

BREAKING BARRIERS: THE RELATION BETWEEN CONTRACT AND INTELLECTUAL PROPERTY LAW

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ABSTRACT

This Article examines the symbiotic relationship between copyright and contract law. The intellectual property bargain, or the delicate balance that allegedly exists in current intellectual property law, cannot be seen merely as a matter of a balance stated in property law rules. An interaction between intellectual property and contract rules has always been a primary characteristic of intellectual property distributed in the open market and that interaction is central to whatever balance has been achieved. When one speaks about an existing balance in the property rights sector, it is futile to focus solely on the statutory provisions of the copyright, patent or trademark laws. One must, of necessity, understand and incorporate the fact that the policy choice has always assumed that property rights are routinely transferred, waived, released, and licensed. Only the most naive observer, or one with a clear political agenda, can look at the intellectual property laws and their history and suggest that policy in the property sphere trumps or precludes the influence of contract.

In contractual relationships, underlying property rights are often relatively unimportant. They provide "default rules" that state a legal position that exists between the contracting parties unless the parties otherwise agree. Contract law provides other default rules. In the digital world, the contract rather than the underlying property law defines the product. This being said, however, there are some settings in which contract law, intellectual property, or competition law place limits on the ability to enforce some contract terms. This Article explores some of these areas and describes their limited role in modern commerce.

TABLE OF CONTENTS

I.	INTRODUCTION.....	828
II.	THE CORE RELATIONSHIP.....	832
	A. Open Forum and Commercial Uses	832
	B. Contracting for Information	834
	1. <i>Nature of an Information Contract</i>	835

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2.	<i>Liability as an Illustration of an Issue Beyond Rights Distribution</i>	836
3.	<i>Incentives to Contract: In General</i>	840
4.	<i>Incentives to Contract: Contract as Product</i>	841
C.	Contract and Informational Property Rights Co-Exist	844
1.	<i>The Nature of Law in the Two Fields</i>	845
a)	Contract Law and Party Choice.....	845
b)	Property Law	849
2.	<i>Property Rights in a Marketplace Transaction</i>	850
a)	Marketplace Effects on Property Transactions.....	851
b)	Value and Terms in an Information Transaction Often Do Not Depend on the Intellectual Property Rights.....	852
3.	<i>Property Law Creates Transactional Default Rule</i>	854
a)	Revision Right.....	855
b)	Transferability of Licenses.....	857
c)	Author's Termination Right.....	857
d)	First Sale and Copy Ownership.....	858
e)	Contract Term Interpretation.....	859
III.	LIMITS ON CONTRACT	860
A.	Preemption of Contracts.....	861
1.	<i>Preemption Based on the Copyright Act</i>	861
2.	<i>Preemption Based on the Supremacy Clause</i>	864
B.	Intellectual Property Misuse and Related Doctrines	867
1.	<i>Origins of the Misuse Doctrine</i>	868
2.	<i>Copyright Misuse</i>	869
3.	<i>Direct Policy Restraints</i>	871
C.	Contract Law Limits	872
1.	<i>Unconscionability</i>	873
2.	<i>Restatement Section 211</i>	874
3.	<i>Article 2B and Unconscionability Limitations</i>	875
4.	<i>Invalidation on Public Policy Grounds</i>	877
D.	Fair Use and First Sale Policies.....	880
1.	<i>Fair Use, First Sale and Preemption</i>	880
2.	<i>First Sale and Fair Use as Over Riding Policy</i>	882
3.	<i>Article 2B and the Fair Use Debate</i>	886
E.	Conclusion	888

I. INTRODUCTION

As I read some of the commentary about the future of copyright in the information industries on the Internet, it often appears as if some believe that we are facing an impending big bang as the fields of copyright and contract head toward some unclearly defined, but cataclysmic conflict.¹ It

1. Compare Jerome Reichman, *Privately Legislated Intellectual Property Rights: The Limits of Article 2B of the U.C.C.* (Apr. 4, 1998) (unpublished manuscript) and David Nimmer et al., *The Metamorphosis of Contract into Expand*, 87 CALIF. L. REV. 19 (forthcoming 1999), with Maureen A. O'Rourke, *Rethinking Remedies at the Intersection of Intellectual Property and Contract: Toward a Unified Body of Law*, 82 IOWA L. REV. 1137 (1997).

is argued, for political effect, that by bringing contract to the context of information transactions, contracts will be used to stifle free speech and comment or to block access to materials that are otherwise in the public domain. Nothing could be further from the truth and, indeed, the fundamental premise is flawed. Contract and intellectual property law have always co-existed, not only peacefully, but in an aggressive interaction between mutually supportive fields. Modern efforts to tailor contract themes to fit the digital information era and the commerce it yields follow that tradition. The fields will continue to co-exist, although changes in distribution and accessibility caused by Internet-related technologies will transform copyright law and expand the role of contracting. In the new world of digital information, especially on-line digital information, contract law and contracting practice play a dominant role. Traditional copyright law will recede in importance because many aspects of the on-line distribution methodology are not suited to property right constructs centered on the making and distributing of *copies* as the main property right.² Instead, intellectual property law grounded in trademark and other competition or product identification principles will have increasing importance. New property interests, dealing with transmission, extraction, and access, will be created.³

Article 2B neither creates nor expands contract law in relationship to intellectual property. Rather, it works within a context in which contract themes already exist and apply to transactions in information. In that environment, it attempts to move some common law into a commercial code and to restructure the focus of some of the law already found in the commercial code to better reflect the informational subject matter. The goal is to clarify contract law premises and to facilitate electronic and other digital-based commerce. Article 2B, therefore, is not a threat to intellectual property law concepts or to the established political and social importance

2. The copyright paradigm is both over-inclusive and under-inclusive in the on-line world. It is hugely over-inclusive in that because technology operates the on-line world, virtually every action taken with respect to information in that context entails the making of copies and most information placed into the on-line world is copyrightable. Thus, the anomaly is that copyright might be said to give exclusive rights to the copyright owner over every action taken on-line with respect to its information. It is under-inclusive because many of the critical rights that might define value on-line, such as the right to allow or deny access to an information repository, are not covered directly under the copyright regime.

3. See, e.g., Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998). See generally Raymond T. Nimmer & Patricia A. Krauthaus, *Information as Property: Databases and Commercial Property*, 1 INT'L J.L. & INFO. TECH. 3 (1990).

of information in our culture. In fact, it supports and promotes those concepts in a new field of commerce.

