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ARTICLE

IMAGES AND CONTRACT LAW—WHAT LAW APPLIES TO TRANSACTIONS IN INFORMATION

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I. INTRODUCTION

This is an era of turmoil in contract law, entailing the most pronounced changes since the 1960's. In the United States, the Uniform Commercial Code ("UCC") is being redrafted; two new

articles have been added and a third is proposed.[1] Numerous states and several countries have redefined the concepts of signature and writing, and have also enacted new theories for determining when or whether a person is responsible in contract.[2] A proposed European Union ("EU") Directive on Electronic Commerce calls for the EU countries to reconsider fundamentals of contract law.[3] A White House white paper lays out a commitment to long-standing U.S. adherence to concepts of contractual freedom updated to a newly emerging electronic

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1. The two new articles are Article 2A (leases of personal property) and Article 4A (funds transfers). *See* U.C.C. §§ 2A-101 to -532 (1993); *id.* §§ 4A-101 to -507. The American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the two UCC governing bodies, approved Article 2A in 1987. *See id.* § 2A-101 cmt. Article 4A was approved in 1989. *See* Julian B. McDonnell, *Definition and Dialogue in Commercial Law*, 89 NW. U. L. REV. 623, 629 (1995). The current, pending proposal is for an Article 2B of the UCC, dealing with "computer information transactions." *See* U.C.C. §§ 2B-101 to -802 (Proposed Draft Feb. 1999).

2. A comprehensive listing of enacted and proposed legislation dealing with this subject is located at McBride Baker & Coles, *Summary of Electric Commerce and Digital Signature Legislation* (last modified Jan. 11, 1999) <http://www.mbc.com/ds_sum.html>. This source lists over 35 states that have enacted legislation dealing with electronic or digital signatures. *See id.*; *see generally* RAYMOND T. NIMMER, THE LAW OF COMPUTER TECHNOLOGY ch. 14 (3d ed. 1997). Many of the statutes or regulations are of limited scope. However, several states, including Illinois, Minnesota, Utah, and Washington, have enacted relatively comprehensive legislation dealing not only with allowing electronics to satisfy traditional writing and signature requirements, but also with the liability of parties using and relying on digital signatures. *See* Electronic Commerce Security Act, Pub. Act 90-759, 90th Gen. Assembly, 1998 Reg. Sess. (Ill.), ILL. COMP. STAT. ANN. 73 (Lexis Pamphlet No. 7 1998) (effective July 1, 1999); MINN. STAT. ANN. §§ 325K.001 to .27 (West Supp. 1999); UTAH CODE ANN. §§ 46-3-101 to -504 (1998); WASH. REV. CODE ANN. §§ 19.34.010 to .903 (West Supp. 1999).

Internationally, the European Union has issued a proposed directive dealing with electronic signature issues. *See* Proposal for a European Parliament and Council Directive on a Common Framework for Electronic Signatures, COM(98)297 final at 3 [hereinafter Framework for Electronic Signatures]. The purpose of the proposal is to "ensur[e] the proper functioning of the Internal Market in the field of electronic signatures by creating a harmonized and appropriate legal framework for the use of electronic signatures within the [European] Community and establishing a set of criteria which form the basis for legal recognition of electronic signatures." *Id.* at 6. McBride Baker & Coles's Web site lists 16 countries that have taken steps with respect to digital and electronic signature laws, including relatively elaborate legislation in Germany, Italy, and Singapore. *See* McBride Baker & Coles, *supra* note 2.

3. *See* Council Proposal for a European Parliament and Council Directive on Certain Legal Aspects of Electronic Commerce in the Internal Market, COM(98) at 3 (Provisional final version 1998) (unofficial English translation) (on file with the *Houston Law Review*); *see also* A European Initiative in Electronic Commerce, COM(97)157 final at 16.

marketplace.[4] A Federal Trade Commission ("FTC") project calls for a fundamental reconsideration of consumer protection rules applying to e-mail, CD-ROMs, and the Internet.[5]

While there are other factors at work, the core explanation for this widespread activity lies in the emergence of a new market (actually a new economy) that does not fit old patterns. This new economy calls for renewed attention to how contract law interacts with commercial contract practices. Transactions in this new environment differ from transactions in the old in both technique and subject matter. The differences demand retailored contract concepts.[6]

We have experienced a fundamental shift from a goods-based economy to one a substantial part of which entails distribution of digital information and services. The contract law developed in the 1940's and 1950's to accommodate sales of toasters, automobiles, and other wares, while adequate for those purposes, does not correspond to the commercial premises relevant to contracts for licensed access to a digital database, for multi-location use of network or communications software, or for access to, or use of, other information assets. The images that legislators, judges, lawyers, and academics tend to employ in understanding these information transactions, however, refer

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4. *See* White House, *A Framework for Global Electronic Commerce* (last modified July 1, 1997) <http://www.ecommerce.gov/framewrk.htm>.

5. *See* Interpretation of Rules and Guides for Electronic Media; Request for Comment, 63 Fed. Reg. 24,996 (1998); *see also* Public Workshop: U.S. Perspectives on Consumer Protection in the Global Electronic Marketplace, 63 Fed. Reg. 69,289 (1998) (inviting comments on the subject of consumer protection in the global electronic market place).

6. A related aspect of the reshaping of law caused by the new economy lies in the changes in traditional intellectual property fields, especially in copyright law. These include the enactment of expanded database protection in Europe and the significant modifications that have been made in U.S. copyright law, including limited statutory recognition of "moral rights," digital performance rights, and, most recently, the enactment of expansive protections for digital monitoring and security devices that augment copyright protection. All of the following have been enacted within the past decade: 17 U.S.C. § 106(6) (Supp. II 1997) (establishing the owner's right to control the digital audio transmission of a sound recording); *id.* § 106A (protecting the rights to attribution and integrity for certain works of visual art); *id.* § 1101 (establishing a right to control fixation and trafficking of certain live performances); and Digital Millennium Copyright Act, Pub. L. No. 105-304, 1999 U.S.C.C.A.N. (112 Stat.) 2680 (to be codified at 17 U.S.C. §§ 1201-1332). *See also* European Parliament and Council Directive 96/9/EC of 11 March 1996 on the Legal Protection of Databases, art. 3-4, 1996 O.J. (L 77) 20, 25 (establishing a new extraction right with reference to the otherwise unprotected content of a database). In addition to various revisions of intellectual property law in its traditional sense, other rights in information have come to the forefront, especially in Europe. *See, e.g.*, Council and European Parliament Directive 95/46/EC, 1995 O.J. (L 281) 31 (promulgating rules to protect the process, sale, and movement of personal data).

back to the other type of commerce, causing dislocation, misunderstanding, and uncertainty.

The idea that "information" can be the subject matter of a commercial exchange is not new, but the extent to which such transactions permeate the marketplace is new. The motion picture, broadcast, and print publishing industries seem to have been with us for a long time but this is true only for the *print publishing industry*. The motion picture industry is approximately one hundred years old, while other information and entertainment industries are far newer, dating only to the 1970's or 1990's. This growth resonates from the emergence of an information-based economy fueled by the interactive and communications capabilities of software and digital systems. The commercial issues in creating, compiling, distributing, and enabling use of the output of these information-sector industries entail, overall, a vastly different enterprise than does manufacturing and distributing hard goods ("wares" as Karl Llewellyn described them). The subject matter is intangible; the rights and duties associated with them are defined not by the old law of personal property, but by technological control of systems or property rights under intellectual property law, such as copyright.[7] The contractual relationships differ dramatically from those of the goods or "real" estate sectors. The dominant types of contracts for intangible property are licenses, or other limited grants, in which the transferor retains the right to control not only the information, but also the uses of the information given to the transferee.[8] This is a far different model than a sale of goods, which gives the buyer full rights in the subject matter (*i.e.*, the item sold).

This Article discusses these differences and their consequences for contract law, especially for commercial contract law. Part I deals generally with the question of how contract law should relate to contract and commercial practice, and with the role of the images used to develop appropriate contract law rules. In the United States, that relationship has always been one of seeking to foster freedom of contract and to facilitate the creation of, and reliance upon, commercial contractual relationships.[9] Although this focus has been muddied by the tendency toward regulation in consumer relationships and other selected areas of

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7. *See, e.g.*, PAUL GOLDSTEIN, COPYRIGHT, PATENT, TRADEMARK AND RELATED STATE DOCTRINES 6 (4th ed. 1997).

8. *See* RAYMOND T. NIMMER, INFORMATION LAW ch. 11 (1996) (discussing licensing of information).

9. *See generally* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 1-3, at 5-6 (3d ed. 1987).

commerce (*e.g.*, securities law), the basic principles remain strikingly resilient in fundamental contract law. Those principles argue for a legal regime in which contract rules serve a background function, providing rules appropriate to the commercial relationship. The rules, however, are routinely and comprehensively subject to the dominant effect of the parties' agreement.[10]

In the 1930's, Llewellyn used a seemingly simple insight to support development of what eventually became UCC Article 2—he emphasized that the labels and images we use as reference points do matter in making decisions about appropriate contract law.[11] In a time following basic change in the economy, the images we deploy are likely to be throwbacks to an older era that may serve poorly in the new. In the 1930's, Llewellyn was talking about the change from an agrarian to an industrial economy. Today, we face the same issue caused by the change from a goods-based economy to an information and services economy. The images that we bring from the world of goods differ fundamentally from the reality and expectations in the world of information and services transactions.

Part II of this Article explores some of the differences between goods and digital information as commercial subject matter. It then asks what should be a simple question in an information economy: "If I give information, rights in information, or services to you, what obligations of accuracy, quality, or utility do I have?" In answering this question, we see a sharp distinction between this field and the application of existing contract law to sales of goods. The obligations established in reference to sales differ from the obligations anticipated regarding services and information. We also see a direct illustration of the disorientation created by mismatched images, for here the distinction between the subject matter of traditional commerce (goods) and the subject matter of the new economy (information and services) is most clear. By relying on categories and images that do not sensibly relate to the commercial context with which we currently deal, current contract law provides little coherent guidance for modern transactions in the information economy. A comparison to the misuse of the concept of title to resolve risk-of-loss in the pre-Llewellyn era is apposite and explicit because in both contexts the result in

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10. *See, e.g.*, U.C.C. § 1-102(2)(b) (1995) (stating that one of the purposes of the UCC is "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties").

11. *See* K.N. Llewellyn, *The First Struggle to Unhorse Sales*, 52 HARV. L. REV. 873, 873 (1939) (discussing the long historical struggle for clear analytical tools and concepts adapted to commercial needs).

reported cases is not always an incorrect outcome; but a failure of relevance. The law fails to provide relevant standards for parties and courts to plan transactions or resolve disputes.

Today, the question of obligation in information-based transactions is resolved by a process of categorization that is not only inexact, it is incomprehensible. The categories range from labeling an information deal as a transaction in goods, to describing it as a services contract. Courts lack a coherent language of obligation for these transactions and, thus, draw on concepts and labels from law geared to another era and a different transactional framework. One primary contribution that we can make to the new economic environment is to begin to provide a lexicon and framework derived from a focus on these types of transactions themselves. This, of course, is exactly what is proposed in proposed Article 2B of the UCC.

II. CONTRACT AND COMMERCE

What we describe as "contract law" is actually comprised of highly differentiated and heterogeneous clusters of cases and statutes pertaining to contracts. These cases and statutes apply different approaches and rules to different types of contractual relationships. Those who focus solely on the uniform provisions of the UCC for sales and leases of goods, or on the seemingly uniform principles of the *Restatement (Second) of Contracts*, may not recognize this. "Contract law" does not exist as a single integrated whole in any manner relevant to parties engaged in commerce.[12] While academics properly seek to delineate common historical and current themes, the reality of contract law in commerce lies more in differentiation than in commonality.

This has always been true. The presence of sub-themes or fields within a general area of law is embedded in common-law decisionmaking. Courts are expected to make distinctions between subject matter and context. The distinctions have been accentuated by statutory and regulatory involvement. Differentiations have been made for example, between "consumer credit contracts" and transactions in "securities" for purposes of promulgating regulatory rules. The law to which courts and parties turn in deciding the enforceability of a term in an employee contract is different from the law courts use in deciding

12. "'One system of precedent' we may have, but it works in forty different ways." K.N. Llewellyn, *On Philosophy in American Law*, 82 U. PA. L. REV. 205, 205 n.* (1934).

the enforceability of a real estate deed; both differ from the law that governs enforceability of licenses of information.

The existence of distinctions among different types of commercial contracts is one reason why the current UCC contains extensive treatment of transactions in goods, but not other transactional subject matter. The statutory treatment of sales of goods defines rules that differ from contract law applicable to real estate, information, services, employment, and other fields of contract law—all fields for which there is currently no treatment in the UCC.[13] A fundamental premise in the proposal and enactment of Article 2 on sales of goods was that commercial practice and, thus, appropriate commercial contract law, differed for contracts involving the sale of manufactured goods.[14]

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13. It is, of course, true that the principles of Article 2 have filtered over into other areas of "common law" as courts have turned to some of these principles by analogy. *See* E. ALLAN FARNSWORTH, CONTRACTS § 1.10, at 33-35 (1982) (discussing the common practice of applying Article 2 to other analogous contractual situations). This is clearly the case in the parallel contract law proposal contained in the *Restatement*. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981) (dealing with the concept of unconscionable terms or contracts). However, analogies are sometimes, but not always, appropriate. As we shall see below, courts have resisted analogies in cases in which they identify the subject matter of the litigation as services or information, and the substantive issue focuses on the application of Code warranty rules. Refer to notes 144-60 *infra* and accompanying text.

14. The question of when it is appropriate or useful to treat a body of related case and statutory law as a field of contract, or as suitable for inclusion in the UCC or other body of uniform law, is at best an inexact science. Llewellyn referred to this question as asking when a body of practice and case law emerge into a field. *See* Llewellyn, *supra* note 11, at 880.

> Our fields of law, our patterns of legal thinking, our legal concepts, have grown up each one around some 'type' of occurrence or transaction, *felt* as a typical something, *seen* in due course as a legally significant type, and, as a type-picture, made a standard and a norm for judging.

Id. at 880. The first treatises on the law of sales did not appear until 1847. *See* COLIN BLACKBURN, A TREATISE ON THE EFFECT OF THE CONTRACT OF SALE ON THE LEGAL RIGHTS OF PROPERTY AND POSSESSION IN GOODS, WARES, AND MERCHANDIZE (1847); WILLIAM W. STORY, A TREATISE ON THE LAW OF SALES OF PERSONAL PROPERTY (1847). Yet by 1940, the United States had already seen a uniform act and the beginnings of a proposed total revision and displacement of that act, namely Article 2. Llewellyn noted:

> [It] would be a very troublesome question, if anyone bothered to look into it, just what the relationship between the "field" of contract and the "field" of Sales might be, or indeed how a man can spot "a field" of law when he sees one, anyhow, and figure out its relation to its neighbors. Enough for us at the moment that Sales is supposed to center on the transfer of property in goods, and covers also contracts which look to that end, and that it must be a field, because there are books about it. . . . But the presence of books, casebooks, and titles in encyclopedias would seem to settle the matter. It is a field.

K.N. Llewellyn, *Across Sales on Horseback*, 52 HARV. L. REV. 725, 728-29 (1939). Elsewhere, I addressed some of the criteria that indicate the desirability of following

This system of contract law hinges on drawing appropriate distinctions and relevant categories within commercial contracting. This does not always happen; it is less likely to happen when the economy, and the demands it places on institutions of law undergo a paradigm shift. Llewellyn highlighted this in 1939 and in the next decade of his writings and politicking.[15] Early on, he described a transition from general "contract" law to a newer sub-field law of "sales," but argued that the transition had previously relied on images from the law of chattels, rather than on concepts related to mercantile "wares" (*e.g.*, manufactured goods) as a source for rules of the law of "sales." This focus affected many contract law rules. One was the doctrine relating to implied assurances of quality in a delivered good. The early courts that dealt with manufactured goods referred for guidance, in part, to the law of horses and, more accurately, to contract decisions dealing with horses.[16] However, the practice regarding horses required the buyer to inspect and take the risk, while in Llewellyn's mind, the commercial expectations for manufactured wares were (and should have been) different. Of course, he preferred rules that reflected this different commercial expectation.

Courts and legislators categorize issues based upon their own experiences and the images that these experiences establish. This is always true. Yet, especially after a paradigmatic change, the images of past experiences often lead to waging or continuing the wars of a prior era with tools developed from that era, while the world of commerce has already been transformed. When new commercial paradigms take hold, such as what occurred in the transition from a farm-based to an industrial economy, the old images are likely to persist, and to mislead our thinking about transactions that engage the newer paradigms. Llewellyn described this situation as one that presents a question about whether courts and others have been given suitable "intellectual equipment" (analytical structures) to approach the issues.[17] He commented:

> *Unless* the *stock* intellectual equipment is apt, it takes extra art or intuition to get proper results with it.

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the course that Llewellyn set for differentiating commercial fields. *See* Raymond T. Nimmer, *Intangibles Contracts: Thoughts of Hubs, Spokes, and Reinvigorating Article 2*, 35 WM. & MARY L. REV. 1337 (1994); Raymond T. Nimmer, *Services Contracts: The Forgotten Sector of Commercial Law*, 26 LOY. L.A. L. REV. 725 (1993).

