DRAFTING AND NEGOTIATING COMMERCIAL SOFTWARE LICENSES: A REVIEW OF SELECTED ISSUES RAISED BY PROPOSED UNIFORM COMMERCIAL CODE ARTICLE 2B

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"Computers are useless, they can only give you answers."
—Pablo Picasso

INTRODUCTION

The Preface to proposed Uniform Commercial Code Article 2B states that the basic philosophy of UCC provisions on commercial law builds on two basic assumptions: (i) to preserve freedom of contract and "provide background rules, playing a default or gap-filling function"; and (ii) to facilitate commercial practice.[1] Regarding the latter

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1. Preface, Uniform Commercial Code Article 2B Licenses, National Conference of Commissioner on Uniform Laws Part 2 (Dec. 12, 1996 Draft). Unless otherwise indicated, all section references and all references to the proposed Article 2B, the "Draft" or the Reporter's Notes are to the January 20, 1997 Draft of Uniform Commercial Code Article 2B: Licenses as available from http:\\www.law.upenn.edu/library/ulc/ulc.htm. Counsel are encouraged to obtain the most recent Draft in evaluating the issues discussed in this article (it is likely that at least two additional drafts will have been made available by the publication date of this article). The January Draft was the eighth and most recently available draft at the time this article was required to be completed. The January Draft was redlined to show changes from prior drafts. Generally, quotations from the Draft herein have omitted the redlining (including strike-outs) but have retained brackets that were a part of the Draft. Language in this article indicating that Article 2B "will" require this or that (or similar language) is used for convenience only and is not intended to imply that the final version of Article 2B, much less any enacted statutory language, will necessarily conform to the Draft on any particular issue. Finally, no attempt is made herein to evaluate the drafters' success in being accurate rather than original as compared to existing case law. Case citations, some of which appear in the Reporter's Notes, are only provided as a possibly convenient research resource to counsel. [AUTHOR'S NOTE: Since the date this article was originally submitted, there have indeed been two additional drafts of Article 2B circulated — a March 21, 1997 Draft and a May 5, 1997 Draft. In the brief period allowed for review of the galley proofs of this article before submission to the printer, it has not been possible to re-write the article to fully reflect the new Drafts. Most U.C.C. Article 2B sections referred to herein have been revised at least slightly, although often the principal thrust of those sections is materially unchanged. In places, however, the footnotes referring to selected provisions have been amended by the addition of a bracketed "Note" referring the reader to the latest version of the section in the proposed May 5, 1997 Draft. Some

point, the Preface quotes Grant Gilmore that "[t]he principal objects of draftsmen of general commercial legislation . . . are to be accurate and not to be original."[2] If the final product is faithful to these assumptions, practitioners in the area of commercial software licensing should have little overall cause for concern with the eventual enactment of Article 2B. In fact, many practitioners may welcome Article 2B's contribution to codifying the law in an area that could be suggested to be relatively ill-defined as compared to the law in other areas of comparable commercial significance.

This Article will summarize some of proposed Article 2B's contributions to defining the law in this area for lawyers charged with drafting and negotiating commercial software licenses. (Although 2B also proposes to address a variety of other areas such as mass market licenses,[3] traditional and electronic contract formation issues[4] and

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section references (sometimes including internal subsection references) have also changed in the latest Draft. The author has not endeavored to include all of those changed references (except in the discussion of remedies where the intervening Drafts substantially altered the organization of proposed Article 2B). Notwithstanding the most recent Drafts, the author believes this article remains a generally accurate overview of the major issues presented by proposed U.C.C. Article 2B.]

2. Preface, Uniform Commercial Code Article 2B Licenses, National Conference of Commissioner on Uniform Laws Part 2 (Dec. 12, 1996 Draft) (citing Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341 (1948)).

3. U.C.C. § 2B-102(a)(25) proposes to define "mass-market license" as:

> a standard form prepared for and used in a retail market for information which is directed to the general public as a whole under substantially the same terms for the same information, if the licensee is an end user and acquired the information in a transaction under terms and in a quantity consistent with an ordinary transaction in the general retail distribution. The term includes consumer contracts. "Mass market license" does not include:
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> (A) a significant transaction between parties neither or whom is a consumer with respect to that transaction, including:
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> (i) any transaction in which either the total consideration for the particular item of information or the reasonably expected fees for the first year of an access or similar contract exceeds [$500] [$1,000];
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> (ii) any license that contemplates concurrent use of software by more than one person acting separately;
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> (iii) any transaction in which the information is customized or otherwise specially prepared for the licensee; or
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> (B) a license of the right to publicly perform or publicly display a copyrighted work.; or
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> [(C) an online or access contract between parties neither or which is a consumer with respect to the particular transaction.]

U.C.C. § 2B-102(a)(25) (Proposed Jan. 20, 1997 Draft). [NOTE: section revised in proposed May 5, 1997 Draft; applicable new definition is "mass market transaction"]. Many of the rules for mass-market licenses are different from those discussed herein for 'commercial software licenses.' For some criticism of proposed Article 2B in this area see Cem Kaner, *Proposed Article 2B: Problems from the Customer's View (Pts. 1 & 2)*, UCC Bulletin (Jan. & Feb. 1997). In addition, see Robert W. Gomulkiewicz & Mary L. Williamson, *A Brief Defense of Mass Market Software License Agreements*, 22 RUTGERS COMPUTER & TECH. L.J. 335 (1996).

4. *See* U.C.C. §§ 2B-110 to -207 (Proposed Jan. 20, 1997 Draft).

'battle of the forms' issues,[5] financing arrangements,[6] and other specific types of contracts such as "access contracts,"[7] those subjects are beyond the scope of this Article.)[8] Despite the fact that broad variation of its terms by agreement will be permitted, Article 2B will likely not be 100% neutral in its impact on current licensing practice. However close the drafters may come to the goal of being 'accurate rather than original,' the background presence of the gap-filling rules will necessitate reconsideration of the terms currently used in commercial software licenses.

As is the case with the existing Uniform Commercial Code, the draft of Article 2B (sometimes referred to herein simply as the "Draft") proposes to allow variation of its terms by agreement.[9] Variation by agreement will not be permitted with regard to the obligation of good faith or a party's right to relief from an unconscionable contract or clause.[10] The Draft also proposes to limit the ability to vary certain of its provisions pertaining to: limitation of warranties; waiver of protections against licensor self-help remedies; the imposition of restrictions on certain assignment/security interest transactions; excuse by unexpected events; and the statute of limitations.[11] This still leaves a great deal of room for variation by agreement. Therefore, if counsel feel that the drafters' final product is 'original rather than accurate' or if they simply wish to avoid the application of particular gap-filling rules, it should usually be possible to draft a solution. The following discussion will present some of the areas where decisions along those lines may need to be made.

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5. *See* U.C.C. § 2B-309 (Proposed Jan. 20, 1997 Draft).

6. *See* U.C.C. §§ 2B-504 & 2B-618 (Proposed Jan. 20, 1997 Draft).

7. An "access contract" is defined as "a contract for electronic access to a resource containing information, resource for processing information, data system, or other similar facility of a licensor or third party . . . ." U.C.C. § 2B-102(a)(1) (Proposed Jan. 20, 1997 Draft). Also dealt with in the Draft are: (i) correction and support contracts, which are discussed elsewhere herein; (ii) contracts involving publishers, distributors and retailers, § 2B-616; development contracts, § 2B-617; and (iii) financial accommodation contracts, as referenced above.

8. Federal intellectual property issues are also not addressed herein, although their importance cannot be overstated. For two treatments of these issues in the licensing context, see RAYMOND T. NIMMER, THE LAW OF COMPUTER TECHNOLOGY ch. 7 (1992 & Cum. Supp. 1996) and Maureen A. O'Rourke, *Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms*, 45 DUKE L.J. 479 (1995).

9. U.C.C. § 2B-115 (Proposed Jan. 20, 1997 Draft).

10. U.C.C. § 2B-115(a)(1) & (2) (Proposed Jan. 20, 1997 Draft).

11. U.C.C. § 2B-115(a)(3) through (8) (Proposed Jan. 20, 1997 Draft). *See* Ram Systems of LaCrosse, Wis., Inc. v. Wichita Coca-Cola Bottling Co., No. 93-1410-PFK, 1994 U.S. Dist. LEXIS 12566 (D. Kan. 1994).

DISCUSSION

LICENSE GRANTS

The Draft defines a license as a "contract for transfer of rights in information which expressly conditions, withholds or limits the rights granted, or expressly grants less than all rights in the information, whether or not the contract transfers title to a copy of the information."[12] This definition is consistent with the centrally important provision of all commercial software licenses — the license grant. From the licensee's perspective, the license grant is the most critical part of the license because it describes what the licensee is acquiring. Unlike transactions in goods, where the sale contract will describe what is being sold, the central feature of a license transaction is the acquisition of intangible rights to use another's intellectual property.[13] Under current practice, a conservative licensee will generally assume that it is only acquiring the rights specifically and expressly set forth in the license. This places a real premium on the value of an accurate and complete formulation of the license grant. The main thrust of the Draft's provision on the interpretation of license grants is consistent with this approach:

> . . . a license grants rights under all rights expressly described and all rights within the licensor's control during the duration of the license that are necessary to use the rights expressly granted in the ordinary course in the manner anticipated by the parties at the time of the agreement. *A license grant contains an implied limitation that the licensee will not exceed the granted scope.* Use of the information in a manner that was not expressly granted or expressly withheld, exceeds this implied limitation if the use was not necessary to the granted uses and would not otherwise be legally permitted in the absence of the implied limitation.[14]

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12. U.C.C. § 2B-102(a)(21) (Proposed Jan. 20, 1997 Draft) [NOTE: section revised in proposed May 5, 1997 Draft].

13. This is not to suggest that there are not other very important parts of the license, but rather that from a pure legal/licensing standpoint the grant of the intangible rights to use, copy, modify, etc. are central. As the Preface to the December 12, 1996 Draft stated: "A license contains two attributes. One consists of a limited or conditional grant from one party to another of a privilege or right to exercise rights in information. . . . The second consists of actions that create in the licensee the capability of exercising those rights." Preface, Uniform Commercial Code Article 2B Licenses, National Conference of Commissioner on Uniform Laws (Dec. 12, 1996 Draft). Obviously, the enabling actions can be key also. Delivery (of object and/or source code and documentation), installation and training, conversion services, and development of key interfaces and modifications, among other things, can be crucial to a successful implementation and require specification in the license to assure the licensee of exactly what it is getting for its money.

14. U.C.C. § 2B-310(a) (Proposed Jan. 20, 1997 Draft) (emphasis added) [NOTE: section revised in proposed May 5, 1997 Draft].

In large part, therefore, a licensee will continue to want to make sure that all desired rights are expressly set forth in the license grant. Under the Draft's formulation, a licensee would not want to take the position that other nonexpressed uses were permissible because a license grant failed to state that the license was "for this use *only*."[15]

The Draft does, however, indicate that a licensee receives certain lesser included use rights, *i.e.*, "all rights expressly described and all rights within the licensor's control during the duration of the license that are necessary to use the rights expressly granted in the ordinary course in the manner anticipated by the parties . . . ."[16] These rights may be helpful in giving licensees some protection against what the Reporter's Notes to the Draft refer to as "unexpected and undesired results."[17] An example given in the Reporter's Notes is that "a license to use a film clip in a CD ROM product impliedly conveys the right to crop or modify the size of the clip to fit the media unless that is expressly excluded."[18] Although this may make sense to avoid depriving a licensee of the right to make use of a product as mutually anticipated by the parties, licensors may wish to give some thought to what those lesser included rights might be (or might be argued to be). Appropriate restrictions might then be included in the license grant to avoid uncertainty with regard to activities that the licensor knows it wants to prohibit. For example, the licensor may wish to expressly

15. *See* U.C.C. § 2B-310 reporter's note 4 (Proposed Jan. 20, 1997 Draft). "Under current law, it is clear that uses of licensed information outside the express scope of a license are breaches of contract *if the scope is defined in terms of "this use only"* or otherwise expressly precludes the use. Where the word "only" does not appear, the cases are less clear and some limited case law would suggest that the omission of the word in formal grant language vitiates the contract claim. The concept of implied lesser use rights is not universally followed in licensing law and some federal policy appears to holds that the proper interpretation is that any use not expressly granted is withheld. Subsection (b) adopts the converse, more commercial perspective as a way of avoiding unexpected and undesired results." *Id.* In addition, see Triad Sys. Corp. v. Southeastern Exp. Co., 64 F.3d 1330 (9th Cir. 1995), *cert. denied*, 116 S. Ct. 1015 (1996); Tingley Sys., Inc. v. Norse Sys., Inc., 49 F.3d 93 (2nd Cir. 1995); MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993); MacLean Assocs., Inc. v. Wm. M. Mercer-Meidinger-Hansen, Inc., 952 F.2d 769 (3rd Cir. 1991); Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970 (4th Cir. 1990); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255 (5th Cir. 1988); Equinox Software Sys., Inc. v. Airgas, Inc., Civ. No. 96-3399, 1997 U.S. Dist. LEXIS 119 (E.D. Pa. 1997); Advanced Computer Servs. v. MAI Sys. Corp., 845 F. Supp. 356 (E.D. Va. 1994); LucasArts Entertainment Co. v. Humongous Entertainment Co., 815 F. Supp. 332 (N.D. Cal. 1993); Microsoft Corp. v. BEC Computer Co., Inc., 818 F. Supp. 1313 (C.D. Cal. 1992); CMAX/Cleveland, Inc. v. UCR, Inc., 804 F. Supp. 337 (M.D. Ga. 1992); PRC Realty Sys., Inc. v. National Ass'n of Realtors, Inc., 766 F. Supp. 453 (E.D. Va. 1991), *aff'd rev'd in part*, 972 F.2d 341 (4th Cir. 1992); Foresight Resources Corp. v. Pfortmiller, 719 F. Supp. 1006 (D. Kan. 1989); SAS Inst., Inc., v. S&H Computer Sys., 605 F. Supp. 816 (M.D. Tenn. 1985).

