

University of Dayton Law Review

Volume 22
Number 3 *Symposium: Copyright Owners'
Rights and Users' Privileges on the Internet*

Article 9

3-1-1997

Digital Information as Property and Product: U.C.C. Article 2b

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DIGITAL INFORMATION AS PROPERTY AND PRODUCT: U.C.C. ARTICLE 2B

Professor David A. Rice

TABLE OF CONTENTS

	PAGE
I. MARKET AND LEGAL BACKGROUND	623
A. <i>Early Use of License As Label</i>	623
B. <i>Transformation of the First Sale Doctrine</i>	626
C. <i>Draft Article 2B - Licenses</i>	627
II. PROPERTY AND CONTRACT UNDER ARTICLE 2B	628
A. <i>So Far, Some Good: Distinguishing Between Property and Contract</i>	628
B. <i>So Far, Some Bad: "License" Transforming Copyright First Sale Doctrine to Expand Downstream Control over Copies</i>	630
C. <i>And Some Worse: Transformation of "License" from Form into Substance</i>	634
III. A SAMPLING OF CASES IN WHICH CONFUSION OF PROPERTY AND PRODUCT MAKES A DIFFERENCE	636
A. <i>Introduction to Supporting Cast: Enforceability of Standard Forms and Terms</i>	636
B. <i>Product Use Control to Enhance Property Protection</i>	636
C. <i>Illustration #1: Licensor Self-Help Remedy for Breach</i>	638
D. <i>Illustration #2: Nontransferability/Nonassignability</i>	638
1. <i>Basic Background</i>	638
2. <i>The Case of Sale of Business by Sale of Assets</i>	640
3. <i>The Case of Asset-Based Business Financing</i>	642
IV. ARTICLE 2B AND FEDERAL INTELLECTUAL PROPERTY LAW	643
A. <i>New Solution to "First Sale" Problem: If a "License" Is a Disguised Sale, Why Not Just Make a "Sale" a "License"?</i>	643
B. <i>Some Thoughts on Federal Preemption</i>	646
V. CONCLUDING COMMENTS	647

DIGITAL INFORMATION AS PROPERTY AND PRODUCT: U.C.C. ARTICLE 2B*

*Professor David A. Rice***

Contracts made on electronic networks pose issues that are being dealt with in numerous significant projects. Formation, interpretation, and enforceability of contracts made electronically are the subject of several Uniform Commercial Code drafting efforts, projects dealing with authentication and security, and various national and global law development initiatives. Already several states have stolen a march by enacting digital signature statutes.

One domestic project deals with contract law governing the transfer of rights in information, broadly defined, and the distribution of information products. The project's aim is to develop a body of uniform state contract law that responds to the state of legal uncertainty about what body of contract law *does* apply in transactions for the transfer of rights in, or products that embody, computer programs and other digital information. The rules of what will become Article 2B of the Uniform Commercial Code will govern contract formation, construction, performance, and remedies for breach of software and information rights and products contracts irrespective of whether they are made in an electronic or non-electronic manner.

This presentation extends prior explorations of the confluence and conflation of property and contract in the law governing transfer of property rights in digital information and that governing the transfer of products that primarily embody digital information.¹ Substantively, I present and show the basis for two new and important points. I also identify a generally unnoticed Article 2B response to the Copyright Act first sale doctrine. First, I deal with how affixing the "license" label to information product contracts has led to a new stage of transforming the first sale doctrine from one that embodies the policy against restraints on alienation into one which, through creative lawyering around the text of § 109(a) of the Copyright Act, extends control of distributed copies and thereby expands the protection of copyright. Second, my presentation examines the fact and consequences of "license" being elevated

* Copyright © 1996, 1997, David A. Rice. This article was prepared for presentation as a paper at the University of Dayton School of Law Scholarly Symposium on *Copyright Owners' Rights and Users' Privileges on the Internet* (Nov. 1-2, 1996). Text and references have been revised and updated since the Symposium to reflect changes and developments in Draft Article 2B of the Uniform Commercial Code.

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1. For prior writings that deal directly with or bear upon this issue, see David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 JURIMETRICS J. 157 (1990) [hereinafter Rice, *Licensing*]; David A. Rice, *Public Goods, Private Contract and Public Policy: Federal Preemption of Software License Prohibitions Against Reverse Engineering*, 53 U. PITT. L. REV. 543 (1992) [hereinafter Rice, *Public Goods*].

from a mere label of convenience into a substantive lodestar in Article 2B drafting sessions in which it is increasingly common to hear “the rule must be *X* because an Article 2B contract is a license.” Finally, the text of Article 2B has come full circle from use of the “license” characterization as a means of avoiding use of the word “sale” and, hopefully, thereby avoiding application of the first sale doctrine. One can, it seems, do almost anything by statute—including defining “sale” as a transfer of title, the conventional wisdom, and yet a specie of a mere “license,” becomes a right to possess and use by attaching use or alienation conditions to the title. Sold computer programs and information copies thus are made open to contractual establishment of copy use and alienation restrictions.

Part I recaps basic background, including an overview of the origins, development, and status of the Article 2B project.² Part II more deeply and technically presents the related property and contract themes and particulars of Article 2B with which this article is principally concerned.³ Part III explores the implications of these themes and particulars for vendors and users that are parties to information product distribution via online electronic access and use, electronic access and download, or tangible magnetic medium.⁴ Part IV then deals with federal law implications of the proposed state law surveyed in Parts II and III.⁵

I. MARKET AND LEGAL BACKGROUND

A. *Early Use of License As Label*

Minicomputers and personal computers brought computer programs off the mainframe and into the mainstream. Emergence during the late 1960s and the 1970s of a market of greater magnitude and broader dimension made prominent the question of what protection law provided for technology that was easily and inexpensively reproducible with exactness and exact useability. Availability of legal protection under patent or copyright was widely doubted. Close examination of the latter was made the mission of the National Commission of New Technological Uses of Copyrighted Works (CONTU) which was established under the 1976 copyright revision legislation. While its Final Report concluded that computer programs were, and more clearly should be, protected by copyright,⁶ legislative establishment of such protection as a certainty did not occur until 1980.⁷ In the interim, distributors relied most

2. See *infra* notes 6-20 and accompanying text.

3. See *infra* notes 21-47 and accompanying text.

4. See *infra* notes 48-68 and accompanying text.

5. See *infra* notes 69-83 and accompanying text.

6. NATIONAL COMMISSION ON NEW TECHNOLOGICAL USES OF COPYRIGHTED WORKS, FINAL REPORT (1978).

7. See Pub. L. No. 96-517, 94 Stat. 3028 (1980) (codified as amended at 17 U.S.C. §§ 101, 117 (1994)).

heavily on a combination of state trade secret and contract law.⁸

The solution of preference in the late 1960s and the 1970s was to use contract as a means to secure or enhance trade secret protection for computer programs.⁹ Licensing, not selling, drew upon intellectual property law imagery and used trade secret law as a way that combined a contract label that connoted permissive use with creation of an obligation of confidentiality. The former skirted the strong policy against contractual restraints on alienation. The latter supported express statement in contracts that the transferred computer program copy embodied economically valuable trade secrets and, because unauthorized disclosure or use would damage the transferor, such disclosure or use would breach the transferee's obligation of confidentiality.¹⁰

When copyright protection was made certain in 1980, continued use of the "license" label kept whatever added protection the original use achieved as a backup to the still uncertain extent of copyright. Soon, it was additionally

8. The author's view regarding the history of the use of "license" as the label for computer program copy contracts has been characterized by a spokesperson for the Business Software Alliance as "revisionist history, and frankly, wrong." Memorandum from the Business Software Alliance to ALI Consultative Group on Article 2B 3 (Nov. 15, 1996) [hereinafter BSA Memo] (on file with the *University of Dayton Law Review*). Since history is highly relevant to the choice of thought mode and to the outcome in this case, the following comments seek to set the record straight and point the readers, Business Software Alliance (BSA) members and BSA's several representatives in the Article 2B drafting process, to illuminating other sources.

I urge that Mr. Robert B. Mitchell, Esq. of Preston, Gates & Ellis, representative, and others similarly situated, to visit the writings of other eminent contemporary authorities, including Thomas M.S. Hemnes, *Restraints on Alienation, Equitable Servitudes, and the Feudal Nature of Computer Software Licensing*, 71 DENV. U. L. REV. 577, 578-81 (1994), and Mark A. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1242-44 (1995). Should these authors also be brushed off as "revisionists," I challenge readers to travel back to the history itself by reading works authored at the time in question by those who participated in and observed the making of that history. See, e.g., Duncan M. Davidson, *Common Law, Uncommon Software*, 47 U. PITT. L. REV. 1037, 1057-58 (1986); Duncan M. Davidson, *Protecting Computer Software: A Comprehensive Analysis*, 23 JURIMETRICS J. 337, 360-69 (1983), reprinted in 1983 ARIZ. ST. L.J. 611, 651-69; David Einhorn, *The Enforceability of "Tear-Me-Open" Software License Agreements*, 67 J. PAT. [& TRADEMARK] OFF. SOC'Y 509 (1985); Glenn J. MacGrady, *Protection of Computer Software—An Update and Practical Synthesis*, 20 U. HOUSTON L. REV. 1033, 1037 n.13, 1047 (1983) (including a one-half page bibliography of articles published prior to 1983 on the issue of software protection); Richard I. Miller, *The CONTU Software Protection Survey*, 18 JURIMETRICS J. 354 (1978); Richard Raysman, *Protection of Proprietary Software in the Computer Industry: Trade Secrets As an Effective Method*, 18 JURIMETRICS J. 335 (1978). Others who choose to read from this list are invited to then ask themselves: Who truly is "revisionist . . . and, frankly, wrong?"