15. *See* Llewellyn, *supra* note 11, at 884 ("To be carried forward, emerging legal ideas need to be shaped, then to *be fixed in doctrine* before the facts which call them forth lose sway.").

16. *See* Llewellyn, *supra* note 14, at 746.

17. *See* Llewellyn, *supra* note 11, at 876.

> Whereas *if* the stock intellectual equipment is apt, it takes extra ineptitude to get sad results with it. And the work of the artist, accomplished with poor intellectual equipment, is not clearly intelligible to the inept reader. It does not talk to him, it does not provide him tools, it does not help him to focus issues.[18]

Why is this important? If we answer that question based on a focus on the effect of law in litigation, the answer is that the wrong tools may lead to wrong decisions unless a creative judge circumvents the problem. Yet, from a transactional perspective, in which contract law has its true impact, an inappropriate decision in a particular case may be less important than the other consequences of wrong "intellectual equipment" or images.[19] Decisions based on wrong images about the nature of the transaction and the commercial demands of the subject matter do not provide guidance to those who plan future economic activity based on the implications of the decision. As Llewellyn observed, a decision based on inapt images does not "talk to" the reader. Instead, the decision uses the wrong language or, at least, language that, in the experience of the commercial reader, is not relevant to the commercial transaction environment in which it functions.

A. *Contract Law: Default Rules*

Correct images are critical to contract law. Ultimately, contract law is a practical legal discipline that contemplates an impact on the behavior of parties and markets. We should evaluate that law not primarily on whether the rules yield correct results in litigation, but on their impact on commercial contracting or the transactional process.

The difficulty in making this evaluation arises from a simple fact: we actually know little about the interaction between law and practice in contracts. Modern jurisprudence reflects various perspectives.[20] Yet, each proposes a different relationship between

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18. *Id.*

19. *See, e.g.*, 1 RAYMOND T. NIMMER, COMMERCIAL ASSET-BASED FINANCING § 1.11 (1992) (discussing the potential impact of external rules of law on contract principles); Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984); Jan R. Macneil, *A Primer of Contract Planning*, 48 S. CAL. L. REV. 627 (1975).

20. *See, e.g.*, Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 733 (1992) [hereinafter Ayres & Gertner, *Strategic Contractual Inefficiency*]; Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 94 (1989) [hereinafter Ayres & Gertner, *Filling Gaps in Incomplete Contracts*]; Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 314 (1986); David

law and contract practice. The actual relationship between a contract law rule and actual contract practice is not well understood; there is little empirical evidence about actual contracting behavior and even less about how contract *law* affects that process.[21]

Lack of understanding about how contract law interacts with other factors in a transactional environment is one cause for being circumspect about attempting to control commercial contract behavior through regulatory rules. When we try to write rules and regulations that *mandate* outcomes or place *limits* on contractual contexts, we may ultimately have no understanding about what adjustment, cost, and dysfunction these mandates create. We do know, however, that adjustments will occur unless the mandate coincides fully to the marketplace demands or expectations. Of course, the mandate is likely to so conform only for a short time as markets change and practices transmute into varying forms over time.

There is one thing that we do know about the relationship between contract law and contract practice: given legal theories of "contract choice" and practical realities of personal options and market dynamics, the rules of contract law affect outcomes of

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Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1861 & n.157 (1991); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 490 (1989); Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J. LEGAL STUD. 105, 108-09 (1989); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 285 (1985); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Default Rules*, 100 YALE L.J. 615, 617 (1990); Peter Linzer, *Uncontracts: Context, Contorts and the Relational Approach*, 1998 ANN. SURV. AM. L. 139, 139; Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 60, 62 (1963); Ian R. Macneil, *Power of Contract and Agreed Remedies*, 47 CORNELL L.Q. 495, 498 (1962); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contacts*, 19 J. LEGAL STUD. 597, 598-99 (1990).

21. *Compare* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 4 (explaining that "only a handful of empirical studies focusing on particular contract problems and relationships" have been made), *with* Macaulay, *supra* note 20, at 55 (reporting findings of when contract is and is not used in exchanges between businesses). The highly theoretical constructs used in some contract literature refer to behavior in an abstract world that does not correspond to actual, much more complex transactional environments. *See, e.g.*, Ayres & Gertner, *Strategic Contractual Inefficiency*, *supra* note 20, at 733 ("The hypothetical contract standard fails to account for the inefficiencies that can be caused by strategic bargaining under conditions of asymmetric information and how these inefficiencies depend upon, and can be exacerbated by, the costs of contracting around a given default rule."); *see also* Daniel A. Farber, *Parody Lost/Pragmatism Regained: The Ironic History of the Coase Theorem*, 83 VA. L. REV. 397, 421 (1997) (describing Ronald Coase as "fiercely critical of modern economics for being too immersed in abstract theory at the expense of realism").

transactions only indirectly, if at all. To the extent that the parties expect that their agreement will be enforced and can alter the effect of contract law rules, those rules become background factors, much like the rules of property law, which play a similar background function. These background rules may provide a bargaining point in negotiated contracts, or they may indicate what language leads to particular results.[22] The relative strength of contract law, however, as contrasted with other more tangible effects such as market power, bargaining strategy, market preferences, marketing strategy, consumer demand, cost, timing, and other considerations, remains unknown, although one suspects that the contract law rules are not routinely the major concerns in a contract negotiation.[23]

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22. *See, e.g.*, Ayres & Gertner, *Strategic Contractual Inefficiency*, *supra* note 20, at 743.

23. One illustration involves the rule in *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854). Law and economics scholars often treat *Hadley* as a rule that sharply limits the liability of a promisor for consequential damages in the event of breach. *See* Johnston, *supra* note 20, at 616. This is a "default" rule in that the parties can contract for a different result. *See* Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 CAL. L. REV. 563, 566 (1992). A number of authors have justified this rule as a "penalty" or an "information-forcing" rule that supposedly forces a promisee concerned about risking extensive consequential losses in the event of breach to signal that concern and seek to bargain around the default rule for contract terms that makes the promisor liable for more extensive damages. *See* Ayres & Gertner, *Filling Gaps in Incomplete Contracts*, *supra* note 20, at 91, 101-02; John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1623 (1989) (advocating coercive default rules because they force "those possessing private information to disclose it to the market," thereby achieving greater accuracy in pricing); Scott, *supra* note 20, at 609-10 (stating that information-forcing default rules maximize the benefits of contracting to achieve greater efficiency "by stimulating the transmission of information between bargainers"). Arguably, this allows the promisor to take a proper level of precaution in return for a higher price. But, while this incentive may exist, it may be off-set by competing strategic considerations. Furthermore, strategic considerations which focus on obtaining a better "bargain" are more immediate and direct in the contracting party's contemplation than concerns about what rule would apply in the event of non-performance, large loss, and resulting litigation. As Jason Johnston notes:

> [I]f we are talking about *bargaining* over the contract, then we are talking about a process of strategic information transmission, a process in which the promisee tries to persuade the promisor that she cannot pay a high price, and the promisor tries to persuade the promisee that she should. In this process, the promisee would generally want to convince the promisor that her value from performance is low . . . .

Johnston, *supra* note 20, at 616-17. The promisee would not desire to communicate to the other party that non-performance may inflict large loss.

The world of commercial contracting is complex. What actually occurs in reference to consequential loss or other default rules must be filtered through an understanding of that complexity and the uncertainty of prediction that it creates. Generally stated, conceptual models of contract bargaining are always inexact. "[R]elatively simple contractual settings can give rise to enormous complexity. While . . . different default rules . . . would be theoretically efficient, our model suggests that there

This yields a preference for contract law rules that serve a default or gap-filling function in a contracting relationship.[24] While some occasionally argue for default rules intended to alter behavior in a contracting process,[25] the very complexity of the context indicates that this will never be a successful strategy. Instead, the dominant approach, pioneered by Llewellyn, is that default rules should mesh with expected or conventional practice in a manner that projects a favorable and predictable result if the parties' agreement does not alter the rule.[26] Here, predictability means *the parties'* predictions or expectations in the particular context. Default rules of this type by definition should be tailored to the commercial context as indicated in ordinary commercial practice. A further, but related premise, is that default rules should reflect the principle that the proper goal of contract law is to facilitate commercial practice, rather than to regulate or impede it.[27]

The idea that the content of default rules should relate to commercial practice in one way or another has been relatively widely accepted. For example, one description about how default rules assist in facilitating contracting goes as follows:

> [T]he law supplies standardized and widely suitable risk allocations which enable parties to take an implied formulation "off the rack," thus eliminating certain types of costs and errors arising from individualized specification of terms . . . . [A]typical parties are invited to formulate express provisions that redesign or replace ill-fitting implied rules. Thus, state-supplied terms provide the parties with time-tested, relatively safe provisions that minimize the risk of unintended effects . . . [while the risk of distortion] can be reduced by exercising the option to specify . . . express terms.[28]

Of course, the actual relationship between the default (off-the-rack) terms and the actual activity that leads to the creation of a

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is small hope that lawmakers will be able to divine the efficient rule in practice." Ayres & Gertner, *Strategic Contractual Inefficiency*, *supra* note 20, at 733.

24. *See* Ayres & Gertner, *Filling Gaps in Incomplete Contracts*, *supra* note 20, at 89.

25. *See, e.g.*, Coffee, *supra* note 23, at 1623.

26. This is in contrast with rules that dictate terms and attempt to regulate commercial behavior. As a matter of practice, default rules are most common in commercial contexts, while "consumer law" contains many immutable rules designed to protect the consumer against mercantile over-reaching.

27. *See, e.g.*, Ayres & Gertner, *Strategic Contractual Inefficiency*, *supra* note 20, at 745; Charny, *supra* note 20, at 1831; Craswell, *supra* note 20, at 509 (explaining that contract laws should be chosen to promote efficiency); Johnston, *supra* note 20, at 618 (declaring that "expansive default rules often eliminate strategic impediments to bargaining around the default").

28. Goetz & Scott, *supra* note 20, at 266.

contractual relationship is far more complex. Yet, the concept remains viable and demands default rules that are standardized and "widely suitable" so that they can be frequently used (or ignored) without disruption or costly negotiation. This reality requires a reference geared at least in part to transactional practice.[29]

One way of measuring whether a law (common law or uniform code) achieves this result is to ask whether parties in general will be surprised or accept the fact that an applicable rule results in a particular manner to their deal on an issue they did not specifically address. There is no way to answer this question for particular individuals or individual transactions in any manner that reasonably informs how the law should develop, nor is there a way to provide a plausible answer for most such questions if one undertakes to cover "all" contractual relationships. But, as Llewellyn recognized, one can begin to answer this question effectively in general terms *if* the applicable rules identify a commercial field for analysis and focus on how commerce generally functions in that environment.[30] Of course, if the analysis incorrectly chooses the focus or is too broad, the result is that we create or employ the wrong intellectual equipment. If we extrapolate commercial concepts from one commercial setting to an entirely different one with different functional principles, we enhance the likelihood of error and give little guidance to parties constructing transactions in *their* world and commercial setting. There are many cases in which this now occurs. Consider the following transaction:

> Party A grants a license to Party B to use A's patented petrochemical technology in return for a royalty interest of ten percent of the sales price of products containing the technology. Party A agrees to provide Party B with

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29. Approaching the issue from a different perspective focused on the role of consent, Randy Barnett reaches the same conclusion. *See* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 829 (1992). Barnett stated:

> First, . . . default rules [that reflect the conventional or common-sense understanding existing in the relevant community] are likely to reflect the tacit subjective agreement of the parties and thereby facilitate the social functions of consent. Second, when parties have asymmetric access to the background rules of contract, enforcing conventionalist default rules will reduce subjective disagreements by providing parties who are rationally informed of the background rules with an incentive to educate those parties who are rationally ignorant of these rules.

Id.

30. *See* Robert D. Cooter, *The Theory of Market Modernization of Law*, 16 INT'L REV. L. & ECON. 141, 145 (1996) (illustrating how Llewellyn "tried to identify and articulate the best commercial practices in contemporary business communities").

> on-going support (advice) to use the technology. Party B invests fifty million dollars in developing systems for its use of the licensed technology. The agreement of the parties does not specify the duration of the license.

As normal commercial practice, it is likely that the parties expect that the license will last for the duration of the patent.[31] The Article 2 sales law rule, however, if it applies, holds that in such cases the duration of an indefinite contract is a "reasonable time," to be judged by the commercial context.[32] This open-ended rule, of course, has the benefit of allowing a court (in the case of a dispute) to fit the law to the facts and equities as it sees them. It also has the negative result of giving the parties involved in such contracts essentially no guidance or their rights without going to court. That being said, what the parties may not expect, however, is the second element of the common law and Article 2 rule: that an indefinite term contract can be terminated "at will" by either party "at any time."[33] This right to terminate, if applicable to this license, means that Party B's investment is at risk because Party A can terminate the license at will.

The point here is not that a court faced with a dispute resulting from the assertion of a right to terminate at will must reach this result, nor is it that a *creative* court could not interpret the basic rule to protect Party B's investment. Either result could happen. The point is that a rule which does not reflect reasonable commercial understandings in a particular area of commerce penalizes parties who did not negotiate or otherwise deal with the issue by forcing recourse to courts for (one hopes) a commercially reasonable result.[34] More generally, the contract

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31. In addition to empirical observation, there are a number of reasons to suspect that this is the ordinary position or expectation. For example, under federal patent case law, licenses that extend beyond the term of the patent may constitute patent misuse. *See, e.g.*, Lear, Inc. v. Adkins, 395 U.S. 653, 674 (1969); Brulotte v. Thys Co., 379 U.S. 29, 33-34 (1964) ("[A]n attempt to project [the patent] into another term by continuation of the licensing agreement is unenforceable."). *But see* Aronson v. Quick Point Pencil Co., 440 U.S. 257, 264 (1979) (finding that the *Lear* rule is inapplicable when "no patent has issued, and no ideas have been withdrawn from public use").

32. *See* U.C.C. § 2-309(1) & cmt. 1 (1995).

33. *See id.* § 2-309(2); Ticketron Ltd. Partnership v. The Flip Side, Inc., No. 92 C 0911, 1993 WL 214164, at *4 (N.D. Ill. June 17, 1993) (explaining that licenses are revocable at will); *see also* Zimco Restaurants, Inc. v. Bartenders & Culinary Workers' Union, Local 340, 331 P.2d 789, 793 (Cal. Ct. App. 1958); Soderholm v. Chicago Nat'l League Ball Club, Inc., 587 N.E.2d 517, 520 (Ill. App. Ct. 1992) (same). This rule may be precluded from application in cases involving indefinite copyright licenses. *See* Rano v. Sipa Press, Inc., 987 F.2d 580, 585 (9th Cir. 1993) (applying 17 U.S.C. § 203(a) to assert that federal copyright law preempts state law regarding licenses that are terminable at will because they contain no duration clause).

34. Of course, if the particular rule does not reflect commercial practice, the

rule fails to give a court reasonable intellectual tools to achieve that result in the event of litigation because it is not based on a reasonable image of the actual commercial context. Here, a default rule more attuned to the commercial context might yield a different result, such as a presumption in a license of intellectual property rights that the license extends for the term of the intellectual property rights or, in some cases, that it is perpetual and cannot be terminated except for breach.[35]

In our illustration, the default rule penalizes parties who do not focus on and resolve the specific issue to which the rule pertains: the right to terminate at will. In structuring contract law for licensing or other information transactions, we need to ask whether that is a sensible outcome. The answer should not hinge on some abstract notion of what the rule should be in a general world, but should focus instead on what in general are the expectations of the parties in such transactions. This is especially the case when, as in the world of information licensing, extensive and significant commercial practice has developed around this type of commercial relationship. Another illustration has greater commercial relevance.

> Assume that Computer Association licenses multi-station software to DuPont for one year for ten million dollars, providing that the software cannot be used by more than one thousand simultaneous users. The license does not contain terms about who owns the disk on which the software is delivered because the parties regard the disk as irrelevant to the contract and as nothing more than a convenient conduit for the transfer of the contractual subject matter—the software. The contract does not give DuPont the right to modify the software. It is silent on the issue because such modification would be copyright infringement unless the right to do so were affirmatively granted to the licensee.

The parties will not be surprised to learn that the one-year duration and the use limitation are ordinarily enforceable.[36] These terms define the nature of the product and the length of the contract. The parties are likely to be surprised, however, when they learn that if an analytical image (or rule) from an

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parties may not anticipate the default rule and bargain around it. *Cf.* Ayres & Gertner, *Filling Gaps in Incomplete Contracts*, *supra* note 20, at 91.

35. *See* U.C.C. § 2B-308(2) (Proposed Draft Feb. 1999) (making various software and other licenses presumptively perpetual, subject to cancellation for breach).

36. *See* Ronald L. Yin, *Hardware and Software Licensing Issues for the 1990s*, 19 HASTINGS INT'L & COMP. L. REV. 691, 697 (1996) ("A field of use limitation is, in general, enforceable.").

