accordance with Section 112(c), a general assent to a license containing a term authorizing use of electronic self-help is not sufficient to manifest assent to the use of electronic self-help. The term must:

(1) provide for notice of exercise as provided in subsection (d);

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

(3) provide a simple procedure for the licensee to change the designated person or place.

(d) Before resorting to electronic self-help authorized by a term of the license, the licensor shall give notice in a record to the person designated by the licensee stating:

(1) that the licensor intends to resort to electronic self-help as a remedy on or after 15 days following receipt by the licensee of the notice;

(2) the nature of the claimed breach that entitles the licensor to resort to self-help; and

(3) the name, title, and address, including direct telephone number, facsimile number, or e-mail address, to which the licensee may communicate concerning the claimed breach.

(e) A licensee may recover direct and incidental damages caused by wrongful use of electronic self-help. The licensee may also recover consequential damages for wrongful use of electronic self-help, whether or not those damages are excluded by the terms of the license, if:

(1) within the period specified in subsection (d)(1), the licensee gives notice to the licensor=s designated person describing in good faith the general nature and magnitude of damages;

(2) the licensor has reason to know the damages of the type described in subsection (f) may result from the wrongful use of electronic self-help; or

(3) the licensor does not provide the notice required in subsection (d).

(f) Even if the licensor complies with subsections (c) and (d), electronic self-help may not be used if the licensor has reason to know that its use will result in substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third persons not involved in the dispute.

(g) A court of competent jurisdiction of this State shall give prompt consideration to a petition for injunctive relief and may enjoin, temporarily or permanently, the licensor from exercising electronic self-help even if authorized by a license term or enjoin the licensee from misappropriation or misuse of computer information, as may be appropriate, upon consideration of the following:

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

(2) irreparable harm or threat of irreparable harm to the licensee or licensor;

(3) that the party seeking the relief is more likely than not to succeed under its claim when it is finally adjudicated;

(4) that all of the conditions to entitle a person to the relief under the laws of this State have been fulfilled; and

(5) that the party that may be adversely affected is adequately protected against loss, including a loss because of misappropriation or misuse of computer information, that it may suffer because the relief is granted under this [Act].

(h) Before breach of contract, rights or obligations under this section may not be waived or varied by an agreement, but the parties may prohibit use of electronic self-help, and the parties, in the term referred to in subsection (c), may specify additional provisions more favorable to the licensee.

(i) This section does not apply if the licensor obtains physical possession of a copy without a breach of the peace and without use of electronic self-help, in which case the lawfully obtained copy may be erased or disabled by electronic means.

c. Proposed Amendments

(1) AG Draft, Tab 6, page 2:

Amend Sections 815 and 816 as follows:

Section 816: Bracket and make section optional with a note re choice

Amend: 815(b)(2) to read: "without physical damage to information or property other than the licensed information"

Delete: 815(b)(3) and related comments

(2) Affect, Tab 1, page 65:
Amend Section 815 and 816 as follows:

Section 815 (amend)

(a) On 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 are 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) In a proceeding to enforce a licensor's rights under subsection (a) ,

the court may enjoin a licensee in breach of contract from continued use of the information and informational rights and may order the licensor or a judicial officer to take the steps described in Section 618. ....

Section 816 (delete and replace with)

The use of electronic means to exercise a licensor's rights under Section 815 ~~(b)~~ (a) is prohibited.

(3) Klein, Tab 5, page 6

Delete all of Section 816.

Replace section 815 (b) with the following:

"(b) A licensor may not use electronic means to exercise its rights under this Section unless the licensor has obtained judicial authorization to do so."

(4) Wolfson, Tab 4
Delete Section 816

d. **Comment:** Section 816 has been one of the most controversial provisions of UCITA. Some view it as creating the right to use electronic self-help, which it does not. Others view it as providing significant protections for the licensee that do not exist under current law, which is its intended purpose. Deleting the section leaves the issue to other law. Prohibiting electronic self-help may conflict with the DMCA and may adversely affect small software developers.

L. REVERSE ENGINEERING

a. Current Law:

In the absence of a contractual restriction or an intellectual property right that precludes it, a party is free to take a product that it owns and closely examine (reverse engineer) that product to determine what technology or other information it has, and then use that unprotected information in its own product.

When the issue involves information that is protected solely by trade secret law, reverse engineering of a product owned by the person is viewed as "proper" acquisition of the information and therefore not a violation of trade secret law. See Uniform Trade Secrets Act § 1, *Cmt.* That result is not followed in

cases where the reverse engineer is a licensee or a lessee (as compared to an owner), nor is it followed when such people are subject to contract terms precluding reverse engineering.

Copyright case law supports the view that intermediate copies made in the process of reverse engineering are fair use when necessary to obtain unprotected information within a product, the copy of which is owned by the reverse engineer. See *Sony Computer Entertainment, Inc. v. Connectix Corp.*, 203 F.3d 596 (9th Cir. 2000); *Sega Enters., Ltd. v. Accolade, Inc.*, 977 F2d 1510 (9th Cir. 1992); *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F2d 832 (Fed. Cir. 1992). This does not allow use of copyrighted information in a product generally distributed, but merely the making of intermediate copies to allow discerning elements of the other program to allow interoperability,

A European Union directive bars enforcement of contract clauses that prohibit reverse engineering to discover unprotected information about interoperability that is not otherwise readily available.

The federal copyright DMCA makes an exception to its bar on circumventing technological restrictions on access to copyrighted works that states:

> (f) Reverse engineering.--(1) Notwithstanding the provisions of subsection (a)(1)(A), a person who has lawfully obtained the right to use a copy of a computer program may circumvent a technological measure that effectively controls access to a particular portion of that program for the sole purpose of identifying and analyzing those elements of the program that are necessary to achieve interoperability of an independently created computer program with other programs, and that have not previously been readily available to the person engaging in the circumvention, to the extent any such acts of identification and analysis do not constitute infringement under this title [17 U.S.C.A. s 1 et seq.].

c. Proposed Amendments

(1) Affect, Tab 1, page 39:
Section 105: Add the following:

(f) (I)A term in a license is unenforceable if it restricts the licensee from reverse engineering if that reverse engineering is done to achieve interoperability or to discover, prove, repair, or mitigate the effects of software errors or security-related risks.

(II) A term in a license is unenforceable if it restricts the licensee from publishing benchmark studies, product reviews or other descriptions of the product that will assist the reader to achieve interoperability or to discover, prove, repair, or mitigate the effects of software errors or security-related risks.

(III) A term in a mass-market license is unenforceable if it restricts the licensee from reverse engineering a computer program or it restricts the licensee from publishing the results of benchmark studies or other reviews of the licensed computer information.

(2) Kunze, Tab 3

Add: Section 208(4):

A term in a standard form contract which has the effect of forbidding or restricting reverse engineering is unenforceable. This section shall not affect the application of any law relating to information rights.