9. All contracts, irrespective of the remoteness of market relationship, "licensed" the use of technology—including trade secrets—embodied in computer programs, established obligations of confidentiality and nondisclosure to at least evidence that reasonable steps had been taken to maintain secrecy, and affirmatively proscribed reverse engineering by the program user. In addition to the various authorities cited in the preceding footnote, see Rice, *Public Goods*, *supra* note 1.

10. The utility of this combination undoubtedly diminished as one moved on one or both of two axes: increase in volume of product units distributed and decrease in frequency or extent of direct dealing between vendor and transferee.

For a well-described commentary on this construct, see Hemnes, *supra* note 8, at 578-81. One interesting and yet unexplored implication of this construct is that the remedies for redress of the breach of trust or an obligation of confidentiality differ from and may provide far greater recovery than traditional remedies for breach of contract. As indicated *infra* note 43, the implication did not escape Draft Article 2B recognition and implementation in drafts prior to the February 1997 Draft.

relied upon to fortify the protection copyright did provide. Making a program copy transferee a "licensee" put license-as-label to use as a means for side-stepping copyright law's antipathy toward copyright owner imposition of post-sale restraints on further transfer of individual copies of protected works. This attempted avoidance of the "first sale" doctrine and its explicit invalidation of attempted control over subsequent transfer of a sold copy offered a means for implementing contract-created restrictions on copy use. The underlying reasoning was that a copy use license containing use restrictions is not a sale because it does not convey title to a copy, and the license use restrictions were permissible as being lesser than, and included within, the exercise of rights reserved by retention of copy ownership: the statutory exclusive rights to reproduce and distribute copies of a work. Even so, whether this lawyering would be upheld or regarded as a sham was long in issue, and is still mooted by some.

Conveniently, licensing seemed equally suited to avoidance or shifting of many other risks. Some of these traced directly to calling a standard form a "license," while others followed from more commonplace "licensor" control over drafting of shrinkwrap and other standard forms. As well put by Thomas Hemnes:

Once lawyers persuaded software developers that they could not sell their programs like books and instead had to demand that their customers sign onerous license agreements as a condition to access to the software, the floodgates were opened for lawyers to pile into the agreements all protections they could think of for their clients. Warranty disclaimers, limitations on liability, noncompetition covenants and clauses indemnifying the vendor against third party claims all seemed to be insignificant if the customer were already willing to sign a rather burdensome license agreement to gain access to the software.¹¹

One of several concerns addressed by the copyright-related use of license-as-label was dealt with by a 1990 amendment to § 109 of the Copyright Act to make unauthorized rental-to-copy an infringement of copyright. Ends still served by this device include attempted foreclosure of competitive reverse engineering of program copy code; end-user market differentiation through restrictions that segment markets by purpose, intensity, and use; and prevention of secondary market competition through subsequent transfer of software and information copies without express authorization of the licensor.¹²

11. Hemnes, *supra* note 8, at 581. This is, quite obviously, a context-specific application of what noted commentators believe is the inevitable tendency-toward-the-minimal inherent in the drafting of standard forms. See KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 368 (1960); W. DAVID SLAWSON, *BINDING PROMISES* 32 (1996); Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, HARV. L. REV. 741 (1982); Arthur A. Leff, *Contract As Thing*, 19 AM. U. L. REV. 131 (1970).

12. For a recent example of these issues as seen through the legal process, see *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

B. Transformation of the First Sale Doctrine

Cosmetic use of the “license” characterization to avoid application of the first sale limitation on exercise of post-transfer control by copyright owners has evolved over time into a device for further expanding post-transfer control. Title retention initially presented a means for contractually establishing “use privileges” in individual copies. This expanded the protection of copyright beyond ownership of exclusive, and limited, statutory “copy rights” in underlying intellectual property. Limits or controls were implemented through contract terms which defined permitted and unpermitted uses and set forth prohibitions against or limits on further transfer of copies by original transferees. This followed generally from elevating a negative implication of the first sale doctrine into an affirmative proposition that the Copyright Act vests a copyright owner with control over use and alienation of a copy so long as she technically avoids “sale” characterization of a copy transfer transaction. Limitation on copy transfer was additionally supported by the argument that only a copy owner, one who acquires title rather than a mere use license, is entitled to the transfer and other privileges which § 117 of the Copyright Act provides with respect to computer program copies as a matter of law.¹³

Specific consequences of this design to avoid application of the first sale doctrine are widely described and discussed. This article is, however, the only one I am aware of in which it is claimed that use of the copy license device has resulted in § 109(a) having become a means for, rather than a barrier to, downstream extension of control over the use and alienation of transferred copies. This notion is counterintuitive. Yet contracting around the doctrine, especially as it is now statutorily expressed in § 109(a) of the Copyright Act, passively and actively uses the doctrine to exercise control which the same doctrine would foreclose if the transaction was labeled a sale.¹⁴

The original use was passive in that it sought merely to avoid purely Copyright Act consequences that follow from sale of a copy. The newer active use is as a foil, a marker of legal shoals around which to lawyerly chart safe passage. Treating the doctrine as technical rather than equitable, a rule rather than a principle, transforms the originally equitable doctrine into mere words. This perspective converts the doctrine into a narrow rule which provides that one who does not sell a copy is vested with the power of post-transfer control over use and alienation of a copy that embodies, but transfers no rights in, intellectual property.

13. Robert A. Kreiss, *Section 117 of the Copyright Act*, 1991 B.Y.U. L. REV. 1497, 1507-08 (1991).

14. The intended contrast is with the pre-1976 status, as well as origin, of the first sale doctrine as a judicially fashioned and evolved limitation on the rights of the copyright owner.

C. Draft Article 2B - Licenses¹⁵

The origins of Article 2B lie in the great change that occurred after the drafting and widespread state enactment of the original Uniform Commercial Code. The emergence, magnitude, and importance of the computer hardware and software industries and the information industry produced changes that had not and could not have been anticipated.

The subject matter of transactions, modes of business conduct, and array of contractual relationships challenged counsel and courts in their application of existing contract law. The project to reexamine and update individual articles of the Uniform Commercial Code presented an opportunity to address a situation that begged comprehensive and uniform address in statutory commercial law.

Several independent projects moved to meet this need. The genesis of the current draft Article 2B emerged as the focus when it was taken up by the Article 2 (Revised) Drafting Committee in 1992 as a candidate for inclusion within a revised Article 2. After study and report, it was determined in March 1993 to attempt integration of new provisions into Article 2 in a manner that brought contract rules common to sale, license, and even lease transactions into a core and dealt with subject matter or transaction characteristics which differed in separate, subject-specific parts of Revised Article 2. Project sponsors, and particularly the National Conference of Commissioners on Uniform State Laws and the American Law Institute, concurred and the endeavor proceeded on what was called the hub-and-spoke model¹⁶ until the sponsors, upon evaluation, determined in 1995 to separate the projects and create a specific Article 2B Drafting Committee. The Reporter, Committee Chair, and Committee members were appointed in late 1995.¹⁷

The new committee met for the first time in Washington, D.C. in January 1996¹⁸ to take up a working draft of a now separate article which further developed the structure and rules in which so much previous effort had been

15. U.C.C. Art. 2B. Licenses (Members Consultative Group Drafts) [hereinafter Proposed U.C.C. Art. 2B].

16. The initial proposal for the hub-and-spoke approach, a model that would combine a body of common rules in a core or hub with specific rules applicable to different types of transactions in spokes, emanated from the Task Force on Computer Software Contracts of the ABA Section on Business Law and was first fully elaborated in Raymond T. Nimmer et al., *License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal*, 19 RUTGERS COMPUTER & TECH. L.J. 281, 318-22 (1993).

17. The Reporter is Raymond T. Nimmer and the Chair is Carlyle C. Ring, Jr., a Commissioner from Virginia. The other members are David E. Bartlett, Amelia H. Boss, John A. Chanin, Stephen Y. Chow, Ronald A. Del Sesto, Patricia Blumfield Fry, Thomas T. Grimshaw, Lee M. McCorkle, Jr., Thomas J. McCracken, Jr., James C. McKay, Jr., Bruce Munson, and David A. Rice.