16. U.C.C. § 2B-310(a) (Proposed Jan. 20, 1997 Draft).

17. U.C.C. § 2B-310 reporter's note 4 (Proposed Jan. 20, 1997 Draft).

18. U.C.C. § 2B-310 reporter's note 2 (Proposed Jan. 20, 1997 Draft).

prohibit modification or reverse engineering of its software.[19]

Beyond laying the foregoing interpretive rule groundwork, the Draft would supply a number of a specific default or gap-filling rules for contracts that are otherwise silent on the following subjects pertinent to license grants:

—If the number of simultaneous users is not specified, the license will be considered to only permit one;[20]

—There is no entitlement to receive source code (or, for that matter, object code) absent a grant thereof;[21]

—Although prior versions of the Draft specifically dealt with the issue of location restrictions,[22] the current Draft would appear to require resort to the general interpretive rule cited above for determination of where use of the subject software would be permitted.[23] For example, if use at a specific location is granted, there would be an implied restriction against use at other locations. The Reporter's Notes state: "[a] grant to use software in Peoria seems to imply the lack of a contract right to do so in Detroit. That is the view taken here."[24] Presumably, the same analysis would apply to CPU and similar restrictions found in many commercial licenses. Licensees receiving licenses with location restrictions will likely want to continue their current practice of including authorization for use at disaster recovery locations in appropriate circumstances. Similarly, licensees that receive licenses with references to licensed computers (and perhaps even licenses that simply refer to the "initial" computer on which the software is to be installed) may want to add provisions dealing with their ability to use the software on upgraded or substitute machines.

—The license term is perpetual if the contract does not re-

19. *See* U.C.C. § 2B-310 reporter's note 2 (Proposed Jan. 20, 1997 Draft) (noting "[a] grant of a license in software conveys the right to use functions provided in the software in the ordinary course to make modified versions of that software." U.C.C. § 2B-310 reporter's note 4 (proposed Jan. 20, 1997 Draft) (stating that "in some cases, a reverse engineering use is permitted in general law. The implied limitation does not alter these results.").

20. *See* U.C.C. § 2B-310(b) (Proposed Jan. 20, 1997 Draft) ("A license grant dealing with digital information which does not specify the number of simultaneous users permitted grants a right for use by one party at any one time, but if the license authorizes display or performance, it permits participation in or viewing by any number of persons, but only a single performance or display at any one time.") Regardless of the number of users authorized, and depending on the type of product involved, the licensee may wish to expressly address its ability to make multiple back-up copies (if that is its practice) and to maintain the same in off-site storage (*i.e.*, storage at other than the licensed location if the license contains a location restriction).

21. U.C.C. § 2B-310(c) (Proposed Jan. 20, 1997 Draft).

22. U.C.C. § 2B-312 (Dec. 12, 1996 Draft).

23. U.C.C. § 2B-310(a) (Proposed Jan. 20, 1997 Draft).

24. U.C.C. § 2B-310 reporter's note 4 (Proposed Jan. 20, 1997 Draft).

quire on-going affirmative performance.[25] If the contract provides for on-going affirmative performances, the license may be terminated at will by either party on reasonable notice to the other.[26] In all other cases, the license term will be a "reasonable time."[27] Preferred practice in this area will nonetheless likely continue to be inclusion of an express term in the agreement.

—A prior version of the Draft stated a default rule that license rights were nonexclusive.[28] The current version of the Draft deleted this rule, but left the definition of nonexclusive license which is "a license in which the licensor or other person authorized to make a transfer or license is not prohibited from licensing the same information or rights therein to other licensees."[29] The definition appears to be based on the assumption that a license is nonexclusive unless otherwise stated. In any event, licensees that wish to assure themselves of exclusive rights would presumably want to do so explicitly in the license agreement.

—If the license is nonexclusive, the licensee will generally be prohibited from transferring its rights without consent of the holder of the relevant intellectual property rights.[30] This is not the case, however, if the licensee receives title to a copy of the relevant information, the license does not preclude transfer, and the transfer complies with federal law pertaining to the ability of an owner of a copy to make the transfer.[31] If the license is not nonexclusive, the general rule is that a party's contract rights are assignable "unless the assignment would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose or threaten to disclose trade secrets or confidential information of the other party, or materially impair the other party's likelihood of obtaining return performance."[32]

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25. U.C.C. § 2B-311(2) (Proposed May 5, 1997 Draft).
26. U.C.C. § 2B-311(3) (Proposed May 5, 1997 Draft).
27. U.C.C. § 2B-311(1) (Proposed May 5, 1997 Draft).
28. U.C.C. § 2B-310(a) (Dec. 12, 1996 Draft).
29. U.C.C. § 2B-102(a)(27) (Proposed Jan. 20, 1997 Draft).
30. U.C.C. § 2B-502 (Proposed Jan. 20, 1997 Draft). *See* S.A.I., Inc. v. General Elec. Railcar Servs. Corp., 935 F. Supp. 1150 (D. Kan. 1996); Baxter Healthcare Corp. v. O.R. Concepts, Inc., No. 94-C-2877, 1995 U.S. Dist. LEXIS 5915 (N.D. Ill.), *aff'd*, 69 F.3d 785 (7th Cir. 1995); *In re* CFLC, Inc., 174 B.R. 119 (N.D. Cal. 1994), *aff'd*, 89 F.3d 673 (9th Cir. 1996); First Nationwide Bank v. Florida Software Servs., 770 F. Supp. 1537 (M.D. Fla. 1991); SQL Solutions, Inc. v. Oracle Corp., No. C-91-1079-MHP, 1991 U.S. Dist. LEXIS 21097 (N.D. Cal. 1991); Transamerica Commercial Fin. Corp. v. Stockholder Sys., Inc., No. 89-C-917, 1990 U.S. Dist. LEXIS 15275 (N.D. Ill. 1990); *In re* Sentry Data, Inc., 87 B.R. 943 (Bankr. N.D. Ill. 1988); *In re* Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W.D. Tenn. 1987).
31. U.C.C. § 2B-502(b)(2) (Proposed Jan. 20, 1997 Draft).
32. U.C.C. § 2B-502(a) (Proposed Jan. 20, 1997 Draft).

One common issue where the Draft does not provide guidance is the interpretation of license language restricting the license solely to "the internal use of the licensee" or "processing the licensee's internal data."[33]

CONFIDENTIALITY

An earlier version of the Draft contained a provision on confidentiality in general and proposed a general rule that a party not be obligated to maintain in confidence information given to it by another party.[34] This provision was proposed for deletion in the January Draft.[35] There remains, however, a provision on "Information Rights in Originating Party."[36] This provision does *not* assure either party that all information it discloses to the other in the course of a license must be kept confidential. The protections of this section will come into play:

> [i]f an agreement requires one party to deliver commercial, technical, or scientific information to the other for its use in performing its obligations under the contract or obligates one party to handle or process commercial data, including customer accounts and lists, and the receiving party has reason to know that the information is confidential . . . .[37]

The section further specifically states that it does not apply to "transactional data."[38] If the parties desire protection for a broader scope of information (or if the disclosing party simply wishes to assure itself that "the receiving party has reason to know that the information is confidential" and thus within the protection of the section), an express confidentiality provision in the license may continue to be advisable.[39]

If this section does come into play, it provides that: (i) the protected information and any summaries or tabulations thereof remain the property of the disclosing party; (ii) the receiving party may use the information only in the manner and for the purpose authorized in the agreement; (iii) the receiving party must exercise reasonable care to maintain the confidentiality of the information; and (iv) the receiving party must make the information available for destruction or re-

33. *See* National Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc., 991 F.2d 426, 428 (8th Cir. 1993); Computer Assocs. Int'l, Inc. v. State St. Bank & Trust Co., 789 F. Supp. 470, 475 (D. Mass. 1992).

34. U.C.C. § 2B-315 (Dec. 12, 1996 Draft).

35. See strike-out of U.C.C. § 2B-315 (Dec. 12, 1996 Draft) following U.C.C. § 2B-311 (Proposed Jan. 20, 1997 Draft).

36. U.C.C. § 2B-312 (Proposed Jan. 20, 1997 Draft).

37. U.C.C. § 2B-312(a) (Proposed Jan. 20, 1997 Draft).

38. U.C.C. § 2B-312(c) (Proposed Jan. 20, 1997 Draft).

39. U.C.C. § 2B-312(a) (Proposed Jan. 20, 1997 Draft). *See* TDS Healthcare Sys. Corp. v. Humana Hosp. Ill., Inc., 880 F. Supp. 1572, 1584 (N.D. Ga. 1995).

turn in accordance with the agreement or the delivering party's instructions.[40] The prior version's general provision on confidentiality would have made unenforceable confidentiality provisions pertaining to information generally known to the public and would have also provided an exception for disclosures pursuant to court order or subpoena.[41] Thus, to the extent the parties believe that certain common exceptions to confidentiality should apply (*e.g.*, public information, information rightfully received from a third party, independently developed information, etc.), those exceptions should continue to be included in licenses.

MODIFICATIONS; UPDATES; CORRECTIONS AND SUPPORT

Most commercial software products are constantly evolving and do not remain static after initial installation. The Draft sets out a number of default rules applicable to changes in software:

—If the license includes provisions for development of a program by the licensor (or another), gap-filling rules in the Draft's section on development contracts may come into play.[42] Absent agreement to the contrary: (i) the developer will be considered the owner of the intellectual property rights in the program, except to the extent it includes the client's intellectual property or the client would otherwise be considered a co-owner under other law; and (ii) the client receives a nonexclusive and irrevocable license.[43] A number of other important provisions of the development contract section can also become relevant in such situations, including provisions on the developer's obligations with respect to use of independent contractors and third party information,[44] certain consequences of an agreement that the client will own the developed program,[45] and the developer's continuing right to use "generally applicable components or code," devel-

40. U.C.C. § 2B-312(a)(1) & (2) (Proposed Jan. 20, 1997 Draft).
41. U.C.C. § 2B-315(b) & (c) (Dec. 12, 1996 Draft).
42. U.C.C. § 2B-617 (Proposed Jan. 20, 1997 Draft).
43. U.C.C. § 2B-617(1)(A) & (B) (Proposed Jan. 20, 1997 Draft) [NOTE: section revised and subsection numbering changed in proposed May 5, 1997 Draft].
44. U.C.C. § 2B-617(2) (Proposed Jan. 20, 1997 Draft) states:

> On request of the client asserting its rights under this section, the developer shall notify the client if the developer used independent contractors or information provided by other third persons to which intellectual property rights may apply and shall provide the client with a statement that either confirms that all applicable intellectual property rights have been obtained or will be obtained from any independent contractor so used, or that it makes no representation about those rights beyond any stated in the agreement. The response must be made within 30 days after the request is received. If the time for performance is less than 30 days, the request must be made at or before the time of contracting, and the response must be made before the transfer of rights.