In this paper, I explore two elements of the interaction between contract and intellectual property. The first element deals with the core relationship. This exploration clearly shows it is a symbiotic conjunction of two important fields of law—contract and property. The symbiosis causes intermittent problems, but more commonly the two areas of law function in comfortable tandem. The intellectual property bargain or the delicate balance that allegedly exists in current intellectual property law cannot be referred to as if these were matters merely of a balance stated in *property* law rules. This clearly misrepresents the circumstances. An interaction between intellectual property and contract rules has always been a primary characteristic of intellectual property rights as distributed in the open market, and this interaction is central to whatever balance has been achieved. When one speaks about an existing balance in the property rights sector, it is futile to focus solely on the statutory provisions of the copyright, patent or trademark laws. One must, of necessity, understand and incorporate into the analysis the fact that the policy choice has always assumed that property rights are routinely transferred, waived, released, and licensed. Contracts provide the means for the development and commercial exploitation of information assets. Only the most naive observer, or one with a clear political agenda, can look at the intellectual property laws and their history and suggest that policy in the property sphere trumps or precludes the influence of contract.

In many contractual relationships that exist with respect to information assets, the transactions are shaped by market factors and considerations of liability risk or other commercial concerns. The underlying property rights are often relatively unimportant in the bargaining process. Indeed, they tend to be treated as “default rules;” those rules that state a legal position that exists between the contracting parties unless the parties otherwise agree. Contract law provides other default rules that function in a similar manner. In this context, the contract defines the product, both in terms of what rights are granted (or withheld) and what assurances or other commitments are made.

The second element deals with an exploration of several of the policy themes that place restrictions on some contract terms in some cases. These limitations on contract come from both contract law theory and from general public policy, including some policies that derive from copyright or other intellectual property law. The contract-based restrictions tend to focus on policing limited circumstances in which the character of a transaction or a particular term of a contract reflect a breakdown of the contract-

ing process, yielding an unconscionable result. The restrictions emanating from intellectual property doctrines and other related policies tend to focus on eliminating unfair competition restraints that may derive from protecting individual autonomy. In each context, however, the basic insight is that existing general doctrines of law, which are largely retained under Article 2B, provide various and effective means to correct or eliminate cases of true abuse without disrupting the basic market-shaping effects of general contract law. The assumption is that parties can shape their own transactions, rather than have their terms dictated by law.

Among the arguments based on the unfounded fear that contract will eliminate important facets of information policy is one that intellectual property law preempts contract law, precluding contracts that are inconsistent with the property rights created (or denied) under copyright law. There is virtually no support for this proposition nor should there be any acceptance of the argument. As shown in this article, copyright and contract law interact; with the one establishing property law principles and the other enabling parties to contract and commercialize their property or other assets. The two areas of law deal with different issues. Here, we see that the claim, if any still make it, that contracts cannot alter the effect of copyright (or patent) rights has never been true or even pursued by any court. Clearly, contracts cannot alter property rights, but property law seldom, if ever, precludes the property holder from contracting to transfer its rights in whole or in part.

Similarly, the argument that the relationship is characterized by preemption simply misstates how the relationship between the fields has historically been managed. When intermittent abuses are identified and courts act to prevent or minimize their effect, the methodology consists of developing and applying themes created in common law, in contract statutes, and in competition law (such as antitrust and misuse doctrines) that restrict enforcement of particular contract clauses in particular contracts. These principles indicate simply and correctly that, to the extent of abuse, the traditional solutions lie in particularized adjudication, rather than in generalized invalidation of the right to make contracts.

Finally, this article examines the claim that copyright concepts of fair use and first sale should preclude contracts that are inconsistent with these premises. The claim that first sale rights control is, as we shall see, a matter of turning the relationship between contract and copyright on its head. The first sale doctrine states default law principles that essentially set out limited principles of copyright law which apply *if* the parties choose to sell and buy a copy but elect to make no further terms in their contract.

II. The Core Relationship

Historically, there have always been two different methods through which information and information assets are created and distributed through our culture, open forum and contract. A fear that drives some of the dispute about the relative roles of contract and intellectual property in the information world lies in the unstated belief that circumstances, mostly economic and technological in nature, will shrink the importance of intellectual property law and enhance the importance of contract law. This fear, however, is unfounded because, as discussed below, contract and intellectual property laws regarding the creation and/or dissemination of informational assets while different are symbiotic.

A. Open Forum and Commercial Uses

The first method for the creation or distribution of information in society involves a case in which a creator or holder of information conditions the transfer of that information to another on receipt of some form of consideration from the other person. We can describe this as *commercialization* of information. Commercialization has always been central to how our system handles the distribution of information. It is, indeed, an inherent feature of the so-called "intellectual property" bargain that some attempt to describe in static terms independent of contracts.⁴ *All of the relationships and distribution choices* involved in commercialization of information assets involve contracts. The contracts range in detail and focus, but they all entail the exchange of value that underlies the very basis of contract law.

The second method through which information and information assets are created and exploited involves situations in which the information is given away and any rights in it relinquished in whole or in part. This we can describe as an *open forum* use of information. Open forum uses are also common and integral to the information culture. They are found on the city streets, in public speeches, political newsletters, and in portions of the Internet. The Internet, in fact, has either increased the scope of open forum uses of information or, at least, drawn together in one "space" a larger number of such open forum uses than heretofore was possible. Given the proliferation of open forum uses in the Internet, it is difficult to understand the fear that their role is diminishing. Indeed, it seems to me

4. See generally Nimmer, *supra* note 1. That view, as we see here, of course, ignores the dynamic interaction that has always existed with respect to property law, contract law and technology. That interaction, changing over time, in any event is an inevitable consequence of the intellectual property rights system placed in a dynamic market economy.

that quite the opposite is true. Yet, even here, copyright rules create a latent, but potentially explosive issue in reference to open forum uses; the issue is quite independent of contract law. Under copyright law, although potentially an open forum use, all Internet postings are shrouded under copyright *property* protection given to the person creating the message, image or the like.⁵ The *property* law question of whether the copyright owner relinquishes all rights by placing text on an Internet open forum is unanswered. If the copyright owner does not relinquish all rights, another person using the text may engage in an infringing act.