18. Many committee members had the opportunity to meet for days beyond the scheduled two and one-half days. They, unlike the author, failed to escape the great blizzard on the first weekend of January 1996 shut down transportation into, along, and out of the Northeast Corridor. A specially designed limited edition T-shirt commemorates the auspicious beginning.

invested.¹⁹ Two further meetings were held prior to presentation of a revised July 1995 Draft to the Annual Meeting of the National Commissioners on Uniform State Laws, and a demanding schedule of at least four meetings between September 1996 and March 1997, informational presentation to the American Law Institute membership at its May 1997 Annual Meeting, a follow-up Drafting Committee meeting, and presentation for Second Reading at the July 1997 Annual Meeting of the Commissioners on Uniform State Laws has been undertaken.²⁰

II. PROPERTY AND CONTRACT UNDER ARTICLE 2B

A. *So Far, Some Good: Distinguishing Between Property and Contract*

The Article 2B drafts put forward from September 1994 through September 1996 progressively decrease a once frequently stated reliance on a controversial assumption about the existence of property rights in information. Several important sections in the draft originally were grounded in a narrow reading of *Feist Publications Inc. v. Rural Telephone Services Co.*²¹ and a correlatively broad view of the power of states to protect interests in information.²² Reliance on this has substantially lessened over time. At the same time, changes in draft sections and Reporter's Notes increasingly manifest the long-stated, but often overlooked, notion that Article 2B is a body of contract, not intellectual property law.²³ These changes better recognize that it is neither

19. The structure of Proposed U.C.C. Art. 2B is not unlike that of U.C.C. Articles 2 and 2A, though differences in subject matter and adopted contract paradigm show in the organization as well as the content of Proposed U.C.C. Art. 2B.

20. All meetings are open and are well attended by actively participating observers, primarily—though not exclusively—representatives of computer software, information, and entertainment industry firms and trade associations. Print publisher, motion picture industry, and major software user representation began to change the mix and dynamics beginning in late 1996 and continuing into early 1997.

21. 111 S. Ct. 1282 (1991).

22. *Id.* Both the prospect of legal recognition of property rights in information as such and not as a data compilation under the Copyright Act were linked to reading the Supreme Court decision in *Feist* as stating only that federal copyright law does not provide such protection. Thus, *Feist* left the establishment of property rights in information open to other law, including state law. Reporter's Note 2 to § 104 of the November 1996 Draft states: "[f]ederal law has no relationship to transactions that involve *pure data* or secret or confidential information. *Feist Publications Inc. v. Rural Telephone Service Co.*, 111 S. Ct. 1282 (1991)." Proposed U.C.C. Art. 2B § 104 Reporter's Note 2 (Nov. 1996 Draft) (emphasis added). Elsewhere, the Reporter's Notes stated: "[f]or discussion of the difference between data [rights] and [federal] copyright in data compilations, see . . . [*Feist*]." *Id.* §201 Reporter's Note.

The author and others contested the premise as a matter of law so far as it was used to support rules based on an assumption that *Feist* should be read as indicating that state law may create property rights in non-secret or non-confidential data and facts. In particular, note was made that *Feist* did not, as stated, speak to a distinction between "data rights" and copyright in data compilations or, for that matter, speak in any manner other than to articulate the policy that facts and data themselves may not be withdrawn from the public domain. This occurred primarily in written submissions to, and discussions at, meetings of the U.C.C. Article 2 Revision Committee and the more recently established Article 2B Drafting Committee. Copies of memoranda presented to these committees by the author are on file with University of Dayton Law Review.

23. Proposed U.C.C. Art. 2B § 104 Reporter's Note 1 (Nov. 1996 Draft).

necessary nor wise to invoke and build on assumptions about the state of rights in data, or the power of states to create such rights.

Article 2B section 501(b) clearly expresses the most significant consequence of the distinction between contract law applicable to the transfer of subject matter and intangible personal property law that defines the existence or scope of ownership or other property rights or interests. The section echoes, yet does not track, § 202 of the Copyright Act²⁴ in distinguishing the transfer of a product that embodies, or is a copy of, intellectual property from the transfer of ownership of the underlying intellectual property.²⁵ This is also evident elsewhere. Yet many contract rules propounded in the current draft still rest upon or even incorporate substantive assumptions about the existence and nature of property rights and interests in information and data. This is rooted in and spreads out from key definitions of terms such as “transfer of rights,” “licensor” and “licensee,” and the statement of Article 2B.

The use of “license” and related terminology, including adoption of that terminology to include all other possible forms of transactions in software and information rights and products, is both a legacy of the original and follows on adaptive use of “license” as a label of convenience. This has fostered a tendency to make the label a pointer toward the body of law to which it historically refers as *the* substantive law applicable to transfer of computer program and information copies as market-distributed products, not just the transfer of rights or interests in intellectual property embodied therein. At the very least, this is confusing and will cause uncertainty of a kind that can be avoided. More important, it already has had significant substantive effects, primarily as an indirect agent for residual retention of early draft incorporation and new infusion of property law rules and premises into the law of contracts.

My concern is not, as some mischaracterize,²⁶ that interpretation of federal “first sale” law be settled by the drafters of Article 2B. The need is to keep clear the well-established distinctions between transaction types which do exist under relevant federal law²⁷ and even Article 2B.²⁸ The three recognized categories of transactions are: classic licenses, either exclusive or nonexclusive, of rights in intellectual property; sale, lease or other transfer of an object that embodies intellectual property; and the combination transfer of rights in intellectual property and an object in which the intellectual property is fixed or

24. 17 U.S.C. § 202 (1994).

25. Article 2B § 501(b) states that: “[t]ransfer of title to or possession of a copy of information does not transfer ownership of intellectual property rights in the information.” Proposed U.C.C. Art. 2B § 501(b) (Jan. 1997 Draft). As to the broad definition of “information” which is inclusive of computer programs and related documentation, see 2B § 102(18) which states: “‘Information’ means data, text, images, sounds, computer programs, software, databases, mask works, or the like, or any associated intellectual property rights or other rights in information.” *Id.* § 102(18).

26. BSA Memo, *supra* note 8 at ¶ 9.

27. See, e.g., 17 U.S.C. § 202.

28. Proposed U.C.C. Art. 2B § 501(b) (Jan. 1997 Draft).

embodied.

Unfortunately, while 2B section 501(b) affirmatively recognizes the distinction, Article 2B more generally makes its rules applicable to the “transfer of rights.”²⁹ This includes, by definition, either or both the transfer of rights in intellectual property and the transfer of a copy a product in which intellectual property is embodied.³⁰ Selected, important examples of this, and their consequences, are discussed below.

B. So Far, Some Bad: “License” Transforming Copyright First Sale Doctrine to Expand Downstream Control over Copies

Article 2B adopts the 1980s and 1990s adaptive use of “license” as a means for achieving contractual control over *uses of works* and *inter-market transfer*. The interplay of immediate transferee *use* and *transfer* restrictions on free or competitive functioning of markets can be best understood by a simple illustration. It is an illustration once used by this author as a means for dispelling any awe and mystique conjured by digital technology as subject matter. It is presented here for a further reason. It now describes a real byproduct of growing initial use license-as-label to escape policy as well as technical constraints of the first sale doctrine into something far larger: use of the label as license to derive new substance.

The illustration concerns common experience. Surely, one does not expect a book purchased in a bookstore, a magazine bought at a newsstand, or a painting (either an original or a reproduction) bought at a gallery to be subject to contract restrictions on how or where you use it, or whether or to whom you can convey it. Copyright law has not heretofore been claimed to abide, or support, this kind of restriction on use of a lawfully acquired copy of a work, including an original. Yet software program copy and information product contract drafters now claim that use of license-as-label can accomplish this, and that Congress intended it to be so. Draft Article 2B embraces this view with respect to the subject matter to which it applies.³¹

29. Proposed U.C.C. Art. 2B § 103 Reporter’s Note 1 (Jan. 1997 Draft).

30. The proposed definition states:

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

Proposed U.C.C. Art. 2B § 102(a)(39) (Jan. 1997 Draft).

This definition must be read *in pari materia* along with the definition of “information” in 2B § 102(a)(18), a definition inclusive of both a copy of information in the form of a product and rights in information as intellectual or comparable property. Specifically, this definition states: “[i]nformation” means data, text, images, sounds, computer programs, software, databases, mask works, or the like, *or any associated intellectual property rights or other rights in information*. Proposed U.C.C. Art. 2B § 102(a)(18) (Jan. 1997 Draft) (emphasis added).

31. The proper scope of Article 2B has been a truly difficult and continuing issue. At the outset, Article 2B dealt only with software licenses. Then it was expanded to deal with transfer of interests in intangibles,

Returning to the illustration, it is easy to appreciate that killing the second-hand or resale market, and thereby increasing a vendor's own copy sales volume, might motivate use of a contract term which states that a book, magazine, or painting—or a computer program copy, or collection of data—cannot be sold, loaned, or given to another without vendor authorization. Only somewhat different in character, the aim might be to make approval of such transfer dependent upon the secondary market transferee's payment of a "license transfer fee."³² Equally, inclusion might be for the purpose of implementing price discrimination between differing markets. Here, again, simple illustration is useful.

Extension of the original illustration shows how use restrictions might be employed to differentiate markets and implement segment-specific pricing. For example, an individual book copy license available only through a retail outlet might restrict the acquirer to personal or family use at a price per copy of \$20; businesses might be restricted to acquisition under a letterhead purchase order at a price per copy of \$75; and libraries might be restricted to acquisition only through a separate distribution channel, with some copies restricted to reference use at a cost per copy of \$200 and other copies authorized for lending use made available at a cost of \$300 per copy. Terms of the retail and business market book licenses would expressly prohibit use for library reference or lending, and forbid transfer to any third party, including a library as well as any other person using for personal, family, or business purposes.