45. U.C.C. §§ 2B-617(3)(A) - (C) (Proposed Jan. 20, 1997 Draft) states:

opment tools or the like.[46] Safe harbor language is also provided for an agreement on ownership: "All rights, title and interest in the completed program will be owned by [named party]."[47]

—Neither party is entitled to rights in improvements or modifications made by the other after the transfer of rights in the software.[48] If a licensor does not prohibit modifications (which the Draft seems to contemplate will be permitted in certain circumstances absent a contractual prohibition), the licensor may want to reverse the preceding rule (*i.e.*, provide that the licensor owns all modifications) or at least attempt to restrict a licensee's ability to exploit modifications made by the licensee.[49]

—Licensees will want to keep in mind that, even if modifications are authorized, modification of software will void all express and implied warranties.[50] Two exceptions are available however. Modification will not void warranties if the licensor so agrees (meaning the licensor must agree, not just to the making of modifications, but to the fact that the modifications will not void warranties).[51] Modification will also not void warranties if made by using capabilities of the software "intended for that purpose in the ordinary course of operation" of the software.[52] At first glance, this voiding of warranties ap-

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(A) Ownership passes in accordance with Section 2B-501 with respect to all components and code in the program developed pursuant to the contract.

(B) The client receives the program free of any restrictions on use on the part of the developer. Its rights in the program may not be canceled by the developer after ownership payment of the contract price.

(C) If the agreement provides that the developer retains ownership of the intellectual property rights in any components or code used in the program that were developed prior to or independent of performance of the contract, the client has an irrevocable license to use or modify in any manner in connection with its use of the program or any modifications thereof, such components or code as were delivered to the client.

46. U.C.C. § 2B-617(3)(D) (Proposed Jan. 20, 1997 Draft) states: "The developer has an irrevocable nonexclusive right to use in other contracts generally applicable components or code, including development tools or the like, developed by it in performance of the contract if the use will not disclose confidential information of the client."

47. U.C.C. § 2B-617(4) (Proposed Jan. 20, 1997 Draft).

48. U.C.C. § 2B-310(c)(i) (Proposed Jan. 20, 1997 Draft).

49. *See supra* note 19 and accompanying text. *See* Aymes v. Bonelli, 47 F.3d 23, 24 (2nd Cir. 1995); S.O.S., Inc. v. Payday, Inc., 886 F.2d 1081, 1085-86 (9th Cir. 1989).

50. U.C.C. § 2B-407 (Proposed Jan. 20, 1997 Draft).

51. *Id.*

52. *Id.* Reporter's Note 2 to this section gives an example:

> The section refers to modifications intending to cover cases where the licensee makes changes in the program that are not part of the program structure or options itself. Thus, if a user employs the built-in capacity of a word processing program to tailor a menu of options suited to the end user's use of the program, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties.

Id. Reporter's note 2 (Proposed Jan. 20, 1997 Draft).

pears more stringent than some licensees are willing to agree to. Often a licensee will agree that modifications void warranties, but only "to the extent" the modification is the source of an error. The Reporter's Notes seem to indicate a slightly different approach to this issue: " . . . the voiding of performance warranties extends only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect."[53]

—As noted above, the licensor has no obligation to provide "improvements or modifications."[54] If a licensor does agree to provide "updates or new versions," that agreement requires the provision only of "such updates or new versions that are developed by the licensor from time to time and made generally available," unless the agreement expressly requires otherwise.[55] A licensor that questions what is meant by "made generally available" may wish to be more specific (*e.g.*, by using the common formulation "made available to our customers generally at no additional charge"). The Draft does not appear to imply any quality standards as being applicable to updates or new versions.[56]

—Quality standards are implied if a licensor agrees to correct errors or provide similar services.[57] If such services are provided in the context of a limited time and as part of a limited remedy, the party's implied undertaking is that it will provide information of a quality conforming to the contract.[58] In all other cases, the undertaking is that the quality of performance will be "consistent with the express terms of the agreement."[59] If not dealt with by the agreement, the quality standard is "a workmanlike manner and . . . reasonably consistent with ordinary standards of the trade for similar contracts."[60] The Draft specifically provides that there is no

53. U.C.C. § 2B-407 reporter's note 1 (Proposed Jan. 20, 1997 Draft).

54. U.C.C. § 2B-310(c)(i) (Proposed Jan. 20, 1997 Draft).

55. U.C.C. § 2B-310(c) (Proposed Jan. 20, 1997 Draft).

56. U.C.C. §§ 2B-613(b)(2) & (3) of the December 12, 1996 Draft did address this issue.

57. U.C.C. § 2B-615 (Proposed Jan. 20, 1997 Draft).

58. U.C.C. § 2B-615(a)(1) (Proposed Jan. 20, 1997 Draft). Reporter's Note 3 to this section indicates: "The focus is on the classic 'replace or repair' warranty. When the obligation to correct errors arises in that context, the promisor's obligation is to complete a product that conforms to the contract." *Id.* reporter's note 3 (Proposed Jan. 20, 1997 Draft).

59. U.C.C. § 2B-615(a)(2) (Proposed Jan. 20, 1997 Draft). Reporter's Note 4 to this section indicates that "(a)(2) deals with the broader case of the general repair obligation outside of the limited remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a perfect result." *Id.* reporter's note 4 (Proposed Jan. 20, 1997 Draft).

60. U.C.C. § 2B-615(a)(1) (Proposed Jan. 20, 1997 Draft).

warranty that all defects or errors will be corrected.[61]
—Similar to the preceding rule is the rule pertaining to support and training. First, the licensor has no obligation to provide support or training.[62] If training and support is agreed to be provided, the obligation is that the quality of performance will be consistent with the express terms of the agreement.[63] If not dealt with by the agreement, the quality standard is "a workmanlike manner . . . consistent with ordinary standards of the trade or industry for the particular type of agreement."[64]

WARRANTIES: AUTHORITY & NON-INFRINGEMENT

Unlike customers in sale of goods transactions, software licensees are not generally concerned with obtaining title to the products acquired by them. The licensee does, however, want assurance that its vendor is authorized to provide the product and that its use of the product will not be interfered with by a third party, specifically, a third party making an infringement claim against the licensee. The Draft addresses these concerns by providing three things to the licensee. The first two are implied warranties that: "(1) the licensor has authority to make the transfer; [and] (2) the licensor and any person holding a claim or interest created by an act of the licensor other than a financier of the licensee will not interfere with the licensee's enjoyment of its rights under the contract."[65] The third protection would pertain to infringements. The January version of the Draft proposed two alternatives in this area, one an implied warranty and the other an implied indemnity:

[ALTERNATIVE A]

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

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61. U.C.C. § 2B-615(a)(3) (Proposed Jan. 20, 1997 Draft).

62. U.C.C. § 2B-615(b) (Proposed Jan. 20, 1997 Draft).

63. *Id.* *See* Richard Haney Ford, Inc. v. Ford Dealer Computer Servs., 461 S.E.2d 282, 283-85 (Ga. Ct. App. 1995).

64. U.C.C. § 2B-615(b) (Proposed Jan. 20, 1997 Draft).

65. U.C.C. § 2B-401(a)(1) & (2) (Proposed Jan. 20, 1997 Draft).

[ALTERNATIVE B (TO BE ADDED AS NEW SUBSECTION)]

> (4) . . . a licensor that is a merchant regularly dealing in information of the kind indemnifies and holds the licensee harmless against any final judgment rendered in favor of a third party for infringement against the licensee with reference to the information and any copies thereof transferred by the licensor to the licensee to the extent that the infringement pertains to an intellectual property right in existence at the time of the transfer of rights. Performance of this indemnity excludes any other liability to the licensee for the infringement.[66]

These warranties will be permitted to be disclaimed by express language or by circumstances giving the licensee reason to know that the licensor does not warrant against competing claims or is only transferring the rights it has.[67] Proposed safe harbor disclaimers are "There is no warranty of title or authority" or "There is no warranty that the [information] [computer program] does not infringe the rights of others."[68]

Licensee counsel will immediately notice that the implied warranty (Alternative A) contains less protection than is often obtained in the express infringement indemnities contained in negotiated (and often even standard form) commercial licenses under current practice. Where the Draft's implied warranty opts for an allocation of risk based on the licensor's reason to know of the infringement, many commercial licenses provide protection on a strict liability basis (*i.e.*, the licensor is obligated to indemnify the licensee for claims regardless of knowledge or a reason to know of the infringement). Indeed, it can be suggested that many commercial infringement indemnities go further still and protect the licensee against *claims,* not just judgments, in favor of the third party claiming infringement.[69] The Reporter's Notes summarize one view of the policy considerations behind the decision on how to allocate risk in this area:

> . . . the warranty focuses on a "no reason to know" standard. This does not impose a duty of inquiry, but relates only to facts actually known to the party. The choice between a "reason to know" and an absolute liability warranty requires a balancing of the interests of the licensor and licensee in an

66. U.C.C. § 2B-401(a)(4) (Proposed Jan. 20, 1997 Draft).

67. U.C.C. § 2B-401(e) (Proposed Jan. 20, 1997 Draft). Note: It should be (d), the Draft skips from (c) to (e).

68. *Id.*

69. For example, one large international vendor has a provision similar to the following: "If a third party claims that our product infringes that party's patent or copyright, we will defend you against that claim at our expense and pay all costs, damages, and attorneys' fees that a court finally awards against you. . . ."

> ordinary case where infringement claims may arise without direct fault of either party. Both in copyright and patent infringement claims, the complexity of the technology, the diverse sources from which it arises and character of modern infringement claims that do not admit of good faith purchase and do not require knowledge of infringement all create significant risk in the modern commercial environment. The choice made here places knowing misconduct risk on the licensor, but in cases where neither party had knowledge that an infringement would ensue, to allows [sic] loss to stay with the licensee if it is the party sued unless the contract reverses that allocation. No knowledge warranties are common in modern licensing. Note that this does not alter current intellectual property law which recognizes neither a concept of bona fide purchaser defense to infringement, nor a lack of knowledge defense. Thus, in the case of a merchant who does not know about the infringement, either the licensee or the licensor may have infringement liability and this warranty will not redistribute the loss.
>
> Part of the difficulty involves the fact that patents are not knowable or readily checked by the myriad of small producers in this market place and that, therefore, an absolute warranty would place liability exposure on them without an effective means of protection.[70]

Although an analysis of the appropriate policy considerations behind a legislatively implied infringement warranty is beyond the scope of this Article, a few questions might be fair: (i) although "complexity of the technology" and the "diverse sources from which it arises" may create a risk of infringement in licensing transactions, why should they result in that risk being imposed on the licensee rather than the licensor; (ii) although there may be a "myriad of small producers" in this market, aren't there at least as many (and actually more) small customers; and (iii) if the licensor has decided to get into this line of business and profit from these products, hasn't the licensor in fact assumed and presumably been compensated for this risk? Of course, the ultimate resolution of these issues need not necessarily adversely affect either party in a negotiated commercial transaction where there is freedom of contract (although one might speculate as to whether the UCC's resolution of this issue will affect standard positions taken by the parties in negotiations and may therefore, practically speaking, make it more difficult for the party pushing for variation by agreement).

The preceding risk issue can cut more than one way for licensees. The Draft also provides that if the licensee has furnished specifica-

70. U.C.C. § 2B-401 reporter's note 7 (Proposed Jan. 20, 1997 Draft).

tions to the licensor, the licensee must indemnify the licensor for infringements arising out of compliance with the specifications.[71] As proposed, that requirement would give the licensee the benefit of the "reason to know" limitation on its indemnity obligation.[72] For all the reasons that licensees may have to object to the availability of this limitation for licensors, licensors may have very similar grounds for objecting to giving licensees the benefit of such a limitation.

In addition to the preceding implied protections against infringement, the Draft's provisions on licensee remedies address two procedural issues on the handling of infringement claims that must be complied with at the risk of being barred from certain recoveries against the licensor. First, a licensee must "seasonably" notify the licensor of receipt of notice of infringement litigation.[73] Second, the licensor is entitled to demand control of the litigation, including settlement:

> If the licensor is answerable over to the licensee for the claim or the contract is a nonexclusive license and the demand states that the licensor will bear all of the expenses and satisfy any adverse judgment or settlement and the licensor provides reasonable assurance of its capability to do so, the licensee is barred from any remedy over against the licensor except for costs already incurred. The licensor may obtain control of the action by appropriate legal remedies unless the licensee after seasonable receipt of the demand turns over control.[74]

WARRANTIES: EXPRESS AND IMPLIED QUALITY

Proposed Article 2B would recognize the creation of express warranties in a manner consistent with current Article 2.[75] One impor-

71. U.C.C. § 2B-401(c) (Proposed Jan. 20, 1997 Draft).

72. *Id.*

73. U.C.C. § 2B-715(b)(1) (Proposed Jan. 20, 1997 Draft) [NOTE: section re-written and moved to § 2B-706 in proposed May 5, 1997 Draft].