Article 2 sale of goods contract applies to this transaction, *delivery* of the *disk* may constitute a first sale, transferring title *to the disk*.[37] The *first sale* gives the licensee the right to modify its copy of the program unless the contract specifies otherwise.[38]

This is an artifact of the images carried over from Article 2 because of its focus on *sales* of goods. In that context, the presumption of passing title to the tangible item upon delivery makes sense and meets most ordinary transactional expectations. In other types of transactions, including licenses, it does not follow ordinary commercial expectations, especially outside of the mass market. For this reason, the presumption was not carried forward into Article 2A, which deals with leases of goods.[39] In leases, of course, it would be absurd to establish a basic principle that the lessor conveys title of the goods to the lessee. In practice, the nature of the transaction is entirely the reverse.

In our hypothetical, the issue is framed by the simple commercial fact that it is most likely that neither the licensor nor the licensee had any concerns about the ownership of the *disk* on which the software was delivered. A default rule centered on the commercial expectations for this type of transaction would more reasonably provide that title to a copy does not affect rights under the contract. Further, if title has importance, title does not pass unless the parties expressly agree that title to the disk will transfer. A sale of goods model renders neither a predictable nor an expected rule in this commercial context. Indeed, it creates a rule that turns on factors that have no relevance to the transaction at all, unless we assume that the focus of the deal was the plastic diskette, rather than its informational contents and the right to use them for one year.[40]

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37. *See* U.C.C. § 2-401(2) (1995) (stating that title passes by the physical delivery of the goods); *see also* Applied Info. Management, Inc. v. Icart, 976 F. Supp. 149, 154 (E.D.N.Y. 1997) ("[A] single payment for a perpetual transfer of possession is in reality a simple sale of personal property and therefore transfers ownership of that property, the copy of the software."); DSC Communications Corp. v. Pulse Communications, Inc., 976 F. Supp. 359, 362-63 (E.D. Va. 1997) (finding that because the transaction at issue involved a single payment, and gave the buyer an unlimited period in which it had the right to possession, it was a sale of a copy of the software).

38. *See* 17 U.S.C. § 117 (1994) (authorizing adaptation when it is an essential step in utilization or done for archival purposes).

39. *See* U.C.C. § 2A-302.

40. One reading of the consequence of applying an Article 2 model here has further implications. Section 2-401 provides that title passes on delivery of the goods and that any reservation of title is limited in effect to a reservation of a security interest. Read literally, this provision means that if an Article 2 model applies, the parties cannot, even by agreement, alter the result that a first sale occurs when the

Over fifty years ago, Llewellyn argued that commercial contract law should be developed by focusing on the commercial context so as to develop rules of relevance and positive effect *in that context*.[41] The same holds true today. Then, the issues centered on a transition from agrarian commerce to mercantile commerce in manufactured goods.[42] Now, contract law has a similar shift to account for, but the transition is away from a model of sales of manufactured goods and toward one in which the subject matter of a commercial transaction consists of digital and other information.

B. Sales of Goods as the Image

The dominant image in U.S. commercial contract law today reflects the rules created for the sale of goods that Llewellyn and his successors struggled to update in the 1940's and 1950's.[43] Those rules were to be closely tailored to a particular commercial context. Yet, they have been widely applied to other fields directly, or by analogy.[44] The sale of goods image has become an integral part of the common law in many states.[45]

Is this appropriate? Certainly the images seem appropriate in the context for which they were formulated. Yet, transactions in information and services differ from sales of goods as fundamentally as the transactions in a world of farms and horses differed from sales in the industrial world of manufactured products.

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diskette is delivered.

41. *See* Llewellyn, *supra* note 11, at 876.

42. Stephen M. Feldman, *From Premodern to Modern American Jurisprudence: The Onset of Positivism*, 50 VAND. L. REV. 1387, 1405 (1997) (explaining that, "the United States began to metamorphose, changing from a largely agricultural country into an industrial society and economy").

43. Llewellyn began his campaign for contract reform in the 1930s. *See* K.N. Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U. L.Q. REV. 159 (1938). The article draws a distinction between sales of goods in commercial and noncommercial settings, as did Llewellyn's draft. *See* Robert L. Flores, *Risk of Loss in Sales: A Missing Chapter in History of the U.C.C.: Through Llewellyn to Williston and a Bit Beyond*, 27 PAC. L.J. 161, 205 (1996) (describing the development of Llewellyn's campaign to reform contract law dealing with goods). By 1959, the drafts were revised to propose the Sales Article of the UCC. *See id.* at 215. By 1967, all states except Louisiana replaced existing statutes and common law of sales with the UCC. *See* John P. Esser, *Institutionalizing Industry: The Changing Forms of Contract*, 21 LAW & SOC. INQUIRY 593, 596 (1996).

44. *See, e.g.*, Whitney Bros., Co. v. Sprafkin, 3 F.3d 530, 533 n.5 (1st Cir. 1993) (applying the UCC by analogy to a sale of securities).

45. *See* Dominick Vetri, *Communicating Between the Planets: Law Reform for the Twenty-First Century*, 34 WILLAMETTE L. REV. 169, 192 (1998) (demonstrating the absorption of "novel statutory provisions introduced by the Code . . . into the remaining realm of the common law of contracts" by the courts).

Here, as in many aspects of Llewellyn's legacy, there is an anomalous aspect to the fruits of his effort and its effect on modern law. Article 2 was originally conceived of as a focused treatment of contract law applicable to a particular, narrow area of commercial contract law-mercantile sales.[46] Contrary to that original conception, the sale of goods model in Article 2 has been broadly applied as a paradigm in many contexts in which the commercial context differs from that associated with sales of mercantile goods.

Llewellyn argued hard for the need to carve out the rules governing mercantile transactions involving sales of wares in a commercial market from the general field of contracts.[47] He believed that these transactions differed from other transactions within the general field of contract.[48] From his perspective, developing tailored rules for this narrowed "field" was essential in order to fit rules rationally to, and thus to support, commercial practice.[49] His writings describe a fixated belief that *this* (the world of mercantile goods) was the law of commerce. It may well have been when he first stated his ideas five decades ago.

Fifty years after Llewellyn began the codification of sales of goods law as a separate field, the codification he produced (Article 2) dominates aspects of the general contract law from which Llewellyn had intended to carve a new field. Its "tailored" concepts are now applied to transactions that have little or nothing to do with the commercial practice with which he dealt and that entail very different commercial expectations.[50] This

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46. *See* Ingrid Michelsen Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn's Attempt to Achieve the Good, the True, the Beautiful in Commercial Law*, 73 GEO. L.J. 1141, 1141, 1143 & n.11 (1985).

47. *See generally* Llewellyn, *supra* note 11 (discussing the need to make "conscious a proper merchants' law of wares"); Llewellyn, *supra* note 43, at 163-64.

48. *See* Llewellyn, *supra* note 11, at 874.

49. *See* Llewellyn, *supra* note 43, at 164.

50. The extension occurs in different ways. One is through doctrines carried forward by analogy to non-UCC contexts. The other, more problematic ways, are when courts construe the idea of "goods" broadly or when, in a "mixed" contract (*i.e.*, involving goods and services), the court concludes that the goods predominate and that Article 2 therefore applies to the entire transaction. *See, e.g.*, Cambridge Plating Co. v. Napco, Inc., 991 F.2d 21, 24-25 (1st Cir. 1993) (concluding that Article 2 governed the contract for design and installation of a wastewater treatment system because the contract "was so heavily weighted toward goods"); Stutz v. Minnesota Mining Mfg. Co., 947 F. Supp. 399, 402 (S.D. Ind. 1996) (applying the UCC to a contract authorizing a party to act as a distributor of products because the "predominant thrust" of the contract was the sale of goods); Colonial Life Ins. Co. of Am. v. Electronic Data Sys. Corp., 817 F. Supp. 235, 239 (D.N.H. 1993) (holding that the UCC applies to a multi-year data processing contract because providing a license to use computer software constitutes a sale of goods); Gross Valentino Printing Co. v. Clarke, 458 N.E.2d 1027, 1030 (Ill. App. Ct. 1983) (holding that a contract for printing magazines was a contract for goods, subject to the UCC, because the intent was to deliver a finished product); Cucchi v. Rollins Protective Servs. Co., 574 A.2d 565, 571

reversed application of Llewellyn's concept is ironic and especially troublesome when the tailored principles for sales of goods apply to transactions in digital information and services, in which the premises of commercial practice are not the same as those in buying and selling goods. The creation of his genius has swallowed its neighbors and, by doing so, has become the successor of the evil from the past that he sought to avoid.

Some of the general principles stated in Article 2 and the UCC are as appropriate for information and services transactions as they are for the sale of goods. These state a *hub* of contract law that does not depend upon an image grounded in the sale of goods. The hub is limited, however, and it is important to understand the nature of its limitations.

One aspect entails the contract rule requiring that a contract be interpreted by applying concepts of "practical construction."[51] This states the premise that a court should consider usage of the trade, course of dealing, and course of performance in interpreting the agreement and its terms.[52] The preference for a "practical," rather than "abstract," interpretation is an important basic tool for fitting contract law to the context.[53] It requires that a court recognize the significance of the commercial context.[54] Thus, in understanding the *agreement* of the parties, entirely different constructs may be relevant depending on the context of the transaction. For example, relevant content of the agreement in a transaction for electrical power or the conveyance of gas from the well-head differ from those in a retail sale of a desk.

The *agreement*, not the statute controls, and the agreement can be found not only in express words, but also in trade usage and course of dealing. Thus, for example, although Article 2 provides for implied warranties in a sales contract, they can be excluded or disclaimed.[55] Also, course of dealing, course of performance, or usage of trade can create or exclude an implied warranty.[56] The premise that practical construction controls, is a theme central to commercial law.

(Pa. 1990) (holding that the warranty provision of Article 2 applies by analogy to a contract for the lease and maintenance of a burglar alarm system).

51. *See, e.g.*, U.C.C. § 2-208(1) (1995).

52. *See id.*

53. *See generally* E. Allan Farnsworth, *"Meaning" in the Law of Contracts*, 76 YALE L.J. 939, 962 (1967).

54. *See* U.C.C. § 2-208(2).

55. *See id.* § 2-314 (implied warranty of merchantability); *id.* § 2-315 (implied warranty of fitness for particular purpose); *id.* § 2-316 (providing the methods by which implied warranties may be disclaimed).

56. *See id.* § 2-314(3); *id.* § 2-316(3)(c).

A second concept relevant to sales and other contracts is the rule that gives a court the power to invalidate a contractual term it believes to be *unconscionable*.[57] Promulgated in Article 2, the doctrine of unconscionability was intended to

> make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished [through various indirect means]. This section is intended to allow the court to pass directly on the unconscionability . . . . The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.[58]

The doctrine of unconscionability was subsequently incorporated into the *Restatement* and into the common law of many states.[59]

The basic theme of unconscionability can be understood only as juxtaposed with the premise that the contracting parties can vary the effect of most contract rules by agreement.[60] This, of course, reflects the doctrine of freedom of contract. Taken together, the doctrine of contract choice and the doctrine of unconscionability state a simple premise: in most cases, the agreement controls, but a court has limited power to set aside some of the contract terms when the circumstances manifest clear abuse and over-reaching. Unconscionability doctrine has served its role nicely and continues to do so.[61]

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57. *See id.* § 2-302(1) ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause.").

58. *Id.* § 2-302 cmt. 1.

59. *See* RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981). The comments to this section of the *Restatement* indicate a close correspondence to the treatment of this issue in the UCC. For example, comment d states:

> A bargain is not unconscionable merely because the parties to it are unequal in bargaining position, nor even because the inequality results in an allocation of risks to the weaker party. But gross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may confirm indications that the transaction involved elements of deception or compulsion, or may show that the weaker party had no meaningful choice . . . .

Id. § 208 cmt. d.

60. *See* U.C.C. § 1-102(3).

61. For recent applications of this theme, see *Intergraph Corp. v. Intel Corp.*, 3 F. Supp.2d 1255, 1285-86 (N.D. Ala. 1998) (finding a termination clause that provided limited notice unenforceable in a commercial context because it created "an *unconscionable state of affairs*"); and *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d

When one goes beyond these and a limited number of other generic themes, however, the adequacy of doctrinal images garnered from the sale of manufactured goods quickly becomes suspect when applied to contracts dealing with other subject matter. "Default rules" from the world of sales of goods create a right to inspect prior to delivery of the goods,[62] a right to immediate payment on their delivery,[63] a right to a perfect tender,[64] a concept of cure limited to the seller,[65] damages formulae that deny the seller consequential damages and that hinge recovery on resale or cover of a particular item.[66] These and other elements of the Article 2 structure presume a transactional focus on the delivery of particular items as the subject matter of the transaction. These rules and the images they follow are inapt models for transactions in which the essence of the contract involves services, intangibles, rights of access, funds, and the other aspects of modern commerce.

What, for example, is the role of a "right to inspect" before payment (presumed under Article 2) in a contract to view a motion picture at a theater? What is the relevance of a "resale" that fixes damages for breach in a non-exclusive license of a patent which, by definition, could be re-licensed by the licensor with or without breach by the licensee? Does the Article 2 concept of "perfect tender" reflect commercial expectations or appropriate public policy in a construction contract, or a maintenance contract or a contract for access to a digital database? The answer to these and other similar questions is simple: a creative judge might be able to bend, fold, and staple sale of goods concepts to avoid incorrect results in the different commercial contexts of information and services, but this mode of analysis is wrong and not conducive to consistently correct results in litigation. It does not yield a reasonably adequate fit between contract law and commercial practice.

The "intellectual equipment" brought over by an image that associates sales of goods law as a model for all contracts often creates the wrong framework. This does not mean that all decisions using that equipment reach the wrong results, although they often do. It does mean that the approach is grounded in the

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569, 571, 575 (N.Y. App. Div. 1998) (stating that although the standard-form contact, which was not seen until after the purchase, was enforceable, the arbitration clause included in the contract was unconscionable and invalid in part).

62. *See* U.C.C. § 2-513.

63. *See id.* § 2-507.

64. *See id.* § 2-503.

65. *See id.* § 2-508.

66. *See id.* §§ 2-703, -706, -712.

wrong concept and, thus, fails to give the parties or, especially, future parties guidance on what is expected in law as contrasted with what is expected in practice.

One further illustration underscores the problems:

> Assume that Licensee acquires a copy of copyrighted word processing software subject to a license from Licensor. The license permits Licensee to copy the software into its network and to use the software so long as there are no more than ten simultaneous users. The license prohibits any transfer of the licensed software without Licensor's written permission and provides that the license will terminate if any of its provisions are breached. Despite the terms of the contract, Licensee transfers the software to X for $10,000. The relevant question for our purposes is whether this transfer of the licensed software is valid.

Under current law, the answer to this question is likely to be controlled by federal law, which prohibits a transfer of a non-exclusive license without the consent of the licensor.[67] Putting the preemption issue aside, how would this case be analyzed under state contract law? One way of addressing the problem reflects a sale of goods model, while the other refers to a model centered on the information (the software) and the attempted transfer of a contract right to use that software.[68] The sale of goods approach yields an image that the key transfer is a transfer of the disk containing the software and that the enforceability of a restriction on this transfer faces up against "traditional" doctrines against restraints on alienation, precluding the enforcement of an anti-transfer clause in the sale of an item of goods. This doctrine, as applied to personal property, argues that a seller cannot sell an item to a buyer and also restrict the buyer's ability to resell it. Yet, it is highly unlikely that Licensor would be concerned about Licensee's transfer of the disk (the goods) electronically cleansed of the software. Licensor is concerned, instead, about the transfer of the *right* to use the software in a network for up to ten users.

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67. *See, e.g.*, Harris v. Emus Records Corp., 734 F.2d 1329, 1333, 1335 (9th Cir. 1984); *see also In re* CFLC, Inc., 89 F.3d 673, 679 (9th Cir. 1996) (concluding that federal law governs the assignability of patent licenses); Unarco Indus., Inc. v. Kelley Co., 465 F.2d 1303, 1306 (7th Cir. 1972) (citing the "long standing federal rule" that patent license agreements are not assignable unless specified as such in the agreements).

68. *See* Joel R. Wolfson, *Express Warranties and Published Information Content Under Article 2B: Does the Shoe Fit?*, 16 J. MARSHALL J. COMP. & INFO. L. 337, 360 (1997) (describing an information model that focuses on the parties' continuing and dynamic relationship).

Thus, the alternative view of the transaction is that it entailed a transfer of information (the software) subject to a contractual license, and that the transaction deals with the information, not primarily the diskette. As to restrictions on the transfer of copyrighted information and of contract rights, the common law applies a much different approach than with respect to resale of goods. This different approach is described in part in the *Restatement (Second) of Contracts*:

> In the absence of statute or other contrary public policy, the parties to a contract have power to limit the rights created by their agreement. The policy against restraints on the alienation of property has limited application to contractual rights. . . . A term in a contract prohibiting assignment of the rights created may resolve doubts as to whether assignment would materially change the obligor's duty or whether he has a substantial interest in personal performance by the obligee; or it may serve to protect the obligor against conflicting claims and the hazard of double liability.[69]

The comment goes on to state that, in some contexts in which assignments are common, this approach may create a policy of close interpretation of ambiguous anti-assignment clauses. However, the *Restatement* nevertheless expressly recognizes the validity of such clauses in reference to the transferability of contracts.[70]

In this case, then, failing to shed an inappropriate sale-of-goods centered model yields a wrong analysis or, at least, an analysis that misstates the underlying principles pertinent to a contractual transfer of a license agreement.