The means for accomplishing this would be to license possession and use of a copy of a work in which the licensor owned the copyright. Enactment in a statute, such as Article 2B, of a rule that made the terms of licenses entered into between original parties fully enforceable against third parties would strongly fortify the plan and its administration. Just such a rule is set forth in Proposed Article 2B section 507(a).³³

The author raised this spectre when the Drafting Committee was considering whether Article 2B should apply only to contracts for transfer of information in digital electronic form or have broader application. The secondary purpose

then narrowed to deal only with transfer of rights in information and software. Proposed U.C.C. Art. 2B § 103(c) Reporter's (Dec. 1995 Draft). Next came expansion to include information in whatever form, nondigital as well as digital. Proposed U.C.C. Art. 2B § 103(c) Reporter's (Sept. 1996 Draft). Thereafter followed a return to digital or electronic form as a differentiating element, before swinging back again to eliminate digital form as a criterion. Proposed U.C.C. Art. 2B § 103(c) Reporter's (Jan. 1997 Draft). Definition of scope, to be sure, is yet unsettled.

32. This has been an issue in antitrust litigation brought by resellers of computer systems with proprietary operating system software against manufacturers of such systems when the latter set fees for license transfers at a level which made contracting with resellers as or more expensive than dealing with system resellers. A bit of the story is told in a District Court decision affirming the denial of a motion for partial relief from an automatic stay in bankruptcy for the purpose of appealing entered by the Northern District of California in the antitrust action brought against Wang. See *TJSJ, Inc. v. In re Wang Labs., Inc.*, 1996-1 Trade Cas. (CCH) ¶ 71,288 (D. Mass. 1996).

33. Proposed U.C.C. Art. 2B § 507(a) (Jan. 1997 Draft).

of putting the example was to highlight possibly unintended consequences of facilitating the very same commercial practices in the distribution of digital information products. The non-digital product market illustration seemed to trouble many participants, but that concern melted when providers of information in both digital and nondigital form pointed out that different treatment of the same content seemed unjustifiable. As traditional publishers became active participants in the drafting process and Drafting Committee meetings, the issue disappeared from the table.³⁴ Quickly passed by was the underlying issue of whether the outcome should be accepted and even facilitated in any information product realm. This outcome, which Article 2B proponents sought for digital information, was one which troubled many until publishers became more active participants.

Concern about the underlying issues would not have been unprecedented. Fully twenty or more years earlier, there was debate about whether public policy that disfavors restraints on alienation constituted a barrier to enforcement of contract terms that enhanced state law protection for trade secrets embodied in computer program copies.³⁵ Following establishment of copyright protection for computer programs, the same concern came to be expressed about the limiting effect of copyright law's expression of the same hostility in its first sale doctrine.

Both initial and early post-1980 use of license-as-label had a limited copyright-related objective. It first was to prevent or defend against possible invalidation of contract terms that sought to secure a measure of legal protection for computer software at a time when statutory intellectual property law protection was in doubt. Next, it was to avoid user reliance on § 109(a) to support the claim that neither the statute nor a sale contract term could bar one who lawfully acquired a program copy from renting the copy to others in order to facilitate their unauthorized reproduction. What many regarded as a statutory loophole resulting from congressional failure to fully take into account the technology seemingly gave *carte blanche* to enter the business of renting-to-copy.³⁶ While copyright could be enforced against those who actually reproduced a rented copy, this entailed such high monitoring and enforcement costs that it was economically impracticable. Use of contract to prohibit copy rental sought to establish an enforceable obligation to not facilitate third party infringement during a time that preceded the Supreme Court's first consideration of whether, and if so when, there could be liability

34. See Proposed U.C.C. Art. 2B Preface: Project History (Dec. 1996 Draft). The change occurred through expansion of the definition of Article 2B scope to include "a license of information," *id.* § 103(a), and not including in either the "license" or the "information" definitions any language that limited application of the draft to transactions involving digital-form information. *Id.* § 102(18),(21).

35. David Bender, *Protection of Computer Programs: The Copyright/Trade Secret Interface*, 47 U. PITT. L. REV. 907 (1986); Hemnes, *supra* note 8, at 579.

36. H.R. Rep. No. 735, 101st Cong., 2d Sess. 8 (1990).

for contributory infringement under the Copyright Act.³⁷ Even after *Sony*, the limits the Supreme Court set on liability for contributory infringement left justifiable doubt about whether those engaged in renting copies to others could be successfully sued for contributory infringement. This uncertainty encouraged continued use of contract to combat rental-to-copy.

This particular ill-fit between the Act and newly covered technology-based expression ultimately was cured by Congress in 1990. The Computer Software Rental Amendments Act of 1990³⁸ had one aim: fully securing the copyright ownership benefits originally intended by Congress in enacting § 106. The rental amendment narrowly responded to a technology-specific factual phenomenon that diminished or threatened realization of the benefits that all owners of copyright were intended to enjoy under the 1976 Act.³⁹ Congress made it equally clear that the rental amendment was not enacted for the purpose of giving greater benefit to owners of copyright in computer programs and other amendment-covered works than §106 secured for owners of copyright in other works.⁴⁰

Nothing indicates that Congress intended to generally validate styling a contract as a license as a means for avoiding application of § 109(a), and there is no indication that Congress even recognized that skillful lawyering had led further to the use of § 109(a) as the fulcrum for leveraging copy protection into use protection. By 1990, § 109(a) had been marked and mapped in such a way as to guide rather than obstruct making copyright the foundation for restricting use and alienation of individual copies.

The existence of copyright is important to the practice. The exclusive copy making and copy distribution rights are made the property rights source upon which contract-implemented copy use and alienation restraints build. What may seem as a natural fit to some seems less so to those who pause to consider that protection of use lies outside the realm of copyright.⁴¹ The capacity for use of these solely statutory copy-related rights as means for contractually effecting extra-statutory aims is, I suggest, made most clear by notice of how leveraging on those rights by contracting around § 109(a) uses the existence of rights-as-foundation to secure or impose classically contract terms, *e.g.*, product quality and performance terms, which have nothing or little to do with the object of copyright.⁴²

37. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), was decided four years after amendment of the Copyright Act to make clear that computer programs are covered as writings under the Act.

38. Pub. L. No. 101-650, 104 Stat. 5089 (codified as amended in scattered sections of 17 U.S.C.).

39. PAUL GOLDSTEIN, COPYRIGHT §5.6.1.1(e) (2d ed. 1996).

40. *Id.*

41. It is this principle which underlies § 102(b) of the Act and cases ranging over time from *Baker v. Selden*, 101 U.S. 99 (1879), to *Computer Associates v. Altai*, 982 F.2d 693 (2d Cir. 1992), and *Lotus Development Corp. v. Borland Int'l, Inc.*, 49 F.3d 807 (1st Cir. 1996), *aff'd by divided court*, 116 S.Ct. 39 (1996).

42. See Hemnes, *supra* note 8, at 579.

The irony in this is that an historically equitable limitation based in social, economic, and legal antipathy toward restraints on alienation has been bent to serve the ends it abhors. I find in this the same lesson that one can draw from post-1976 experience with the conversion of the judicially developed fair use doctrine into a statutory formulation. The history under § 107 and § 109(a) show how a principle can become or be made into a prisoner of words, and how emphasis on word formulations tends toward subordination of equitable to legalistic reasoning. The specific outcome, I believe, is that legalistic thinking and practice has facilitated uses of contract that the courts would not have brooked.⁴³

C. *And Some Worse: Transformation of "License" from Form into Substance*

"License" use most recently has ascended from a consequence-escaping device, through a rationale for justifying secondary market restraints, to a rule-prescriptive lodestar. It increasingly is reasoned in Reporter's Notes and Drafting Committee discourse that *because* software contracts are called licenses, they have legal consequence 'X'. It is explained, for example, that an information contract, even if labeled a "sale," transfers a mere privilege or right to use *because* the contract is in fact a mere license. Similarly, some licensor

43. See Rice, *Licensing*, *supra* note 1, at 168, 172-76. Notably, the interpretation therein of *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977), a case which arose under 1909 Act although it was decided after enactment of the 1976 amendments and subsequent Ninth Circuit decisions applying and refining *Wise* differs from the Article 2B Reporter's reliance on *Wise* as authority for the rule stated in § 501 of the November 1996 Draft. Reporter's Note 2 explains that:

The right to a copy of information depends on the terms of the contract and not on the label one applies to handling the underlying media. The media here is not the message, but the conduit. See *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977) (Copyright licenses transferred only rights for exhibition or distribution of films and did not constitute first sales); *Data Products Inc. v. Reppart*, 18 U.S.P.Q. 1058 (D. Kan. 1990) (license not a sale). This is a default rule that applies regardless of the terms of the license contract. It does not apply, however, to cases not involving a license—that is to sales of copies of software.

Proposed U.C.C. Art. 2B § 501 Reporter's Note 2 (Nov. 1996 Draft).