By and large, open forum uses of information are non-contractual. They involve giving away information and a willingness not to assert rights, at least to some extent and under some conditions. While a future court might decide to use an "implied license" analysis to resolve the copyright issue mentioned above, that analysis would not hinge on contract law, but on theories of estoppel, release and waiver. The classic phrase "Take my wife—please" is one way of characterizing what an Internet user means when it posts to a list-serve or erects a website without placing contract-based restrictions on access to or use of the site. "Take my information—please."

The difference between open forum and commercialization uses of information lies primarily in choices made by the person holding the information. It is fair to say that, outside the scope of patent law and perhaps trademark law, concepts of independent creation place limits on that choice, especially with respect to materials that are widely distributed. Nevertheless, as to obtaining information known to or held by a person *from that person*, the difference between open forum and commercialization lies in the choice made by the individual about how (or if) to distribute its information. The Federal Circuit Court of Appeals recently confirmed an obvious principle in this regard.⁶ The principle being that, even if public policy favors movement of information into public arenas, this

5. See, e.g., *Playboy Enter., Inc. v. Webbworld, Inc.*, 968 F. Supp. 1171, 1175-77 (N.D. Tex. 1997) (holding that an operator of an Internet web-site was directly liable to a magazine publisher for infringement when it provided its subscribers with copyrighted adult images that were stored on its computers. Operator obtained material from adult news groups and had no control over the persons posting the infringing images to those news groups; it only had control over the images it chose to sell on its Web site.); *Micro Star v. Formgen, Inc.*, 942 F. Supp. 1312, 1317-18 (S.D. Cal. 1996) (holding that author of a computer game did not waive copyright protection by allowing users to trade scenes and create new levels in game and to upload them to other users on the Internet. No implied license where game file contained restrictive license).

6. See *Leatherman Tool Group, Inc. v. Cooper Indus., Inc.*, 131 F.3d 1011, 1014-15 (Fed. Cir. 1997).

does not create a public right of *access* to information held by a private person. While I keep the only manuscript of my most recent book in my house, absent rights associated with litigation, you cannot compel me to allow you to read the manuscript or to enter my house to view it. The ultimate choice to distribute and how to do so lies in my hands, although you are of course entirely free to write an identical book as your own creation.⁷ If I choose to allow you only to scan the copy for five minutes, rather than to make a copy for your personal pleasure, that too is my choice.

The choice does not hinge on the existence or non-existence of property rights *in the information*. But the choice exists today and has always existed. Indeed, allowing this choice provides a central feature of how our contract-based economic system functions and how the supposed incentives in intellectual property law work. An argument that either Article 2B or the digital information world shifts the balance between open forum and commercialization use is empirically unfounded. The facts actually suggest the converse. Merely saying that a person can contract for the distribution of information (a premise that is true today) says nothing about when or whether the person will elect to do so.

Recognizing the distinction between open forum and commercialization uses of information places the discussion of contracts in an appropriate focus. Contracts relate to many, but not all distributions of information. However, for the transactions to which contracts relate, the idea of contract is in no sense outside the contemplation of intellectual property theory; it is, instead, fully contemplated by and integral to this type of *property* law. Indeed, there can be no other conclusion unless one assumes that the theory of copyright law is that all information is to be made freely available for all uses.

B. Contracting for Information

Contracts are a common, integral part of the dissemination of information and information assets in our economy. Yet, in discussing these contracts, in principle and in practice, it is essential to avoid the fallacy that the primary focus of the transaction is typically on the intellectual property rights involved. That fallacy stems from the traditional separation of intellectual property and commercial law issues. In some cases, the in-

7. This right not to distribute, of course, is part of the so-called intellectual property bargain and, indeed, a fundamental element of the right of free speech. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 149 (1989).

tellectual property rights issues may dominate in a contract, but in many contracts for transfer of information, distribution of intellectual property rights or permissions is neither the sole, nor even the dominant subject of the contractual terms. Some who view this context solely from an intellectual property law perspective may believe that rights issues always dominate. A commercial lawyer would never make that same assumption.

1. Nature of an Information Contract

To understand the scope of an information contract, it is useful to define the issues associated with such a contract. There are many ways to make distinctions among the issues in an information contract. This is because the issues differ not only depending on the type of information involved, but also based on the method of distribution chosen. A three-part classification, however, highlights the basic theme. The three categories are:

Product Issues: Defining the subject matter of the transaction, what rights are transferred or withheld, and what fee, royalty, or price is charged for that product.

Liability Issues: Defining the allocation of risk for errors, defects, third party claims for libel, defamation or the like, associated with the informational subject matter.

Performance Issues: Defining how the transaction will be performed, when it will be completed, what laws apply and other issues associated with establishing the relationship between the parties.

As this indicates, the point is not that issues of intellectual property rights are unimportant. Indeed, in many respects, contract terms related to these rights are the product itself. But rather, that other issues not involving intellectual property rights are also part of the contract.

No sustainable logic suggests that copyright or other intellectual property law should control liability or performance issues in any respect or that copyright preempts or otherwise precludes contracts dealing with those issues. Copyright does not, by and large, deal with questions in these categories. Just as not all distributions of information involve contracts, so too most contracts relating to information assets deal with a vastly broader array of issues than simply spelling out the rights granted or withheld. Yet, in any given transaction, these issues are likely to be the most important ones addressed by the contract. Digital and Internet distribution methods

heighten, rather than limit, the extent to which these non-rights-related issues move toward the forefront. Equally important, technology and market circumstances are increasing the importance of these issues.

To illustrate, consider the case of a publisher of a non-fiction magazine (or book). Under traditional paper distribution systems, the publisher contracts with a distributor for distribution of the work in a given market. The contract will deal with geographic scope and allowed method of distribution, but also with rights to return copies, quality of the copies delivered, advertising obligations of the parties, and indemnification for third party claims. When the magazines are eventually distributed by retail contracts to members of the general public, however, the contracts in traditional hard copy distribution are typically devoid of any terms other than price and perhaps policy on returns.

When that same publisher elects to distribute the same information through the Internet, a far different contractual emphasis occurs. The middle man or distribution contract may not exist, but if it does, there will be a license between the information provider and an on-line distribution service. A more important difference lies in the relationship with the "end user" or customer who is a member of the general public. Here, in a commercial use, it is almost certain that the information will be made available only subject to contractual terms. The contracts are likely to deal with price and with the customer's right to make and retain additional copies. But they also deal with questions such as the time availability of the on-line service, choice of what law governs, assurance or disclaimer of accuracy or quality of the information, representations about or limitations on commercial or non-commercial use, indemnities, and other issues.