(3) Suggested Alternatives, Tab 7:

Section --- [new]

(a) Notwithstanding the terms of a contract under this Act, a licensor who lawfully obtained the right to use a copy of a computer program may identify, analyze and use those elements of the program that are necessary to achieve interoperability of an independently created computer program with other programs, provided that:

(1) such elements have not previously been readily available to the licensee;

(2) such identification, analysis, or use is performed solely for the purpose of enabling such interoperability; and

(3) such identification, analysis or use is not prohibited by other law.

(b) For purposes of this subsection, the term interoperability means the ability of computer programs to exchange information, and of such programs mutually to use the information which has been exchanged.

d. Comment:

U.S. law does not preclude enforcement of contract terms against reverse engineering. The European Union does in limited circumstances. For terms that preclude reverse engineering in setting where there is a fundamental public policy against such terms, UCITA already allows a court to bar enforcement of the term. Proposal (2) would disallow any such terms as a matter of contract law, even as between major corporations. Proposal (1) is less clear, but creates entirely new law that might benefit on group of companies over another. Proposal (3) mirrors property law language including in the DMCA. The question is whether property law policy should preclude contracts even if the policy is not a fundamental policy that would in general outweigh the policy of enforcing contracts.

M. LIBRARIES, GIFTS, ETC.

a. Current Law

Copyright law provides special exemptions for various non-profit libraries, archives, and educational institutions associated with fair use considerations. As a general matter, these property rights exemptions are subject to contrary contractual terms. A significant debate in Congress has been ongoing about the nature of these exemptions or other appropriate exemptions with respect to digital information and online systems.

c. Proposed Amendments

(1) Suggested Alternatives, Tab 7 (based on Virginia Amendment): Add:

Section 310 [new]. Licenses to non-profit libraries, archives or educational institutions.

<u>(a) To the extent that the conduct is not otherwise wrongful or restricted under the Copyright Act, 17 USC § 101 et. seq., or other law, in a standard form contract for the use of a tangible copy of informational content to a licensee that is a nonprofit library or archive, or a nonprofit educational institution, the licensee may, without any purpose of direct or indirect commercial advantage:</u>

<u>(1) make the tangible copy available to library or archive users, including reserving the copy for a course, and may lend that copy to users in accordance with ordinary practices of nonprofit libraries or archives;</u>

<u>(2) make a copy of the tangible copy for archival or preservation purposes;</u>

<u>(3) engage in inter-library lending of tangible copies of the copy; and</u>

<u>(4) make classroom and instructional use of the tangible copy.</u>

(b) The rules in subsection (a) may be varied by a term in a standard form contract only if:

(1) the term varying the rule is conspicuous and

(2) the nonprofit library, archive or educational institution specifically manifests assent to the term pursuant to Section 112(c); and

(3) where the term is not made available to the library, archive or educational institution before it orders the tangible copy of the computer information:

(i) the library, archive or educational institution knew or had reason to know that terms would follow when it ordered the copy; and

(ii) it is given a right to a return in the event that it refuses the license with reimbursement of any reasonable expenses incurred in complying with the licensor's instructions for returning or destroying the computer information or, in the absence of instructions, expenses incurred for return postage or similar reasonable expense in returning the computer information.

(c) Nothing in this section shall be construed to:

(1) alter the burden of proof in an infringement, contract or other action;

(2) deal with making the informational content available on a computer server or other system for simultaneous access and use by multiple users; or

(3) limit any defense that a term of a contract violates a fundamental public policy pursuant to Section 105(b) including any such policy of federal copyright law.

(d) For purposes of this section, the terms "nonprofit library, archive or educational institution" have the meaning as used in Sections 108, 109 and 110 of the Copyright Act §§ 108, 109, and 110.

(3) Suggested Alternatives, Tab 7:
Amend Section 503(2) by adding:

(C) the transfer is to a nonprofit library or archive by the owner of a tangible copy of computer information that complies with Section 117 of the Copyright Act and the nonprofit library or archive is subject to any contractual use terms applicable to that copy.

(4). Virginia Amendment
Amend Section 503(2) by adding:

(C) the term is in a mass-market license, the transfer is made along with a computer, and the transfer is a gift or donation (i) to a public elementary or secondary school, (ii) to a public library, (iii) to an organization exempt from taxation under § 501(c)(3) of the Internal Revenue Code, or (iv) from a consumer to another consumer.

d. Comment: Each of the proposed amendments gives libraries and the other mentioned institutions contract law protections that do not exist under current law. The economic impact on information providers is not certain were any of these to be adopted.

N. FORMATION ISSUES

(A). ASSENT TO A CONTRACT

a. Current Law:

(1) General. Contract law distinguishes between agreement or assent that creates a contract and agreement or assent that adopts terms of a record or other source as the terms of that contract. Although older common law placed limitations on this concept, modern law allows assent or agreement to a contract

in any appropriate manner. However, it recognizes that the person making an offer or an acceptance has a right to condition it on adherence to its specified terms or means of acceptance. The basic rule is that an offer cannot be converted into a contract unless that offer is accepted (reflecting all its conditions). The further rule is that a person making an offer or an acceptance can condition its presentation on terms of its own choosing. A conditional acceptance does not create a contract unless the conditions are met.

(2) Article 2. Article 2 provides that agreement can be expressed in any manner, including conduct or words sufficient to indicate that an agreement to a contract was intended. UCC § 2-204(1) ("A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract."). Article 2 also provides that a contract can be formed even if the time of its formation cannot be specifically determined. UCC § 2-204(2) ("An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.").

The most controversial section of Article 2 allows creation of a contract even if the acceptance states terms in addition to or different from the offer. Section 2-207 provides:

> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
>
> (a) the offer expressly limits acceptance to the terms of the offer;
>
> (b) they materially alter it; or
>
> (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
>
> (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

Among the issues created by this section are questions of what or when a response to an offer that differs from the terms of an offer can be treated as a "definite" acceptance, rather than a counter-offer. Article 2 also does not provide guidance on what constitutes a "confirmation" as compared to a counteroffer. Section 2-207(1), however, does recognize the traditional common law rule that an acceptance made expressly conditional on assent to its own terms does not constitute a "definite" acceptance that creates a contract.

(3) Common Law. Common law rules do not generally adopt the idea that an "acceptance" that accepts terms different from those that were offered can still be an acceptance that creates a contract. Cases enforce conditions in an acceptance if the conduct of the party corresponds to the condition.

b. UCITA Rules:

UCITA adopts the Article 2 rules that assent or agreement to a contract can be manifested in any manner that indicates assent and that a contract can

be formed even if the specific time of formation cannot be precisely determined. It also deviates from common law by allowing a contract to be formed by an acceptance that has different terms from the offer. UCITA, however, elaborates on the conditions under which varying acceptances are effective and on when a condition offer or acceptance is effective. These rules give greater guidance to commercial parties than current law, but are consistent with that law.

SECTION 203. OFFER AND ACCEPTANCE IN GENERAL. Unless otherwise unambiguously indicated by the language or the circumstances:

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

SECTION 204. ACCEPTANCE WITH VARYING TERMS.

(a) In this section, an acceptance materially alters an offer if it contains a term that materially conflicts with or varies a term of the offer or that adds a material term not contained in the offer.