This is in fact a partly correct, partly questionable, and mostly confusing comment. The first two sentences are correct, except for citation of and parenthetical summary of *Wise* following the second sentence. The citation and parenthetical shifts focus, subtly, from transfer of a copy to "copyright license," in a way that is misleading. *Wise* and subsequent Ninth Circuit decisions in which *Wise* is applied and explained focused on whether contracts under which copies of copyright works were transferred were conveyed by sale or lease, or conveyed adjunct to grant of a nonexclusive license to exhibit or distribute copies made from the transferred copy for exhibition. In each case, calling a contract a "license" was strong and not conclusive evidence that the transfer was of a nonexclusive right to exhibit or distribute, not a sale of the copy. The analysis in each took into account multiple other factors, with it being concluded in some instances that a copy transfer constituted a sale of the copy.

None of the cases established, as the citation and parenthetical summary of *Data Products Inc.* suggest and the last sentence in the Reporter's Note states, that denominating a contract as a "license" *ipso facto* makes it not functionally a sale for purposes of the Copyright Act. Proposed U.C.C. Art. 2B § 501 Reporter's Note 2 (Nov. 1996 Draft). Quite the contrary, *Wise* and related cases indicate that substance, not form, controls the point made in the Reporter's Note first sentence and then undermined thereafter. On the basic point, see GOLDSTEIN, *supra* note 39, § 5.6.1.1(a).

performance obligations are less than they would be in a sale of goods transaction in part *because* the transfer is a mere use license.⁴⁴ The case for statutory authorization of licensor resort to electronic self-help in the event of breach likewise rests in part on reasoning that a mere licensee has even less an interest in property than a financed buyer, U.C.C. Article 2, or a debtor, U.C.C. Article 9, thus making the licensor interest to be protected greater and the affected legal interest of the licensee substantially less in comparison.⁴⁵ One further, though very recently struck, provision carried this so far as to make any licensee breach, not just breach of a term restricting trade secret disclosure or use, a basis for recovery of consequential damages resulting generally to underlying intellectual property rights.⁴⁶

The shift from initial use of license-as-label in order to avoid the first sale doctrine, thence to rationalize enforceability of particular contract terms, and now to present certain provisions as prescribed by license law is a truly extraordinary phenomenon. Few statutory particulars noted above show this occurrence in concrete terms. The previously noted Business Software Alliance attack of a memorandum I prepared for the American Law Institute Council, and circulated to the Article 2B Drafting Committee as well, demonstrates my point that it is a paradigm shift rather than a product of conceptual evolution.⁴⁷ Part III builds on both this insight and the preceding demonstration of how “license” and its use to avoid or evade the first sale doctrine has grown from its initial use to technically avoid the doctrine’s application into a contract drafter’s instrument for leveraging that avoidance

44. The “in part” qualification recognizes that other prominent reasons offered for differences in warranty focus on differences in the nature or character of information and other products and, in the case of data or information as such, concern for First Amendment policies.

45. Proposed U.C.C. Art. 2B § 712 (Nov. 1996 Draft).

46. Proposed U.C.C. Art. 2B § 703 (Jan. 1997 Draft). This section generated much debate at the January 1997 Drafting Committee Meeting and was then omitted from the February 1997 draft. Proposed U.C.C. Art. 2B § 703 Reporter’s Note 2 (Jan. 1997 Draft). The extended discussion in this footnote is included because the section was a principal focus in my symposium presentation. The most recent change in the draft is not necessarily final. This is a useful place to highlight the process reality that, with respect to any and all changes made during the drafting process, the matter that can and likely will be revisited.

Returning now to substance: The creation of a tort-like contract remedy for breach of an obligation of confidentiality would itself quite substantially expand contract beyond a law for enforcement of promise or undertaking. Making 2B § 703 applicable in any case in which a contract breach, not necessarily limited to a breach of an obligation of confidentiality, caused any foreseeable injury to the other party’s property right or interest in confidential information reached much, much farther. This was notable especially because 2B § 316 provides that there is not obligation of confidentiality except as created by a license term or other applicable law. Viewing statutory text as an information source about the law of obligations, it might well come as a surprise that one who does not have an obligation of confidentiality nevertheless may have rather open-ended liability for confidential information injury resulting from breach of a different class of contract obligation.

Two further facts testify to the confusion of property and contract. 2B § 703 did not make liability depend upon breach of confidentiality or commission of another classic trade secret wrong as the basis for liability, nor did it recognize the right to interpose a trade secret law defense. Similarly, creating strict contract liability for injury to an interest in trade secret or confidential information effectively created a remedy not previously known to either contract or trade secret law.

47. BSA Memo, *supra* note 8.

into a means for making copyright ownership a source of contract-based control over downstream use of copies and primary and secondary market competition in the distribution of copies rather than rights in intellectual property.

III. A SAMPLING OF CASES IN WHICH CONFUSION OF PROPERTY AND PRODUCT MAKES A DIFFERENCE

A. Introduction to Supporting Cast: Enforceability of Standard Forms and Terms

Article 2B recognizes that most contracts are standard forms. In two separate provisions, it makes standard forms and their terms enforceable in general,⁴⁸ and enforceable subject to limited provision for nonenforcement of particular terms in the case of mass market licenses.⁴⁹ The basic condition for enforcement in each instance is manifestation of assent as that is defined in 2B section 112. Introduction of these provisions in this article is for the limited purpose of showing the market effect of inconstant recognition of differences between property and product, property and contract rights, and transfers of each. What is topically critical is the already sounded concern about the confusion and conflation, whether through lack of appreciation or by design, of property and product.

B. Product Use Control to Enhance Property Protection

Article 2B section 312(b) expressly validates contract terms that restrict transferee use and alienation of a computer program or information product unit.⁵⁰ Among use terms to which this provision would apply are those which

48. Proposed U.C.C. Art. 2B § 307 (Jan. 1997 Draft).

49. *Id.* § 308. "Mass market license" is defined in 2B § 102 (25). The definition is to be redrawn following the September 1996 Drafting Committee meeting, but the effort is to distinguish standard forms typically used in the general retail market, electronic or otherwise, for occasional transactions from those standard forms used in more typically commercial transactions.

50. Proposed U.C.C. Art. 2B § 312(a) (Dec. 1996 Draft). This draft has been something of a foil. The December 1996 Draft version provides that, in the absence of any express restriction, "the licensee may use the information any number of times for any purpose and in any location that does not infringe any intellectual property right not granted by the agreement." *Id.* The meat of 2B § 312 is in subsection (b) which states: "[i]n a license, a grant contains an implied limitation that the licensee will not exceed the rights, location, and uses granted." *Id.* Perhaps most striking, in its validation of contract terms creating property-like rights in ideas and facts, is the further statement that: "[a] use exceeds an implied limitation if the use itself as compared to any uses of ideas or facts obtained through such use results in a more significant impact on the value of the retained intellectual property rights than does the granted use." *Id.* (emphasis added). This statement suggests, among other things, that so-called "black box" (external observation of behavior, etc.) reverse engineering discloses otherwise legally unprotectable facts or ideas, let alone deconstructive reverse engineering, which leads to such disclosure or discovery is statutorily prohibited by 2B § 312(b) as it appeared in the December 1996 Draft.

The January 1997 Draft Article 2B § 310 replaces former draft 2B § 310, 2B § 311, 2B § 312, 2B § 315

prohibit use of a computer program or other information product copy to reverse engineer or analyze it. As indicated in discussing use of the license characterization to finesse the Copyright Act first sale doctrine, I find it doubtful that a standard term in a standard form used in a context characterized by lack of direct relationship, and no opportunity to bargain, can effect market-wide modification of trade secret or other intellectual property law. It has been aptly observed that use of a standard form term to prohibit reverse engineering of a computer program effectively remakes trade secret law through what Friedrich Kessler was first to call private legislation.⁵¹ This transformation of reverse engineering from a privilege integral to a specie of unfair competition law⁵² into a market wide prohibition effectuated by contract proscription in vendor-drafted standardized contracts is remarkable for its use of contract to negate public policy extrinsic to contract.⁵³ This is a use quite different than the usual and widely accepted aim of securing consistency and efficiency in the allocation of performance and quality obligations and risks, and establishing with some certainty the remedies for and consequences of breach.

Holding the position that freedom to contract is in this instance not subject to any constraint in the nature of freedom from contract necessarily asserts that private legislation by contract may do what state legislation may not.⁵⁴ There are those who do hold this view and express it as support for 2B section 312(b) statutory validation of standard form as well as negotiated contract terms that restrict use and alienation of lawfully acquired product units. Yet establishment of downstream use and alienation restrictions through market wide use of contract terms that alter property, tort, and unfair competition rules is, Judge Frank Easterbrook notwithstanding,⁵⁵ decidedly different in aggregate market as well as individual party effect.

Noncontract legal rules, including those of trade secret law, embody social

and 2B § 316. Subsection (a) of the proposed new 2B § 310 section captures the previous provisions in the first and the third sentences, respectively. Proposed U.C.C. Art. 2B § 310 (Jan. 1997 Draft).

51. See Robert P. Merges, *Expanding Boundaries of the Law: Intellectual Property and the Costs of Commercial Exchange—A Review Essay*, 93 MICH. L. REV. 1570, 1611 (1995); Rice, *Public Goods*, *supra* note 1, at 562-64; and David A. Rice, *Sega and Beyond: A Beacon for Fair Use Analysis*, 19 U. DAYTON L. REV. 1131, 1200 (1994). *But see*, Maureen A. O'Rourke, *Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms*, 45 DUKE L.J. 479, 528, 532-34 (1995).

52. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974).

53. An example of the contrast being drawn here is found in U.C.C. Article 1 § 203 which makes any U.C.C. requirement of reasonableness not excludable by contract, but permits parties to define by agreement their own standard of reasonableness so long as the agreed standard is not manifestly unreasonable. This is a case of strict limit, freedom within, and final check to assure no mutual or one-sided abuse of that freedom.

54. This is the teaching of *Bonito Boats, Inc. v. Thunder Craft Boats*, 489 U.S. 141 (1989), as to state legislation.

55. Judge Easterbrook's opinion in *ProCD v. Zeidenburg* like a few other selectively chosen stand-alone judicial decisions, has been adopted by the Reporter and proponents of assumptions and provisions which I herein question as definitive. It is as if, in this instance, that Easterbrook's interpretation of Wisconsin law and the enforced standard form and federal intellectual property law is a given for all, and all courts. The decision, reasoning included, has drawn much criticism among lawyers in copyright-related Internet news groups.

and economic policy and norms wholly unrelated to the fact or premises of bargain. They express standards of conduct for businesses and individuals, the emphasis being duty rather than obligation, and the right of one to exclude possession or use by others. Contract more narrowly deals with transfer of rights inherent in the latter, and with allocation of risks related to performance of promise. Freedom of contract leaves parties great leeway to fashion agreement on these, and generally little latitude to alter the former except, perhaps, where alteration of *ex contractu* liability rules are bargained-in-fact.⁵⁶

C. Illustration #1: Licensor Self-Help Remedy for Breach

The most notorious section in Article 2B is section 712 which provides that, in the event of licensee breach, a licensor may resort to electronic self-help to prevent further use of a computer program or information. Among reasons presented in support of the provision is that a licensee's rights are limited to mere possession and use of a copy and that a licensee has no rights in the underlying intellectual property. It thus is explained that licensor protection of intellectual property rights or interests justifies a statutory right of self-help prevention of copy use.⁵⁷

Close reading shows that, on one hand, self-help is urged on the ground that licensor action does nothing more than pull the string on the limited contract-based right to possess and use a copy.⁵⁸ Simultaneously, it is claimed that self-help is justified because continued licensor use constitutes not only a breach of contract, but an infringement or violation of licensor rights in underlying intellectual property. There is in this serious, and readily apparent, internal inconsistency and illogic.

D. Illustration #2: Nontransferability/Nonassignability

1. Basic Background

A second important example of confusing property with product deals with the transfer of interests in computer program and information copies. The relevant provisions generally are considered in discussions of whether one who lawfully acquires a single computer program may lawfully transfer it to another. These provisions in fact have far greater, and little recognized importance, in two commercial settings: collateralization of loans made to

56. See *Delta Airlines, Inc. v. Douglas Aircraft Co.*, 238 Cal. App. 2d 95 (1965).

57. Proposed U.C.C. Art. 2B § 712 Reporter's Note 2 (Jan. 1997 Draft), and more expanded discussion of right to stop use and retake copies in Reporter's Notes 2 and 3, *id.* § 711, which deals with judicial remedies.

58. This argument reflects and rests on the provision elsewhere that transfer of a copy conveys only a right to possess and use it subject to any conditions stated in the contract and, in the same section, that transfer of a copy conveys no rights or interests in underlying intellectual property. See *id.* § 501.

authorized users of copies, *i.e.*, licensees; and sale of a business accomplished by sale of its assets.

Consideration of both cases begins with reference to Article 2 section 501(b) which provides that transfer of copy does not itself transfer any interest in embodied intellectual property. Progressing into 2B section 502, 2B section 503, 2B section 504 and 2B section 508 presents a fundamental conflict in that each expresses or necessarily rests on the proposition that transfer of a program or information copy under a nonexclusive use license makes the copy nontransferable and contract rights to use a copy nonassignable. The rule of 2B section 501(b) is explained as reflecting the fact that intellectual property law clearly distinguishes between the transfer of rights in intellectual property, and a copy or product which embodies that intellectual property.⁵⁹ Stated otherwise, the transferor has intellectual property rights in the subject matter embodied in a copy and those rights exist and are enforceable irrespective of whether this or any other copy is ever distributed.

On the heels of this it is explained that 2B section 502, 2B section 503, 2B section 504, and 2B section 508 follow from the basic teaching that a nonexclusive license of intellectual property rights, which 2B section 501(b) declares that transfer of a copy does not convey, is personal and nonassignable without consent.⁶⁰ Overlaying the rule and explanation of 2B section 501 with the rule and explanation of 2B section 502, 2B section 503, 2B section 504 and 2B section 508 computes as follows: Transfer of a program or information copy in no way diminishes or parts with any intellectual property rights of the transferor/licensor *and* a copy is nontransferable because a nonexclusive license of intellectual property rights is not assignable.

This is truly a "having your cake and eating it too" package: Licensors give over no rights in intellectual property through transfer of a copy, and a copy transferee may not further transfer a copy, or create a security interest therein, because a nonexclusive license of intellectual property rights is personal and nonassignable.⁶¹ This is what many current standard form computer program copy contracts themselves prescribe, and some would contend that Article 2B therefore must simply incorporate this because it is "established commercial practice." Yet appreciation of the substance and the intended consequences is itself enough to caution that, because all persons with power to prescribe standard form content use such terms. Thus the ends of the standard forms drafters' practice rather than evolved mutual expectation dictate the statute. The rule set, whether contractual or statutory, fashions tight primary and secondary market transaction control and competition restraint through severe

59. *Id.* § 501 Reporter's Note 1 (emphasizing consistency with § 202 of the Copyright Act).

60. *Id.* § 502 Reporter's Notes 2, 3; *Id.* § 504 Reporter's Note 1; *Id.* § 508 Reporter's Notes 1-3.

61. The observation does not ignore that transactions take place in which transfer of a copy and a nonexclusive intellectual property rights license occur pursuant to a single contract. The point is that the respective subject matter and their legal character remain distinct.

limitation of transferee and third party freedom to contract.

2. The Case of Sale of Business by Sale of Assets

The common case of a business owner selling her business through the sale of all assets provides an important illustration of the referenced market transaction control or competition restraint.⁶² Plain application of the discussed sections and related provisions in Part 5 of Article 2B require that any attorney from whom an opinion letter is sought must advise that software and information products used in the business may not be transferred without first receiving authorization from each software and information product licensor. Although such a requirement may even be required with respect to transfer of a true license of intellectual property,⁶³ it is insensible and unsound as economic and social policy for other cases where, for other reasons, a contract is labeled "license."

The rule burdens, complicates, and raises costs of transactions for both sellers and buyers. Business sellers are required to secure express approval from each and every licensor of software or information product or copy used in the business and business buyers' due diligence is made to include verification that all such approvals have been secured.⁶⁴ Creating new costs of doing business downstream must be justified in terms of ends, and by securing benefits at least equal to the costs. In this instance, justification does not exist. It may be claimed that a rule requiring approval is required or justifiable

62. A change in the text of 2B § 502 in moving from the September 1996 to November 1996 draft strengthened application of the rules. Proposed U.C.C. Art. 2B § 502 Reporter's Notes 2 (Nov. 1996 Draft). Reporter's Note 2 stated that this was dictated by the Ninth Circuit decision in *Everex Systems, Inc. v. Cadtrak Corp.* (In re: CFLC, Inc.), 89 F.3d 673 (9th Cir. 1996). Proposed U.C.C. Art. 2B § 502 Reporter's Notes 2 (Nov. 1996 Draft). Citing the patent license assignability decision as establishing that any state law rule that makes a nonexclusive patent license nonassignable is preempted by federal patent law, the Note presents that federal intellectual property law dictates inclusion of the rule discussed herein. Generalization of patent to copyright law ordinarily is not something done without more reflection, but that is far less significant than the fact that the Reporter's Notes apply *Everex* without distinguishing between license transfer of rights in intellectual property as such and a contract for transfer of a copy of a product which embodies intellectual property. Notable, though far less significant, is that *Everex* is the subject of some controversy rather than a necessarily settled precedent.

Proposed U.C.C. Art. 2B § 502 Reporter's Notes 4, 5 (Jan. 1997 Draft) rather perfunctorily cite *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984), as indicating that federal copyright law deals with non-exclusive licenses in the same manner as *Everex* concludes about how federal law applies as to the assignability of patent licenses. Just as the Reporter does with respect to *Everex*, he presents this "as if" a contract for transfer of a license-labeled copy is a true non-exclusive license of one or more of the "copy rights" comprised in §106 of the Copyright Act. *But see*, Proposed U.C.C. Art. 2B § 501(a) Reporter's Note 1 (Jan. 1997 Draft).

63. *Everex*, 89 F.3d 673.