There are many reasons for the shift in the contractual relationship between the end user and the person with whom it deals. Some are grounded in informational property concerns, heightened by the character of digital information copies as compared to print copies. Many, perhaps most, of the reasons for the difference lie outside rights-related issues.

2. *Liability as an Illustration of an Issue Beyond Rights Distribution*

To focus the question we can concentrate on liability issues. The question is: why does a magazine retailer not concern itself with warranties, while an on-line provider does? The answer lies in part in the traditions of the book and magazine industry. More importantly, however, it can be traced to a potentially important difference in law.

The magazine (or book) retail seller is protected by a consistent, national body of law disallowing liability claims against it for errors in the

informational content that it purveys. The same is true for the publisher, who has *no contractual* relationship to the end user (buyer). Although it concerned a tort claim, the language of the Ninth Circuit Court of Appeals encompasses the tone and essence of the applicable body of law within which the magazine and book sellers function since, in fact, the cases do generally focus on tort liability concepts:

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. As a New York court commented, with the specter of strict liability, "[w]ould any author wish to be exposed ... for writing on a topic which might result in physical injury? e.g., How to cut trees; How to keep bees?" One might add: "Would anyone undertake to guide by ideas expressed in words either a discrete group, a nation, or humanity in general?"⁸

In this context, the decision simply to sell without contractual provisions about liability for errors is grounded in supportive law. The fact that case law is so well-established in this country means that the decision as to method and terms of contract are not constantly re-evaluated and, if they were, marketplace expectations would sharply limit what retail contract would be acceptable.

The circumstance in the on-line distribution is far less clear. In this case, the publisher *does* have a direct contractual relationship to the end user of the information. In some states, that relationship might fall within general case law which imposes on a service provider a general obligation of exercising reasonable care in its contractual performance. Alternatively, that relationship may be within Restatement (Second) of Torts section 552 on negligent misrepresentation, which deals with a quasi-tort, quasi-contract form of liability. It provides that a person who supplies *information* to another for purposes of guiding that other person's business activi-

8. *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033, 1035 (9th Cir. 1991) (citation omitted).

ties has an obligation to ensure that there are no errors in the information caused by the provider's failure to exercise reasonable care.⁹

One New York state trial court addressed the liability issue in a manner favorable to sustaining public distribution of information. In *Daniel v. Dow Jones & Co., Inc.*,¹⁰ the court rejected an on-line subscriber's claim against the information provider based on an alleged error in the presentation of information concerning the price of a reported commercial transaction.¹¹ The court stated:

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 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. Technological advances must continually be evaluated and their relation to legal rules determined so that antiquated rules are not misapplied in modern settings. "[W]ith new conditions there must be new rules." Yet, if the substance of a transaction has not changed, new technology does not require a new legal rule merely because of its novelty.¹²

9. See RESTATEMENT (SECOND) OF TORTS § 552 (1977) ("One who ... 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.").

10. 520 N.Y.S.2d 334 (N.Y. Civ. Ct. 1987).

11. See *id.* at 337-38. On a related issue, a federal district court similarly insulated the on-line provider in reference to liability for defamatory material made available through its service: "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 [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose an undue burden on the free flow of information." *Cubby, Inc. v. CompuServe, Inc.*, 776 F. Supp. 135, 140 (S.D.N.Y. 1991).

12. *Daniel*, 520 N.Y.S.2d at 337-38 (citation omitted).

In contrast to the approach in *Daniel*, an Illinois appellate court expressly recognized the potential liability of an information provider in a contractual context. *Rosenstein v. Standard & Poor's Corp.*¹³ dealt with the provider of a stock index which, in addition to being made generally available, was provided to be used as the basis for trading on the Chicago commodities exchange.¹⁴ On one occasion, the provider made an erroneous calculation of the index, causing economic loss to many who traded based on the false number.¹⁵ The Illinois court held that the doctrine of negligent misrepresentation created potential liability (to all users of the index as a trading measure), but that in this case the liability was disclaimed by the *contract*.¹⁶ A subsequent Illinois court, dealing with different parties, but the same underlying event, also held that there was no liability, but based this conclusion on its belief that the contract merely called for providing *the index* figure, not an *accurate* index figure.¹⁷

There are more nuances to the law here, but the fundamental point is important. When a publisher shifts from indirect distribution of books or magazines in printed copies to on-line distribution through access to digital databases of the same information, it moves into a world of different or at least unknown liability risk. Under current law, a distributor of information on-line has a risk that courts will conclude that it has contract (or tort) liability to its customers for errors in the information provided. This risk is especially true for information that may be used by the end user for guidance in its business affairs. For a provider of information that emphasizes low cost per unit of information and rapid access to a changing world of information, the exposure may threaten the economic foundation of the distribution system because of litigation and liability costs. In any event, the existence of the liability risk creates an incentive to contract in more detail in this context than in indirect sales to the general public. Not surprisingly, the contract terms are likely to deal with limitations to non-commercial use of the information, disclaimers or limitations on assurances of the accuracy of the information, and limitations on damages that can be claimed in the event of breach.

As presented in Article 2B, this issue contains important overtones of how law goes about promoting widespread and unencumbered availability of information. In answering this question, Article 2B adopts a strong

13. 636 N.E.2d 665 (Ill. App. Ct. 1993).

14. *See id.* at 666.

15. *See id.*

16. *See id.* at 672.

17. *See Lockwood v. Standard & Poor's Corp.*, 682 N.E.2d 131, 135 (Ill. App. Ct. 1997).

policy encouraging public distribution by limiting and, in some contexts, eliminating the liability risk in a manner consistent with case law on print media unless a different risk is expressly assumed by the information provider in its contract. Thus, section 2B-404 adapts the terms of the negligent misrepresentation tort as a basis for contract obligations relating to informational content, but excludes any *implied* warranty of accuracy for *published informational content*.¹⁸

3. *Incentives to Contract: In General*

The on-line world into which we are heading contains many such illustrations of where United States (and international) law creates a significant incentive to contract on terms that go beyond simple definition of price and quantity. These include questions about what state law governs a contractual relationship entered into and performed on-line and whether an on-line provider is subject to suit in any and all fifty states and two hundred countries in this world. The answers to either question are unclear and create a risk of potentially costly litigation. When one views this as a transactional issue, however, these uncertainties and risks create a strong reason to make contractual choices and place contractual limitations on the risk.