(b) *Except as otherwise provided in Section 205, 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 alters the offer.*

(c) If an acceptance materially alters the offer, the following rules apply:

(1) A contract is not formed unless:

(A) a party agrees, such as by manifesting assent, to the other party=s offer or acceptance; or

(B) all the other circumstances, including the conduct of the parties, establish a contract.

(2) If a contract is formed by the conduct of both parties, the terms of the contract are determined under Section 210.

(d) If an acceptance varies from but does not materially alter the offer, a contract is formed based on the terms of the offer. In addition, the following rules apply:

(1) Terms in the acceptance which conflict with terms in the offer are not part of the contract.

(2) An additional nonmaterial term in the acceptance is a proposal for an additional term. Between merchants, the proposed additional term becomes part of the contract unless the offeror gives notice of objection before, or within a reasonable time after, it receives the proposed terms.

SECTION 205. CONDITIONAL OFFER OR ACCEPTANCE.

(a) In this section, an offer or acceptance is conditional if it is conditioned on agreement by the other party to all the terms of the offer or acceptance.

(b) Except as otherwise provided in subsection (c), a conditional offer or acceptance precludes formation of a contract unless the other party agrees to its terms, such as by manifesting assent.

(c) If an offer and acceptance are in standard forms and at least one form is conditional, the following rules apply:

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

(2) A party that agrees, such as by manifesting assent, to a conditional offer that is effective under paragraph (1) adopts the terms of the offer under Section 208 or 209, except a term that conflicts with an expressly agreed term regarding price or quantity.

c. Proposed Amendments

(1) Affect, Tab 1, pages 3-13

Delete current Section 204 and replace as follows:

A definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer

(2) Affect, Tab 1, pages 3-13
Delete Section 205 and replace as follows:

SECTION 205. TERMS OF CONTRACT; EFFECT OF CONFIRMATION.

If (i) conduct by both parties recognizes the existence of an contract although their records do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance, or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract, subject to Section 2-202, are:

(1) terms that appear in the records if both parties;

(2) terms, whether in a record or not, to which both parties agree; and

(3) terms supplied or incorporated under any provision of [the Uniform Commercial Code].

d. Comment: The proposed amendments eliminate the guidance provided in UCITA on when a varying acceptance creates a contract and also eliminate any recognition that a party can effectively make a conditional offer or acceptance.

(B). ASSENT: STANDARD FORMS

a. Current Law:

(1) General Theme. Case law enforces standard forms in both consumer and commercial contexts, while invalidating terms that are unconscionable or that violate a fundamental public policy of the state, which policy overrides the general policy of enforcing contracts. For terms to be enforced, the party to be bound must agree, such as by manifesting assent through behavior or otherwise, regardless of whether it had the ability to negotiate or alter terms and regardless of whether it read the terms. Under common law, a party is bound by the terms of a writing to which it assents even though it did not read the written terms. See, e.g., *Kilgallen d/b/a LJK Software, Inc. v. Network Solutions, Inc.*, 99 F.Supp.2d 125 (D. Mass. 2000).

(2) Electronic "Clicks" as Agreement. Cases enforce the terms of online contracts based on an indication of assent by clicking an "I agree" button or otherwise. See, e.g., See *Caspi v. The Microsoft Network, L.L.C. et. al.*, 323 NJ Super. 118, 732 A2d 528 (N.J. Super. A.D. 1999); *Hotmail Corp. v. Van$ Money Pie, Inc.*, 47 U.S.P.Q.2d 1020 (N.D. Cal. 1998); *Rudder v. Microsoft Corp.*, Ontario Superior Ct., (Oct. 8, 1999); *Jessup v. America Online, Inc.,* 20 F. Supp.2d 1105 (ED Mich. 1998); *Groff v. America Online, Inc.,* 1998 WL 307001 (R.I. 1998); *DiLorenzo v. AOL,* 2 ILR (P&F) 596 (NY S. Ct. 1999); *Compuserve Inc. v. Patterson,* 89 F.3d 1257 (6th Cir. 1996); *Register.com, Inc. v. Verio, Inc.,* 6 ILR (PNF) 3115 (SD NY 2000) (assent to online contract found without clicking); *Kilgallen d/b/a LJK Software, Inc. v. Network Solutions, Inc.*, 99 F.Supp.2d 125 (D. Mass. 2000); *Barnet v. Network Solutions, Inc.*, 38 S.W.3d 200 (Tex. App. 2001); *America Online, Inc. v. Booker*, 2001 WL 98614 (Fla. App. 2001). Cases

to the contrary online are those where the circumstances neither yielded an act that constituted assent nor gave awareness that contract terms were sought. See, e.g., *Specht v. Netscape Communications Corp.*, 2001 WL 755396, -- F.Supp.2d – (SD NY 2001); *Ticketmaster Corp. v. Tickets.com*, -- F. Supp.2d -- (CD Cal. 2000) (while such contracts are generally enforceable, there was no showing of assent in this case).

(c) Manifesting Assent. The *Restatement (Second) of Contracts* adopts the concept of manifestation of assent in reference to both questions of when a party agrees to a contract and when it adopts terms of writing that documents the contract. Under the *Restatement*, manifestation of assent entails conduct or inaction taken with reason to know that the other party will view that conduct or inaction as assent to a contract or as assent to the terms of a writing, including a standard form. *Restatement (Second) of Contracts* §§ 19, 211. The *Restatement* is often followed in concept, but its terminology and standards are seldom expressly applied. Section 19 states:

> (1) The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act.
> (2) The conduct of a party is not effective as a manifestation of his assent unless he intends to engage in the conduct <u>and knows or has reason to know</u> that the other party may infer from his conduct that he assents.

(d) Article 2. Article 2 does not deal with assent to standard forms except in the context of a battle of forms involving different terms or conditions. The Section that does so (§ 2-207) is highly controversial and widely regarded as one of the least effective and understandable sections of Article 2.

b. UCITA Rules:

UCITA articulates and provides clarity for the concept of manifesting assent to a record. Sections 208 and 209 provide that a party adopts the terms of a record if it manifests assent to that record, subject of course to doctrines of unconscionability and fundamental public policy. UCITA, however, clearly articulates as a uniform statutory matter that a manifestation of assent requires 1) an opportunity to review the terms of the contract that is clearly presented to the party, and 2) conduct that the party has reason to know will indicate assent to the other party. It also deals specifically with various issues that commercial parties often must consider.

SECTION 208. ADOPTING TERMS OF RECORDS. Except as otherwise provided in Section 209, the following rules apply:

(1) A party adopts the terms of a record, including a standard form, as the terms of the contract if the party agrees to the record, such as by manifesting assent.

(2) The terms of a record may be adopted pursuant to paragraph (1) after beginning performance or use if the parties had reason to know that their agreement would be represented in whole or part by a later record to be agreed on and there would not be an opportunity to review the record or a copy of it before performance or use begins. If the parties fail to agree to the later terms and did not intend to form a contract unless they so agreed, Section 202(e) applies.

(3) If a party adopts the terms of a record, the 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 [Act].