74. U.C.C. § 2B-715(b)(2) (Proposed Jan. 20, 1997 Draft).

75. U.C.C. § 2B-402 (Proposed Jan. 20, 1997 Draft). *See* Consolidated Data Terminals v. Applied Digital Sys., Inc., 708 F.2d 385 (9th Cir. 1983); Management Sys. Assocs., Inc. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985); Otobai, Inc. v. Auto Tell Servs., Inc., Civ. No. 93-2855, 1994 U.S. Dist. LEXIS 7592 (E.D. Pa. 1994); Foundation Software Lab., Inc. v. Digital Equip. Corp., 807 F. Supp. 1195 (D. Md. 1992); Hoke, Inc. v. Cullinet Software, Inc., Civ. No. 89-1319 (HLS), 1992 U.S. Dist. LEXIS 4616 (D.N.J. 1992), *aff'd*, 986 F.2d 1409 (3rd Cir. 1993); Ottawa Strong & Strong v. McLeod Bishop Sys., Inc., 676 F. Supp. 159 (N.D. Ill. 1987); Fargo Mach. & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. 1977); Computerized Radiological Servs., Inc. v. Syntex Corp., 595 F. Supp. 1495 (E.D.N.Y. 1984), *rev'd in part on other grounds*, 786 F.2d 72 (2d Cir. 1986); Latham & Assocs., Inc. v. William Raveis Real Estate, Inc., 589 A.2d 337 (Conn. 1991); Cricket Alley Corp. v. Data Terminal Sys., Inc., 732 P.2d 719 (Kan. 1987).

tant variation, however, applies in the case of "published informational content." This is defined as:

> informational content prepared for distribution or distributed in substantially the same form to all licensees and not provided as customized advice tailored for the particular licensee by an individual acting on behalf of the licensor using judgment and expertise. This term does not include informational content provided within a special relationship of reliance between the provider and the transferee.[76]

The rationale for excluding published informational content from the Draft's express warranties provision (thus leaving the parties to resort to existing law for a determination of how express warranties can be created) is described in the Reporter's Notes:

> While there are many reported cases dealing with express warranties in the context of goods and using the standards outlined here, no such case law exists with respect to warranties in reference to published information. This subject matter entails significant First Amendment interests and courts that deal with liability risk pertaining to that subject matter must balance contract themes with more general social policies. By excluding this type of information content from the coverage of this section, the intent is to leave undisturbed any existing law dealing with under what obligations can be created and how they are established with reference to published information. Courts may, if inclined to find liability in reference to published information, do so under any general contract law theory. The Drafting Committee, however, concluded that merely adopting Article 2 concepts applicable to sales of goods would risk a large, and substantially uncontrollable over-reaching of liability in this sensitive area. Comments to this section will underscore that the goal is not to make information providers immune from liability, but to let First Amendment case law continue to evolve.[77]

The Draft takes a different approach to implied warranties of quality than existing UCC provisions by largely discarding the concept of merchantability except for mass-market software.[78] Assuming the licensor is a merchant, the implied warranty is that:

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76. U.C.C. § 2B-102(a)(28) (Proposed Jan. 20, 1997 Draft).

77. U.C.C. § 2B-402 reporter's note 2 (Proposed Jan. 20, 1997 Draft).

78. U.C.C. § 2B-403 (Proposed Jan. 20, 1997 Draft). *See* Walter Raczynski Product Design v. International Business Machines Corp., No. 92-C-6423, 1993 U.S. Dist. LEXIS 9944 (N.D. Ill. 1993); Dart Energy Corp., Inc. v. Vogel, No. 1:91-CV-184, 1991 U.S. Dist. LEXIS 10079 (W.D. Mich. 1991); Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Schroders, Inc. v. Hogen Sys., Inc., 522 N.Y.S.2d 404 (N.Y. Sup. Ct. 1987); Communications Groups, Inc. v. Warner Communications, Inc., 527 N.Y.S.2d 341 (N.Y. Civ. Ct. 1988); Micro-Managers, Inc. v. Gregory, 434 N.W.2d 97 (Wisc. Ct. App. 1988).

> any media on which the program is transferred will be merchantable and that the computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation or specifications provided by the licensor at or before the delivery of the program. An affirmation of the value of the program or a statement of opinion or commendation does not create a warranty.[79]

This corresponds closely to the express warranty currently given in most negotiated commercial license transactions. Implied warranties, however, are very often disclaimed in current practice.[80] It will therefore be interesting to see if the drafters' attempt to accurately capture current practice (by converting today's standard express warranties into tomorrow's implied warranties) will be accepted by practitioners.

As is the case with current practice regarding warranties of conformance to documentation, the Draft's implied warranty places a premium on the sufficiency of the documentation that serves as a basis for the warranty. A licensee cannot really judge the value of this warranty without reviewing the relevant documentation and specifications. In addition, whether the licensee carries through with that exercise or not, the licensee will want to remember that this warranty is tied to documentation and specifications provided "at or before the delivery of the program."[81] Although delivery of documentation at that time may be the norm, a licensee relying on this implied warranty in any particular transaction may wish to take steps to assure that it is not effectively deprived of the warranty by a delay in delivery.

Licensees may also want to continue to evaluate whether a warranty on conformance to documentation is all they need. For example, many licensees are now requiring warranties pertaining to year 2000 compliance. If a satisfactory 'promise or affirmation of fact' along those lines is not included in the documentation or specifications, an express warranty may be in order.

Two other implied warranties are also proposed in the Draft:

> —One of these implied warranties corresponds somewhat to the warranty of fitness for a particular purpose under existing Article 2. If a licensor has reason to know of the particular purpose for which information is required and that the licensee is relying on the licensor's expertise: (i) there is a warranty the information will be fit for such purpose "if the contract is for a fixed price for performance that will not be paid if the end product is not suitable for the particular pur-

79. U.C.C. § 2B-403(b) (Proposed Jan. 20, 1997 Draft).
80. *See* U.C.C. § 2B-403 reporter's note 5 (Proposed Jan. 20, 1997 Draft).
81. U.C.C. § 2B-403(b) (Proposed Jan. 20, 1997 Draft).

pose";[82] (ii) otherwise, "if, from all the circumstances, it appears that the licensor was to be paid for the amount of its time or effort regardless of the suitability of the end product, there is an implied warranty that the licensor will make a workmanlike effort to achieve the licensee's purpose."[83] These warranties are not made with respect to "aesthetic value, commercial success, or market appeal of informational content."[84] The Reporter's Notes indicate that this provision is intended to deal with development and design contracts.[85] Presumably, it would also apply to contracted customization work that a licensor might agree to in connection with a license. Given the common practice of disclaiming warranties of fitness in current practice, it would not be surprising to see these warranties disclaimed with similar frequency in future commercial practice.

—The Draft also proposes to add an implied warranty pertaining to informational content and services.[86] This warranty would generally be applicable to "consulting, data processing, information content and similar contracts," and thus would not necessarily be applicable to many software transactions where the focus was the application, not information content.[87] The warranty would be that "there is no inaccuracy, flaw, or other error in the informational content caused by [the merchant's] failure to exercise reasonable care and workmanlike effort in its performance in collecting, compiling, or transcribing the information."[88] The warranty would not arise for: (i) "the aesthetic value, commercial success, or market appeal of the content;" (ii) "published informational content"; or (iii) certain information content prepared by third parties.[89] In addition, the provision indicates that it is not applicable to "informational content that is merely incidental to a transfer of rights and does not constitute a material portion of the value in the transaction."[90] The Reporter's Notes appear to indicate that this refers to "instructional manuals, documentation and the like, where the primary focus is on software or other information involved in the transaction; under current law and in the comments that will eventually follow here, defects in such materials are part

82. U.C.C. § 2B-405(1) (Proposed Jan. 20, 1997 Draft).
83. U.C.C. § 2B-405(2) (Proposed Jan. 20, 1997 Draft).
84. U.C.C. § 2B-405 (Proposed Jan. 20, 1997 Draft).
85. U.C.C. § 2B-405 reporter's note 1 (Proposed Jan. 20, 1997 Draft).
86. U.C.C. § 2B-404 (Proposed Jan. 20, 1997 Draft).
87. *See* U.C.C. § 2B-404 reporter's note 1 (Proposed Jan. 20, 1997 Draft).
88. U.C.C. § 2B-404(a) (Proposed Jan. 20, 1997 Draft).
89. U.C.C. § 2B-404(b) (Proposed Jan. 20, 1997 Draft).
90. U.C.C. § 2B-404(b)(3) (Proposed Jan. 20, 1997 Draft).

of merchantability and express warranties."[91]

As is the case under Article 2, implied warranties under Article 2B may be disclaimed if certain rules are followed. A variety of safe harbor disclaimers are proposed:

> —To disclaim the warranties of quality or information content, language is sufficient if it mentions "warranty of quality," "warranty of merchantability," "warranty of accuracy," or language of similar import.[92] Language that is sufficient to disclaim either the warranty of quality or the warranty of informational content will be sufficient to waive the other.[93] In addition, these warranties can be disclaimed by language sufficient to disclaim an Article 2 warranty of merchantability.[94]
>
> —To disclaim the Article 2B analog to a warranty of fitness (the Article 2B language is "Effort to Achieve Purpose"), the safe harbor is: "There is no warranty that the subject of this transaction will fulfill any of your particular purposes or needs," or language of similar import.[95] This warranty can also be disclaimed by language sufficient to disclaim an Article 2 warranty of fitness.[96]
>
> —Disclaimers with the language "as is" or "with all faults" or similar language will exclude the warranties of quality and informational content and perhaps the warranty of effort to achieve purpose (the latter issue being bracketed language in the January Draft).[97]

In addition to express disclaimers, implied warranties will be subject to disclaimer or modification by course of performance or course of dealing (although not, apparently, by "usage of trade").[98] Under current Article 2, implied warranties are excluded in cases where the buyer has examined the goods "as fully as he desired" or has refused to do so.[99] Proposed Article 2B takes a slightly different approach, by excluding implied warranties:

> with respect to a defect that was known or discovered by, or disclosed to the licensee prior to entering into the contract, or that would have been revealed to the licensee if it had not refused to make reasonable use of an opportunity reasonably provided to it to examine, inspect or test the information or a

91. *See* U.C.C. § 2B-404 reporter's note (Proposed Jan. 20, 1997 Draft).
92. U.C.C. § 2B-406(b)(2) (Proposed Jan. 20, 1997 Draft).
93. *Id.*
94. *Id.*
95. U.C.C. § 2B-406(b)(3) (Proposed Jan. 20, 1997 Draft).
96. *Id.*
97. U.C.C. § 2B-406(b)(4) (Proposed Jan. 20, 1997 Draft).
98. U.C.C. § 2B-406(b)(5) (Proposed Jan. 20, 1997 Draft). *See* U.C.C. § 2B-406 reporter's note 3 (Proposed Jan. 20, 1997 Draft).
99. U.C.C. § 2-316(2)(b).

> sample thereof made available prior to entering into the contract, unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time.[100]

The Reporter's Notes indicate that the drafters questioned whether the Article 2 approach was workable with respect to complex systems.[101]

Licensors may also wish to notice that the Draft recognizes the existence of third party beneficiaries with respect to warranties.[102] "A warranty made to a licensee extends to persons for whose benefit the licensor intends to supply the information, directly or indirectly, and who use the information in a transaction or application in which the licensor intends the information to be used."[103] Although instances of intended third parties may be the exception rather than the rule, a licensor that wishes to avoid any argument in this area may do well to expressly disclaim any intended third party beneficiaries.

VIRUSES

Many sophisticated commercial licensees have added to their software acquisition checklists a requirement for a virus warranty from the vendor. The Draft also addresses this issue but does not treat it as a warranty.[104] In fact the Draft specifically states that: "[a] party's obligations with respect to the existence of a virus is measured under this section and the express terms of the contract and not under implied warranty."[105] The obligation imposed under proposed Article 2B with regard to viruses is that:

> Unless the circumstances clearly indicate that no duty of care could be expected, a party must exercise reasonable care to ensure that, when it completes a particular electronic performance or message, that performance or electronic message does not contain an undisclosed virus that may be reasonably expected to damage or interfere with the use of data, software, systems, or operations of the other party.[106]

Unlike current practice in many situations with respect to express virus warranties (which often only impose an obligation on the licensor), licensees will want to note that the Article 2B obligation is a mutual

100. U.C.C. § 2B-406(b)(6) (Proposed Jan. 20, 1997 Draft).
101. U.C.C. § 2B-406 reporter's note (Proposed Jan. 20, 1997 Draft).
102. U.C.C. § 2B-409 (Proposed Jan. 20, 1997 Draft).
103. U.C.C. § 2B-409(a) (Proposed Jan. 20, 1997 Draft).
104. U.C.C. § 2B-313 (Proposed Jan. 20, 1997 Draft) [NOTE: section revised and definition of virus added in proposed May 5, 1997 Draft].
105. U.C.C. § 2B-313(e) (Proposed Jan. 20, 1997 Draft).
106. U.C.C. § 2B-313(a) (Proposed Jan. 20, 1997 Draft).

one.[107] (Although there may often be little practical risk of the licensee 'infecting' the licensor in a straight software license transaction, this will not necessarily always be the case. Therefore, to the extent that the contract may attempt to address the licensor's virus screening responsibilities, licensees may wish to ask themselves whether they would benefit from having their responsibilities spelled out as well.)