We can describe all of these as *incentives to contract* so long as we recognize that the issue is not whether to *commercialize* or instead to release into a *open forum*, nor is it an issue of whether or not to make a contract in connection with a *commercialization*. Rather, the issue and the incentives to which this phrase refers focus on how elaborately or narrowly the contract terms should reach. An incentive to contract here means an incentive to seek contract terms beyond mere price and quantity.

Incentives to contract in this sense exist in the commercial on-line world, but they also exist in digital information distributed on tangible copies. In this *copy-based* world, however, a number of courts have held that computer programs distributed in the mass market are governed by existing Article 2 as to *liability* issues such as warranties and damages risk, and as to a limited number of *performance* issues.¹⁹ While the case

18. See U.C.C. § 2B-404(b) (Apr. 15, 1998 Draft).

19. Many court decisions place software licensing in Article 2 even though software is licensed and not sold and even though the focus of the transaction centers not on the acquisition of tangible property, but on transfer of capability and rights intangibles. See *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 676 (3d Cir. 1991); *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 546-47 (9th Cir. 1985); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 737, 741 (2d Cir. 1979). *But see Data Processing Servs., Inc. v. LH Smith Oil Corp.*, 492 N.E.2d 314, 318 (Ind. Ct. App. 1986); *Micro-Managers, Inc. v. Gregory*, 147 Wis. 2d 500, 509 (Ct. App. 1988).

law is not uniform, it creates an incentive to contract. The same incentives exist in automobile sales and leasing, and in manufacturer's warranties for other types of goods. The incentive is not limited to, but is actually more relevant in transactions outside the mass retail market. The issue for information assets, however, takes on a somewhat different tone when one considers the newer products in the information marketplace. For example, is a multi-media interactive encyclopedia subject to an implied warranty of merchantability because it is a computer program? If so, does that warranty entail an assurance that the informational content of the encyclopedia is free from errors?

4. *Incentives to Contract: Contract as Product*

An additionally potent "incentive to contract" in the world of digital information stems from the relationship between the contract terms and the product. In licensing, the contractual rights terms are in effect the product itself. That has long been true in the upstream segments of information industries in which the focus is on creation of a work, development of software, or arrangements for commercial distribution. The development of digital information products and on-line distribution has brought this same principle into the end user marketplace.

In the world of goods, contract terms define the product being sold (or leased), but different descriptions typically require delivery of a different tangible item. In the world of information, especially digital information products, different contract terms describe different products. The differing terms, however, do not necessarily require delivery of a different tangible item (copy). Consider the following contract term:

A right to publicly perform "James Bond 1998" in Houston from June 1 through July 1.

There is no doubt that the contract term defines and describes the product being transferred. While the *tangible* subject matter of the contract is most likely to involve delivery of a copy of the motion picture "James Bond 1998," the product is not the copy, but the rights granted in use of the content contained on the copy. If that point is not clear, compare the value of the contract term stated above to the value of the product in a contract in which the contract term provides the transferee with "exclusive rights throughout the United States" to publicly perform or display "James Bond 1998." Yet, both contracts are satisfied by delivery of the same copy of the motion picture. The contract, not merely the copy, is the product.

The reality that contract terms are the product also create an "incentive to contract" in the sense that the contract terms are used and useful to dif-

ferentiate markets and pricing. This has always been true in upstream licensing, but digital products make it useful and commercially important in end user markets. In these contexts, the provider may elect to provide a product solely for consumer use or one that can be used for either consumer or commercial purposes, reflecting the different value in the pricing, but in essence controlling the difference in the products solely through the terms of the license.²⁰ Similarly, a software vendor may contractually allow use by a single user of a copy of "Windows NT" and, in a separate transaction, deliver a copy of "Windows NT" under a license allowing the licensee to use the software in a 10,000 site network or allowing it to make 20,000 additional copies for commercial distribution. In the latter case, the provider, in effect, transferred 20,000 copies in the single tangible copy.²¹ In each case, the product is the license and the value of the product is substantially different.

This provides another simple insight into the interaction of copyright and contract. Granting a proprietor of informational property rights the ability to contractually differentiate among the rights granted or withheld, and uses permitted or precluded, contributes to the establishment of an active and heterogeneous market in which "products" can be tailored to actual demand, distribution of information optimized, and pricing tailored to marketplace value.

If the proprietor of an information asset is not permitted to contractually distinguish what rights it grants or withholds, that proprietor has only one asset available for transfer and with respect to which it can contract only one time. That rule obviously does not exist in modern law and is not consistent with basic property or contract law. The ability to contractually define and isolate what rights are and are not transferred is critical to commercialization of informational assets. Any proposals to restrict or restrain that right, in general, need to be carefully and critically examined. Such proposals would contradict not only the basic contract law principle of party choice, but also alter the fundamental role of commercial uses in implementing the basic "intellectual property bargain" and, to borrow a

20. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1455 (7th Cir. 1996) (holding that license was limited to consumer use); *Storm Impact, Inc. v. Software of the Month Club*, 13 F. Supp. 2d 782, 791 (N.D. Ill. 1998) (holding that an on-line shareware license allowed copying and distribution except for resale).

21. See *Microsoft Corp. v. DAK Indus., Inc.*, 66 F.3d 1091, 1095 (9th Cir. 1995) (concluding that a distribution agreement involving a lump sum payment and delivery of a master disk is more like a sale of the right to make the stated number of copies, than an executory license for purposes of characterizing claims under bankruptcy law).

phrase, alter the "delicate balance" that has been established in which commercialization is an important part of the intellectual property right.

While few, if any, writers advocate the blanket proposition that no contractual rights or limitations are permitted in any distribution of information except for the terms of the Copyright Act,²² it can be argued that a distribution of copies of a work cannot contractually establish a package of contractual rights or limitations that differ from the copyright default rules pertaining to a first sale of a copy. This argument assumes that, since this is the way we (publishers, retailer, and end users of *print* copies) have done business in the past, the law should prohibit any change in doing business in the future. This premise appeals to instincts of many that prefer to continue on comfortable and predictable paths without being buffeted by change.