SECTION 209. MASS-MARKET LICENSE.

(a) A party adopts the terms of a mass-market license for purposes of Section 208 only if the party agrees to the license, such as by manifesting assent, before or during the party's initial performance or use of or access to the information. A term is not part of the license if:

(1) the term is unconscionable or is unenforceable under Section 105(a) or (b); or

(2) subject to Section 301, the term conflicts with a term to which the parties to the license have expressly agreed.

(b) If a mass-market license or a copy of the license is not available in a manner permitting an opportunity to review by the licensee before the licensee becomes obligated to pay ……….

SECTION 112. MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

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

(1) authenticates the record or term with intent to adopt or accept it; or

(2) intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term.

(b) An electronic agent manifests assent to a record or term if, after having an opportunity to review it, the electronic agent:

(1) authenticates the record or term; or

(2) engages in operations that in the circumstances indicate acceptance of the record or term.

(c) If this [Act] or other law requires assent to a specific term, a manifestation of assent must relate specifically to the term.

(d) Conduct or operations manifesting assent may be proved in any manner, including a showing that a person or an electronic agent obtained or used the information or informational rights and that a procedure existed by which a person or an electronic agent must have engaged in the conduct or operations in order to do so. Proof of compliance with subsection (a)(2) is sufficient if there is conduct that assents and subsequent conduct that reaffirms assent by electronic means.

(e) With respect to an opportunity to review, the following rules apply:

(1) A person has an opportunity to review a record or term only if it is made available in a manner that ought to call it to the attention of a reasonable person and permit review.

(2) An electronic agent has an opportunity to review a record or term only if it is made available in manner that would enable a reasonably configured electronic agent to react to the record or term.

(3) 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 it has a right to a return if it rejects the record. However, a right to a return is not required if:

(A) the record proposes a modification of contract or provides particulars of performance under Section 305; or

(B) the primary performance is other than delivery or acceptance of a copy, the agreement is not a mass-market transaction, and the parties at the time of contracting had reason to know that a record or term would be presented after performance, use, or access to the information began.

(4) The right to a return under paragraph (3) may arise by law or by agreement. ….

(g) Providers of online services, network access, and telecommunications services, or the operators of facilities thereof, do not manifest assent to a contractual relationship simply by their provision of those services to other parties, including, without limitation, transmission, routing, or providing connections, linking, caching, hosting, information location tools, or storage of materials, at the request or initiation of a person other than the service provider.

c. Proposed Amendments

(1) Affect, Tab 1, pages 3-13

Delete Section 112 on opportunity to review and manifesting assent

(2) Affect, Tab 1, pages 3-13

Delete Section 208

(3) Affect, Tab 1, pages 3-13

Delete Section 209 and replace with a different rule as noted later.

(4) Wolfson, Tab 4

Add the following language to sections 208 and 209:

"Principles of law and equity related to the law of agency and what natural persons can bind another person, corporation, partnership, or other legal entity are not displaced by the Act."

d. Comment: The proposed amendments (1) thru (3) would eliminate the guidance and uniformity offered by UCITA for commercial entities involved in commerce and to expand the arena for litigation in ordinary business transactions. Proposal (4) clarifies a rule that is already true in UCITA by virtue of its general preservation of equity and other legal rules, but a direct statement of this fact may be a useful clarification.

(C). ASSENT: LATER TERMS

a. Current Law.

(1). General. Case law generally enforces contract terms provided after the initial agreement of the parties if there was some reason to believe that the additional terms would be presented, that a refusal of the terms would mean that there was no agreement, that the refusing party could return it for a refund, and that the party manifested assent to the terms. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); ; <u>M.A.</u> *Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. 2000). Case law splits on the enforceability of terms provided in labels or the like that do not ask for assent of the recipient. See, e.g., *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992); *Jazz Photo Corp. v. International Trade Commission*, 2001 WL 945930 (Fed. Cir. 2001); *Bowdoin v. Showell Growers, Inc.*, 817 F.2d 1543 (11th Cir. 1987).

(2). License: Shrink-Wrap and Click Wrap. Case law enforces contract terms where when an initial purchase was made there was some (even minimal) reason to think that the purchaser was aware that license terms would follow and the process with reference to those terms required assent in order to use software. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); ; <u>M.A.</u> *Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. 2000). Many reported cases enforce the terms of these licenses without seriously questioning their enforceability in general. See *Management Computer Controls, Inc. v. Charles Perry Const., Inc.*, 743 So.2d 627 (Fla. App. 1999); *Arizona Retail Sys., Inc. v. Software Link, Inc.,* 831 F.Supp. 759 (D. Ariz. 1993); *Green Book Int'l Corp. v. Inunity Corp.,* 2 F. Supp. 112 (D. Mass. 1998); Kaczmarek v. Microsoft, 39 F. Supp. 2d 974 (ND Ill. 1999) (treats contract as enforceable without discussion); Peerless Wall and Window Coverings, Inc. v. Synchronics, Inc., 85 F.Supp2d 519 (W.D. Pa. 2000); Against Gravity Apparel, Inc. v. Quarterdeck Corp., 699 NYS2d 368 (NYAD 1999) (no substantial discussion of enforceability, terms enforced); Jurisline.com v. Reed Elsiver Corp., -- F.Supp. -- (SD NY 2000); Rinaldi v. Iomega Corp., 1999 WL 1442014 (Del. Super. 1999) (conspicuousness of disclaimer not affected by fact it was delivered in shrink wrap format); Lieschke v. Realnetworks, Inc., 2000 WL 198424 (ND Ill. 2000) (The court did not dwell on enforceability, but assumed it.); Westendorf v. Gateway 2000, 2000 WL 307369 (Del. Ch. 2000) (contract enforceable against

donee of the system); *Reed Technology & Information Services, Inc. v. Future Vision Holding, Inc.,* 1998 WL 1181781 (Mass. Super. 1998); *In re RealNetworks, Inc. Privacy Litigation*, No. 00 C 1366, 5 ILR (Pike & Fisher) 3049 N.D. Ill. 2000) (Click screen satisfies requirement of writing under federal and state arbitration laws); *Levy v. Gateway 2000, Inc.,* 1997 WL 823611, 33 UCC Rep. Serv.2d 1060 (N.Y.Sup.Ct. August 12, 1997); *Kilgallen v. Network Solutions, Inc.*, 2000 WL 722558 (D. Mass. 2000); *Scott v. Bell Atlantic,* -- NYS2d --, 7 ILR (P&F) 3103 (NY AD 2001) (fact that it was possible to install and use digital subscriber line without have read the terms of services and disclaimers did not render them unenforceable); *Reed Tech. & Info. Servs., Inc. v. Future Vision Holding, Inc.*, 1998 WL 1181781 (Mass. Super. 1998).

(3) Equipment Purchases. While there is a split of opinion, most cases enforce contract terms accompanying a product where some indication of assent to those terms is required. See *Hill vs. Gateway 2000 Inc.*, 105 F.3d 1147 (7th Cir. 1997); *Brower v. Gateway* 2000, Inc., 676 N.Y.S.2d 569 (NY AD 1998). Many cases refuse to enforce terms where they are merely presented on labels or other methods where no assent is asked for or received, and the terms are not brought to the recipient's attention. See *Jazz Photo Corp. v. International Trade Commission*, 2001 WL 945930 (Fed. Cir. 2001).