Another critical feature to be recognized about this provision is that it establishes an obligation to exercise reasonable care and is thus subject to Article 1's restriction on disclaimer of obligations of reasonableness.[108] Article 2B does, however, provide that:

> The obligation described in subsection (a) is satisfied if:
> (1) the party exercised reasonable care in fact; or
> (2) except with respect to a mass market license involving physical delivery of a copy of information, language in a contract stating that no action was taken to ensure exclusion of a virus or that a clear risk exists that viruses have not been excluded.[109]

The Draft does list factors a court should consider in determining whether reasonable care has been exercised and it is clear that the drafters do not intend for this to create an "absolute liability" standard such as might be the case with a warranty obligation.[110] In addi-

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107. *See* U.C.C. § 2B-313 reporter's note 1 (Proposed Jan. 20, 1997 Draft) ("The section creates a mutual obligation. . . .").

108. U.C.C. § 2B-313(a) (Proposed Jan. 20, 1997 Draft). *See* the Reporter's Note regarding changes to U.C.C. § 2B-313, which states:

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

Id. reporter's note (Proposed Jan. 20, 1997 Draft).

109. U.C.C. § 2B-313(b) (Proposed Jan. 20, 1997 Draft).

110. U.C.C. § 2B-313(d) (Proposed Jan. 20, 1997 Draft). U.C.C. § 2B-313 reporter's note 3 states:

> Reasonable care does not equate to absolute liability. It creates a flexible standard that, as indicated in this section, gauges the party's conduct against a variety of contextual considerations. No requirement exists that a party take extraordinary steps to preclude viruses in all cases. Thus, for example, in a situation where the rate of new virus risk created daily exceeds any reasonable

tion, the Draft makes clear that neither party will be liable "if the virus was introduced by a third party after the party completed its performance or if the other party failed to exercise reasonable care to prevent or avoid loss."[111]

In addition to viruses, licensees may be concerned with other undisclosed intentional features of code. Some of these features are dealt with elsewhere in the Draft under the heading of "Electronic Regulation of Performance" and "Licensor's Self-Help."[112] Some of these undocumented intentional features may not, however, fall into those categories (*e.g.*, a means of access to the licensee's system that is not documented, or undocumented functionalities which override security systems with which the software may be designed to operate). Licensees with these concerns may still find it advisable to require express warranties regarding the items of concern to them.

ELECTRONIC REGULATION OF PERFORMANCE

Viruses are not the only things waiting to surprise licensees in some software.[113] Calendar or clock functionalities that shut off the software, counters that deny access to users in excess of an authorized number, and anti-copying devices, among other things, are sometimes used by licensors to assure that license restrictions are not exceeded. Such devices are permissible if they restrict use in a manner consistent with the agreement and if:

> (1) a term in the contract authorizes use of the program, code or a device;
>
> (2) the program, code or device or the licensor provides reasonable notice to the licensee before the program, code or device prevents further use at the expiration of the term of the license;
>
> (3) the information is obtained for a stated period of not more than thirty days or for a stated number of uses and the code or device merely enforces that time or use limitation;

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testing or preventative developments, compliance with reasonable activities suffices even if it fails to disclose all viruses. Similarly, the standard varies depending on the party to whom it applies. A retailer producer that makes no effort to screen a virus from its packaged products would not be acting in a reasonable manner. On the other hand, under contemporary conditions, a private individual with no expertise may be acting reasonably even if it takes no particular screening efforts.

Id. reporter's note 3 (Proposed Jan. 20, 1997 Draft).

111. U.C.C. § 2B-313(c) (Proposed Jan. 20, 1997 Draft).

112. U.C.C. §§ 2B-314, 2B-711 (Proposed Jan. 20, 1997 Draft). [NOTE: section revised in proposed May 5, 1997 draft.]

113. *See* Esther C. Roditti, *Is Self-Help a Lawful Contractual Remedy?*, 21 RUTGERS COMPUTER & TECH. L.J. 431, 431-32 (1995).

> (4) the program, code or device merely prevents use of the information other than in a manner consistent with the license, but does not destroy or alter the information; or
>
> (5) the program, code or device merely prevents use of the information in a manner inconsistent with a licensor's right under copyright or patent law not granted by law or by contract to the licensee, but does not destroy or alter the information. . . .[114]

The Reporter's Notes give the following illustrations of permissible electronic regulation: (i) the licensor uses an electronic device to turn off the software at the end of the license term, which is valid if either the contract authorized that action or the licensor or the device itself gave reasonable advance notice to the licensee; (ii) a limiting device that denies access to the sixth user attempting to access a product licensed for five simultaneous users, which is valid without prior notice or an authorizing provision in the contract; and (iii) an anti-copying device that merely prevents unauthorized copies, which is also valid without a contractual authorization.[115] The devices in the latter two examples would not, however, be authorized under this provision *if they disabled the system* when the unauthorized act occurred (*i.e.*, the attempted unauthorized copying or the attempted access by a nonpermitted user).[116] It is also important to note that such devices cannot be used *under the authority of this provision of Article 2B* if the licensor is canceling for breach.[117] For example, although the contract might authorize the licensor to shut-off the software at the expiration of the license term, the licensor could not necessarily use that authority to shut-off the software in the event the licensee was late with a payment. Use of electronics to exercise self-help in the event of a breach is regulated in detail in the Draft's provisions on licensor remedies.[118]

ACCEPTANCE

Commercial software license transactions commonly include provisions on acceptance testing that give the licensee the right to verify the performance of the product and, frequently, the right to withhold payment (or at least a portion thereof) until acceptance has occurred. In the absence of contractual provisions to the contrary, proposed Arti-

114. U.C.C. § 2B-314(a) (Proposed Jan. 20, 1997 Draft) [Note: section revised in proposed May 5, 1997 Draft].

115. U.C.C. § 2B-314 reporter's notes 3 and 4 (Proposed Jan. 20, 1997 Draft).

116. *Id.*

117. U.C.C. § 2B-314 reporter's note 1 (Proposed Jan. 20, 1997 Draft).

118. *See infra* notes 193-95 and accompanying text.

cle 2B will establish a set of rules for the parties pertaining to the tender of performance and acceptance:

> —Acceptance will be considered to have occurred when the receiving party (*e.g.*, the licensee receiving the software product):
>
> (1) substantially obtains the value or access expected from the performance and, without objecting, retains the value or utilizes the access beyond a reasonable time to refuse the performance;
>
> (2) signifies or acts with respect to the information in a manner that signifies to the other party that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;
>
> (3) fails effectively to refuse performance under the terms of the contract or Section 2B-610;
>
> (4) acts in a manner that makes compliance with the licensee's duties on refusal impossible because of commingling; or
>
> [(5) receives a substantial benefit or knowledge of valuable informational content from the performance and the benefit or knowledge cannot be returned.][119]
>
> Except in cases subject to (4) and (5) above, if performance involves the delivery of a copy (as is usually the case in commercial software license transactions), the recipient of that performance is entitled to a reasonable opportunity to inspect.[120] Licensees will nonetheless want to keep in mind that failure to act can constitute acceptance. This will not necessarily preclude the licensee from recovering for a breach of contract but will preclude the licensee from exercising a right of return which might be available otherwise.[121] Subsections (a)(4) and (a)(5) should also serve as warnings to

119. U.C.C. § 2B-612(a) (Proposed Jan. 20, 1997 Draft).

120. U.C.C. §§ 2B-609(a) & 2B-612(b) (Proposed Jan. 20, 1997 Draft).

121. U.C.C. § 2B-610(c) (Proposed Jan. 20, 1997 Draft); U.C.C. § 2B-612 reporter's note 4 (Proposed Jan. 20, 1997 Draft) ("Acceptance does not waive a right to recover for deficiencies in the performance."). *See* Triad Systems Corp. v. Alsip, 880 F.2d 247, 249-50 (10th Cir. 1989); St Louis Home Insulators v. Burroughs Corp., 793 F.2d 954, 955-56 (8th Cir. 1986); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573, 576-77 (8th Cir. 1982); Eaton Corp. v. Magnovox Co., 581 F. Supp. 1514, 1530-32 (E.D. Mich. 1984); Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351, 1357-58 (D.N.J. 1992); Money Mortgage & Inv. Corp. v. CPT of South Fla., Inc., 537 So. 2d 1015, 1016 (Fla. Dist. Ct. App. 1988); Softa Group v. Scarsdale Dev., 632 N.E.2d 13, 15-16 (Ill. App. Ct. 1993); National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785, 787 (Mich. Ct. App. 1975); David Cooper, Inc. v. Contemporary Computer Sys., Inc., 846 S.W.2d 777, 779-80 (Mo. Ct. App. 1993); Dreier Co., Inc. v. Unitronix Corp., 527 A.2d 875, 879-80 (N.J. Super. Ct. App. Div. 1986); Highland Rim Constructors v. Atlantic Software Corp., No. 01-A-01-9104-CV-00147, 1992 Tenn. App. LEXIS 675, *7-12 (Tenn. Ct. App. 1992); Integrated Title Data Sys. v. Dulaney, 800 S.W.2d 336, 339-41 (Tex. App. 1990); Aubrey's R.V. Ctr., Inc. v. Tandy Corp., 731 P.2d 1124, 1127-30 (Wash. Ct. App. 1987).

licensees that in certain situations Article 2B's gap-filling rules will not provide an opportunity to withhold acceptance (this may be of special interest in light of the Reporter's Notes which state that "[c]ommingling does not refer only to placing the information into a common mass from which they are indistinguishable; it also includes cases in which software is integrated into a complex system in a way that renders removal and return impossible or where they are integrated into a database *or knowledge base* that they cannot be separated from)."[122] The licensee's solution for the foregoing concerns is to negotiate acceptance test procedures and spell out the consequences of failure of acceptance in the contract (*e.g.*, return and refund).

—The Draft's acceptance scheme also specifically provides that "[t]ender of performance that substantially conforms to the contract entitles the party to acceptance of that performance."[123] In other words, Article 2B is not proposed to follow the perfect tender rule of Article 2.[124]

—For situations where the performance is a transfer of rights, although the licensor is required to tender first, it is not required to complete performance until the licensee pays.[125] As noted above, if performance requires delivery of a copy, the licensee has a right to inspect before payment or acceptance.[126] If the parties have specified a place or method of, or a standard for inspection, that specification is presumed to be exclusive.[127] Although inspection is at the licensee's expense, if performance is rightfully refused, reasonable expenses may be recovered from the licensor.[128] Licensors may well want to contractually exclude such a recovery.

—Licensees relying on Article 2B gap-filling rules will also want to note that there are situations in which their right to inspect will be denied: (i) if the terms of the contract are inconsistent with an opportunity to inspect before making payment (which could easily be the case depending on when the contract calls for payment);[129] (ii) "[i]f inspection would provide the licensee substantially with the value of the information before payment"[130] (which would not necessarily be the

122. U.C.C. § 2B-612 reporter's note 2 (Proposed Jan. 20, 1997 Draft) (emphasis added).

123. U.C.C. § 2B-607(b) (Proposed Jan. 20, 1997 Draft).

124. *See* D.P. Technology Corp. v. Sherwood Tool, Inc., 751 F. Supp. 1038, 1039-41 (D. Conn. 1990).

125. U.C.C. § 2B-607(c) (Proposed Jan. 20, 1997 Draft).

126. U.C.C. § 2B-609(a) (Proposed Jan. 20, 1997 Draft).

127. U.C.C. § 2B-609(a)(3) (Proposed Jan. 20, 1997 Draft).

128. U.C.C. § 2B-609(a)(2) (Proposed Jan. 20, 1997 Draft).

129. U.C.C. § 2B-609(b) (Proposed Jan. 20, 1997 Draft).

130. U.C.C. § 2B-609(a)[(5)] (Proposed Jan. 20, 1997 Draft).

case in many straight software license transactions, but could easily be the case in certain transactions where a data base or other information content is the crux of the transaction); or (iii) unless the licensor otherwise agrees, if the manner of the inspection would disclose or jeopardize information the licensor has designated as trade secret or confidential[131] (which would seem to be the case very often since software if frequently designated as trade secret or confidential information).