Of course, it is never possible to legislate the *absence* of change.

Of course, it is never possible to bar the effects of technological, social and economic revolution.

Change is reality in our revolutionary era.

This reactionary posture is neither correct nor simple. It superficially masks a proposed fundamental change in the relationship between commercialization and intellectual property rights policy. To understand this, we need only to ask a single question: assuming that a copyright owner has the *exclusive* right to distribute (or not distribute) copies of its work, what rule of law can adequately ensure that a retail vendor must only *sell* copies without restriction to end users? Most retail vendors do not own copyright in the works they distribute. Thus, the only feasible answer lies far up the distribution chain; it must reach to the point at which the copyright owner *first* chooses to make its work available to others.²³ To ensure that, at the end point of the distribution of copies, nothing other than a first sale to an end user can occur, law would of necessity have to provide that

22. 17 U.S.C. § 101 et. seq. (1994 & Supp. II 1996).

23. In establishing a distribution system for the mass market, an informational property rights owner may elect to establish a transaction in which it gives its distributors either (1) ownership of a copy and a right to sell copies of its work to others, or (2) a license (permission) to license copies to others. Copyright and other intellectual property law supports either choice. It also provides that, if a license is created and the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected under bona fide purchaser concepts. See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208, 214 (E.D.N.Y. 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035, 1040 (D.N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077, 1084 (D. Md. 1995); *Marshall v. New Kids on the Block*, 780 F. Supp. 1005, 1008-9 (S.D.N.Y. 1991).

the copyright owner that elects to distribute its work has no choice about how or under what conditions that distribution *to the first distributor* can occur. Any other rule would mean that the retailer is forced to infringe the exclusive right of distribution in any case where the copyright owner elects to preclude or restrict sales of copies of its works, supplanting that old methodology with a contract-based distribution.

That proposition must be rejected from both the contract and the property rights perspective. It is totally inconsistent with the premise that intellectual property law should encourage and support the creation and distribution of works.

C. Contract and Informational Property Rights Co-Exist

If one narrowly focuses on contract terms associated with rights distribution, it is clear that not only is there not a conflict between intellectual property concepts and contract, but that each is an inherent and essential part of the policy scheme of the other. As we have seen, commercialization use (e.g., contracting for) informational assets is one of two primary means by which information is distributed. It represents that portion of the matrix that yields financial and similar incentives for the creation of new, and the distribution of existing, information assets. In that sense, the so-called intellectual property bargain does not exist in the absence of contract law and practice.

Even more fundamentally, throughout United States law, it is clear that one primary attribute of a "property interest" is that the property can be transferred in whole or in part. The decision to do so ordinarily lies with the property right owner. It is anomalous, if not a flat out contradiction, to speak about a property right that *cannot be transferred*, even temporarily. In a market economy, an assumption of non-transferability would strip the property right of most of its personal value.

We come then to the question of how these laws (contract and property) interrelate, not whether they conflict. To focus on that question, I will make three points:

- First, the two bodies of law differ in how they regulate a party's conduct.
- Second, the impact of a property right in a marketplace shaped by contractual relationships is most often indirect, with the rules of property being filtered and adapted through contractual and other relationships.
- Third, in this marketplace setting, intellectual property law provides "default rules" for contractual relationships. These are default rules in

that, by their own terms, the effect of the rule can ordinarily be altered by contract.

1. *The Nature of Law in the Two Fields*

Contract law is a party *choice* regime, emphasizing with few exceptions the ability of the parties to define their own relationship. In contrast, intellectual property law (with the possible exception of trade secret law) is a vested *rights* regime. It defines the relationship of persons to an identified corpus of information in the absence of a contractual relationship altering that established or vested right.

a) Contract Law and Party Choice

Because it reflects an assumption of party autonomy or choice, the rules formulated within a contract law regime, whether in common law or in a uniform codification, are subservient to the actual choices of the parties. In general, the law of contract does not mandate outcomes in a contract relationship. Instead, in this setting, contract *law* has three primary functions. First, it establishes when an agreement becomes enforceable in law between the parties (e.g., when an "agreement" becomes a "contract").²⁴ Second, contract law provides "background" or default rules which indicate what the terms of the relationship are in the event that the parties do not otherwise agree.²⁵ Third, in limited situations, contract law provides that particular terms may be *unenforceable* on the grounds, for example, that the term is *unconscionable*.²⁶

24. Contract formation, of course, is a major issue in contract law. When it was first adopted, Article 2 of the U.C.C. was viewed as establishing highly permissive rules enabling the early formation of contracts despite the lack of precise agreement as to all specific terms. The "open term" or "layered" contract model is found in several provisions in Article 2. See, e.g., U.C.C. § 2-204 (1996) (allowing formation in any manner); *id.* § 2-207 (allowing formation even though offer and acceptance have varying terms); *id.* § 2-311 (permitting formation with open terms even though one party retains the right to particularize the details of performance after the fact).

25. In most cases, these "default" rules are subject to contrary agreement. Article 2B, for example, provides expressly that with specified exceptions, the provisions of the statute are applicable only if the agreement of the parties does not otherwise so indicate. It lists a total of 13 provisions that are not subject to this general rule of contract choice. See U.C.C. § 2B-106 (Apr. 15, 1998 Draft).

26. This particular limitation was originated in the development of the original Article 2 of the U.C.C. See U.C.C. § 2-302 (1962). It has subsequently been incorporated into the common law of many states as applicable to contracts outside the U.C.C., but this adoption has not been universal. Article 2B adopts the literal language of existing Article 2 on the issue of unconscionable contracts or clauses. See U.C.C. § 2B-110 (Aug. 1, 1998 Draft). This, of course, would uniformly extend this concept to all contracts within the new scope of the U.C.C.