(4) Unconscionability. All of the above rules are subject to cases where a court views a particular term as unconscionable or in violation of a state's fundamental public policy. See *Brower v. Gateway* 2000, Inc., 676 N.Y.S.2d 569 (NY AD 1998).

(5) Article 2. Article 2 does not deal with assent to terms except in context of a battle of forms. UCC § 2-207. That provision has been viewed as the most controversial and least effective provision of Article 2. One case has held that under Article 2, terms of a contract are fixed at the original telephone or other contact, and later terms are proposals for modifications unenforceable unless express assented to. See *Step-Saver Data Sys., Inc. v. Wyse Technology*, 939 F.2d 91 (3d Cir. 1991); *Arizona Retail Sys., Inc. v. Software Link, Inc.,* 831 F.Supp. 759 (D. Ariz. 1993) (follows Wyse as to one agreement, but enforces another where prior agreement was made with understanding other terms would follow). The *Wyse* approach has been routinely rejected in cases in our subject matter where the circumstances indicated that a license would follow the initial contact and actual assent to the license was requested. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. 2000) (license enforced when it followed purchase order; "Reasonable minds could not differ concerning a corporation's understanding that use of software is governed by licenses containing multiple terms.")

b. UCITA Rules:

UCITA denies enforceability to "later terms" unless 1) the recipient had reason to know that terms would follow the original contact; 2) when the later terms are presented the recipient has a right to return the product if it refuses the terms; 3) in a consumer/ mass-market transaction, the right of return is cost free;

4) there is a clear manifestation of assent to the terms if they are not refused; and 5) that assent follows an opportunity to review the terms that are called to a person's attention. UCITA §§ 112; 208; 209. UCITA also provides a safe harbor provision that encourages online presentation of terms before the customer downloads software or other digital content. UCITA § 211.

SECTION 112. MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

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

(1) authenticates the record or term with intent to adopt or accept it; or

(2) intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term. …..

(e) With respect to an opportunity to review, the following rules apply:

(1) A person has an opportunity to review a record or term only if it is made available in a manner that ought to call it to the attention of a reasonable person and permit review. ……

(3) 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 it has a right to a return if it rejects the record. ….

SECTION 208. ADOPTING TERMS OF RECORDS. Except as otherwise provided in Section 209, the following rules apply:

(1) A party adopts the terms of a record, including a standard form, as the terms of the contract if the party agrees to the record, such as by manifesting assent.

(2) The terms of a record may be adopted pursuant to paragraph (1) after beginning performance or use if the parties had reason to know that their agreement would be represented in whole or part by a later record to be agreed on and there would not be an opportunity to review the record or a copy of it before performance or use begins. If the parties fail to agree to the later terms and did not intend to form a contract unless they so agreed, Section 202(e) applies [requiring return of all property and payments].

SECTION 209. MASS-MARKET LICENSE.

(a) A party adopts the terms of a mass-market license for purposes of Section 208 only if the party agrees to the license, such as by manifesting assent, before or during the party=s initial performance or use of or access to the information …

(b) If a mass-market license or a copy of the license is not available in a manner permitting an opportunity to review by the licensee before the licensee becomes obligated to pay and the licensee does not agree, such as by manifesting assent, to the license after having an opportunity to review, the licensee is entitled to a return under Section 112 and, in addition, to:

(1) reimbursement of any reasonable expenses incurred in complying with the licensor=s instructions for returning or destroying the computer information or, in the absence of instructions, expenses incurred for return postage or similar reasonable expense in returning the computer information; and

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

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

(B) the installation alters the system or information in it but does not restore the system or information after removal of the installed information because the licensee rejected the license. ….

SECTION 211. PRETRANSACTION DISCLOSURES IN INTERNET-TYPE TRANSACTIONS. This section applies to a licensor that makes its computer information available to a licensee by electronic means from its Internet or similar electronic site. In such a case, the licensor affords an opportunity to review the terms of a standard form license which opportunity satisfies Section 112(e) with respect to a licensee that acquires the information from that site, if the licensor:

(1) makes the standard terms of the license readily available for review by the licensee before the information is delivered or the licensee becomes obligated to pay, whichever occurs first, by:

(A) displaying prominently and in close proximity to a description of the computer information, or to instructions or steps for acquiring it, the standard terms or a reference to an electronic location from which they can be readily obtained; or

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

(2) does not take affirmative acts to prevent printing or storage of the standard terms for archival or review purposes by the licensee.

c. Proposed Amendments:

(1) Suggested Alternatives, Tab 7:

Add:

Section 211A --- [new] Summary of Later Terms Rules

If terms of a standard form contract are not available in a manner permitting review before the party becomes obligated to pay, and the terms are supplied later, the following rules apply:

(1) If the party receiving the terms did not have reason to know that terms would be presented later, the terms are proposed modifications that may be accepted or rejected under rules applicable to contractual modification including Section 303.

(2) If the party receiving the terms had reason to know that terms would be presented later, the following rules apply:

(i) The later terms are not adopted and do not become part of the contract unless the party agrees to them, such as by manifesting assent after an opportunity to review in accordance with Section 112, including the right of return as applicable in Section 112(e), and adopts them pursuant to applicable sections of this Act, including Sections 208, 209, 211, and 102(a)(57).

(ii) If the parties did not intend to have a contract unless the later terms are agreed, adoption of the terms creates a contract, but if the later terms are rejected, no contract exists and the parties obligations are determined by this Act, including Sections 208, 209 and 202(e) as applicable.

(iii) If the parties intended to have a contract even if the later terms are rejected and they are rejected, the rejected terms are left open pursuant to this Act, including Section 306, unless subject to other agreement of the parties.

(2) Affect, Tab 1, pages 3-13

Delete Section 209 and replace as follows:

SECTION 209. ~~MASS-MARKET LICENSE.~~ DISCLOSURE OF MASS-MARKET LICENSE TERMS. A term is not part of the license if the term is not available for viewing both before the consumer is required or requested to perform or pay (whichever occurs first) and thereafter:

(1)in a printed license; or

(2)in electronic form that:

(A) Can be printed or stored for archival and review purposes by the licensee; or

(B) Is made available by a licensor to a licensee, at no cost to the licensee, in a printed form on the request of a licensee that is unable to print or store the license for archival and review purposes.

(3) Affect, Tab 1, pages 3-13

Delete Section 211:

d. Comment: Amendments (2) and (3) would require that all terms be presented at the outset, invalidating any later terms in telephone, mail order, online or other setting where the expectation is that later terms will follow. This is a proposal that was not adopted by proposed revisions of Article 2 or in federal consumer protection law. Proposed Amendment (1) provides clarification and guidance on what rules are adopted by UCITA. UCITA formation rules give significant protections unstated in the law for persons who receive later proposed terms.