C. *Consumerism and Mass Markets as an Image*

Images generated by sales of goods dominate modern commercial contract law, often inappropriately extending into commercial contexts for which they were never designed and in which they do not give relevant guidance. Another powerful image in contract law embodies the idea of consumerism and images of the mass market in which consumers function as buyers. There are many aspects to this image, but the one most relevant here couples an assumption about the economic relationship between vendors and purchasers with the observation that most contracts are not extensively negotiated to

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69. RESTATEMENT (SECOND) OF CONTRACTS § 322 cmt. a (1981).
70. *See id.* § 322.

posit, as a matter of policy, the need to protect the purchaser and restrain the vendor.

The core premise of consumerism holds that individual consumers lack the sophistication and bargaining leverage to protect themselves in the thousands of contractual relationships into which consumers enter each year.[71] As a result, the analysis goes, government must intervene on behalf of consumers to ensure a balance in the relationship or, at least, to require disclosures in forms that the consumer can understand.[72] A corollary is that consumers lack the resources, and their transactions lack the economic stakes to make litigation an effective protection, thus creating a need for regulated outcomes and rules that enhance the ability to litigate individually.[73]

Focused on the prototypical *consumer* transaction involving a purchase of goods in the mass market, these premises have some empirical validity. Whether and to what extent their purported policy implications are appropriate requires comparing the benefits of a regulation, or litigation-causing rule, and the cost that such rules place on commerce to the results of reliance on general market effects. Regulation may be justified if the benefits clearly exceed the costs, and those benefits would not reasonably occur in an open-market, contract choice regime for consumers.

This is not a context to attempt to resolve or to propose principles for the resolution of this cost-benefit comparison for particular *consumer* rules.[74] My point lies elsewhere. It focuses on

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71. *See, e.g.*, John J.A. Burke & John M. Cannel, *Leases of Personal Property: A Project for Consumer Protection*, 28 HARV. J. ON LEGIS. 115, 152 (1991).

72. *See id.* (linking "[t]he relatively unequal economic power and knowledge of the market between the consumer and merchant" to the "basis for extending special protections to the consumer"); *see also* Henry G. Manne, *The Judiciary and Free Markets*, 21 HARV. J.L. & PUB. POL'Y 11, 33-34 (1997) (identifying the unequal bargaining power that places "uniformed buyers completely at the mercy of greedy and devious sellers who [are] trying to trick them").

73. *See, e.g.*, John L. Hill, *Introduction* to *Consumer Law Symposium*, 8 ST. MARY'S L.J. 609, 613 (1977) (stating that the primary purpose of the Texas consumer protection statute is to protect the "ignorant, the unthinking, and the credulous" and to give a remedy that makes cases cost effective for legal representation by removing the disincentives to litigate that are apparent with the small actual damages in most consumer claims).

74. As might be expected, in the revision projects related to the generally applicable UCC articles, the conflict between consumer protection rules and the goal of designing an appropriate commercial code has been sharp and extensive. *See* Mary Jo Howard Dively & Donald A. Cohn, *Treatment of Consumers Under Proposed U.C.C. Article 2B Licenses*, 16 J. MARSHALL J. COMPUTER & INFO. L. 315, 315-16 (1997) (commenting on the "provisions of Article 2B which are intended to increase consumer protection beyond that which is traditionally afforded to consumers under existing commercial statutes" (footnote omitted)); Gail Hillebrand, *The Uniform*

the more general effect of applying the consumer or mass-market image itself outside the prototypical marketplace for which it was constructed.

We live in a world in which the mass-market economy so dominates our experience in personally acquiring goods and services that the images of consumer law cannot avoid influencing our thoughts about contract law generally. The image is explicit. The purchaser of goods is in the subservient contractual position, while the seller of goods has market leverage and legal sophistication. Derived from an image of a world of retail sales of goods, this image assumes a lack of choice or alternatives on the part of an under-informed purchaser.[75] It also assumes that the seller is always the dominant party, while the purchaser (consumer) is always the subservient party in need of protection.

In a true consumer market, the image has some relevance. Outside a context defined by the consumer mass market, this image is an incorrect model for commercial contract law development. In a commercial market, the image of routinely subservient purchasers (licensees or buyers) does not accurately reflect practice. The nature of the information marketplace accentuates the degree to which the inaccuracy exists. Most vendors of information who provide works to publishers are individual authors dealing with relatively large corporate *purchasers*. Although there are large companies in the modern computer software industry, the average size of a computer software provider is fewer than twelve employees.[76] These small companies routinely deal with large corporate clients (*purchasers*). For example, Walt Disney Corp. is seldom the subservient party in its contracts and is never the unsophisticated party, especially in the many contracts in which it acquires services from small software development companies. Exxon is not subservient when it *buys* widgets for drilling rigs from a *seller* with total assets of $500,000. Warner Publishing is not the weaker party when it acquires a manuscript from an

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Commercial Code Drafting Process: Will Articles 2, 2B and 9 Be Fair to Consumers?, 75 WASH. U. L.Q. 69 (1997) (focusing on the scope of the changes to the UCC and how they will affect consumers and suggesting ways for the UCC drafting process to be more open to considering the interests of consumers); Fred H. Miller, *Consumers and the Code: The Search for the Proper Formula*, 75 WASH. U. L.Q. 187, 217 (1997) (emphasizing the importance of a UCC reform that includes provisions sensitive to consumers).

75. *See, e.g.*, Yvonne W. Rosmarin, *Consumers-R-Us: A Reality in the U.C.C. Article 2 Revision Process*, 35 WM. & MARY L. REV. 1593, 1596 (1994).

76. *See* Wendy R. Leibowitz, *In New UCC Software Contracts, is the Customer Always Wrong?*, NAT'L L.J., Feb. 23, 1998, at B8.

author. Who is the least sophisticated person in a contract for the sale of computers between Compaq Computer and DuPont Corporation?

In commercial transactions, it is as likely that the purchaser is the dominant, more sophisticated party as it is likely that it is the vendor who dominates. This, of course, is a simple aspect of the market, which consists of entities and people of all sizes and degrees of sophistication on each side of various transactions. A rule or predilection that establishes *protection* to benefit a buyer based on a consumer perspective makes little sense if applied to a corporate buyer whose multi-million dollar net worth exceeds the total value of the vendor by 10,000%. Yet, in many settings, expressly or implicitly, we equate "consumer" with "purchaser" and treat both as routinely in need of protection. For example, in Texas, the Deceptive Trade Practices-Consumer Protection Act[77] gives a right to treble damages for consumers injured by breaches of warranty or other similar conduct.[78] Originally, the Act defined "consumer" to include any individual who acquired goods or services,[79] and was used extensively in commercial litigation between corporate parties.[80] After years of political debate, the definition was refined to limit consumer status to any entity with assets of less than $25 million.[81]

Just as is true in the sale of goods, it is important to confine the consumer model to its appropriate context; otherwise, it yields an inapt analytical structure. This is especially relevant to transactions involving information assets. Unlike the world of goods in which large capital resources are often important for an effective commercial entity, small companies in information industries often survive and thrive. Indeed, small companies and individual entrepreneurs dominate in many of these industries. Even though the average size of a software company in this country is less than twelve employees, they routinely provide software to much larger entities. The ordinary size of the licensor

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77. TEX. BUS. & COM. CODE ANN. §§ 17.41 to .63 (Vernon 1987 & Supp. 1999).

78. *See id.* § 17.50; *see generally* Nancy Friedman Atlas et al., *DTPA in the Courts: Two Empirical Studies and a Proposal for Change*, 21 ST. MARY'S L.J. 609 (1990).

79. *See* TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1973) (amended 1987).

80. *See* John R. Harrison, Jr., Comment, *The Deceptive Trade Practices-Consumer Protection Act: The Shield Becomes a Sword*, 17 ST. MARY'S L.J. 879, 885 (1986).

81. *See* TEX. BUS. & COM. CODE ANN. § 17.45(4) ("'Consumer' means an individual, partnership, [or] corporation . . . who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of $25 million or more . . . .").

(provider) of text to a publisher is one person, but information vendors of this type are integral to traditional publishing and on-line commerce. The average size of an information research company is quite small, but the research and knowledge industries are critical to modern commerce. The average size of an Internet provider is unknown, but the medium allows small entrepreneurs to become international commercial entities.

Images based on a world in which the vendor routinely is the large party, and the recipient often is unsophisticated, have little relevance and are often dysfunctional in commerce in information. Here we need to ask a question that relates to the focus of contract law in a commercial code or in common law oriented to commercial practice. The question is not new. In 1970, David Carroll, a leading commentator, made the following observations about the then-new UCC:

> Although it has been effective in many states for only a few years, [it] is being attacked with increasing frequency. Charges are made of bias against consumers and of favoritism toward merchants, and angry rhetoric often erupts in classrooms from new law students, highly sensitive to the injustice and business bias they perceive in the Code.[82]

Carroll argued a simple premise, widely accepted at the time. This premise is that the *commercial* code failed to adequately address *consumer* issues.[83] Of course, he was right. A code or common law of *commercial* contract principles does not, and should not, center on consumer protection themes in its development of commercial law principles.

One innovation Llewellyn proposed in Article 2 was the development of merchant rules.[84] His proposal was consistent with the overall focus of Article 2. The concept was that contract law should support commercial practice.[85] By centering default rules on merchant (commercial) transactions, the rules could fit the commercial field.[86] In fact, however, the merchant rules mostly did not survive eventual enactment. Some were dropped entirely, and others were generalized so as to no longer provide a

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82. David W. Carroll, *Harpooning Whales, of Which Karl N. Llewellyn is the Hero of the Piece; or Searching for More Expansion Joints in Karl's Crumbling Cathedral*, 12 B.C. INDUS. & COM. L. REV. 139, 139 (1970) (footnotes omitted).

83. *See id.* at 140-41.

84. *See* Hillinger, *supra* note 46, at 1141-43 (describing the "unveiling" of separate rules for merchants and nonmerchants).

85. *See id.* at 1147.

86. *See id.* at 1151.

mercantile (commercial) framework.[87] In this transformation, however, was sown the seeds of the reverse effect—the penetration of images of consumerism into rules defining aspects of merchant-to-merchant (commercial) transactional law.

There are many ways in which this effect is evident, but perhaps the clearest illustration deals with the treatment in contract law of the use of "standard forms" to document the terms of a contract. Viewed through the image of a consumer marketplace, standard-form contracts epitomize the imbalance in transactions between consumers and dominant sellers and the lack of bargaining capacity or leverage that the consumer possesses. This is true even though few mass-market consumer transactions actually involve standard forms.[88] Standard-form terms are more common in commercial marketplaces, in which it is often the case that parties to an agreement document the deal with a standard form prepared by either party. Here, the prevalence of such forms is a by-product of efficiency considerations.[89] It is too costly and unproductive to closely negotiate each and every term of all contracts, even many that involve large dollar amounts.

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87. *See* Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 519-38 (1987).

88. Indeed, in the consumer marketplace, few "written" contracts are used. None, for example, arise between the typical retailer of a television, toaster, bag of groceries, or fast-food hamburger. In some hard goods cases, the sale is accompanied by a standard-form manufacturer's warranty, but this does not purport to govern the retailer's relationship to the buyer. The ordinary consumer transaction is governed by the "default rules" of the UCC, which are augmented by various consumer "protection" statutes. Written, standard-form contracts agreed to on a transaction-by-transaction basis are common only with respect to purchases of large ticket items, such as automobiles and boats, in credit contracts pertaining to such items, and in rental arrangements, such as when renting a car. In addition, of course, standard forms are used and assented to in the creation of various common forms of on-going contractual relationships, such as deposit accounts and credit card agreements.

While there are many transactions in information or services that occur in the consumer marketplace which do not involve written contract terms (*e.g.*, sale of a newspaper, book, or record), in digital information transactions, there are many, even small value, transactions in which assent to express contractual terms is routinely made a part of the transaction. This is clearly true in the context of mass-market software, but is also common for on-line transactions and motion picture video rentals. In some cases, such as in the recently developed DIVX technology, entertainment industries utilize technological restraints embedded in the informational product to enforce restrictions that, in an older environment, would have become parts of the contractual relationship (*e.g.*, a restriction permitting viewing of the motion picture only over a forty-eight-hour period in a transaction that is otherwise designated as a "sale" of a copy of the motion picture).

89. *See, e.g.*, W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529-30 (1971) ("Standard form contracts probably account for more than ninety-nine percent of all the contracts now made. . . . The[ir] predominance . . . is the best evidence of their necessity.").

There are two competing perspectives on the efficacy of standard forms. One, built at least in part on the images of the mass market, assumes the forms result from economic imbalances and carry great risk of unfair surprise. One consequence, is a belief that affirmative rules must restrict their terms or allow courts to invalidate terms even though the terms are not unconscionable.[90] While one form of this approach was adopted in the *Restatement (Second) of Contracts*, it has been followed in only a handful of states since first proposed over a quarter of a century ago.[91] Importantly, however, the *Restatement* concept is not limited to consumer contracts.

The alternative approach, built on the concepts of a free market and contract choice, argues that standard forms should be interpreted no differently than any other type of written agreement and that, subject to concepts of unconscionability and other "traditional" restraints on particular types of contract terms, they should be enforced. In this country, there is relatively widespread judicial support for this approach in commercial contracts.[92]

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90. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1981) ("Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."). This approach, however, does not stem solely from a mass-market image. It also comes from a perspective on what the proper relationship between a court and the terms of the contract should be in cases of litigation. Stated simply, it flows from the view that judicial oversight of the terms of a contract (including, most particularly, a standard-form contract) should be encouraged in order to avoid over-reaching and unfair surprise. The most commercially expansive illustration of this approach lies in Article 2.19 of the UNIDROIT *Principles of International Commercial Contracts* (1994).

91. *See* James J. White, *Form Contracts Under Revised Article 2*, 75 WASH. U. L.Q. 315, 323-25 (1997) (noting that § 211(3) has "slumbered peacefully").

92. *See, e.g.*, Klos v. Polskie Linie Lotnicze, 133 F.3d 164, 168-69 (2d Cir. 1998). In *Klos*, the Second Circuit noted:

> The concept of adhesion contracts introduces the serpent of uncertainty into the Eden of contract enforcement. At the very least, it represents a serious challenge to orthodox contract law that a contract is to be interpreted in accordance with the objective manifestation of the parties' intent . . . . It may not be invoked to trump the clear language of the agreement unless there is a disturbing showing of unfairness, undue oppression, or unconscionability.

Id.; *see also* Fireman's Fund Ins. Co. v. M.V. DSR Atl., 131 F.3d 1336, 1338 (9th Cir. 1997) (holding that "serious inconvenience" resulting from a forum selection clause does not amount to unconscionablility), *cert. denied*, 119 S. Ct. 275 (1998); Chan v. Society Expeditions, Inc., 123 F.3d 1287, 1292 (9th Cir. 1997) (declaring that "[c]ruise passenger tickets are contracts of adhesion . . . [and] must be construed against the carrier"), *cert. denied*, 118 S. Ct. 906 (1998); American Bankers Mortgage Corp. v. Federal Home Loan Mortgage Corp., 75 F.3d 1401, 1412 (9th Cir. 1996) (explaining that a contract of adhesion is fully enforceable in the absence of a showing of unconscionability); E.H. Ashley & Co. v. Wells Fargo Alarm Servs., 907 F.2d 1274, 1278 (1st Cir. 1990) (stating that the plaintiff must establish an absence

When the debate on these issues is centered on commercial contracts shorn of the images of the consumer mass market, the limited regulation approach has the stronger position. Yet, when images of consumer mass markets provide the primary background, a more regulatory approach arises. In the consumer marketplace for goods, for example, the Magnuson-Moss Warranty Act[93] precludes disclaimers of implied warranties as part of a written warranty in transactions involving "consumer products."[94] In Europe, a European Union Council Directive requires the enactment of laws prohibiting certain "unfair terms" in consumer contracts.[95] A second directive regulates the terms of certain contracts involving "remote sales."[96] The laws of various states in this country likewise provide for regulation on different bases of the terms of consumer contracts.[97]

Yet, it is clear that these consumer rules frequently spill over into commercial transactions, with effects measured at least in terms of creating a dissonant paradigm not gauged to the actual context.[98] For example, the Magnuson-Moss Warranty Act

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of "meaningful choice" by a party and that challenged contract terms were "unreasonably favorable" to the other party to establish unconscionability); Graham v. Scissor-Tail, Inc., 623 P.2d 165, 172 (Cal. 1981) (in bank) ("To describe a contract as adhesive in character is not to indicate its legal effect."). *But see* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1176 (1983) (asserting that the terms of adhesion contracts should be considered presumptively unenforceable, instead of enforceable).

93. 15 U.S.C. §§ 2301-12 (1994).

94. *See id.* § 2308(a).