—If a tendered performance constitutes a material breach of contract, the Draft then provides rules as to the receiving party's rights and that party's duties following refusal.[132]

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131. U.C.C. § 2B-609(a)(4) (Proposed Jan. 20, 1997 Draft). *See* U.C.C. § 2B-609 reporter's note 2 (Proposed Jan. 20, 1997 Draft) (stating:

> Absent contrary agreement, inspection prior to payment is not appropriate if the type of inspection involved would reveal designated trade secrets or confidential information. This does not bar any inspection, but merely indicates that a right to see trade secret information cannot be presumed. Also, the balance here is limited to situations where the licensor designates information as confidential or a trade secret.

132. U.C.C. § 2B-610 (Proposed Jan. 20, 1997 Draft) provides, in part:

> (a) Subject to subsection (b), if a tender of performance, or the tendering party's previous performance, constitutes a material breach of contract, as to the particular tendered performance, the party to which it is tendered may:
> (1) refuse the entire performance;
> (2) accept the entire performance;
> (3) accept any commercially reasonable units and refuse the rest; or
> (4) permit an opportunity to cure the nonconformity.
>
> . . . .
>
> (c) Refusal is ineffective unless (i) made within a reasonable time after the tender and the completion of any permitted effort to cure, (ii) before acceptance, and (iii) the party whose performance is refused is notified within a reasonable time after the breach was or should have been discovered.

U.C.C. § 2B-611 (Proposed Jan. 20, 1997 Draft) provides:

> (a) After refusal or revocation, any use or exercise of rights by a licensee with respect to the information or copies involved in the performance, or any disclosure of a trade secret or confidential information of the other party inconsistent with the agreement, constitutes a breach of contract, except that use or exercise of rights for a limited time solely to avoid or mitigate loss is not prohibited if not inconsistent with the licensee's refusal of the performance.
> (b) A licensee that takes possession of copies or documentation or has made additional copies, shall return all copies and documentation to the licensor or hold them with reasonable care for disposal at the licensor's instructions for a reasonable time. In this case, the following additional rules apply:
> (1) If the licensee elects to hold the documentation or copies for the licensor's disposal, the licensee shall follow any reasonable instructions received from the licensor. However, instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.
> (2) If the licensor does not give instructions within a reasonable time after being notified of refusal, the licensee may in a reasonable manner to avoid or mitigate loss store the documentation and copies for the licensor's account or ship them to the licensor with a right of reimbursement for reasonable costs of storage, shipment, and handling.
> (c) A licensee has no further obligations with regard to information or related copies and documentation refused, but both parties remain bound by any

Rules on revocation of acceptance are also provided.[133]

BREACH OF CONTRACT

The Draft and the Reporter's Notes give special attention to the concept of breach versus material breach of contract.[134] Two major themes are: (i) that different remedies flow from ordinary or insubstantial breaches than do from material breaches; and (ii) providing some guidance on what constitutes a material breach. Although these distinctions are frequently recognized and operate as underlying concepts in most commercial licenses, it may be fair to say that the parties to those licenses are not as frequently successful in explicitly defining and addressing the distinctions. Licenses used in current practice often use the term "material breach" without express definition (and when clients inquire about the definition of that term, they seem curiously dissatisfied with answers that boil down to 'a material breach is any breach other than an immaterial breach').

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obligations of nondisclosure or confidentiality and any limitations or restrictions on use which would have been enforceable had the performance not been refused.

(d) In complying with this section, a licensee is held only to good faith and a standard of care that is reasonable in the circumstances. Conduct in good faith under this section does not constitute acceptance or conversion and is not the basis for an action for damages or equitable relief. [NOTE: section revised in proposed May 5, 1997 Draft].

133. U.C.C. § 2B-613 (Proposed Jan. 20, 1997 Draft) provides:

(a) Subject to subsections (b) and (c), a licensee may revoke acceptance of a commercial unit that is part of a performance by the licensor if the nonconformity of the commercial unit is a material breach of the contract and the party accepted the performance:

(1) on the reasonable assumption that the breach would be cured and it has not been seasonably cured;

(2) during a period of continuing efforts at adjustment and cure and the breach has not been seasonably cured; or

(3) without discovery of the breach and the acceptance was reasonably induced by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party sends notice of it to the other party and is barred if:

(1) the revocation does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) the revocation does not occur before any substantial change in condition or identifiability of the information not caused by the breach; or

(3) the party attempting to revoke acceptance received a substantial benefit to it or knowledge of valuable informational content from the performance or access and the benefit or knowledge cannot be returned.

(c) A party that justifiably revokes acceptance:

(1) has the same duties and is under the same restrictions with regard to the information and any documentation or copies as if the party had refused the performance; and

(2) is not obligated to pay the contract price for the performance as to which revocation occurred.

134. U.C.C. § 2B-108 reporter's notes (Proposed Jan. 20, 1997 Draft).

Breach of contract occurs if a party fails to perform an obligation timely or exceeds a contractual limitation, as determined by the terms of the agreement and by Article 2B.[135] The Draft's approach begins with the straightforward recognition that a breach is material "if the contract so provides."[136] If the contract fails to provide a definition, the Draft would define a breach as material:

> (b) . . . if the circumstances, including the language of the agreement, expectations of the parties, reasonable expectations of ordinary parties in a similar contractual arrangement, and character of the breach, indicate that the breach caused or may cause substantial harm to the interests of the aggrieved party including imposing costs that significantly exceed the contract value, the injured party will be substantially deprived of the benefit it reasonably expected under the contract, or the breach meets the conditions of subsection (c) or (d).
>
> (c) A breach of contract is material if it involves:
>
> (1) an uncured failure to perform in conformance with and substantially in the time required by express performance standards or specifications;
>
> (2) wrongful disclosure or use of confidential information of an aggrieved party not authorized by the license;
>
> (3) knowing infringement of an aggrieved party's intellectual property rights not authorized by the license and occurring over more than a brief period;
>
> (4) an uncured [substantial] failure to pay a license fee when due which is not justified by a bona fide dispute about whether payment is due; or
>
> (5) a failure of performance under a contract term that requires performance to be to the subjective satisfaction of the party receiving that performance.
>
> (d) A material breach of contract occurs if the cumulative effect of nonmaterial breaches by the same party satisfies the standards for materiality.[137]

The Reporter's Notes indicate that both the factors in subsection (b) and the listing of specific occurrences in subsection (c) are intended to be nonexclusive.[138] One interesting example of the effect of subsection (c)(1) is discussed in an illustration in the Reporter's Notes:

> What constitutes an express performance standard varies depending on the nature of the agreement, but the concept clearly includes situations in which the licensee or the licen-

135. U.C.C. § 2B-108(a) (Proposed Jan. 20, 1997 Draft).
136. U.C.C. § 2B-108(b) (Proposed Jan. 20, 1997 Draft).
137. U.C.C. § 2B-108(b) - (d) (Proposed Jan. 20, 1997 Draft) [NOTE: section revised and subsection (c)'s listing of what is "material" deleted in proposed May 5, 1997 Draft].
138. U.C.C. § 2B-108 reporter's notes 3 & 7 (Proposed Jan. 20, 1997 Draft).

> sor propose and the parties agree to detailed specifications of performance for the completed product.
>
> Illustration 1. The licensee provides specifications that the parties accept as part of the contract for development of a new word processing program. The standards require a dictionary with no less than 5 million words. The actual dictionary has 4.99 million. The developer fails to meet the standard within the agreed period of time. The failure to meet the express standards constitutes a breach which, under the current draft of subsection (c)(1) is by definition material regardless of whether it pertains to actual needs of the licensee. The licensee need make no payments for any of the work and can simply refuse the product.[139]

If this is indeed the approach taken by the final version of the proposed Article 2B, licensors may wish to take a very close look at the specifications that they permit to be incorporated into the agreement. Parties to commercial licenses should also be interested in how the final version of the Draft addresses time delays. The Reporter's Notes ask the question of how a breach should be treated if, for example, in the above illustration the software meets all specifications but is delivered one day late. The Restatement's approach to this issue is then provided for reference by the Reporter's Notes:

> (c) the extent to which the agreement provides for performance without delay, but a material failure to perform . . . on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.
>
> This provision is designed to deal with boilerplate "time is of the essence" clauses that are not related to the realities of the deal but might be used to justify a forfeiture even where the day late has no consequence. Restatement (Second) of Contracts 242, comment d.[140]

The distinction between breach and material breach is critical to the remedies allotted by proposed Article 2B as discussed further below. As indicated in the Reporter's Notes, the distinction is not intended to insulate either party from liability for ordinary breaches:

> *The concept of materiality does not affect whether a party has a remedy, but merely what remedies are available.* A breach of contract entitles the injured party to remedies as provided in this article or in the contract. What remedies are available, however, depends on whether the breach is material or nonmaterial. The material breach concept rests on the com-

139. U.C.C. § 2B-108 reporter's note 8 (Proposed Jan. 20, 1997 Draft).
140. *Id.*

> mon law belief that it is better to preserve a contract relationship in the face of minor performance problems and the related belief that allowing one party to cancel the contract for minor defects may cause unwarranted forfeiture and unfair opportunism. Materiality relates to the injured party's perspective and to the value that it expected from performance. Faced with only a nonmaterial breach, the injured party can recover for damages that arise in the ordinary course as a consequence of the breach, but cannot cancel the contract or reject the tender of rights unless the contract expressly permits that remedy. Faced with a material breach, a wider panoply of remedies is available to the injured party, including the right to cancel the contract.[141]

Parties to a license agreement (and particularly licensees) will want to consider the extent to which their license agreement preserves this distinction, not just as a matter of definition, but also in terms of retaining a remedy for ordinary breaches. The prevalence of contractual "sole and exclusive" remedies provisions (which are often keyed to material breaches) may sometimes have the effect of purporting to only provide remedies for material breaches.

Before discussing the remedies afforded by proposed Article 2B, it bears noting that the Draft does include gap-filling rules on performance that, in the absence of relevant contractual provisions, will be relevant to the performances required of the parties. Generally, a party is required to perform in a manner that conforms to the contract.[142] In the absence of such terms in the contract, the party is to perform "in a manner and with a quality that is reasonable in light of the circumstances including the ordinary standards of the relevant trade."[143] That duty to perform is contingent on there being no uncured *material* breach by the other party.[144] If a party breaches its obligations, the other party may suspend its performance and demand assurance of future performance or exercise its rights on breach under Article 2B or the agreement.[145] If, however, a party is subject to "contractual use restrictions" or has other future or ongoing performance obligations, that party cannot exercise its rights if it is in uncured *material* breach of its obligations.[146] To the extent that a party's obligations include contractual use restrictions, those obligations are not contingent on the other party's performance and may not be sus-

141. U.C.C. § 2B-108 reporter's note 6 (Proposed Jan. 20, 1997 Draft).
142. U.C.C. § 2B-601(a) (Proposed Jan. 20, 1997 Draft).
143. *Id.*
144. U.C.C. § 2B-601(b) (Proposed Jan. 20, 1997 Draft).
145. U.C.C. § 2B-601(e) (Proposed Jan. 20, 1997 Draft).
146. U.C.C. § 2B-601(d) (Proposed Jan. 20, 1997 Draft).

pended for breach by the other party.[147] Contractual use restrictions include "obligations of nondisclosure and confidentiality and limitations on scope, manner, method, or location of use to the extent that those obligations or duties are created by the contract."[148]

If a party has breached its duties, proposed Article 2B would permit that party to cure the breach if it: "(1) without undue delay notifies the other party of its intent to cure; and (2) effects cure promptly and before cancellation or refusal of a performance by the other party."[149] This is not the equivalent of the right to cure often found in many negotiated commercial licenses. As stated in the Reporter's Notes: "[t]his Section allows cure if it is prompt, but does not create a right to cure. The cure is subject to prior cancellation or refusal by the other party. This places control in the aggrieved party who has suffered a material breach by the other person."[150] Additional provisions are provided for waiver of rights arising out of breach,[151] right to adequate assurance of performance,[152] and anticipatory repudiation.[153]