(D). MODIFYING CONTINUING TERMS

a. Current Law.

Courts ordinarily enforce contract terms that allow a fair procedure for changing terms of service. Article 2 allows modifications of contracts without consideration. UCC § 2-209 ("An agreement modifying a contract within this Article needs no consideration to be binding.").

Article 2 also enforces agreements that provide that one party may provide specifications of performance for the contract. Section 2-311 provides:

> (1) An agreement for sale which 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. Any such specification must be made in good faith and within limits set by commercial reasonableness. …
>
> (3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies
>
> (a) is excused for any resulting delay in his own performance; and
>
> (b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

b. UCITA Rule:

UCITA adopts Article 2 rule about modifications without consideration, emphasizing that agreed terms about modifications should control.

UCITA delineates rule about contract *terms* that affect changes in *future* terms. This does not give a right to change consequences for past performance (e.g., a charge for ten dollars cannot be changed to a charge for one hundred dollars). Section 304 provides:

> (a) Terms of an agreement involving successive performances apply to all performances, even if the terms are not displayed or otherwise brought to the attention of a party with respect to each successive performance, unless the terms are modified in accordance with this [Act] or the contract.
>
> (b) If a contract provides that terms 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 the procedure:
>
> (1) reasonably notifies the other party of the change; and
>
> (2) in a mass-market transaction, 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.

c. Proposed Amendments

(1) Affect, Tab 1, page 20
Amend Section 304 as follows:

(b) If a contract provides that a terms 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 the procedure:

(1) reasonably notifies the other party of the change; and

(2) in a mass-market transaction, ~~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.~~

(i) the term is available for viewing both before the consumer is required or requested to perform or pay (whichever occurs first) and thereafter:

(1)in a printed license; or

(2)in electronic form that:

(A) Can be printed or stored for archival and review purposes by the licensee; or

(B) Is made available by a licensor to a licensee, at no cost to the licensee, in a printed form on the request of a licensee that is unable to print or store the license for archival and review purposes, and

(ii) the licensee agrees to the term

(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.

(d) The enforceability of changes made pursuant to a procedure that does not comply with subsection (b) is determined as follows:

(i) in a mass market transaction, the term is enforceable if after receiving notice of the term the licensee explicitly agrees to the term, or

(ii) otherwise by the other provisions of this [Act] or other law

---

d. Comment: [None]

O. MASS-MARKET TRANSACTIONS

a. Current Law. No other Uniform law and no general contract statute uses the concept of “mass-market transaction”. Instead, existing laws distinguish simply between a transaction involving a consumer and all other transactions for purposes of developing special bodies of rules, although the definition of consumer varies in some cases. The concept was expressly rejected in the Article 2 and Article 2A revision process; both committees determined to retain the traditional distinction between consumer transactions and all other types of transactions, a decision ratified by NCCUSL.

b. UCITA Rule: UCITA defines a third type of transaction instead of the ordinary consumer-commercial dichotomy. The concept of a mass-market transaction was intended to refer to ordinary, small volume retail transactions and, in some cases, use consumer-like rules for such transactions. The term includes all consumer transactions and some retail purchases by businesses. The places in which the term is used in UCITA are described in the DCC letter in Tab 2. Section 102(a)(45) was the result of lengthy discussions over several years and defines the term as follows:

(45) “Mass-market transaction” means a transaction that is:
(A) a consumer contract; or
(B) any other transaction with an end-user licensee if:
(i) the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information;
(ii) the licensee acquires the information or informational rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and
(iii) the transaction is not:
(I) a contract for redistribution or for public performance or public display of a copyrighted work;
(II) 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;
(III) a site license; or
(IV) an access contract.

c. Proposed Amendments:

(1) Affect, Tab 1, page 71
Amend definition as follows:

(45) "Mass-market transaction" means a transaction that is: …..
(ii) the licensee acquires the information or informational rights in a retail transaction under terms ~~and in a quantity~~ consistent with an ordinary transaction in a retail market; and
(iii) the transaction is not:
(I) a contract for redistribution or for public performance or public display of a copyrighted work;
(II) 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;
~~(III) a site license; or~~
~~(IV) an access contract.~~

(2) DCC, Tab 2:
Delete the definition
Replace use of the term by use of “consumer”.

d. Comment: Deleting the term would make UCITA more consistent with existing uniform contract law statutes and other traditional laws, as well as with pending proposals regarding Article 2 and 2A. Adopting the deletions suggested in the other amendment would move the term more into the area of regulating commercial contracts, a position that the Committee has consistently resisted.

P. SCOPE-RELATED ISSUES

(A). DEFINITION OF “COMPUTER”

a. Current Law: The term “computer” is defined in a wide variety of federal and state statutes. The definitions vary widely. Many of these were surveyed by the Committee prior to the final draft of UCITA. They share the basic concept

that a computer is a device that accepts and processes information pursuant to programs or other instructions.

b. UCITA Rule: The term plays a central role in defining the subject matter of the Act, which applies only to computer information transactions. The term "computer" is part of a three-definition structure relevant to scope:

> ""Computer" means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions."
> "Computer information" means information in electronic form which is obtained from or through the use of a computer or which is in a form capable of being processed by a computer. The term includes a copy of the information and any documentation or packaging associated with the copy.
> "Computer information transaction" means an agreement or the performance of it to create, modify, transfer, or license computer information or informational rights in computer information. … The term does not include a transaction merely because the parties' agreement provides that their communications about the transaction will be in the form of computer information."

c. Proposed Amendments:

(1) Affect, Tab 1, page 22
Amend the definition of "computer" as follows:

(9): "Computer" means an electronic device that ~~accepts~~ is designed for the sole purpose of accepting information in digital or similar form and manipulates it for a result based on a sequence of instructions.

(2) McKay, Tab 8:
Delete the definition of "computer"

d. Comment: [none]

(B). MIXED TRANSACTIONS

a. Current Law: All contract law statutes must deal with the case of where a single transaction includes both the subject matter of the particular statute and subject matter that falls outside the scope of the statute and is within common law or another statutory or regulatory regime. Article 2 on goods resolves this issue through case law. The cases dealing with transactions that include both *goods* and *services,* case law generally uses a "predominant purpose" test in which Article 2 either applies to both subject matters or to neither, depending on what the court views as the main purpose of the deal. In other contexts involving goods and other subject matter, some courts use the same approach, but others focus on the particular issue involved and hold that each body of law applies to its own subject matter. See Raymond T. Nimmer, *Through the Looking Glass: What Courts and UCITA have to say About the Scope of Contract Law in the Information Age*, 38 Dusquene L. Rev. (2000).

b. UCITA Rule: UCITA generally follows the rule that, in a mixed transaction, UCITA provisions apply only to the aspect of the transaction that involves computer information, while other contract law applies to other aspects

of the transaction. Separate treatment is given to cases where the information is embedded in goods (an issue discussed in the next section of the agenda). Consistent with the doctrine of contract freedom, UCITA also provides that in mixed cases, the parties can agree to be covered entirely b y UCITA or entirely by other contract law. The affirmative statement of scope is in Section 103; the opt-in rules are in Section 104.