If we put aside contract formation rules for the moment, the use of background or default rules in a contract law regime means that the black letter of contract law must be understood differently than its counterpart in a vested rights regime. The contract rule *presumes* that a contractual relationship exists; the rule would not otherwise apply. It then indicates what the nature of the relationship is *if* the parties do not otherwise agree. While there has been some debate in the literature about what should be the source and logic of those background rules, in a commercial statute, in contrast to common law, the most common reference point centers on ordinary commercial or other transactional practice suited to the context.²⁷ This is, after all, a party choice regime. As Grant Gilmore observed, the purpose of the drafter of a commercial statute is to ensure that transactions when undertaken by the parties have the effect in law that was anticipated in practice.²⁸

Contract law relies on the premise that *parties*, rather than laws, create (or decline to create) a relationship. The parties do so by exercising personal choices. However, the ideas of choice and agreement conveys a romantic view of contracts, i.e.; that the choices must follow actual negotiation between parties of equal bargaining power. Negotiation over terms seldom occurs in either a mass market or a commercial marketplace. Our economy, and the mass market in particular, is not, and never was, a bazaar economy characterized by recurrently dickered terms shaped to each transaction. Nor can it ever be so. Economics and efficiency concerns preclude it.²⁹ One party (the vendor or the purchaser) proposes terms and the other party assents or refuses. In some cases, the proposed terms relate solely to price and quantity, while in others they are more extensive because there are important "incentives to contract."³⁰

27. See Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 (1992); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 734 (1992); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 266 (1985).

28. See Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341, 1341 (1957).

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

30. See *supra* section II(B)(3) for discussion of incentives to contract. There are incentives to do more in a contract than simply specify price and quantity.

Under contract law, formation of a contract and definition of its terms do not require sophisticated or equally leveraged parties, nor parties with incentive to devote time, effort, and cost to negotiate. Standard terms, leverage, and adherence to pre-set terms characterize all commerce. Most importantly, it has never been considered to be the role of contract law to generally reshape the balance created by market conditions. If DuPont offers a cleaning fluid for sale to a consumer or a janitorial company, but only at a specific price coupled with a rigid disclaimer of warranties, transactions that result in buyers willing to purchase the product under the stated terms are fully enforceable.³¹ With very few exceptions, standard form contract terms are enforceable. The ability of parties to standardize and control the terms under which a product or information is marketed gives an important element of efficiency in transactional environments.

The decision in law to enforce standard form contracts is fully consistent with contract theory. While the party with the lesser leverage may view its position as not involving any choices, there are choices at work throughout this form of distribution. The choices begin with the decision to market (or offer to purchase) a product only under stated terms. In the consumer market, that choice is the vendor's. In other settings, the purchaser is dominant. In the seller-dominant scenario, the buyer chooses to accept the product and terms or to reject them and purchase a different product or no product at all. If enough potential purchasers decline the product and terms, the provider will change the price or terms, or leave the market. With the advent of the Internet, the ability of purchasers to discuss products and terms creates the likelihood that they will have an increasingly powerful influence.

The phrase most commonly associated with standard form contracts is "contract of adhesion." Actually, modern courts use that phrase only if the adhering party had virtually no other choice in the market because no other providers offered the same or equivalent product or service and there are other indicia of non-disclosure, unbalanced sophistication or the like in the transaction.³² The idea of an adhesion contract does not mean simply that I insist on my terms and have the power to do so.

31. Of course, tort products liability may override liability limitations in cases to which they apply. As a general rule, however, tort claims arise only in the event of personal injury or property damage. Contract law, including Article 2B, does not alter the range of product liability law.

32. *See, e.g.,* *Klos v. Polskie Linie Lotnicze*, 133 F.3d 164, 169 (2d Cir. 1997) (holding that round trip air tickets were not contracts of adhesion); *Fireman's Fund Ins. Co. v. M.V. DSR Atl.*, 131 F.3d 1336, 1339 (9th Cir. 1998) (finding forum selection clause in bill of lading enforceable and the fact that the contract was a contract of adhesion

Contracts of adhesion are routinely enforced. A contract of adhesion analysis typically indicates that a court enforces the contract, but scrutinizes its terms more closely for terms that are procedurally or substantively unconscionable.³³ Article 2B follows that principle but requires application of procedures that protect the party adhering to the contract terms.

It might be argued that rights-related terms can only be adopted by contract if the contract conforms to a romantic view of contract law that the only true contract is a fully dickered agreement between parties of equal leverage. That romantic view of contract actually proposes that courts should affirmatively reshape economic imbalance and redefine agreements. Instead, modern contract law does not purport to restructure the economic system, but assumes that deals are enforceable while acknowledging that courts should police and alter terms of agreement when needed to avoid oppressive results and unfair surprise in cases of extreme unbalance.

The romantic view also assumes that assent to a contract requires formality of execution and proof of subjective agreement. That has never been true. Contracts range from formally negotiated agreements drafted by batteries of lawyers to informal agreements between individuals who contract without formally making an express offer or an express acceptance. In the Restatement (Second) of Contracts a contract exists if the parties

was irrelevant); *C.H.I., Inc. v. Marcus Bros. Textile*, 930 F.2d 762, 763-64 (9th Cir. 1991) (holding that a standard form confirmation was not an adhesion contract); *Aviall, Inc. v. Ryder Sys., Inc.*, 913 F. Supp. 826, 831 (S.D.N.Y. 1996) (finding adhesion only when the party seeking to rescind the contract establishes that the other party used "high pressure tactics," or "deceptive language," or that the contract is unconscionable).

33. See, e.g., *Klos*, 133 F.3d at 168-69 ("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."); *Fireman's Fund Ins.Co.*, 131 F.3d at 1339; *Chan v. Society Expedition, Inc.*, 123 F.3d 1287, 1292 (9th Cir. 1997); *Dillard v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 961 F.2d 1148, 1154-55 (5th Cir. 1992); *Riggs Nat'l Bank of Washington D.C. v. Dist. of Columbia*, 581 A.2d 1229, 1251 (D.C. Ct. App. 1990); *American Bankers Mortgage Corp. v. Federal Home Loan Mortgage Corp.*, 75 F.3d 1401 (9th Cir. 1996) (contract of adhesion fully enforceable in the absence of showing of unconscionability); *E.H. Ashley & Co. v. Wells Fargo Alarm Serv.*, 907 F.2d 1274, 1279 (1st Cir. 1990); *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 172 (1981). Compare *Todd D. Rakoff, Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983).

manifest assent to an agreement by their overt actions.³⁴ A party can manifest assent by an offer or an acceptance, but it can also do so by conduct, without the formalities.³⁵

Article 2B builds on these theories, but it creates enhanced protections for the assenting party. There are procedural limits on when manifesting assent can occur. There are rules requiring refund opportunities associated with when assent occurs. There are rules that preserve expressly agreed terms notwithstanding use of a standard form. With those concepts built around the idea of manifesting assent, all of which benefit the licensee, Article 2B then adopts the basics of the assent concept found in all commerce, modern or ancient.

b) Property Law

A common, although not completely accurate, image of property or vested rights law is that the rules define a party's relationship to a corpus (the "property") in terms independent of any relationship between the rights owner and a third party.³⁶ From a transactional viewpoint, these form, in effect, a starting point for fashioning the transaction. One court described property rights as involving "rights good against the world," while contract rights are rights good against the other contracting party.³⁷ This is true in the sense that true property rights do not hinge on the creation of a voluntary relationship, while contract rights depend on the existence of that relationship.