64. The rule will put third parties at risk of sudden loss of copy use where approval of copy transfer had been falsely represented to have been obtained. This is beyond question given that 2B § 508 makes original license terms enforceable against third parties, including purchasers, even in the absence of knowledge of those terms. Addressing this risk will create costly new due diligence burdens for potential business acquirers, and generate a great deal of new business for their lawyers.

because transfer of copy ownership or use exposes intellectual property rights, the only true residual interest of licensors, to new infringement or other risk. At the very least, this argument supports only a requirement that notice of copy transfer be given by a licensee at the time of transfer. Yet even this could be required where no rights in intellectual property itself are being transferred only upon the Drafting Committee, the Uniform Law Commissioners, the American Law Institute, and state legislatures consciously choosing to use statutory contract law to shift from licensors to licensees and their transferees the costs of protecting licensors' intellectual property interests.

Shifting protection costs from intellectual property owners to others who hold no rights in intellectual property through their transactions with rights owners would go well beyond what intellectual property law itself does: create rights in particular subject matter and remedies for violation of those rights. Overlaying law's creation of a right in intellectual property with imposition of an obligation on others to protect it is far different from creating a remedy for violation of that right by the same others. It statutorily creates, in contract law, an additional right incident to copyright, patent, or other legal recognition or grant of an intellectual property right. The right to disapprove, the mirror of the right to require prior approval, makes copy licensors gatekeepers. Gatekeepers have inherent capacity to appoint themselves toll collectors.

An obvious guise for exacting tolls would be to characterize approval charges as license transfer fees.⁶⁵ There is no basis in intellectual property law for facilitating this by fashioning a statutory rule of contract that is, it appears from a reading of the relevant sections, one of the Article 2B rules that is beyond the power of even arms length bargainers to waive or modify.⁶⁶ Doing so is to confer a new property-like benefit on software and information product providers, not merely state a gap-filler rule that applies in the absence of express agreement in the matter between contracting parties. Defending creation of rules that produce this outcome on the ground that it is compelled by federal intellectual property law with respect to transfer of rights which, by express provision in the same statute, include no rights in intellectual property is perhaps one of the egregious examples of Article 2B confusion and conflation of property and contract. Indeed, no better example exists of the elevation of "license" from label to lodestar and consequences that follow from proforma derivation of substance from form.

65. Proponents may honestly assure now that this is not intended and will not occur. Recent history teaches that changing market conditions indeed may lead some to future discovery of this prospect as a source of essentially unearned revenue to subsidize licensor survival, revival, or expansion. Thus, for one example, Wang Laboratories' resort to such measures was the focus of the pre-bankruptcy antitrust action brought against Wang by a number of independent resellers of used Wang systems. *TSJ, Inc.*, *supra* note 32.

66. Nonwaivability and nonmodifiability operate, of course, to vest benefits of the rule in a way that is akin to the statute creating a right to payment for approval.

3. The Case of Asset-Based Business Financing

Application of this set of provisions to asset-based business financing provides a second important illustration of the business and economy burdening fall-out of this untoward, if not misguided, conflation of property and product. 2B section 504 also provides that the owner⁶⁷ or other lawful possessor of a copy of software or information through a licensor may not create a security interest in the copy. That is, no copy is personal property, either tangible or intangible, within any category which Article 9 of the Uniform Commercial Code classifies collateral that may be security for debtor payment of a credit obligation.

This is quite at odds with the tenor and particulars of U.C.C. Article 9 section 406(b) of the most recent draft of Revised Article 9. Although the fit between Article 9 and federal intellectual property law is imperfect,⁶⁸ Article 9's scope expansively makes almost all tangible and intangible personal property available as collateral even though the article in other respects defers to, for example, federal copyright and patent law concerning what must be done in order to perfect or even make enforceable a security interest in intellectual property rights themselves. Concerning contractual restrictions on the right to create security interests in intangibles, Article 9 section 406 currently provides as follows:

(b) A term in a general intangible, including a contract, permit, [or] license. . . that prohibits . . . [or] restricts . . . creation, attachment, or perfection of a security interest in the general intangible, is ineffective to the extent that (i) the term would impair the creation, attachment, or perfection of the a security interest, or (ii) the creation, attachment, or the perfection of the security interest would cause a default, breach, . . . termination, right of termination, or remedy under the general intangible.

The rationale given for the contrary rule in 2B section 503 is, once again, that a license is personal and creates no vested rights in its subject matter, and that neither it nor interests therein are transferable without licensor consent. Once more, "license" as transformed from a label of convenience into concept from which rules derive is what forges the rule. Reference to the effect or consequence of a true license first transforms what once was technical use of license-as-label to avoid application of the Copyright Act first sale doctrine into label/form-is-substance for purposes of ascertaining the legal implications or

67. It is useful in both this and the sale of business by sale of assets cases to recall that Article 2B makes a copy to which title was acquired through sale made in exchange for a license fee is, for purposes of Part 5 as well as all other parts of Article 2B, a license if the contract under which it was transferred includes any term which limits or conditions use or transfer. Thus, the "licensee" and "license" to which 2B § 502, 2B § 504, and 2B § 508 apply do and are intended to include most "owners" and "contracts of sale" in software and information copy or product transactions.

68. See, e.g., Alice Haemmerli, *Insecurity Interests: Where Intellectual Property and Commercial Law Collide*, 96 COLUM. L. REV. 1645 (1996).

consequences of a contract being labeled “license.”

In law, the rule of 2B section 503 is the converse of that in Revised (Draft) U.C.C. 9 section 406 and roughly contemporaneous consideration of Article 2B and Revised Article by the NCCUSL, ALI, and state legislatures undoubtedly will be forced to address the conflict. Among factors which should be considered in that process, and in further Drafting Committee work on Article 2B, is that the rule in practice makes debt capital formation difficult for commercial enterprises engaged in businesses that heavily use software and information products. It is not insignificant that such enterprises are likely to grow in number and economic importance as we move further into the information age.

Here again, of course, the rule positions licensors to appoint themselves as toll setters and extractors. The likelihood that the number of information-based enterprises will continue to increase presents the prospect that software and information product licensors will be legally armed by Article 2B to add and collect, through the courts if necessary, a surcharge on business transactions in which they have no direct interest and to which they provide no added value in exchange for the collected toll. It is quite unnecessary to subject this prospect to further and fine economic, social, and legal policy analysis for the author, at least, to opine that supposedly balanced, interest-neutral uniform state law applicable to all such transactions should do this or can be presented to the elected representatives of the public for enactment with either a straight face or clear conscience.

IV. ARTICLE 2B AND FEDERAL INTELLECTUAL PROPERTY LAW

A. New Solution to “First Sale” Problem: If a “License” Is a Disguised Sale, Why Not Just Make a “Sale” a “License”?

The basic story is completed by showing how the new draft transforms a “sale,”—an agreed transfer of title to digital information⁶⁹—into simply another transfer of rights that may be made subject to contractual restrictions on use and alienation which are validated. The means for accomplishing this is really quite direct: make “sale” a specie of “license.” Article 2B does just that; and doing that is the ultimate, as well as my final, illustration of the article’s confounding of rights in intellectual property with transfer of rights in a product that embodies intellectual property.

Article 2B “solves” the “first sale problem” through the combination and interplay of several key terms. The combination consists of Article 2B definitions of “transfer of rights” and “license,” and the 2B section 103 scope

69. Proposed U.C.C. Art. 2B § 102(36) (Dec. 1996 Draft), like U.C.C. Article 2 § 106, defines a sale as “the passing of title from a seller to a buyer for a price.”

provision. Article 2B's scope of application is defined in 2B section 103(a) as "licenses of information and software contracts."⁷⁰ Proceeding from there, 2B section 102(21) defines "license" as "a contract for transfer of rights in information which expressly makes the rights conditional or limited, *whether or not it transfers title to a copy* of the information . . . and a software contract."⁷¹ From there, one must look next to 2B § 102(a)(30) which defines "sale" as "the passing of title to a copy of information for a license fee" and 2B § 102(a)(39) which defines "transfer of rights" to include "a grant of a contractual right or privilege . . . to purchase . . . information."⁷² "Information," as noted earlier, is broadly defined to include "data, text, images, sounds, computer programs, software, database, mask works, and the like, and any associated intellectual property rights or other rights in information."⁷³

Sale of a computer program or information copy is thereby made a "license" so long as the contract makes rights conditional or limited. Trying to get this untangled before it makes one too jangled leads me to offer this: although sale of a copy of, for example, a computer program leads to § 109(a) "first sale" cutoff of copyright owner control over that copy, where transfer of title to a copy by sale is under a contract that subordinates title to transferor control over use or alienation, the contract is a "license." The nature of a nonexclusive license, as noted in Reporter's Notes, is a licensor's covenant not to sue for use which otherwise contravenes the exclusive rights of the licensor. Making a "sale" a "license" of course has the legal consequence of immunizing the computer program or information product transfer from operation of § 109(a) of the Copyright Act—and comparable first sale principles of patent, trade secret, and other law.

One might wonder whether this convoluted, tail-chasing reasoning process

70. Proposed U.C.C. Art. 2B § 103(a) (Sept. 1996 Draft).

71. *Id.* § 102(21) (emphasis added). "Software contract" is defined in terms that first require looking at the definition of "software" which states that "software" consists of "a computer program in source code, object code, or any other form and any data, program description, media, and supporting documentation which are provided by the licensor." *Id.* § 102(32). This is a substantially more inclusive definition than the definition of "computer program" in § 101 of the Copyright Act and Proposed Article 2B § 102(3). "Software contract . . . means any contract to transfer rights in software . . . whether the contract provides for transfer of *ownership* of or conditional rights in *copies* of the software." *Id.* § 102(33) (emphasis added).