SECTION 103. SCOPE; EXCLUSIONS.

(a) This [Act] applies to computer information transactions.

(b) Except for subject matter excluded in subsection (d) and as otherwise provided in Section 104, if a computer information transaction includes subject matter other than computer information or subject matter excluded under subsection (d), the following rules apply:

(1) If a transaction includes computer information and goods, this [Act] applies to the part of the transaction involving computer information, informational rights in it, and creation or modification of it. However, if a copy of a computer program is contained in and sold or leased as part of goods ……… [see later]

SECTION 104. MIXED TRANSACTIONS: AGREEMENT TO OPT-IN OR OPT-OUT. The parties may agree that this [Act], including contract-formation rules, governs the transaction, in whole or part, or that other law governs the transaction and this [Act] does not apply, if a material part of the subject matter to which the agreement applies is computer information or informational rights in it that are within the scope of this [Act], or is subject matter within this [Act] under Section 103(b), or is subject matter excluded by Section 103(d)(1) or (3). However, any agreement to do so is subject to the following rules:

(1) An agreement that this [Act] governs a transaction does not alter the applicability of any statute, rule, or procedure that may not be varied by agreement of the parties or that may be varied only in a manner specified by the statute, rule or procedure, including a consumer protection statute [or administrative rule]. In addition, in a mass-market transaction, the agreement does not alter the applicability of a law applicable to a copy of information in printed form.

(2) An agreement that this [Act] does not govern a transaction:

(A) does not alter the applicability of Section 214 or 816; and

(B) in a mass-market transaction, does not alter the applicability under [this Act] of the doctrine of unconscionability or fundamental public policy or the obligation of good faith.

(3) In a mass-market transaction, any term under this section which changes the extent to which this [Act] governs the transaction must be conspicuous.

(4) A copy of a computer program contained in and sold or leased as part of goods and which is excluded from this [Act] by Section 103(b)(1) cannot provide the basis for an agreement under this section that this [Act] governs the transaction.

c. Proposed Amendments:

(1) Affect, Tab 1, page 22:

Amend Section 103 as follows:

(a) This [Act] applies to computer information transactions.

(b) Notwithstanding any other provision of this Act, this Act does not govern contract formation in a transaction including both computer information and goods. For issues other than contract formation, ~~E~~except for subject matter excluded in subsection (d) and as otherwise provided in Section 104 …..

(2) Affect, Tab 1, page 27

Amend Section 104 as follows:

(1) An agreement that this [Act] governs a transaction does not alter the applicability of a statute, rule, or procedure that may not be varied by agreement of the parties or that may be varied only in a manner specified by the statute, rule or procedure, or of any law protecting ~~including~~ a consumers ~~protection statute [or administrative rule].~~ In addition, in a mass-market

transaction, the agreement does not alter the applicability of a law applicable to copy of information in printed form.

……………

(4) A copy of a computer program which operates the features ~~contained in and sold or leased as part~~ of goods and which is excluded from this [Act] by 103(b)(1) cannot provide the basis for an agreement under this section that this [Act] governs the transaction.

d. Comment: [None]

(C). EMBEDDED SOFTWARE

a. Current Law: The treatment of embedded software with reference to proper scope of a contract statute has been the subject of extensive debate over a period of years in UCITA, revisions of Article 9 and current discussed revisions of Article 2 and 2A of the UCC. Revised Article 9 treats most software as not goods, but treats some embedded software as goods based on a test which asks whether the software is ordinarily viewed as nothing more than part of the goods. Pending revisions of Article 2 and 2A have language that treats some embedded software as goods under a controversial test that is contained in a proposal by Jim McKay in Tab 8 and reprinted below.

b. UCITA Rule: UCITA generally provides that in mixed goods and information transactions, UCITA governs the information and the UCC governs regarding the goods, but for software embedded in goods, the following rule applies:

Section 103(b)(1):

If a transaction includes computer information and goods, this [Act] applies to the part of the transaction involving computer information, informational rights in it, and creation or modification of it. However, if a copy of a computer program is contained in and sold or leased as part of goods, this [Act] applies to the copy and the computer program only if:

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

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

c. Proposed Amendments:

(1) Affect, Tab 1, page 22:
Amend Section 103 (b)(1) as follows:

(1) If a transaction includes computer information and goods, this [Act] applies to the part of the transaction involving computer information, information rights in it, and creation or modification of it. However, if a copy of a computer program operates the features ~~is contained in and sold or leased as part~~ of goods, this [Act] applies to the copy and the computer program only if:

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

~~(B) giving the buyer or lessees of the goods access to or use of the program is ordinarily a material purpose of transactions in goods of the type sold or leased.~~

(2) Affect, Tab 1, page 38
Amend Section 103(b) (1) as follows:

(1) If a transaction includes computer information and goods, this [Act] applies to the part of the transaction involving computer information, informational rights in it, and creation or

modification of it. However, if a copy of a computer program is contained in and sold or leased as part of goods, this [Act] applies to the copy and the computer program only if:

(A) the computer program does not control or interact with the goods in such a way that an error in the program could cause personal injury or damage to personal property, and

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

(3) McKay, Tab 8:
Amend Section 103 as follows:

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

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

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

d. Comment: [none]

(D). EXCLUSIONS

a. UCITA: Section 103 of UCITA contains a variety of exclusions from the scope of the Act intended to make clear its inapplicability to certain types of transactions and, in some cases, to preserve bodies of law that a widely and broadly evolved already in a manner not consistent with the digital information industries on which the Act focuses.

b. Proposed Amendments

(1) Affect, Tab 1, page 71:
Amend Section 103(C) as follows:

(c) To the extent of a conflict between this [Act] and [Article 9 of the Uniform Commercial Code], [Article 9] governs.

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

(1) a financial services transaction;

~~(2) an insurance services transaction;~~

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

(2) Affect, Tab 1, page 70:
Delete Section 102(a)(39):

~~(39) "Insurance services transaction" means an agreement between an insurer and an insured which provides for, or a transaction that is, or entails access to, use, transfer, clearance, settlement, or processing of:~~

~~(A) an insurance policy, contract, or certificate; or~~

~~(B) a right to payment under an insurance policy, contract, or certificate.~~

c. Comment: [none]

Q. MISCELLANEOUS AMENDMENTS:

(A). SECTION 814: DISCONTINUING ACCESS AFTER BREACH.

a. Current Law: Access contracts are generally subject to termination at will and enforcement of a remedy for breach through denial of continued access is further consistent with the fact that the computer system being accessed in property of the access provider. *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993). Access providers have not been treated as common carriers. See *Howard v. America Online Inc.*, 208 F.3d 741 (9th Cir. 2000). Federal criminal law provides that unauthorized access to a protected computer is a crime. The term "protected computer" refers essentially to all computers involved in interstate commerce. Access that breaches the terms of the contractual permission is unauthorized for purposes of this state. See *Register.com,Inc., v. Verio, Inc.*, 126 F.Supp.2d 238 (SD NY 2000).

b. UCITA Rule: Section 814 provides that on material breach, access by the breaching party can be denied without prior notice: "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." UCITA also provides, however, for a duty to promptly return the other party's information after cancellation (Section 802 and Section 618) and, of course, merely creates a default rule subject to contrary agreement.

c. Proposed Amendment:
(1) Affect, Tab 1, page 76:
Amend Section 814 as follows:

(a) Subject to subsection (b) of this section, 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.