147. U.C.C. §§ 2B-601(b) & (e)(1) (Proposed Jan. 20, 1997 Draft).

148. U.C.C. § 2B-601(f) (Proposed Jan. 20, 1997 Draft).

149. U.C.C. § 2B-619(a) (Proposed Jan. 20, 1997 Draft).

150. U.C.C. § 2B-619 reporter's note 5 (Proposed Jan. 20, 1997 Draft).

151. U.C.C. § 2B-620 (Proposed Jan. 20, 1997 Draft) provides:

> (a) Any claim or right arising out of an alleged breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record authenticated by the party making the waiver.
>
> (b) A party that accepts a performance, knowing or with reason to know that the performance constitutes a breach of contract:
>
> (1) waives its right to revoke acceptance or cancel because of the breach, unless the acceptance was on the reasonable assumption that the breach would be seasonably cured, but acceptance does not in itself preclude any other remedy provided by this article; and
>
> (2) waives any remedy for the breach if the party fails within a reasonable time to object to the breach.
>
> (c) Except with respect to a failure of a performance to meet a contractual requirement that it be to the subjective satisfaction of a party, a party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on the unstated defect to justify refusal or to establish breach only if:
>
> (1) the other party could have cured the defect if stated seasonably and the other party was not aware of the defect; or
>
> (2) between merchants, the other party after refusal of a performance has made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.
>
> (d) A waiver may not be revoked as to the performance to which the waiver applies. However, waiver of breach in one performance does not waive the same or similar breach in future performances of like kind unless the party making the waiver expressly so states. Other than a waiver pursuant to subsection (a) and a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance is required in the future of any term waived unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

152. U.C.C. § 2B-621 (Proposed Jan. 20, 1997 Draft) provides:

REMEDIES AND DAMAGES GENERALLY

Generally, the Draft's rules on remedies: (i) are intended to place the aggrieved party "in as good a position as if the other party had fully performed"[154] and allow a court to limit remedies (except liquidated damages) if the aggrieved party would be put in a *substantially* better position than if the other party had fully performed;[155] (ii) require mitigation by the aggrieved party;[156] and (iii) are cumulative, but not intended to allow more than one recovery for the same injury.[157] More specifically, but except as limited by contract, an aggrieved party is entitled to the recovery of direct damages incurred in the ordinary course as measured in any reasonable manner, plus incidental and consequential damages, less expenses avoided as a result of the breach (consequential damages are not, however, recoverable in the case of published informational content unless expressly provided in the agreement).[158] These damages may include unpaid fees and recovery of down payments in appropriate circumstances.[159] If the breach involves disclosure or misuse of confidential or trade secret information, damages may include compensation for the benefit received by the breaching party in addition to remedies under other law, unless otherwise provided in the agreement.[160] Significantly, the Draft provides definitions for each of the three preceding general categories of damages:

> "Direct [general] damages" means compensation for losses of a party consisting of the difference between the value of the expected performance and the value of the performance re-

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(a) A contract imposes on a party an obligation not to impair another party's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, in a record the other may demand adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance for which the agreed return performance has not already been received.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of the assurance offered is determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand, failure to provide within a reasonable time, not exceeding 30 days, assurance of due performance that is adequate under the circumstances of the particular case is a repudiation of the contract.

153. U.C.C. §§ 2B-622 & 2B-623 (Proposed Jan. 20, 1997 Draft).

154. U.C.C. § 2B-701(a) (Proposed Jan. 20, 1997 Draft).

155. U.C.C. § 2B-701(d) (Proposed Jan. 20, 1997 Draft).

156. U.C.C. § 2B-701(b) (Proposed Jan. 20, 1997 Draft) [NOTE: mitigation rule moved to § 2B-707(c) in proposed May 5, 1997 Draft].

157. U.C.C. § 2B-701(c) (Proposed Jan. 20, 1997 Draft).

158. U.C.C. §§ 2B-701(g) & 2B-701(e) (Proposed Jan. 20, 1997 Draft) [NOTE: general damages rule moved to § 2B-707(a) in proposed May 5, 1997 Draft].

159. U.C.C. § 2B-701(g) (Proposed Jan. 20, 1997 Draft).

160. U.C.C. § 2B-701(h) (Proposed Jan. 20, 1997 Draft).

ceived. The term does not include compensation for losses resulting from the aggrieved party's inability to use the results of the expected performance in a commercial or other context, consequential damages, or incidental damages.[161]

"Incidental damages":

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

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

(ii) stopping shipment;

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

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

(v) actions otherwise incidental to the breach;

(B) but do not include consequential or [direct] [general] damages.[162]

"Consequential damages" means compensation for losses of a party resulting from its general or particular requirements and needs which, at the time of contracting, the other party had reason to know would probably result from a breach of contract and which are not unreasonably disproportionate to the risk assumed by the party in breach under the contract and could not have been prevented by the aggrieved party by reasonable measures after breach. The term includes compensation for losses . . . [resulting from] injury to person or property proximately resulting from breach of warranty. The term does not include direct or incidental damages.[163]

The Reporter's Notes indicate that the Draft's damages provisions have been the subject of a good deal of analysis, debate and revision in the course of the Drafting Committee's work.[164] Further material revision of these provisions, and in particular rules on consequential damages and damages for violation of contractual use restrictions appears likely.[165]

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161. U.C.C. § 2B-102(a)(11) (Proposed Jan. 20, 1997 Draft).

162. U.C.C. § 2B-102(a)(17) (Proposed Jan. 20, 1997 Draft).

163. U.C.C. § 2B-102(a)(5) (Proposed Jan. 20, 1997 Draft).

164. *See* U.C.C. §§ 2B-102 & 2B-701 reporter's notes (Proposed Jan. 20, 1997 Draft).

165. *See* RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546-47 (9th Cir. 1985); Colonial Life Ins. Co. of Am. v. Electronic Data Sys. Corp., 817 F. Supp. 235, 239-43 (D.N.H. 1993); Midland Management Corp. v. Computer Consoles, Inc., No. 87-C-971, 1992 U.S. Dist. LEXIS 6651, *14-17 (N.D. Ill. 1992); Harper Tax Servs., Inc. v. Quick Tax Ltd., 686 F. Supp. 109 (D. Md. 1988); Hi Neighbor Enters., Inc. v. Burroughs Corp., 492 F. Supp. 823, 826-27 (N.D. Fla. 1980); McCrimmon v. Tandy Corp., 414 S.E.2d 15, 18-19 (Ga. Ct. App. 1991); Metropolitan Life Ins. Co. v. Noble Lowndes Int'l, Inc., 600 N.Y.S.2d 212, 215-16 (N.Y. App. Div. 1993), *aff'd*, 643 N.E.2d 504 (N.Y. 1994); International Talent Group, Inc. v. Copyright Management, Inc., 769 S.W.2d 217 (Tenn. Ct. App. 1988).

In addition to damages, the Draft permits a party to cancel the contract if the other's conduct constitutes an uncured *material* breach or if the contract otherwise so provides.[166] The Draft's use of the term cancel or cancellation (defined as "an act by either party which ends a contract because of a breach by the other party") is somewhat at odds with the terminology used in current licensing practice.[167] Generally, commercial licenses use "terminate" or "termination" to refer to ending an agreement due to default. Under the Draft's terminology, "termination" means "an act by a party pursuant to a power created by agreement or law which ends a contract *for a reason other than for breach* by the other party."[168] Terminology aside: (i) all executory obligations are discharged on cancellation, except specified obligations which survive termination and certain obligations imposed on a party in possession of information, material or copies;[169] (ii) cancellation is not effective until the canceling party notifies the other;[170] (iii) a contractual term precluding cancellation of a licensee's rights is enforceable, but does not necessarily preclude other rights and remedies;[171] and (iv) language of cancellation "is not a renunciation or discharge of any claim" for damages for antecedent breaches, unless a contrary intention clearly appears.[172]

In addition to damages and cancellation, the Draft proposes that either party may be able to seek:

> —Specific performance, if the agreement expressly provides therefor and specific performance is possible, or "the agreed performance was unique and monetary compensation would be inadequate."[173] Specific performance would not be available for personal services contracts or for an obligation to pay a fee for information or services already received.[174]
>
> —Liquidated damages, if "in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach."[175] Provisions for "unreasonably large" liq-

166. U.C.C. § 2B-703(a) (Proposed Jan. 20, 1997 Draft) [NOTE: cancellation remedy moved to § 2B-702 in proposed May 5, 1997 Draft].

167. U.C.C. § 2B-102(a)(3) (Proposed Jan. 20, 1997 Draft). *See* U.C.C. § 2B-703 reporter's note 1 (Proposed Jan. 20, 1997 Draft).

168. U.C.C. § 2B-102(a)(38) (Proposed Jan. 20, 1997 Draft) (emphasis added).

169. U.C.C. § 2B-703(c) & (d) (Proposed Jan. 20, 1997 Draft) [NOTE: cancellation moved to § 2B-702 in proposed May 5, 1997 Draft].

170. U.C.C. § 2B-703(b) (Proposed Jan. 20, 1997 Draft).

171. U.C.C. § 2B-703(e) (Proposed Jan. 20, 1997 Draft).

172. U.C.C. § 2B-703(f) (Proposed Jan. 20, 1997 Draft).

173. U.C.C. § 2B-704(a) (Proposed Jan. 20, 1997 Draft) [NOTE: specific performance moved to § 2B-711 in proposed May 5, 1997 Draft].

174. *Id.*

175. U.C.C. § 2B-706(a) (Proposed Jan. 20, 1997 Draft) [NOTE: liquidated damages moved to § 2B-704 in proposed May 5, 1997 Draft].

uidated damages are unenforceable.[176]

In a section that will undoubtedly be close to the heart of licensors' counsel (although licensees are increasingly pressing for limitation of liability provisions as well), the Draft recognizes the enforceability of provisions limiting damages and remedies "such as by precluding the licensor's right to cancel or limiting the remedies to return of all copies of the information and refund of the license fee, or repair and replacement of copies of the information by the licensor."[177] Consequential and incidental damages are specifically permitted to be excluded or limited, unless the exclusion or limitation is unconscionable.[178] If remedies in the contract are specified as exclusive, resort to other remedies is precluded (although the Reporter's Notes state: this "must be interpreted in this context as not being exclusive as to all 'rights' of a party, such as the right to prohibit use or copying, or disclosure.").[179] "Failure or unconscionability of an agreed remedy" will not invalidate separate terms limiting consequential and incidental damages, unless the contract expressly makes those terms subject to performance of the agreed remedy.[180] Subject to the preceding, failure of an agreed remedy may give the aggrieved party a right to specific performance of that remedy or other remedies under Article 2B.[181]

LICENSOR REMEDIES

The Draft proposes three basic remedies specifically for the benefit of licensors: (i) damages;[182] (ii) the right to complete[183] (principally

176. *Id.*

177. U.C.C. § 2B-705(a) (Proposed Jan. 20, 1997 Draft). This section also provides that the parties may "add to" these provisions. Thus, for example, the licensee that desires a clear refund right in certain circumstances may want to expressly address that remedy in the agreement. If possible, the licensee would want to avoid characterization of any such added remedy as "exclusive." [NOTE: modification of remedies moved to § 2B-703 in proposed May 5, 1997 Draft]

178. U.C.C. § 2B-705(d) (Proposed Jan. 20, 1997 Draft).

179. U.C.C. § 2B-705(b) & reporter's note 3a (Proposed Jan. 20, 1997 Draft).

180. U.C.C. § 2B-705(c) (Proposed Jan. 20, 1997 Draft).

181. U.C.C. § 2B-705(b) (Proposed Jan. 20, 1997 Draft).

182. U.C.C. § 2B-708 (Proposed Jan. 20, 1997 Draft). *See* Harris Market Research v. Marshall Mktg. & Communications, Inc., 948 F.2d 1518, 1524-25 (10th Cir. 1991); Deltak, Inc. v. Advanced Sys., Inc., 767 F.2d 357, 361-63 (7th Cir. 1985); Data Gen. Corp. v. Grumman Sys. Support Corp., 825 F. Supp. 340, 349-51 (D. Mass. 1993), *remanded in part*, 36 F.3d 1147 (1st Cir. 1994); Trandes Corp. v. Guy F. Atkinson Co., 798 F. Supp. 284, 288-90 (D. Md. 1992), *aff'd & rev'd in part*, 996 F.2d 655, 666-67 (4th Cir. 1993); Engineering Dynamics, Inc. v. Structural Software, Inc., 785 F. Supp. 576, 583 (E.D. La. 1991), *aff'd & rev'd in part*, 26 F.3d 1335 (5th Cir. 1994), opinion supp. by 46 F.3d 408 (5th Cir. 1995); Darell Ross & Renters Info-CK, Inc. v. D&M Consulting, Inc., No. CA94-993, 1995 Ark. App. LEXIS 474, *1-3 (Ark. Ct. App. 1995); Management Computer Servs., Inc. v. Hawkins, Ash, Baptie & Co., 539 N.W.2d 111, 124-25 (Wis. Ct. App. 1995), *aff'd & rev'd in part*, 557 N.W.2d 67 (Wis. 1996).

relevant to development contracts); and (iii) the right to possession and discontinue performance, either through judicial process, or in certain cases, through the exercise of self-help.[184] In the event of material breach by the licensee, the Draft proposes that the licensor be entitled to recover damages (either for the particular breach, or in appropriate cases, for the entire contract) which are the sum of:

> (1) as [direct] [general] damages, accrued and unpaid license fees for any performance for which the licensor has not been paid, plus:
>
> (A) the present value of the total unaccrued license fees for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;
>
> . . . ; or
>
> (C) damages calculated pursuant to Section 2B-702; and
>
> (2) the present value of any consequential and incidental damages, as permitted under this article and the agreement, determined as of the date of entry of the judgment.[185]

As the Reporter's Notes indicate, the licensor may have other avenues of recovery, such as intellectual property law if the licensee's conduct is a violation of the licensor's intellectual property rights, either because the licensee has exceeded the license, or the license has been canceled due to the licensee's default.[186]

If a breach has occurred which is material as to the entire contract, the licensor is given the right to: (i) "take possession of any copies of the licensed information" (and any other materials that were to be returned by the licensee under the contract); and (ii) "prevent the licensee's continued exercise of rights" therein.[187] This remedy is not available if, before the breach "and in the ordinary course of perform-

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183. U.C.C. § 2B-709 (Proposed Jan. 20, 1997 Draft) [NOTE: right to complete moved to § 2B-712 in proposed May 5, 1997 Draft].