95. *See* Council Directive 93/13/EEC, art. 1(1), 1993 O.J. (L 95) 29, 31 (defining an "unfair term" as one "which has not been individually negotiated" and "causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer").

96. *See* Council Directive 97/7/EC, 1997 O.J. (L 144).

97. *See, e.g.*, CONN. GEN. STAT. ANN. § 42-225(b) (West 1998) ("No dealer shall fail to disclose to a consumer in a contract for the sale of a used motor vehicle that such vehicle has been declared a constructive total loss.").

98. Although largely grounded in transactions involving the sale or lease of goods, the consumer protection paradigm is equally applicable to *consumer* transactions involving other types of contractual subject matter. As with any form of contract, however, the way in which it should be applied outside the area of goods should be determined by addressing the actual nature of the subject matter and the transaction it entails. Some have argued for an expansion of warranty concepts based on a sale of goods model into consumer services contracts. *See, e.g.*, Michael M. Greenfield, *Consumer Protection in Service Transactions—Implied Warranties and Strict Liability in Tort*, 1974 UTAH L. REV. 661, 661 ("[P]ersons providing defective services to consumers should . . . be subject to the doctrines of implied waranty [sic] and strict liability in tort."); Andy Norman, *Consumer Service Transactions, Implied Warranty and a Mandate for Realistic Reform*, 11 LOY. U. CHI. L.J. 405, 405 (1980) (asserting that "[a]n implied warranty of results to be achieved by the rendition of a service" is just and practical). In fact, however, services agreements entail different expectations and different types of controllable and uncontrollable risk than in a sale of goods, a fact that, as we shall see below, is well-recognized in the common law

covers transactions in "consumer products," which are defined as goods of a type "normally used for personal, family, or household purposes."[99] It covers transactions in these products regardless of whether a transaction even involves a consumer.[100] The European Directive, as enacted in some countries, is not limited to consumer contracts, but covers all standard-form transactions.[101] The *Restatement* rule also is not restricted to consumer transactions.[102]

The point here is not to argue for the validity of either perspective on standard forms—that is a matter for a different forum. The point lies in the importance of the image one brings to the discussion of applicable law in a contractual relationship. Other than on antitrust or similar bases, few, I believe, would argue that a need exists to regulate the terms of a standard-form contract Citibank and General Motors use for a $15 million loan, or the terms of a contract between IBM and Exxon. On the other hand, many would argue that there is a need for regulation or active judicial oversight of a standard form used in a contract between Sears and the little consumer who resides down the street. The images of imbalance and potential over-reaching are relatively strong in the latter case, but those images should not extend to the commercial context.

D. The Goods-Services Image

A third image influences decisions interpreting the scope of the current Article 2 and of modern products-liability law. This image essentially places commercial, non-real estate, contracts into two categories: transactions in *goods* and transactions in *services*. This goods-services dichotomy arguably corresponds to an older market in which the primary transactions were either that I purchased your product or that I purchased your time to work for me. It is doubtful that anyone believes that these were the only alternatives in modern commerce, but the dichotomy has a peculiar attraction in modern Article 2 scope decisions and elsewhere. For our purposes, the most significant aspect of this dichotomy is that it omits any reference to transactions involving rights in, access to, or use of, information.

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of all states. Refer to Part III.B *infra*.

99. 15 U.S.C. § 2301(1).

100. *See id.* (defining a "consumer product" by its purpose, and not by its user).

101. *See* NIMMER, *supra* note 2, § 14.33[2], at 14-72.

102. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981); *see also* White, *supra* note 91, at 325 (finding that most courts that apply § 211 do so in the insurance context).

The goods-services dichotomy connects to the "predominant purpose" test, which a majority of courts use in dealing with the applicability of Article 2 to mixed transactions involving goods and other subject matter, and in determining whether a particular subject matter constitutes "goods."[103] The predominant purpose test requires that a court examine a transaction to determine whether the goods or another subject matter (*e.g.*, services) constitute the main purpose of the deal.[104] If the goods aspect predominates, Article 2 applies to the entire transaction, including the goods, the services, and the informational subject matter.[105] If not, other law applies to the entire transaction, including the goods component.[106] The difficulty lies in the lack of predictability as to when or whether a particular transaction is predominantly a transaction in goods, services, or something else, such as information.

The dichotomy in mixed transactions ignores the relevance of the informational content of a transaction. This pattern is also clear in situations where the question is whether the subject matter itself is goods or services. The Article 2 definition of

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103. *See, e.g.*, Design Data Corp. v. Maryland Cas. Co., 503 N.W.2d 552, 557 (Neb. 1993) (declaring that the predominant purpose of the transaction was the sale of a computer system); Kirkpatrick v. Introspect Healthcare Corp., 845 P.2d 800, 803 (N.M. 1992) (applying the "primary purpose" test to a contract for interior decorating and design); Cincinnati Gas & Elec. Co. v. Goebel, 502 N.E.2d 713, 714 (Ohio Mun. 1986) (applying the dominant purpose test to a retail sale of electricity); Tacoma Athletic Club, Inc. v. Indoor Comfort Sys., Inc., 902 P.2d 175, 179 (Wash. Ct. App. 1995) (adopting the predominant factor test under Washington's version of the UCC). *But see* Elkins Manor Assocs. v. Eleanor Concrete Works, Inc., 396 S.E.2d 463, 468 (W. Va. 1990) (declining to apply the predominate factor test to a construction contract). The result of holding the subject matter of a contract to be either goods or services can be quite surprising in some cases. *See, e.g.*, Colonial Life Ins. Co. of Am. v. Electronic Data Sys. Corp., 817 F. Supp. 235, 238-39 (D.N.H. 1993) (finding that a multi-year data processing contract was a sale of goods); Lake Wales Publ'g Co. v. Florida Visitor, Inc., 335 So. 2d 335, 336 (Fla. Dist. Ct. App. 1976) (determining that a contract for compiling, editing, and publishing pamphlets and other materials was a transaction in goods); Gross Valentino Printing Co. v. Clarke, 458 N.E.2d 1027, 1030 (Ill. App. Ct. 1983) (holding that a contract to print magazines was a contract for goods because the intent was to deliver finished copies); Hedges v. Public Serv. Co., 396 N.E.2d 933, 936 (Ind. Ct. App. 1979) (holding that electricity in a household system is a good under the UCC, but raw voltage is not); Southwestern Bell Tel. Co. v. FDP Corp., 811 S.W.2d 572, 574 (Tex. 1991) (stating that the sale of advertising space is predominantly a services contract)

104. *See, e.g.*, *Elkins Manor Assocs.*, 396 S.E.2d at 468-69.

105. *See id.* at 468. This approach, of course, guarantees that the wrong contract law paradigm will apply to some aspects of the "mixed" transaction. Thus, sale of goods principles will apply to the *services* aspect of a deal that has, as its predominate purpose, the sale of goods, while common-law services concepts will apply to the goods aspect of the transaction if it is concluded that *services* predominate the deal.

106. *See id.*

"goods" is wondrously inexact and elastic, especially as it has been brought into the modern digital era. Goods are "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action."[107]

"All things movable." Consider the elegance and utterly undefined nature of this concept, along with its capacity for an expansive reading that takes the principles of sales law into many venues in which they are inapt. Your television certainly qualifies as a "good." However, what about the images that appear on the screen? In one view, they also constitute goods because the images "moved" in electronic form from the point of broadcast to the point of reception. The electricity that runs the television set could also be considered a good under this definition. In fact, some courts have so held, at least as to electricity after it has been delivered to the consumer's home.[108] Is a motion picture a "good"? Possibly, at least when recorded on celluloid. Is a will that a lawyer prepares and delivers to a client a "good"? Quite likely. Is a citation downloaded from Westlaw a "good"?

The consequence of this approach is that deciding that something is a good, if coupled with a conclusion that obtaining the good was the predominant (perhaps sole) purpose of the contract, places the transaction within Article 2 and makes it subject to contract default rules that were developed for application to the world of commercial sales of goods.[109] But did the lawyer sell goods to her client simply because she delivered the will on a piece of paper? Did the motion picture director or

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107. U.C.C. § 2-105(1) (1995).

108. The reason for distinguishing electricity in the distribution system and electricity after it passes the consumer's meter is not at all clear, but courts consistently make this distinction. *See, e.g.*, G & K Dairy v. Princeton Elec. Plant Bd., 781 F. Supp. 485, 490 (W.D. Ky. 1991) (ruling that stray electrical voltage, which did not pass through the consumer's meter, is not a good under the UCC, and, therefore, the utility was entitled to summary judgment on the consumer's claim of express or implied warranty); *Hedges*, 396 N.E.2d at 936 (stating that electricity running through a power line, a ladder, and into the plaintiffs' bodies was not a good and therefore plaintiffs did not have a cause of action for personal injury based on breach of warranty); Singer Co. v. Baltimore Gas & Elec. Co., 558 A.2d 419, 424 (Md. Ct. Spec. App. 1989) (determining that electricity remaining in the utility's distribution system is not a good under the UCC); Farina v. Niagara Mohawk Power Corp., 438 N.Y.S.2d 645, 647 (N.Y. App. Div. 1981) (concluding that electricity was not a good for purposes of a claim for injuries resulting from contact with a power line).

109. Refer to note 15 *supra* and accompanying text (detailing how Article 2 was designed with commercial sales of goods in mind).

the software developer engage in a sale of goods? Did HBO or ABC sell goods to the television owner by communicating images of the latest comedy show into the television owner's living room?[110]

The breadth of "all things movable," when coupled with a judicial tendency to rely on the goods/services dichotomy, creates problems in any case in which the work product of one party is delivered to the other party on a tangible medium. The decisions dealing with such cases defy reconciliation largely because they often use a wrong and excessively limited paradigm for making a decision on whether or not this is a transaction in goods. They use the wrong image and deploy the wrong intellectual tools. Consider the following two cases, both of which involved the question of whether a software development contract was a sale of "goods" or a "services" contract.

In *USM Corp. v. Arthur D. Little Systems, Inc.*,[111] a Massachusetts appellate court held that a software development contract was a sale of goods, rather than a services contract.[112] The terms of the written agreement referred to a program that would substantially meet various systems specifications, but also bound the developer to use its "best efforts" to complete the system.[113] The lower court had held that the contract was a services contract in light of the reference to "best efforts" and the fact that substantial time, skill, and effort were involved in designing and creating the computer system.[114] The appellate court described this analysis as too "grudging" and, instead, focused on language in the agreement that referred to the delivery of a turnkey system and warranties as indicating that this was a sale of goods.[115] In *Micro-Managers, Inc. v. Gregory*,[116] by contrast, a Wisconsin court held that a software development contract was mainly for services.[117] The court emphasized that payment was based on hours of work and that the contract referred to an obligation to develop and design the program.[118]

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110. For a discussion of whether the transmission of cable television qualifies as a sale of goods under the UCC, see *Kaplan v. Cablevision, Inc.*, 671 A.2d 716, 723-25 (Pa. Super. Ct. 1996).

111. 546 N.E.2d 888 (Mass. App. Ct. 1989).

112. *See id.* at 894.

113. *See id.* at 891-94.

114. *See id.* at 896.

115. *See id.* at 894, 896.

116. 434 N.W.2d 97 (Wisc. Ct. App. 1988).

117. *See id.* at 100.

118. *See id.*; *see also* Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 318 (Ind. Ct. App. 1986) (deciding that a software development contract was a service based contract because "DPS was *to act* with specific regard to Smith's

The decisions on software development contracts are roughly equally divided in holding that the transaction involves goods or services.[119] But what are the "goods" in such transactions? They are either the diskette (if any) on which the program was delivered, or the electronic digits that constitute the program. Clearly, neither contract in the foregoing cases emphasized the acquisition of the diskette itself. Yet, are digits, or words, goods? The answer should be no. What both courts, and other courts deciding the same issue, failed to focus on was that the purpose of the transaction was to obtain the intangibles—the program. The program is neither goods nor services. It is information in digital form. Thus, the critical question in all of these cases is not whether the focus of the transaction was on obtaining the end result (a program) or on obtaining the work effort (design and development), but on the fact that what is being obtained is an intangible (information) rather than a tangible (goods). It is in this way that software development, motion picture products, book authorship, sound recording performances, and the myriad of other information-related contracts differ from a contract to design and deliver a drill press or a tractor.

The fact that a third part of the goods/services dichotomy exists is an important adjustment courts must make to the modern economy. Although the case did not deal with the scope of Article 2, the court's analysis in *Snyder v. ISC Alloys, Ltd.*,[120] indicates a willingness to entertain the fact that the goods/services dichotomy over-simplifies the issue. In *Snyder*, the issue was whether the supplier of designs, technical advice, and drawings along with a license to operate a process for converting solid zinc into zinc dust could be liable for the death of an employee that occurred while operating the plant constructed pursuant to the plans.[121] Following the conventions of the goods/services dichotomy, the court concluded that the transaction (a license) was not a transaction in goods, but a transaction in *services* that did not come within applicable theories of product liability law.[122] However, it went on to expand its analysis to at least acknowledge the true core of the transaction, the conveyance of information:

> [ISC] cannot be held liable for breach of warranty because this theory of recovery is inapplicable to ideas,

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need [and] Smith bargained for DPS's skill in developing a system to meet its specific needs").

119. For a collection of cases, see NIMMER, *supra* note 2, § 6.02[1][b], at 6-7 to 6-9.

120. 772 F. Supp. 244 (W.D. Pa. 1991).

121. *See id.* at 244, 247-48.

122. *See id.* at 253.

> information and services. The concept of breach of warranty stems from Article 2 of the Uniform Commercial Code [which] governs the sale of goods. . . . I have thus already implicitly decided that ISC did not sell "goods" within the meaning of Article 2. Accordingly, plaintiff cannot recover under a breach of warranty theory.[123]

The court's conclusion blended a characterization of the license as a *services* contract and as a contract relating to information.[124] A court analyzing this same case from the perspective of an intellectual property licensing transaction would not have been concerned about whether this license was a services contract. It would simply observe that the transaction involved a license of designs and other information, which should not be treated as a basis for product liability unless the licensor is actively involved in making and selling the product.[125]

A failure to acknowledge intangibles (information) as the third component in the goods/services distinction is one reason

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123. *Id.* (internal citations omitted).

124. *See id.* at 252. The court went on to say that:

> Obviously, what ISC sold here—information—did not reach the decedents in substantially the same condition in which it was sold. That information did not cause them injury. On the contrary, the injury causing instrumentality, although derived from ISC's plans, had an existence completely separate and independent of ISC's plans. Thus, when ISC relinquished control over the item it sold—namely the plans—the thing that ultimately caused decedents' deaths did not yet exist. ISC did not even have a role in supervising the zinc plant's construction. Accordingly, it cannot be held liable pursuant to section 402A.

Id.; *accord In re* North Am. Leisure Corp., 468 F.2d 695, 697 (2d Cir. 1972) (determining that a contract to produce cassettes from a master tape was not a sale of goods); R.J. Longo Constr. Co. v. Transit Am., Inc., 921 F. Supp. 1295, 1310 (D.N.J. 1996) (holding that a designer who licensed its design to a manufacturer was not in a contract covered by Article 2); Western Lake Superior Sanitary Dist. v. Orfei & Sons, Inc., 463 N.W.2d 781, 787 (Minn. Ct. App. 1990) (stating that Article 2 does not apply to a contract to design and test piping for a specific project).

125. *See, e.g.*, J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:74 (4th ed. 1998) (discussing the tort liability of trademark licensors and franchisors); *see also* Burkert v. Petrol Plus, Inc., 579 A.2d 26 (Conn. 1990). In *Burkert*, the court noted:

> [T]he imposition of liability against [a] trademark licensor [under tort law] is appropriate only when the licensor is significantly involved in the manufacturing, marketing or distribution of the defective product. . . . GM's status as a trademark licensor, without more, does not render GM liable under the apparent manufacturer [tort] doctrine. . . . GM was not sufficiently involved in the stream of commerce to warrant [a claim for indemnification for breach of warranties]. . . . [T]he only cases holding that a trademark licensor can be held liable under a common law warranty theory, like the tort liability cases, rest upon a predicate finding of far more substantial participation in the stream of commerce than is involved in this case.

Id. at 35-36.

many reported decisions summarily include pre-designed and packaged software within Article 2, treating it *as goods*, rather than excluding it *as services.*[126] For pre-packaged software, what the licensee obtains is not analogous to services and, thus, if one follows the simple goods/services dichotomy, it must be goods.[127] But that is simply because the tool used in the analysis, a choice between services and goods, is wrong. That is not the distinction relevant to decide how to handle the intangible, licensed subject matter as a matter of contract law. It lacks the critical element of explicitly recognizing that transactions in intangibles (information) differ from either of the other two categories. In fact, they represent a major facet of the modern economy.