72. *Id.* § 102(a)(39). The definition states in substantial part:

"Transfer of rights" means a grant of a contractual right or privilege as between the parties for the transferee to have access to, modify, disclose, distribute, purchase, lease, copy, use, process, have used, display, perform, or otherwise take action with respect to information.

Id. Whether "purchase" here is meant as "buy" or has the broader meaning set forth in U.C.C. Article 1 § 102(32) is not made clear either in the Article 2B text or accompanying Reporter's Notes. It is to be assumed, given that other sections severely restrict transferee power to create a security interest in a copy, that the intended meaning is narrow, *e.g.*, "buy."

73. Proposed U.C.C. Art. 2B § 102(18) (Sept. 1996 Draft). Indeed, perhaps I simply should have made this paper a quotation of this definition. The subject matter of the article is here defined as both products that embody intellectual property and any underlying intellectual property or other rights *in* information. On this base, the rest of the draft often deals with transfer and use of "information" without indicating whether the reference is to products which embody it or underlying rights in it.

and its outcome were in fact intended. The answer is yes, a point settled by several Reporter's Notes. The first explains that "license" excludes those sales which are "implied in law licenses such as occur under first sale rules in copyright relating to the sale of a copy of a book."⁷⁴ The same Note states that "[a] license deals with the control of rights of use and the like with reference to the information, while the title to the goods deals simply with that—title to goods."⁷⁵ This follows upon setting the stage with the observation that "while a sale of a copy transfers some copyright rights under federal [law], the licensor retains control of a great deal of the copyright law's exclusive rights *even as to that copy*."⁷⁶

The last, and all-underlying statement, is simply wrong as a matter of law. First, § 202 of the Copyright Act very directly states that transfer of a copy in which intellectual property is embodied does not itself transfer copyright ownership or rights in the underlying intellectual property. Section 2B section 501(b), in contrast to the above-quoted Reporter's Note 19 to 2B section 102, expressly states the same.

Second, the fact that the exclusive rights of a copyright owner under § 106 are uncompromised by even sale of a copy does not support the assertion that a licensor or transferor of a copy retains rights therein that include "copyright law's exclusive rights even as to that copy."⁷⁷ This statement is one of the most egregious Article 2B text and commentary misstatements of law and confounding of rights in intellectual property with the rights in a product that embodies intellectual property. The limited statutory rights of the copyright owner do not subsist in the individual copy, but in the infinitely replicable expression itself.

The most troubling datum is that much of Article 2B builds upon and demands acceptance of this (mis)statement. It explains and rationalizes control-enhancing contract rules in terms that intimate that such control is necessary in order to assure that transfer of a program or information copy not give the transferee any twig from the bundle of rights comprised in copyright. Yet a copy transfer never does this except as expressly agreed or necessarily implied⁷⁸ and the only right obtained by acquisition of title to a copy is its ownership and included power to convey possession, title, or both to another. Clearly not included in ownership of a copy as such is any right to reproduce the original or distribute copies of the protected work. Doing either act without authority constitutes infringement of copyright, regardless of who commits the act. Liability is statutory, and it is wrong as a matter of law to intimate otherwise. Far worse is to build a separate and important new statute on the deeply flawed legal premise and implications derived therefrom.

74. Proposed U.C.C. Art. 2B § 102 Reporter's Note 19 (Sept. 1996 Draft).

75. *Id.*

76. *Id.* (emphasis added).

77. *Id.*

78. 17 U.S.C. § 202 (1994).

B. Some Thoughts on Federal Preemption

My purpose in this part is not to recapitulate what I and others have already written about federal preemption of property-like state contract law rules. Doing so would in fact cover ground that other participants in this symposium have led us over.⁷⁹ The sole purpose here is to identify some aspects of the current draft of Article 2B that present potential preemption issues.

Federal court decisions hold that reverse engineering of at least a sold computer program copy is a "fair use." Yet Article 2B makes sale a covered transaction, nominally a "license," and the transaction subject matter subject to downstream use restraints.⁸⁰ Other provisions similarly assume that a contract of sale may restrict resale or further transfer.

Article 2B also makes a standard form record or contract and its terms enforceable. As discussed previously,⁸¹ this alone, and especially together with express validation of use restriction terms, is a potential means for contractually creating new property or property-like rules. Property rules and their related remedies are, of course, exclusionary and limit market competition. This clearly has potential implications for, and poses potential direct conflict with, federal competition policy and federal intellectual property law.

Genuine dispute exists as to whether § 301(a) of the Copyright Act preempts enforcement of contract terms that, for example: (1) prohibit computer program copy reverse engineering which otherwise is a fair use under § 107; (2) restrain further sale or other transfer of program copies acquired in the open market; (3) leverage ownership of copyright and the § 106 exclusive, but limit rights therein to regulate purpose or manner of copy use; (4) make self-help termination of program copy use a state law remedy for alleged infringement when the Act makes specific relief available only through judicial process. Different results arguably could be obtained with respect to (1) through (3) above depending on whether the operative contract term was part of a unbargainable standard form contract used on a market wide basis. The fourth question is different in kind because it is directly presented by Article 2B as a statute rather than by contracts drawn to it.

Preemption challenges to state-enacted uniform law are to be avoided, not tempted. They can be best avoided by revisiting premises and rules that conflate rights or interests in intellectual property with rights in product units that embody intellectual property. A second best solution is to drop from Article 2B the provisions that present likely preemption challenge targets, and leave it to contracting parties to write their own terms in the manner and with

79. Dennis S. Karjala, *Federal Preemption of Shrinkwrap and On-line Licenses*, 22 U. DAYTON L. REV. 511 (1997).

80. See Proposed U.C.C. Art. 2B § 502(b)(2) (Sept. 1996 Draft).

81. See *supra* notes 50-53 and accompanying text.

the content of current standard forms. There is little need for these provisions if, as supporters of this group of practice-validating provisions contend, parties are free to contract for terms of the kind described above and inclusion of those terms in contracts is not subject to preemption. Even if others like myself who do not share the view that there is no appreciable risk of preemption are wrong, it makes sense to not beg the occurrence, cost of defending, and risk of losing statute-aimed challenges regardless of whether contract alone can achieve the desired ends.

Proceeding on the suggested course limits potential controversy and litigation to the question of whether state judicial power may be exercised to enforce particular terms fashioned by the parties within the freedom assured by 2B section 114. This places the risk and cost with the interested parties, not individual states. Given that this is not a case in which enacting state law can settle controversy and thereby minimize uncertainty costs, reason indicates that the best course is one under which any resulting costs of exceeding legal limits are borne directly by interested parties rather than the public treasury.

This course of action may dissatisfy some who doubt the risk and want the universality and certainty that would come from wide enactment of the provisions as uniform state law. Against this is a longer and broader view that the general aims of uniform law are best served by dropping provisions that invite challenge under federal law: that is, those aims are best served by making certain the integrity of the whole of a comprehensive statute.

V. CONCLUDING COMMENTS

The premise which underlies Draft Article 2B's use of the license, licensor, and licensee language and its articulation of related contract rules is that transfer of a copy as a product transfers some rights in intellectual property. This strongly favors the interest of transferors over transferees of copies, notwithstanding the argument that the software industry in particular has come to present in relation to the drafting and content of Article 2B. That argument has two elements. Succinctly stated it is: (1) *because* software and information contracts are licenses, transfer of a copy authorizes use of the copy only for expressly stated or necessarily implied purposes and (2) inclusion of provisions in Draft Article 2B which establish rights or privileges in licensees, and especially provisions which secure for transferees any use or privilege not required to be given by applicable intellectual property law, Article 2B and copy use licensing improves the position of and secures otherwise unavailable benefits to copy transferees ("licensees"). The generous benefactor model fades a bit, however, upon closer examination of the Draft. This shows that, when it is most beneficial to suppliers or "licensors," the Draft hews to well established law which clearly distinguishes rights in intellectual property from copies in which intellectual property is embodied. Taking an even closer view makes clear, on the other hand, that the Draft operates on the premise that

every copy transfer conveys some interest in the intellectual property itself. The latter is the contract law property premise; the property foundation for operating always on the premise that the licensor is entitled to exercise strict control over the use and alienation of every copy because it has a paramount property interest therein.

The paradigm thus is as follows. Except as expressly provided by contract or statutory rule, or by preemptive federal law: (1) copy licensees never acquire any property interest in intellectual property; (2) because transfer of a copy necessarily conveys some interest in intellectual property, the contract of transfer is personal and nonassignable, and with respect to the copy, the licensee acquires only permissive possession and use of a copy for agreed, limited purpose; and (3) every transaction is subject, in some measure, to both principles and some sections of the article implement both.

Some folks see no internal inconsistency in this. Some sense the existence of something wrong. Still others see it, something I know from the fact that it is partly through their insights that I have progressed from having a strong sense that something seemed amiss to discovering and still learning more about what it is.



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