184. U.C.C. §§ 2B-710 & 2B-711 (Proposed Jan. 20, 1997 Draft) [NOTE: right to possession and prevent use moved to § 2B-715 and licensor self-help moved to § 2B-716 in proposed May 5, 1997 Draft].

185. U.C.C. § 2B-708(a) (Proposed Jan. 20, 1997 Draft) [NOTE: the cross-reference in (C) is now to § 2B-707 in the proposed May 5, 1997 Draft]. Subsection (b) sets out the applicable date for determining present value:

> The date for determining present value of unaccrued license fees and date for determining the sum of accrued license fees under subsection (a) is:
>
> (1) if the licensee never received a transfer of rights, the date of the breach of contract;
>
> (2) if the licensor cancels and discontinues the right to possession or use, the date the licensee no longer had the actual ability to use the information; or
>
> (3) if the licensee's rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.

U.C.C. § 2B-708(b) (Proposed Jan. 20, 1997 Draft).

186. U.C.C. § 2B-708 reporter's note 11 (Proposed Jan. 20, 1997 Draft).

187. U.C.C. § 2B-710(a) (Proposed Jan. 20, 1997 Draft) [NOTE: § 2B-715 in the proposed May 5, 1997 Draft].

ance under the license," the licensed information was altered or commingled so as to be no longer reasonably identifiable and "the remedy cannot be administered without undue harm" to the licensee's (or another person's) property or information.[188] The licensor may exercise these rights without judicial process only if it complies with the separate rules on self-help.[189]

Licensor self-help is subject to a variety of constraints. Self-help is permitted only in the case of breaches that are material as to the entire contract, *without regard to contractual definitions of material breach*.[190] The licensor must be able to act without a breach of the peace, forseeable risk of personal injury, or significant damage to or destruction of the licensee's property or information.[191] The limitations on self-help and the licensee's remedies may not be waived by the licensee prior to breach.[192]

If the licensor wishes to go one step further than self-help and employ electronic self-help measures, additional restrictions apply. A licensor is prohibited from including in the subject matter of a license the means to enforce its self-help rights unless the licensee "manifests assent to a term of the license" permitting the same.[193] Manifesting assent to a term requires more than simple inclusion of the term in the license; the conduct manifesting assent must relate specifically to that term.[194] A licensor may, for example, wish to have the term specifically initialed. The licensor's improper use of the means to prevent further use of information may subject it to a damages claim by the licensee.[195]

LICENSEE REMEDIES

The licensee remedy provisions of the Draft address four issues:

188. U.C.C. § 2B-710(c) (Proposed Jan. 20, 1997 Draft).
189. U.C.C. § 2B-710(a) (Proposed Jan. 20, 1997 Draft).
190. U.C.C. § 2B-711(a) (Proposed Jan. 20, 1997 Draft) (emphasis supplied) [NOTE: § 2B-716 in the proposed May 5, 1997 Draft].
191. *Id.*
192. U.C.C. § 2B-711(b) (Proposed Jan. 20, 1997 Draft).
193. U.C.C. § 2B-711(c) (Proposed Jan. 20, 1997 Draft) [NOTE: proposed May 5, 1997 Draft adds bracketed alternative that may permit this if provided in a "conspicuous term" of the contract].
194. U.C.C. § 2B-112(c) (Proposed Jan. 20, 1997 Draft).
195. U.C.C. § 2B-711(c)(2) (Proposed Jan. 20, 1997 Draft). *See* Esther C. Roditti, *Is Self-Help a Lawful Contractual Remedy?*, 21 RUTGERS COMPUTER & TECH. L.J. 431 (1995); Synergistic Techn., Inc. v. IDB Mobile Communications, Inc., 871 F. Supp. 24, 31-34 (D.D.C. 1994); American Comp. Trust Leasing v. Jack Farrell Implement Co., 763 F. Supp. 1473, 1488-91 (D. Minn. 1991), *aff'd & remanded sub nom.* American Comp. Trust Leasing v. Boerboom Int'l., INc., 967 F.2d 1208 (8th Cir. 1992); Franks & Sons, Inc. v. Information Solutions, Inc., No. 88-L-1474-E, 1988 U.S. Dist. LEXIS 19356, *1-4 (N.D. Okla. 1988); Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc., 549 N.Y.S.2d 789, 790-91 (N.Y. App. Div. 1990).

(i) damages;[196] (ii) the licensee's right of recoupment;[197] (iii) the licensee's right to continue use;[198] and (iv) "licensor's liability over" (dealing with notice and defense of actions in situations where an indemnity obligation may be present, and which has already been partially addressed above in connection with infringement claims).[199] In the event of material breach by the licensor, the Draft proposes that the licensee be entitled to recover damages (either for the particular breach, or in appropriate cases, for the entire contract) which are the sum of:

> (1) as [direct] [general] damages, payments made to the licensor for performance that has not been rendered, plus :
>
> (A) the present value, as of the date of breach, of the market value if any of any performance not provided minus the license fees for the performance, both of which must be calculated in the case of damages for the entire contract, for the remaining contractual term plus any extensions available as of right;
>
> (B) damages computed pursuant to Section 2B-701; or
>
> (C) if a licensee has accepted performance from the licensor and not revoked acceptance, the present value, at the time and place of performance, of the difference between the value of the performance accepted and the value of the performance had there been no defect, not to exceed the agreed price . . . ; and
>
> (2) the present value of incidental and consequential damages resulting from the breach as of the date of the entry of judgment.
>
> [The foregoing damages must be]
>
> (1) reduced by expenses avoided as a result of the breach; and
>
> (2) if further performance is not anticipated under the agreement, reduced by any unpaid license fees that relate to performance by the licensor which has been received by the

196. U.C.C. § 2B-712 (Proposed Jan. 20, 1997 Draft). *See* Rockport Pharmacy, Inc. v. Digital Simplistics, Inc., 53 F.3d 195, 198-99 (8th Cir. 1995); Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304, 1306-07 (3rd Cir. 1982); Western Geophysical Co. v. Bolt Assocs., Inc., 584 F.2d 1164, 1172-73 (2nd Cir. 1978); Accusystems, Inc. v. Honeywell Info. Sys., Inc., 580 F. Supp. 474, 483-84 (S.D.N.Y. 1984); VMark Software, Inc. v. EMC Corp., 642 N.E.2d 587, 590-93 (Mass. App. Ct. 1994); and Microsoft Corp. v. Manning, 914 S.W.2d 602, 609-12 (Tex. App. 1995).

197. U.C.C. § 2B-713 (Proposed Jan. 20, 1997 Draft).

198. U.C.C. § 2B-714 (Proposed Jan. 20, 1997 Draft) [NOTE: licensee right to continue use moved to § 2B-713 in proposed May 5, 1997 Draft].

199. U.C.C. § 2B-715 (Proposed Jan. 20, 1997 Draft) [NOTE: section revised and moved to § 2B-706 in proposed May 5, 1997 Draft]. *See supra* notes 73-74 and accompanying text.

licensee . . . .[200]

The other two specific licensee remedies provided for in the Draft are:

—If the licensor is in breach, the licensee may be permitted to deduct any damages resulting from the breach from any license fees still due to the licensor.[201] The licensee must notify the licensor of its intention to exercise this right of recoupment.[202] If the breach in question is nonmaterial, the right of recoupment may be exercised only if the agreement does not require further affirmative performance by the licensor and the amount of damages to be deducted can be readily liquidated under the terms of the agreement.[203]

—The licensee may opt to continue to exercise its rights under the contract (*e.g.*, continue to use the software). If the licensee does so: (i) it continues to be bound by all terms and conditions of the contract (including obligations to pay license fees); (ii) the licensee may pursue its other remedies; and (iii) the licensor's rights and remedies remain in effect.[204]

MISCELLANEOUS/BOILERPLATE PROVISIONS

The Draft addresses a number of other issues that are often dealt with in commercial software licenses. Some of those provisions are:

—The Draft would confirm the enforceability of choice of law provisions. If a choice of law provision was not present in a contract, Article 2B choice of law rules would provide the governing law.[205]

—Choice of forum provisions would be validated. A forum chosen would not be exclusive unless expressly so stated.[206]

—Article 2B would provide a list of obligations that survive contract termination: (1) rights and remedies based on breach of contract or performance; (2) limitations on the use, manner, method, or location of the exercise of rights in information; (3) confidentiality, nondisclosure, and noncompetition obligations; (4) obligations to return or dispose of information; (5) a choice of law or forum; (6) obligations to arbitrate or resolve contractual disputes through alternative

200. U.C.C. §§ 2B-712(a) & (b) (Proposed Jan. 20, 1997 Draft) [NOTE: licensee damages moved to § 2B-709 in proposed May 5, 1997 Draft; cross reference in (B) is now to § 2B-707].

201. U.C.C. § 2B-713(a) (Proposed 1997 Draft) [NOTE: recoupment moved to § 2B-710 and made mutual in proposed May 5, 1997 Draft].

202. *Id.*

203. U.C.C. § 2B-713(b) (Proposed Jan. 20, 1997 Draft).

204. U.C.C. § 2B-714 (Proposed Jan. 20, 1997 Draft) [NOTE: licensee right to continue use moved to § 2B-713 in proposed May 5, 1997 Draft].

205. U.C.C. § 2B-106(a) (Proposed Jan. 20, 1997 Draft).

206. U.C.C. § 2B-107 (Proposed Jan. 20, 1997 Draft).

dispute resolution procedures; (7) terms limiting the time for commencing action or for providing notice; (8) indemnities; and (9) other terms stated in the agreement as surviving.[207]
—The Draft permits agreements to limit the statute of limitations to not less than one year and not more than eight years.[208] The Draft also includes its own statute of limitations — "four years after the right of action accrues or one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued."[209]

CONCLUSION

Proposed Article 2B provides many useful answers to counsel in the area of commercial software licensing. Some key questions that licensor and licensee counsel will want to ask as they evaluate their licenses section-by-section are: (i) does Article 2B provide a gap-filling rule that needs to be varied by agreement (*e.g.*, that consequential damages are recoverable); (ii) are there provisions in the license that are unnecessary because a gap-filling rule satisfactorily addresses the issue (or is it still desirable to expressly deal with the issue in the license) (*e.g.*, the implied warranty of conformance to documentation); (iii) are any of the license's provisions impermissible attempts to vary a provision that cannot be varied by agreement; (iv) does Article 2B give a new impact to a license provision (*e.g.*, a license grant of specific uses being deemed to imply no other uses are permitted); and (v) are there any Article 2B rights or remedies that *must* be expressed in the agreement in order to be enforceable (*e.g.*, licensee assent to licensor's electronic self-help)? Article 2B will provide answers regardless of when these questions are asked. Its *usefulness*, however, will depend on counsel raising the right questions in advance.

207. U.C.C. § 2B-626(b) (Proposed Jan. 20, 1997 Draft) [NOTE: proposed May 5, 1997 Draft would add limitation of remedies and warranty disclaimers to this list].
208. U.C.C. § 2B-707(a) (Proposed Jan. 20, 1997 Draft) [NOTE: statute of limitations moved to § 2B-705 in proposed May 5, 1997 Draft].
209. *Id.*