This is not to suggest that all courts fail to observe the third part of the distinction. Despite the prevalence of the "predominant purpose" test, some courts faced with the question of whether UCC warranties apply to the informational aspect of a transaction are capable of drawing the information/goods/services trichotomy to hold that Article 2 warranties do not apply to the information.[128] At least one court has expressly focused on

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126. *See, e.g.*, Advent Sys. Ltd. v. Unisys Corp., 925 F.2d 670, 675-76 (3d Cir. 1991) (stating that computer programs "tailored for specific purposes need not alter their status as 'goods' because the Code definition includes 'specially manufactured foods'"); RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546 (9th Cir. 1985) (concluding that "employee training, repair services, and system upgrading were incidental to sale of the software package and did not defeat characterization of the system as a good"); Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 742-43 (2d Cir. 1979) (discussing the services contemplated as "merely incidental or collateral to the sale of goods" and concluding that contract remains one of a sale of goods); *In re* Amica, Inc., 135 B.R. 534, 545 (Bankr. N.D. Ill. 1992) (holding the "term 'goods' includes computer programs"). In fact, however, when the issue is presented in a setting in which the contract calls for software development and design, the result of the cases is mixed, and there is not a clear consensus that software transactions are transactions in goods. *See, e.g.*, Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 493 N.E.2d 1272, 1273 (Ind. Ct. App. 1986) (noting that a contract for software development is not a contract for the sale of goods); Micro-Managers, Inc. v. Gregory, 434 N.W.2d 97, 99-100 (Wis. Ct. App. 1988) (determining that the UCC did not apply in a contract to develop software). In such cases, of course, the relevance of services (*e.g.*, design work, coding, etc.) is obvious, and could provide a basis for excluding the transaction from Article 2 as a services contract.

127. There are some cases in which this type of analysis is painfully explicit in a court's written opinion. For instance, in *Advent Systems*, the court explained that:

> Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. . . . That a computer program may be copyrightable . . . does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, movable and available in the marketplace [and therefore is a good].

Advent Sys., 925 F.3d at 675. But, of course, the program is not the floppy disk any more than the work of authorship that constitutes a novel is the paper and binding of the book.

128. *See, e.g.*, Gilmer v. Buena Vista Home Video, Inc., 939 F. Supp. 665, 671 (W.D. Ark. 1996). On a slightly different issue, see *Cardozo v. True*, 342 So. 2d 1053

intangibles, rather than on just goods versus services, to hold that Article 2 did not apply to an information transaction.[129] In addition, in cases in which the issue is whether Article 2 applies to the sale of a business, courts routinely inquire as to what extent intangible values (*e.g.*, goodwill) comprise the main part of the value conveyed.[130]

The recent *Restatement (Third) of Torts: Products Liability* expressly recognizes that information is treated differently than tangible products for purposes of third-party liability.[131] Developments of this sort are the beginning of an inevitable recognition of information transactions as a separate form of commercial contract, with considerations of practice and commercial context differing from both the field of services and goods transactions.

III. EXPLORING THE DIFFERENCES

A. *Transactions in Information*

Transactions in information differ from sales of goods in terms of their subject matter and the transactional frameworks they employ. The transactions are subject to different ordinary

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(Fla. Dist. Ct. App. 1977), in which case the court held:

> [A]bsent allegations that a book seller knew that there was reason to warn the public as to contents of a book, the implied warranty in respect to sale of books by a merchant who regularly sells them is limited to a warranty of the physical properties of such books and does not extend to the material communicated by the book's author or publisher.

Id. at 1057.

129. *See* Architectronics, Inc. v. Control Sys., Inc., 935 F. Supp. 425, 432 (S.D.N.Y. 1996) (discussing the "transfer of intellectual property rights" as an intangible, taking it outside the scope of Article 2 of the UCC).

130. *See, e.g.*, Monarch Photo, Inc. v. Qualex, Inc., 935 F. Supp. 1028, 1032-33 (D.N.D. 1996) (explaining that the sale of a business involved predominantly intangible assets which were comprised of customer lists and a noncompetition agreement); Stewart v. Lucerno, 918 P.2d 1, 4-5 (N.M. 1996) (declaring that the predominant assets transferred were intangibles).

131. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 19 (1998) (limiting the definition of product to "tangible personal property"). The comment states:

> [When plaintiffs] seek to recover against publishers in strict liability in tort based on product defect, . . . [a]lthough a tangible medium such as a book, itself clearly a product, delivers the information, the plaintiff's grievance in such cases is with the information, not with the tangible medium. Most courts, expressing concern that imposing strict liability for the dissemination of false and defective information would significantly impinge on free speech have, appropriately, refused to impose strict products liability in these cases.

Id. § 19 cmt. d.

transactional expectations and different overriding social policy considerations.

The primary focus of an information transaction consists of value that is separable from any physical embodiment in which it is conveyed.[132] In a sale of goods, the value provided consists of the particular goods themselves. In information transactions, the content, rather than the medium, is the message. Because it is severable from any tangible embodiment, information has many unique attributes that account in part for the different transactional and property rights frameworks that are involved.

Information is described in economics literature as a "public good."[133] Once released, one cannot prevent further dissemination of information without the aid of law in the form, of property rights or enforceable contractual arrangements. For the rights owner, once created in digital form, information has an additional unique capability to be duplicated for little or no cost. This cuts two ways. It enhances the risk of piracy, which has become a major concern throughout the digital industries.[134] However, it also sharply reduces the licensor's cost of making or distributing copies in the marketplace. Each copy has less significance than the contract or property-based restrictions on use of the content contained on that copy.

Because the focus of an information transaction is not on acquiring the tangible item, rights concerning information are generally not defined by the possession (or lack of possession) of the tangible copy. Instead, in most commercial cases, rights are defined by a property law (*e.g.*, copyright, patent or trademark) that does not treat *possession* of the copy as dispositive. That property law expressly assumes that the rights owner (not the copy possessor) retains the rights and significant control over

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132. That premise is stated in the Copyright Act. *See, e.g.*, 17 U.S.C. § 202 (1994) ("Ownership of a copyright . . . is distinct from ownership of any material object in which the work is embodied."). Equally important, it is implicit in how we all engage in information transactions. No one, for example, purchases a modern hard cover novel because of a desire to acquire the paper and binding. We buy the book for the information (intangible), not for the good itself (tangible).

133. *See, e.g.*, Otto A. Davis & Andrew B. Whinston, *On the Distinction Between Public and Private Goods*, AM. ECON. REV., May 1967, at 360, 360, 363-66; Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 387 (1954). This characteristic applies most clearly to unitary or discrete facts and to composite information that can be reduced to single copies. More complex or multi-faceted information, however, is not so readily transferable and, indeed, may be extremely difficult to communicate in the first place or to transfer on to other parties. *See, e.g.*, Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEG. STUD. 683, 711-12 (1980).

134. See Michael J. Meurer, *Price Discrimination, Personal Use and Piracy: Copyright Protection of Digital Works*, 45 BUFF. L. REV. 845, 888-89 (1997).

even the copy of the information delivered to the transferee, regardless of possession or knowledge of the information by the transferee.[135]

Among other results, this means that most transactions in information subject to copyright, trademark, or patent rights entail a transfer of only conditional rights or permissions to use the information. The same is true for most transactions involving access to information from the transferor's facility and to transfers of useful information whose value lies in its being relatively secret. The conditional nature of the transaction is most explicit in licenses of information, in contrast with the unrestricted sale of a copy of the information. In commercial markets, licenses are the most common type of transaction in information. In a license, contractual terms either expressly permit only restricted use of information or expressly limit the permission granted to the licensee.[136] Additionally, many license

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135. Unlike a contract for goods, there is no concept of a protected good faith purchaser of copyrighted works or patent protected technology. *See, e.g.*, Microsoft Corp. v. Harmony Computers & Elecs., Inc., 846 F. Supp. 208, 211, 213 (E.D.N.Y. 1994) (holding that a retailer that obtained copies of software from third parties in an unauthorized transaction could not be protected as a good faith purchaser). The *Harmony* court held that the buyer of a copy cannot obtain any greater rights than the seller had the right to convey. *See id.* at 212-14. Also, "[e]ntering a license agreement is not a 'sale' for purposes of the first sale doctrine. . . . Moreover, the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products." *Id.* at 213; *accord* Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077, 1084 (D. Md. 1995) (stating that Microsoft, as the owner of the copyrighted works, "has the exclusive right to limit the distribution chain of its products"); Marshall v. New Kids on the Block Partnership, 780 F. Supp. 1005, 1009-10 (S.D.N.Y. 1991); Major League Baseball Promotion v. Colour-Tex, 729 F. Supp. 1035, 1042 (D.N.J. 1990) (holding both a licensee and a sublicensee "liable for acts carried out by the sublicensee which would constitute infringement of the licensor's rights when the licensor has not authorized the sublicensing agreement"). This lack of protection for a bona fide purchaser does not apply to information protected only under trade secrecy law and not covered by intellectual property rights pursuant to a copyright, trademark, or patent. The essentials of trade secrecy are grounded in enforcing confidential information. *See, e.g.*, RESTATEMENT (FIRST) OF TORTS § 757 cmt. b (1939) ("The protection is merely against breach of faith and reprehensible means of learning another's secret."); UNIF. TRADE SECRETS ACT §§ 1(4), 2 (amended 1985), 14 U.L.A. 433 (1990) (defining "trade secret" as information that is the subject of reasonable efforts employed to maintain its secrecy" and providing for the prevention of misappropriation of such information).

Proposed Article 9 may fail to recognize the nature of rights in this environment and, instead, proposes a form of bona fide purchaser status applicable to licensees in the ordinary course of business. *See* U.C.C. [Rev.] § 9-321 (1998). This proposal represents another illustration of the phenomenon discussed previously in this Article—the tendency to apply goods-related principles to transactions in services or information when their relevance is unclear and their use is inappropriate.

136. In traditional forms of patent licensing, a license is nothing more than a promise to not sue the licensee if the licensee engages in acts with respect to the

contracts grant a license to access information contained in or accessible through facilities (*e.g.*, computers) that the licensor controls.[137] This, of course, is characteristic of on-line access contracts.

In mass markets, we are more traditionally comfortable with transactions involving the unrestricted sales of tangible copies of information, such as books, newspapers and magazines. That comfort, however, is being restructured by modern distribution systems involving digital information. These developments include:

- Most companies that engage in mass-market transactions license their software, contractually granting more (or less) rights in the information than would occur if the software copy were sold on an unrestricted basis with rights being determined solely under copyright law doctrine of "first sale."[138]
- The motion picture industry recently unveiled DIVX, a digital product with technology that limits the use of digital copies of movies distributed on the mass market to a pre-set number of hours unless or until the purchaser pays for additional use rights.[139] Although some advertising for this product states

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information that would otherwise infringe upon the intellectual property rights of the owner. *See* Spindelfabrik Suessen-Schurr Stahlecker & Grill GmbH v. Schubert & Salzer Maschinenfabrik Aktiengesellschaft, 829 F.2d 1075, 1081 (Fed. Cir. 1987).

In *Spindelfabrik*, the Federal Circuit court discussed the concept of a licensor:

> [A] patent license agreement is in essence nothing more than a promise by the licensor not to sue the licensee. Even if couched in terms of "[l]icensee is given the right to make, use, or sell X," the agreement cannot convey that absolute right because not even the patentee of X is given that right. His right is merely one to exclude others from making, using or selling X.

Id. at 1081 (alterations in original, internal citations omitted); *see also* Cohen v. Paramount Pictures Corp., 845 F.2d 851, 854 (9th Cir. 1988) (holding that it would "frustrate the purposes of the Act" to construe the license as "granting a right in a medium that had not been introduced to the domestic market at a time the parties entered into the agreement").

137. *See, e.g.*, Storm Impact, Inc. v. Software of the Month Club, 44 U.S.P.Q.2d (BNA) 1441, 1442, 1446 (N.D. Ill. 1997) (regarding shareware); Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92 C 0911, 1993 WL 214164, at *1, 3 (N.D. Ill. June 17, 1993) (describing a license in which the licensee was allowed to sell tickets through the licensor's computerized ticketing system).

138. *See* 17 U.S.C. §§ 109(a)-(b), 117(2) (1994) (granting the purchaser of copies, phone records, and computer programs certain limited rights of transfer). Among the rights that do not accrue as a result of a first sale is the right to make multiple copies of the work or to distribute those copies. Some mass-market licenses, however, grant those rights as incidental to the informational "product" that they provide. *See, e.g.*, Green Book Int'l Corp. v. Inunity Corp., 2 F. Supp.2d 112, 116 (D. Mass. 1998) (discussing a licensing agreement that permits the license to distribute the "product" to users).

139. *See* Joel Brinkley, *It's a Made for Television Controversy*, N.Y. TIMES, Oct

that the purchaser "owns" the copy,[140] this form of ownership is strange for one familiar with transactions in goods. It refers only to ownership of the tangible disk, not to the information it contains. The time-of-use limitations create a form of technological license that does not depend on *express* contract terms, but presumably rests on the understanding that the purchaser's agreement only gives a limited right to play the motion picture.

- Also, of course, there is the Internet and the on-line databases in which many sites distribute information through electronic systems under licenses often entirely without relying on or using tangible copies of the information. In many cases, these contracts are *both* formed and performed electronically (digitally).

We can anticipate a continuing shift of distribution techniques in the mass market and in other forums as technology enables the use of varying forms of distribution and creates a circumstance in which contract terms are important.[141] This is true because, especially in electronic contexts, the terms of the contract have a role with respect to the commerce that is different than in cases involving the sale of goods. In a sales transaction, the contract terms define what tangible product is required and what quality the goods are expected to have. A contract calling for a diesel engine car cannot be met by delivering a gas-powered six cylinder automobile. There are tangible and observable differences between the two, even if both are black Mercedes-Benz. In information transactions, a similar product-defining function occurs. For example, a contract for a word processing system is not met by delivery of spreadsheet software, because the two are observably different.

15, 1997, at D1.

140. *See DIVX, A Home Video System that Offers. . .* (visited Mar. 10, 1999) <http://www.divx.com/no_frills/about_intro.htm> ("DIVX discs are yours to keep.").

141. The change in distribution strategies that we see occurring today did not arrive without warning. A 1986 study conducted by the former U.S. Office of Technology Assessment foreshadowed and discussed these changes. *See* OFFICE OF TECHNOLOGY ASSESSMENT, U.S. CONGRESS, INTELLECTUAL PROPERTY RIGHTS IN AN AGE OF ELECTRONICS AND INFORMATION 204-05 (1986). According to the study:

> [E]lectronic dissemination—unlike printing—does not involve the publication of copies. As a consequence, copyright ownership is transformed from the right to reproduce a copyrighted work in copies for sale to the right to control access to the copyrighted work for any reason. Thus, when copyright is applied to works that are electronically disseminated, the balance between the rights held by the proprietor and those retained by the public is changed.

Id.

In addition, however, especially for digital information, the contract often also has a far different product-defining role.

> Consider, for example, three contracts: (1) a contract between Software Publisher and a distributor to allow distribution of up to 100,000 copies of Publisher's database software; (2) a contract between Consumer and Publisher for a copy of the software for consumer use; and (3) a contract with Drug Company and Publisher for use of the database software in a multi-person network with up to five thousand users.

The value and cost of the three contracts is entirely different. However, it is possible that Publisher will perform all three contacts by delivering an identical, single copy of the software. In the world of goods, the distribution contract would require delivery of up to 100,000 copies to Distributor. In digital industries, that is not necessary. More often, a single copy suffices if coupled with a contractual license of the right to make and distribute up to 100,000 additional copies. In the world of goods, it is likely that the consumer product would be different from the heavy-use commercial product. In the world of digital information, they are more likely to be identical, with the product-defining difference lying entirely in the terms of the license.

This example illustrates a fundamental difference between digital information contracts and contracts for the sale of goods. The tangible material and the digital information in all three contracts was identical. The commercial difference lies in the product-defining characteristics of the licenses. Sales of goods contracts may describe the product, but they do not define or become the product.

B. Performance Obligations

The differences between goods-based transactions and transactions involving services or information are striking with respect to default rules that apply to performance obligations regarding quality that arise in the contract. On the one hand, Article 2 establishes a relatively uniform and cleanly articulated body of implied warranty law that applies to goods and focuses on the quality of the *result* of the transaction—the delivered product. On the other hand, case law concerning services and information contracts lacks uniformity or clear articulation, but generally focuses on the obligations pertaining to the *process* of performing the contract—the exercise of reasonable care and

workmanlike effort.[142] The cases also go further for some types of information by insulating the information provider from any implied obligation in the absence of an express undertaking.[143]

Under Articles 2 and 2A, transactions in goods are characterized by two different sources of potential obligations concerning the quality of required performance. Article 2 sets forth how express warranties regarding the quality of delivered goods are created.[144] For our purposes, the more relevant source of obligations of quality lies in the implied warranties. These are default rules because, if the proper factual predicate exists, the warranty applies unless disclaimed.[145]

The first implied warranty is the implied warranty of merchantability.[146] This warranty requires that goods "delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement."[147] The implied warranty is premised on the judgment that expectations in sale of goods transactions are generally that the *delivered goods* are of comparable quality to other goods of similar type.[148] The warranty focuses on the quality of the *result* of the contract, not on the process of how the goods were produced.

A similar focus on results of performance (delivered product) occurs in the second implied warranty: the warranty of fitness for a particular purpose.[149] This warranty applies only if the seller is aware of the buyer's purpose for obtaining the goods, and the buyer is relying on the seller's expertise to select or furnish suitable goods.[150] In such cases, the furnished goods must be fit for the buyer's particular purpose.[151] Again, this standard relates

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142. *See, e.g.*, Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 319 (Ind. Ct. App. 1986).