(b) Except as provided in subsection (c) of this section, before discontinuing all contractual rights of access in an access contract, a party shall give notice in a record to the party in breach stating:

(1) That the party intends to discontinue all contractual rights of access in the access contract on or after 3 days following the date notice is given;

(2) The nature of the claimed breach that entitles the party to discontinue all contractual rights of access in the access contract;

(3) The opportunity to cure as provided under section 703 of this title; and

(4) Information to allow for communication concerning the claimed breach, includes the party's:

(I) Address and telephone number; and

(II) Facsimile number or e-mail address

(c) The notice required in subsection (b) of this section is not required for a discontinuation to meet a statutory or legal requirement.

d. Comment: [none]

(B). CLARIFYING EDITS

A. SECTION 403: WARRANTY

(1) Proposed Amendment:

Suggested alternatives, Tab 7:

Amend Section 403 as follows:

(a) Unless the warranty is disclaimed or modified and except as otherwise provided in Section 409, a licensor that is a merchant with respect to computer programs of the kind warrants:

(1) to its end user licensee that the computer program is fit for the ordinary purposes for which such computer programs are used;

(2) to its distributor that:

(A) the program is adequately packaged and labeled as the agreement requires; 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) to the parties in subsections (1) and (2) that the program conforms to any promises or affirmations of fact made on the container or label.

Comment: The purpose is to clarify the intent of the current draft that the warranties pertain to rights between the parties.

(B). SECTION 613:

(1) Proposed Amendment

Suggested alternatives, Tab 7:

Amend Section 613 as follows:

(c) If an agreement provides for distribution of copies on a tangible medium or in packaging provided by the publisher or an authorized third party, a dealer may distribute those copies and documentation only:

(1) in the form as received; and

(2) subject to the terms of any license that the publisher provides to the dealer to be furnished to end users.

(C). SECTION 502(A) – TITLE TO A COPY

a. Current law: Current case law repeatedly holds that ownership of a copy delivered pursuant to a license is determined by the agreement. The Ninth Circuit has held that the mere existence of a license may indicate that the licensee is not the owner of a copy and, in a separate case, that license terms so indicating were enforceable. The Court of Appeals for the Federal Circuit has held that the licensee is not the owner of a copy of a program is the license terms are inconsistent with the rights of an owner. See, e.g., *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F2d 511 (9th Cir. 1993); *SOS, Inc. v. Payday, Inc.,* 886 F2d 1081, 1087 (9th Cir. 1989); *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F3d 1354 (Fed. Cir. 1999); *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086 (ND Cal. 2000); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995). The U.S. Copyright Office concluded that downloading of copies does not constitute a

first sale. Clearly, many mass-market transactions are not sales of copies under any imagined scenario (e.g., library loans, video store rentals).

b. UCITA Rule: Section 502(a) provides:
"(a) In a license: (1) title to a copy is determined by the license; (2) a licensee's right under the license to possession or control of a copy is governed by the license and does not depend solely on title to the copy;"

c. Proposed Amendment:
Klein: Tab 4, page 7
In Section 502 (a):
Replace "IN A LICENSE:" with "IN A MASS MARKET LICENSE THE LICENSEE SHALL HAVE TITLE TO THE COPY. IN ANY OTHER LICENSE:

d. Comment: UCITA as drafted adopts the general case law rule and clarifies it. The scope of impact of the proposed amendment is not clear, but it would in effect preclude various current methods of marketing software and other digital products.

(D). ELECTRONIC AGENTS: OPPORTUNITY TO REVIEW A RECORD

a. Current Law: Federal electronic signature law and UETA recognize the existence and validity of use of electronic agents, a concept originally set forth in drafts of UCITA. No law deals with under what conditions can such electronic devices be said to have had an opportunity to review terms of a proposed contract.

b. UCITA Rule: Section 112(e)(2) provides: "An electronic agent has an opportunity to review a record or term only if it is made available in manner that would enable a reasonably configured electronic agent to react to the record or term."

c. Proposed Amendment:
Klein: Tab 4, page 7
In section 112 (e) (2) replace "a reasonably configured" with "the".

d. Comment: The proposed Amendment would place the party seeking to rely on contractual terms at risk that the other party may have used an atypical system without giving the sending party notice of that fact. The current UCITA rule allows reliance on systems being within reasonable configurations.

(E). ENFORCEABILITY AND RECORD AVAILABILITY

a. Current law: Federal electronic signature law and UETA deal with the retainability of an electronic record in cases where other law requires a writing (e.g., statute of frauds cases). Statutes of frauds or similar rules, however,

are not applicable to all cases. For example, Article 2 does not require a writing (or an electronic record) in cases where the goods have been delivered. Statute of frauds and similar laws typically do not require that the writing, if one is required, actually be retained.

b. UCITA Rule: The UCITA statute of frauds can be satisfied by a writing or an electronic record and, in many cases, neither is required. UCITA 208 and 209 provide that the terms of a record become part of the contract only if one manifests assent to them. Section 112 of UCITA provides that one manifests assent only by conduct indicating assent which conduct occurs *after* you have had an opportunity to review the record. It further provides that there was an opportunity to review only if: "A person has an opportunity to review a record or term only if it is made available in a manner that ought to call it to the attention of a reasonable person and permit review."

c. Proposed Amendment:
Klein: Tab 4, page 7
Add to Section 112:

"(H) No license term shall be enforceable unless the term is in a readable printed license or in an electronic form that can be easily located and can be viewed or printed using widely available readers or word processors."

d. Comment [none]

(F). SECTION 905: FEDERAL E-SIGN STATEMENT

a. Current Law: Federal electronic signature law provides that its terms can be over-ridden by a state law the contains rules consistent with the federal law and that contains a statement referencing an intent to displace the federal rules. The federal rules generally preclude discriminating against electronic records and signatures and provide special handshake procedures applicable if state or federal law requires written disclosures to a consumer.

b. UCITA Rule: UCITA contains no rule that requires a writing or a written notice, all such requirements can be met by a writing or an electronic record or signature. UCITA does not alter existing consumer laws regarding disclosures or the like. Section 905 provides: "The provisions of this [Act] governing the legal effect, validity, or enforceability of electronic records or signatures, and of contracts formed or performed with the use of such records or signatures conform to the requirements of Section 102 of the Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, 114 Stat. 464 (2000), and supersede, modify, and limit the Electronic Signatures in Global and National Commerce Act."

c. Proposed Amendments:

(1) AG Draft, Tab 6

Delete Section 905

(2) Alternative Suggestions, Tab 7
Replace Section 905 with the standard NCCUSL language on this issue.

d. Comment: The Uniform Language was adopted by NCCUSL subsequent to promulgation of UCITA.