143. *See, e.g.*, Winter v. G.P. Putnam's Sons, 938 F.2d 1033, 1036-37 (9th Cir. 1991); Gilmer v. Buena Vista Home Video, Inc., 939 F. Supp. 665, 671 (W.D. Ark. 1996).

144. *See* U.C.C. § 2-313 (1995).

145. *See id.* § 2-316(2) (outlining the rules for the disclaimer of implied warranties). In the context of consumer transactions, contrary regulations may override these disclaimers. When this occurs, of course, the regulation transforms the implied warranty into a legislative mandate.

146. *See id.* § 2-314.

147. *Id.* § 2-314 cmt. 2.

148. *See id.* § 2-314.

149. *See id.* § 2-315.

150. *See id.*

151. *See id.*

to the result of contract performance, which in this case is the furnishing of goods suited to the buyer's purpose.

Outside of Article 2 (or Article 2A), far greater diversity exists. There is no body of law that establishes an implied warranty of appropriate *results* with respect to information or services contracts. Instead, case law focuses on the process of contract performance and the quality of that performance. Indeed, in many states, applicable case law holds that there are no implied warranties of quality in a services or information contract. For example, this holding apparently was made by the court in *Insul-Mark-Midwest, Inc. v. Modern Materials, Inc.*[152] An Indiana appellate court held that there was no implied warranty of quality in a transaction in which the services provider took screws and fasteners the client supplied, applied a protective coating to them, and then returned the treated materials to the client.[153] The court commented:

> The parties here were both corporations dealing at arm's length. Each was free to negotiate the terms of the contract as it saw fit, and to secure assurances of performance, guarantees, warranties, etc. We do not deem it necessary to extend the protection of implied warranties to service transactions between merchants dealing at arm's length.[154]

The view expressed in this language, beyond holding that no implied warranty exists, treats the idea of warranty as something other than a default rule reflecting the expectations of the parties. Instead, it views the implied warranty as a form of purchaser protection which is not necessary in an arm's length transaction between businesses.

The holding in *Chemical Bank v. Title Services, Inc.*,[155] focuses more on fitting implied obligations to the ordinary expectations of parties engaged in such transactions, while also recognizing that in many services or information contracts, those expectations do not focus on assurances of the adequacy of a result, but rather on the quality of the process involved. *Chemical Bank* involved a contract with a UCC filings search

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152. 594 N.E.2d 459 (Ind. Ct. App. 1992), *adopted in part, vacated in part*, 612 N.E.2d 550.

153. *See id.* at 461-62, 466. Although the Indiana Supreme Court vacated a portion of this decision, it specifically affirmed the appellate court's holding on this point. *See* Insul-Mark Midwest, Inc. v. Modern Materials, Inc., 612 N.E.2d 550, 556 (Ind. 1993).

154. *Insul-Mark Midwest*, 594 N.E.2d at 466.

155. 708 F. Supp. 245 (D. Minn. 1989).

firm.[156] The court held that the firm was not liable for a report to the client bank that failed to identify liens recorded under a common misspelling of the debtor's name.[157] The court expressly rejected any implied warranty couched in terms of an assurance of an appropriate *result*.[158]

> In the absence of express language, . . . courts are reluctant to construe [such] contracts . . . as implying a contract of guaranty or insurance of favorable results. One reason for this reluctance is that persons providing professional services frequently deal with factors beyond their control. . . . To treat a cause of action for nonfeasance or misfeasance of a contractually-imposed duty as sounding in warranty "might serve to extend [a services provider's] duty beyond the duty anticipated in the original contract."[159]

A holding that there are no implied warranties in an information or services contract does not mean that there is no obligation of quality of performance in that contract. Rather, what these courts suggest is that the idea of warranty, as found in Article 2, is not appropriate as a base line in these other contracts. The UCC structure misses the mark because the Article 2 warranty provisions focus on assurances about the *result* of the contract performance, while in these other contractual relationships, the ordinary and acceptable expectations of the parties focus more on the *process* of performing.[160]

A decision that there is no implied warranty in many contexts leaves courts free to find implied assurances about the quality of the process of performance of the contract. Because this is a common-law venue, not encompassed in a coherently

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156. *See id.* at 246.

157. *See id.* at 249.

158. *See id.* at 246-47.

159. *Id.* at 247 (citations omitted) (quoting Williams v. Polgar, 215 N.W.2d 149, 156 (Mich. 1974)).

160. The language problem here reflects a long-standing uncertainty about what constitutes a warranty as compared to another form of contract obligation. Samuel Williston observed that the word warranty "illustrates as well as any other the fault of the common law in the ambiguous use of terms." 5 SAMUEL WILLISTON & WALTER H.E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 673, at 168 (3d ed. 1961). Llewellyn, whose work on Article 2 firmly established the language of warranty and warranty disclaimer as a crucial ingredient of the law of sales contracts, had commented before Williston: "To say 'warranty' is to say nothing definite as to legal effect." KARL N. LLEWELLYN, CASES AND MATERIALS ON THE LAW OF SALES 210 (1930). Warranties are central to Articles 2 and 2A, but the *Restatement (Second) of Contracts* makes no reference to warranties. It discusses instead the law of conditions, duties, and performance obligations.

stated or uniform national law, how and whether courts find implied assurances varies wildly among the states. In some states, for example, the process obligation is described as a "warranty," but this warranty is not like the results warranty of Article 2.[161] Elsewhere, a court may refer to general contractual obligations or even to tort concepts involving standards of negligence and reasonable care.[162] Consistently, however, when an obligation of any sort is recognized, the obligation focuses not on an Article 2-like warranty, but an obligation to perform with reasonable care and in a workmanlike manner.[163]

With respect to services contracts, the basis for this focus was stated in part by the New York Court of Appeals in *Milau Associates, Inc. v. North Avenue Development Corp.*,[164] in which, after concluding that a contract to design and install a sprinkler system was a services contract rather than a contract for the sale of

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161. In *Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987), the Texas Supreme Court held that there is an implied warranty in a contract for repair services. *See id.* at 354. This issue was significant because a warranty claim would qualify the client for a remedy under the Texas Deceptive Trade Practices Act ("DTPA"). *See id.* The *Melody Home* court held that an implied warranty of workmanlike conduct and performance exists in repair contracts. *See id.* The language focused on a remedy. As a concurring opinion noted, prior Texas case law had established that in a services contract the service provider does not owe an implied duty of good and workmanlike performance under contract principles. *See id.* at 358 (Gonzales, J., concurring) (citing Dennis v. Allison, 698 S.W.2d 94 (Tex. 1985)). The critical issue in *Melody Home*, however, dealt with a matter of label and remedy, rather than the underlying obligation. *See id.* at 355 n.9 (noting that consumers should have protection against poor quality services, and that an implied warranty of workmanlike conduct and performance would secure such protection). The DTPA contains enhanced damages provisions and a remedial structure designed to provide more effective remedies for "consumers." *See* TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon 1999). Indeed, the majority opinion in *Melody Home* emphasized the policy basis of its decision, noting that the creation of an implied warranty in these cases was intended to enhance the remedies available for clients of repair services. *See Melody Home*, 741 S.W.2d at 355 & n.9.

162. *See, e.g.*, Southwestern Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 495-96 (Tex. 1991) (Gonzalez, J., concurring) (discussing the common-law duty of reasonableness that arises in contract from tort principles).

163. *See, e.g.*, LeSueur Creamery, Inc. v. Haskon, Inc., 660 F.2d 342, 348 (8th Cir. 1981) (stating that professionals must possess a minimum of special knowledge and exercise reasonable care); Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 319 (Ind. Ct. App. 1986) ("Those who hold themselves out to the world as possessing skill and qualifications in their respective trades or professions impliedly represent they possess the skill and will exhibit the diligence ordinarily possessed by well informed members of the trade or profession."); Marcus v. Lee S. Wilbur & Co., 588 A.2d 757, 759 (Me. 1991) (opining that every repair contract has an implied term to perform the work in a reasonably skillful and workmanlike manner); *Polgar*, 215 N.W.2d at 156 (finding that abstractors are subject to the obligation to perform in a diligent and reasonable workmanlike manner); Hoven v. Kelble, 256 N.W.2d 379, 385 (Wis. 1977) (holding members of the medical profession to a standard of reasonable care under the circumstances).

164. 368 N.E.2d 1247 (N.Y. 1977).

goods,[165] the court rejected the argument that there could be an implied warranty of fitness with respect to services contracts.[166] The court stated:

> [T]hose who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct . . . unless the parties have contractually bound themselves to a higher standard of performance . . . .[167]

The court followed the "conventional" goods/services dichotomy in a contract that contained a heavy informational element.[168] However, the basic theme states a generally applicable premise. It is for this reason that the *Restatement (Second) of Torts* § 299A provides perhaps the most relevant information for contractual settings when it states that "one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade . . . ."[169] The "undertaking" in this tort principle is often a contractual relationship. The *Restatement* meshes with a comment Williston made to the effect that in every service contract, there is a promise that the work will be rendered with reasonable care.[170] Whether the obligation is grounded in tort or contract may affect the remedies, but should not alter the obligations.

The foregoing applies unless a court adopts an image of the transaction as one of a sale of goods, rather than "services." This same pattern generally carries forward to transactions that directly involve information as the primary focus of the deal (even if described as services).[171] The overall pattern, however, is further influenced by considerations about not imposing potentially chilling and unwarranted risk of liability on some types of informational transfers. In some cases, this leads to a

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165. *See id.* at 1251.

166. *See id.*

167. *Id.* at 1250.

168. *See id.* at 1249.

169. RESTATEMENT (SECOND) OF TORTS § 299A (1965).

170. *See* 9 WILLISTON & JAEGER, *supra* note 160, § 1012C, at 38.

171. *See, e.g.*, Chemical Bank v. Title Servs., Inc., 708 F. Supp. 245, 246-47 (D. Minn. 1989) (results of filing search); Rosos Litho Supply Corp. v. Hansen, 462 N.E.2d 566, 571 (Ill. App. Ct. 1984) (architectural design); Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 318-19 (Ind. Ct. App. 1986) (software development and design); Micro-Managers, Inc. v. Gregory, 434 N.W.2d 97, 102 (Wis. Ct. App. 1988) (affirming the trial court's finding that there was no implied warranty of results in a contract for computer software).

holding of nonliability for faulty informational content even if there is evidence of a lack of reasonable care in its preparation.[172]

Section 552 of the *Restatement (Second) of Torts* is the dominant tort law doctrine regarding liability and performance concepts in information-related contracts. It deals with negligent misrepresentation and states that:

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.[173]

This obligation identifies three criteria that must be met for liability: (1) an inaccuracy; (2) reliance; and (3) lack of care in causing the inaccuracy. Although stated as a tort concept, of course, this obligation, by its nature, revolves around a contractual relationship, involving the provision of information to another.

There is a close relationship between these contractual obligations and tort liability concepts for negligence. As a result, we see a significant divergence between sales-related transactions and transactions in services or information in the role played by tort theory in defining the relationship of the immediate parties.

In defining the scope of tort law, a majority of states adopt the so-called "economic loss doctrine."[174] This doctrine originated in the law of products liability, essentially serving to limit that doctrine to cases involving damage or injury to persons and property, excluding product liability claims for mere "economic loss." Products liability cases, of course, deal with liability to remote third parties, rather than between the immediate parties to a contract. However, the economic loss doctrine is also applied

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172. *See, e.g.*, Winter v. G.P. Putnam's Sons, 938 F.2d 1033, 1037 (9th Cir. 1991) (holding, because of the First Amendment and other social ramifications, that a book publisher had no duty to investigate the accuracy of the contents of a book it published); Walter v. Bauer, 439 N.Y.S.2d 821, 822-23 (N.Y. Sup. Ct. 1981) (holding that no liability exists for the publisher of a book for injuries resulting from information contained in the book because a finding of liability would have a chilling effect on the freedoms of speech and press). *But see* Brocklesby v. United States, 767 F.2d 1288, 1297 (9th Cir. 1985) (en banc) (holding a chart publisher strictly liable for errors in an aviation chart that contributed to an airplane crash).

173. RESTATEMENT (SECOND) OF TORTS § 552(1) (1977).

174. *See* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 871 (1986) (holding that a manufacturer in a commercial relationship has no duty under strict liability theory to prevent a defective product from causing pure economic loss); Moorman Mfg. Co. v. National Tank Co., 435 N.E.2d 443, 448 (Ill. 1982) (rejecting the application of strict liability solely for recovery of economic loss).

in the two-party context.[175] Here, it essentially provides that the economic risks of the parties are governed by their own contract, rather than by externally imposed concepts under tort law.[176]

The economic loss doctrine is widely applicable to cases involving sales (or leases) of goods.[177] Thus, many courts hold that negligent misrepresentation has no role in a buyer-seller relationship.[178] In contrast, the decisions are far less consistent with respect to services and information-related contracts. Here, principles revolving around the standard of care often provide the basic source for an obligation of quality in the contract relationship itself, even though those principles are sometimes enforced through actions grounded in tort.[179] This does not,

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175. *See, e.g.*, *East River S.S. Corp.*, 476 U.S. at 859.

176. *See id.* at 871-73 (explaining that contract law is better suited for commercial controversies regarding economic risk and loss than is tort law).

177. *See id.* at 859, 871 (adopting the economic loss approach in a case involving the sale of four supertankers); Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965) (in bank) (denying recovery, under a negligence claim, for pure economic loss in an action involving a contract for the sale of a truck); *Moorman*, 435 N.E. 2d at 444-45 (applying the economic loss doctrine to the sale of a storage tank); *see also* Rosos Litho Supply Corp. v. Hansen, 462 N.E.2d 566, 572 (Ill. App. Ct. 1984) (stating that "in the absence of a special agreement . . . [the architect] does not imply or [warrant] a perfect plan or satisfactory result," but holding that there may be liability for economic loss in tort).

178. *See, e.g.*, Apollo Group, Inc. v. Avnet, Inc., 58 F.3d 477, 480 (9th Cir. 1995); Rockport Pharmacy, Inc. v. Digital Simplistics, Inc., 53 F.3d 195, 198 (8th Cir. 1995); Accusystems, Inc. v. Honeywell Info. Sys., Inc., 580 F. Supp. 474, 478 (S.D.N.Y. 1984); Black, Jackson & Simmons Ins. Brokerage, Inc. v. International Bus. Machs. Corp., 440 N.E.2d 282, 283 (Ill. App. Ct. 1982).

179. This is not the context to address the quagmire of what may be an intractable problem of consistently separating tort and contract liability principles. Courts use different approaches to solve this problem, but part of the uncertainty lies in the lack of a coherent set of contract principles for services and information-related contracts. Some focus on the inherent nature of the cause of action, emphasizing that contract law enforces obligations taken on by consent, while tort law protects the public policy involved in enforcing a person's interest in being free from particular harms or risks. *See, e.g.*, *East River S.S. Corp.*, 476 U.S. at 871-73; Northern Mont. Hosp. v. Knight, 811 P.2d 1276, 1278-79 (Mont. 1991). Arthur Corbin suggested:

> If the defendant's conduct would have been tortious, even if he had made no contract whatever, and the establishment of the plaintiff's case does not require the proof of any contract, it is open to him to allege and prove his case as being solely for tort [despite the existence of a contract].

5 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1019, at 118-19 (1964). Under this view, allegations of mere nonperformance of contract obligations do not state separate negligence claims. *See, e.g.*, *Northern Mont. Hosp.*, 811 P.2d at 1278-79 (holding, in an action against an architect based on an alleged negligent design of hospital ventilation system, that if claims are based on the breach of specific provisions in the contract, then the action is in contract, but if the claims are based on the breach of a legal duty imposed by law that arises out of performance of the contract, then the action is in tort). Using this approach, allegations that the defendant-vendor negligently failed to deliver an appropriate computer system, an advertiser negligently failed to complete and publish the advertisement, or a vendor fraudulently delivered defective

however, indicate that the contract cannot itself alter the scope of risk, or the obligation undertaken. Rather, the tort principles often perform the identical function that contract default rules perform in other commercial contracts.

Thus, in *Rosenstein v. Standard & Poor's Corp.*,[180] an Illinois court disregarded the economic loss rule and applied the tort doctrine of negligent misrepresentation to a contract to provide stock index information.[181] In *Rosenstein*, Standard & Poor's calculated and made available its stock index values based on the closing price of stocks for trading in securities options.[182] On one occasion the index was wrong, causing trading loss to certain persons investing or selling on that day.[183] On the threshold question of whether Standard & Poor's owed a duty to the investors, the court held that negligent misrepresentation claims were an exception to the economic loss rule, at least when the contract involved information or services.[184] In reaching this conclusion, it rejected the argument that there was no duty because the index figures were "products."[185] If the information was a "product," the economic loss standard would preclude tort liability.[186] However, the court observed that, simply because Standard & Poor's "Indexes have been considered salable products, we do not believe that it sheds its character as information used to guide the economic destinies of others."[187] Under this approach, the court reached the proper conclusion that the accuracy of the information and the adequacy of contract performance should be gauged under a negligence concept in the case of economic loss.[188] In this case, however, the contract (license) disclaimed any obligation for informational accuracy.[189] This disclaimer effectively precluded the assessment of liability against Standard & Poor's.[190]

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equipment do not state a tort claim, but merely allege a breach of contract or warranty. *See* Closed Circuit Corp. v. Jerrold Elecs. Corp., 426 F. Supp. 361, 364-65 (E.D. Pa. 1977) (stating that one cannot change a claim from coverage under the UCC to one covered under tort law by making general allegations of fraud); Investors Premium Corp. v. Burroughs Corp., 389 F. Supp. 39 (D.S.C. 1974); Southwestern Bell Tel. v. DeLanney, 809 S.W.2d 493, 495 (Tex. 1991).

180. 636 N.E.2d 665 (Ill. App. Ct. 1993).

181. *See id.*

182. *See id.* at 666.

183. *See id.* at 667.

184. *See id.* at 668.

185. *See id.* at 669.

186. *See id.* at 668.

187. *Id.* at 669.

188. *See id.* at 670.

189. *See id.* at 671.

190. *See id.* at 672 (giving effect to the exculpatory clause in the license

In *Rosenstein*, the court appropriately recognized that an information contract falls outside general laws associated with goods. The case also demonstrates that, whether grounded in contract or tort concepts, underlying obligations stating the implied qualitative obligations of the parties can be modified by appropriate agreement. In the area of goods, disclaimers refer to "merchantability" and "fitness." In this (services/information) context, it is appropriate that the contractual disclaimer refer to concepts of "negligence," "reasonable care," or "accuracy" of the data.[191]

Most decisions that use negligent misrepresentation as a basis for contractual performance obligations apply that concept only if there is a special relationship with the provider in which the information provided is intended to influence the recipient's acts.[192] This also requires a more direct relationship between the parties than a concept of mere "foreseeability."[193] The rationale lies in avoiding expansive liability risk, which could stifle commercial patterns that make information widely available at a low cost per unit.[194]

When the potential liability for inaccurate information is considered in other than specially reliant relationships, a clear pattern of protecting the information provider emerges. For

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agreement, thus preventing the plaintiff from recovery).

191. *See, e.g.*, Industrial Tile, Inc. v. Stewart, 388 So. 2d 171, 176 (Ala. 1980) (requiring the indemnity clause to clearly and succinctly indicate that the indemnitee is indemnified against loss caused by his own negligence); St. Paul Fire & Marine Ins. Co. v. Amerada Hess Corp., 275 N.W.2d 304, 307 (N.D. 1979). It may not be possible to disclaim liability for gross negligence. *See* Orthopedic & Sports Injury Clinic v. Wang Lab., Inc., 922 F.2d 220, 224 (5th Cir. 1991); David Gutter Furs v. Jewelers Protection Servs., Ltd., 571 N.Y.S.2d 702, 703-04 (N.Y. App. Div. 1991) (stating that exculpatory clauses in security alarm contracts are generally enforced, are not applicable to willful or grossly negligent conduct); Idone v. Pioneer Sav. & Loan Ass'n, 552 N.Y.S.2d 424, 425 (N.Y. App. Div. 1990) (same).

192. *See, e.g.*, A.T. Kearney, Inc. v. International Bus. Machs. Corp., 73 F.3d 238, 241-43 (9th Cir. 1995) (providing, as examples of such special relationships, the attorney client relationship, the agent-principal relationship, the relationship of engineers or architects to their beneficiaries, and the relationship of primary insurer to the insured and the excess insurer).

193. *See* Bily v. Arthur Young & Co., 834 P.2d 745, 761 (Cal. 1992). The court assessed, in the absence of contractual privity, whether a party owed a legal duty.

> [We] decline to permit all merely foreseeable third party users of audit reports to sue . . . on a theory of professional negligence . . . . The asserted advantages of more accurate auditing and more efficient loss spreading relied upon by those who advocate a pure foreseeability approach are unlikely to occur; indeed, dislocations of resources, including increased expense and decreased availability of auditing services . . . are more probable consequences of expanded liability.

Id.

194. *See id.* at 766.

example, in *Winter v. G.P. Putnam's Sons*,[195] the court held that the publisher of a book on mushrooms owed *no duty* of care to a family that relied on the information in the book with resulting serious physical injuries to family members.[196] The court noted:

> Although there is always some appeal to the involuntary spreading of costs of injuries in any area, the costs in any comprehensive cost/benefit analysis would be quite different were strict liability concepts applied to words and ideas. We place a high priority on the unfettered exchange of ideas. We accept the risk that words and ideas have wings we cannot clip and which carry them we know not where. The threat of liability without fault (financial responsibility for our words and ideas in the absence of fault or a special undertaking or responsibility) could seriously inhibit those who wish to share thoughts and theories. . . . [W]ith the specter of strict liability, . . . "Would anyone undertake to guide by ideas expressed in words either a discrete group, a nation, or humanity in general?"
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> Strict liability principles even when applied to products are not without their costs. Innovation may be inhibited. We tolerate these losses. They are much less disturbing than the prospect that we might be deprived of the latest ideas and theories.[197]

This ruling, unlike a mere finding that no warranty exists, excludes all liability, unless the obligation has been expressly undertaken.

Similarly, the court in *Daniel v. Dow Jones & Co.*,[198] held that an electronic news service was not liable to its customer for incorrect information contained in its database and upon which the customer allegedly relied, to its detriment.[199] The court held that in this broadly distributed information context, the weight of policy concerns and transactional expectations yielded the conclusion that no qualitative obligation of accuracy or reasonable care could be applied.[200] According to the court:

> The relationship between the parties here is the same as between any subscriber and a news service; it is functionally identical to that of a purchaser of a newspaper. The advances of technology bring the

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195. 938 F.2d 1033 (9th Cir. 1991).

196. *See id.* at 1037 (asserting that such a duty would have a chilling effect on the First Amendment).

197. *Id.* at 1035.

198. 520 N.Y.S.2d 334 (N.Y. Civ. Ct. 1987).

199. *See id.* at 335.

200. *See id.* at 337-39.

> defendant's service into the home or office of more than 200,000 persons; indeed even non-subscribers may receive defendant's service through computerized linkages with other database enterprises. There is no functional difference between defendant's service and the distribution of a moderate circulation newspaper or subscription newsletter. The instantaneous, interactive, computerized delivery of defendant's service does not alter the facts: plaintiff purchased defendant's news reports as did thousands of others. The "special relationship" required to allow an action for negligent misstatements must be greater than that between the ordinary buyer and seller.[201]

If any obligation was to arise, it would have to come from an express agreement.[202]

This deference emphasizes the need to encourage and sustain broad distribution of information by minimizing liability risk. It is both understandable social policy and essential to the development of the information economy. Equally true, it reflects the ordinary expectation of users and vendors. As the *Daniel* court notes, published information transactions are not similar to consulting agreements or other special relationships in which it is expected that the information provider will exercise care and effort commensurate with the obvious reliance and its purported expertise.[203]

The general deference breaks down if the transaction is described as a sale of goods. A number of decisions support the view that transactions in computer software constitute transactions in goods, rather than information or services, at least when the software was pre-packaged.[204] The basis for these decisions lies in

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201. *Id.* at 337-38. In addition, see *Cubby, Inc. v. Compuserve, Inc.*, 776 F. Supp. 135, 140 (S.D.N.Y. 1991), in which the court stated:

> Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard of liability to an electronic news distributor such as CompuServe than that which is applied to a public library, book store, or newsstand would impose an undue burden on the free flow of information.

Id.

202. *See Daniel*, 520 N.Y.S.2d at 336.

203. *See id.* at 337-38.

204. *See, e.g.*, RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546 (9th Cir. 1985); Chatlos Sys., Inc. v. National Cash Register Corp. 635 F.2d 1081, 1084 (3d Cir. 1980); Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 743 (2d Cir. 1979); Synergistic Techs., Inc. v. IDB Mobile Communications, Inc., 871 F. Supp. 24, 29 n.7 (D.D.C. 1994); Carl Beasley Ford, Inc. v. Burroughs Corp., 361 F. Supp. 325 (E.D. Pa. 1974) (applying Article 2 principles to a contract dealing with both computer hardware and software); Neilson Bus. Equip. Ctr., Inc. v. Monteleone, 524 A.2d 1172, 1174 (Del.

large part because contrary holdings would place this major commercial information "product" under unruly and often uncertain common law. Often, the cases fail to focus on the explicit parallels between commerce in software and commerce in other types of printed or digital information, relying instead on images based on how the information is delivered (*e.g.*, diskette) and a simple but expansive application of the UCC's definition of goods.

If one steps beyond the classification issue and asks what performance obligations should be associated with pre-packaged software, the appropriate analysis distinguishes between obligations for accurate or aesthetic content, and obligations regarding functional attributes of the software. The latter should be grounded in warranties of *result*, as in Article 2, rather than the *process* obligations as in other contexts. Ordinary expectations in a mass-market transaction for a license of word processing software, database software, or communications software lie in the expectation that the licensor should provide, and the licensee should receive, a program that *functions* in a manner generally consistent with other similar software. That result, of course, could be achieved without the other negative by-products of forcing licensed information into the entire Article 2 sales of goods environment. It could be done through enactment of Article 2B or by a more nuanced analysis under common law principles of what obligations should be implied in this form of information transaction.

Significantly, none of the decisions placing software within Article 2 discuss concepts of merchantability or other warranty with respect to the informational content contained in the software. None use merchantability to gauge the acceptability of the aesthetics of the information. None use goods-related concepts to measure whether the accuracy of the data in the software suffices. If any of these issues arise, it would be appropriate to hold that goods concepts cannot apply to these informational aspects of software even if an implied warranty of result might apply to the functionality of the program. These are transactions in digital information. However, regardless of how we characterize them, there is no sustainable basis in policy or transactional expectation to extend goods concepts to these informational content issues. The images used with respect to the content and its aesthetics must be those used for informational products, not for drill presses.

There exists a limited, but persuasive, body of law supporting the distinction between functionality and

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1987).

informational content. Historically, courts and parties accepted this distinction with little debate. Thus, the purchase of a book could be a sale of goods, but the seller does not warrant the merchantability of the story in the text. The court in *Winter* found that the publisher of a book which sold copies into the general market had no duty of care or other obligation with respect to the accuracy of the informational content.[205] In *Cardozo v. True*,[206] the court held that a merchantability warranty was limited to the paper and binding of the book, but not to the content.[207] The court in *Gilmer v. Buena Vista Home Video, Inc.*,[208] held that a warranty of merchantability in the sale of a motion picture video extended only to the physical properties "of the film or the covers as opposed to the ideas, thoughts, or images contained thereon."[209]

The true weakness of our current context lies in a combination of assuming that goods-related principles should apply broadly to an entirely different economic exchange and in the fact that the common-law principles for obligations regarding services and information transactions are incomplete and in some conflict. In this context, with the strong image of goods and good-related transactions, the choices courts make and their bases for doing so may not relate to the expectations of the parties. Thus, they may fail to give guidance for current and future transactions.

In *Kaplan v. Cablevision, Inc.*,[210] a Pennsylvania court was presented with the issue of whether the UCC warranty of merchantability applied to a cable television service.[211] The issue did not focus on the quality of the content the service provided, but on whether there was an implied contractual obligation about

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205. *See* Winter v. G.P. Putnam's Sons, 938 F.2d 1033, 1037 (9th Cir. 1991).

206. 342 So. 2d 1053 (Fla. Dist. Ct. App. 1977). The court held that:

> [A]bsent allegations that a book seller knew that there was reason to warn the public as to contents of a book, the implied warranty in respect to sale of books by a merchant who regularly sells them is limited to a warranty of the physical properties of such books and does not extend to the material communicated by the book's author or publisher.

Id. at 1057.

207. *See id.*

208. 939 F. Supp. 665 (W.D. Ark. 1996).

209. *Id.* at 671; *accord In re* North Am. Leisure Corp., 468 F.2d 695, 697 (2d Cir. 1972) (finding that a contract to produce cassettes from a master tape was not a sale of goods); Filmservice Lab., Inc. v. Harvey Bernhard Enters., Inc., 256 Cal. Rptr. 735, 739 (Cal. Ct. App. 1989) (explaining that a contract to create and deliver release prints of a motion picture from a negative was not a contract for goods).

210. 671 A.2d 716 (Pa. Super. Ct. 1996).

211. *See id.* at 722-25.

the availability of the service and of access to it.[212] The case thus dealt with *function*, rather than content. The court held that this was not a transaction in goods.[213] This outcome, perhaps, is not surprising, but it is not necessarily consistent with other approaches to similar issues by other courts.

Here, the court distinguished cases that have held that gas and electric utility contracts with end users were transactions in goods.[214] The basis of the distinction, in the eyes of this court, was that utility companies provide not only the access, but also the electricity and the gas,[215] whereas in *Kaplan*, the cable company only provided the means for receiving the cable programs, and not the programs themselves.[216] According to the court, "[t]he Cable Companies do not sell a tangible, separate identifiable good—instead they supply a continuous stream of audio and video signals. . . . They merely act as a common carrier transmitting numerous cable signals through cable wires into the subscriber's home."[217] If this is the basis for the distinction, however, then a company such as HBO, which does provide both the signals and content, may be a seller of goods over the cable system because it provides the content and signals to the end users themselves for a fee.

Of course, the conduit and supplier distinction states the wrong issue. The point of this Article concerns identifying the role of images as intellectual equipment. In *Kaplan*, what were the "goods" that were part of the transaction? One answer is that the signals themselves are the "goods." The court declined to adopt this view because the signals "were not fairly" identified as moveable before the contract was formed.[218] However, electronic signals or digits that communicate information should never be considered goods, whether they subsist in a cable system or in a software program. The only reason that this claim receives any support lies in our failure to develop the alternative analysis, grounded not in the law of services contracts, but in the combined law of services and information contracts.

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212. *See id.* at 722.

213. *See id.* at 724; *see also* Satellite Television & Associated Resources, Inc. v. Continental Cablevision, Inc., 714 F.2d 351, 358 (4th Cir. 1983) (holding that for purposes of the Clayton Act, the provision of cable television was a service, rather than a good).

214. *See Kaplan*, 671 A.2d at 723-24.

215. *See id.* at 724.

216. *See id.*

217. *Id.*

218. *See id.*

The court in *Kaplan* did not consider the cases that treat as a sale of goods the situation in which the licensor provides software that enables operation of the system in addition to an obligation to provide computer-based services over a several year period. For example, the court in *Colonial Life Insurance Co. of America v. Electronic Data Systems Corp.*,[219] held that a contract for outsourcing a data processing system over a four-year period was a sale of goods because the contract required the services provider to adapt its software to the functions of the client.[220] While the court admitted that the contract had a blend of services and goods, intangibles, and skill, it concluded that the essence of the transaction was for the client to license the use of the software.[221] Thus, the warranty and remedy provisions of Article 2 applied to the dispute.[222]

An implied warranty of merchantability hovering over a four-year period of performance makes little sense. Perhaps it can be manipulated to create plausible results suited to the context of the transaction, but it misses the fundamental point. The contract in *Colonial Life* involved automated services and the design of an informational product.[223] Treating this as a sale of goods is senseless. The results of such analyses, while bright judges may bend them to avoid harm to individual parties, give little guidance for the future. For example, is the cable company a seller of goods as to its entire electronic product simply because it provides the software to enable use of the system? The answer under these cases must be "yes." That such an answer is possible indicates our failure to provide the correct tools for analysis of transactions in information and automated services on a uniform basis.

IV. CONCLUSION

Images matter. How we approach the treatment of a particular transaction through legislation or case law has a significant effect on those engaged in the existing dispute and

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219. 817 F. Supp. 235 (D.N.H. 1993).

220. *See id.* at 239.

221. *See id.*

222. *See also* Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351 (D.N.J. 1992) (holding that Article 2 applies to outsourcing a hospital data system when the software was developed for the particular transaction). *Cf.* St. Anne-Nackawic Pulp Co. v. Research-Cottrell, Inc., 788 F. Supp. 729, 733-34 (S.D.N.Y. 1992) (stating that a contract to design and install a pollution control system is a sale of goods when the client would operate the system after installation).

223. *See Colonial Life*, 817 F. Supp. at 237.

those who will conduct commerce in similar transactions in the future. This is especially a problem when, as today, we have felt the effects of a sea change in the economy and the types of transactions which drive that economy. While transactions in goods remain important in modern commerce, transactions in information and in services to provide or manipulate information match or exceed them in significance. This new economy does not function in the same way as did the old goods-dominated economic system. Until our contract law adapts to recognize the differences and provides a coherent framework for this new type of commerce, the structure of commercial law will confuse, rather than support, the modern character of economic exchanges.

The point of this Article was to identify situations in which the contract images misconnect with the reality of commerce in information and digital services. Once identified, many of these misconceptions are easily understood. The major value in a digital book is not the goods, but the information. The value that lies in a cable system service or a database contract is not a good, but information and services. Software is not equivalent to an automobile in respects relevant to contract law. The distinctions not only need to be identified, but applied in case law and legislation.