The policy decision to create or deny property rights occurs in the context of a focus on rights defined by law in relationship to a particular corpus (property). The property right exists in the absence of a contractual relationship between parties with respect to that property. Thus, for example, the fact that I own my Mercedes means that, in the abstract, I have certain exclusive rights of possession and use; these rights are enforced in law against persons who infringe them without my permission. It does not mean that I cannot lend the car to you. Similarly, the fact that I own the copyright to my recent book gives me certain exclusive rights enforced by law against persons who infringe them without my permission.

This is the underlying premise and thrust of the most significant Supreme Court rulings on the scope of intellectual property *rights*. Thus, for

34. See RESTATEMENT (SECOND) OF CONTRACTS § 19 (1981).

35. *Id.*

36. As I discuss below, copyright law does not fully conform to this property law structure in that many of the rules it promulgates are stated as "default rules" which apply in the case of a transactional relationship between the parties or their transferees.

37. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1454 (7th Cir. 1996).

example, the Court in *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*³⁸ invalidated a state law on grounds of preemption. The law purported to grant the distributor of boats a right to prevent others from duplicating the design of the boat hull through use of a particular technology.³⁹ The Court argued that this state law purported to create rights that federal copyright and patent law denied.⁴⁰ Those rights contradicted the "intellectual property bargain" established in property law by federal legislation.⁴¹ The underlying factual premise was that there was no contractual or other relationship between the original designer-manufacturer and the person duplicating the hull design. In effect, the state law created enforceable rights in the absence of a relationship that federal law denied. That type of right states the domain of property rights law.

2. *Property Rights in a Marketplace Transaction*

The impact of a property right in a marketplace shaped by contractual relationships is most often indirect, with the rules of property being filtered and adapted through contractual and other relationships. This does not mean that there is no effect.

Whether a party has a property right in the information it offers, plays a role in defining the terms of the transaction. This is true even though some would argue to the contrary, treating the policy decision to allocate property rights as irrelevant to the ultimate distribution of value in any transaction. That theory, however, applies only to an abstract and friction-free world that does not exist.⁴² In a real world, the situation is more complex. Deciding which party (if either) has a property right in the transactional subject matter does affect the terms of a transaction.⁴³ However, the effect is not always direct or linear in relationship to the policy decision that creates or denies a property right; often, the effect of the choice in property law doctrine cannot be predicted in the transactional world. A property right does not translate automatically or directly into a transactional advantage. Rather, it yields a transactional effect only through negotiation, marketplace, and other influences on the transaction.

38. 489 U.S. 141 (1989).

39. *See id.* at 144-45.

40. *See id.* at 168.

41. *See id.* at 157.

42. *See generally* Herbert Hovenkamp, *Marginal Utility and the Coase Theorem*, 75 CORNELL L. REV. 783 (1990); Jules L. Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221 (1980).

43. *See* Daniel Farber, *Parody Lost/Pragmatism Regained: The Ironic History of the Coase Theorem*, 83 VA. L. REV. 397, 406 (1997).

This limited role of property interests in determining the contours of contractual relationships should play an important role in debates on any issue relating to the creation (or denial) of property rights in information or in any other asset. Any assumption that property rights equates directly into an ability to control or determine value in a modern marketplace is often not true. Rather, control and value relate to many other transactional elements, and the information that brings the most value in a transaction may be information in which there are no recognized property rights.

a) Marketplace Effects on Property Transactions

Property rights provide *one* point around which terms of a transaction are established, but only one point. Transactions occur in a marketplace. That marketplace shapes and determines the character of transactional terms. The marketplace influences are ordinarily far more relevant than are the scope and character of the property rights involved.

For example, assume that I own a Zenith television and that you desire a television of that type. The amount that you are willing to pay and the terms you will accept depends in part on whether other acceptable televisions are available from other sources and whether I have a right to prevent you from taking my television without paying for it. Property rights affect this last element since they allow me to retain my own television against your attempts to forcibly take it. Those rights, however, do not routinely influence the first element: the availability of substitutes, including the alternative of going without a television.

The transactional value of the property right depends on the strength of the demand for the particular information, the availability of alternatives to it, and the existence or absence of exclusivity rights in the information. Thus, while I may desire to transfer my television for \$1,000 and only on the condition that you return it after a single use, my capability to insist on those terms requires your assent. My *desire* for those terms has no meaning unless someone is willing to transact under those terms or unless I am willing to forego all transactions unless the terms are met. You will not assent to those terms unless the cost and the limits are acceptable in light of alternatives and your need or desire for the television.

Contract law assumes that markets normalize and regulate transactional behavior and ultimately prevent over-reaching in most cases.⁴⁴ Given that assumption, the need for regulatory restrictions seldom arises.

44. See, e.g., RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 89-96 (4th ed. 1991); Richard Epstein, *Unconscionability: A Critical Reappraisal*, 28 J.L. & ECON. 293 (1975).

The model is a marketplace that accommodates choices. If market dysfunction, fraud, or abuse wrongfully distorts that context, the abuses are dealt with on a case by case basis to eliminate or regulate them.⁴⁵

There are many illustrations of this market-based theme in intellectual property law. Indeed, many copyright law rules presume a transactional context and define default rules relevant to that context. These include:

- a first *sale* gives some presumptive rights to the buyer of a copy
- *transfer* of a copy does not transfer the copyright
- *contribution* of a work to a collective work gives the collective author a right to use the work in revisions of the original
- an *owner* of a copy of a computer program can make a copy of the program
- employment *contracts* give ownership of some works to the employer

Indeed, one can make a reasoned argument that *all* property rules are default rules when they are made operational in a market defined by transactions and economic demand. In the context of that market, debate over proposals to expand or contract *property* rights in information often miss the salient point that the change in rights (if adopted or rejected) may have little or no effect on the transactions that actually occur.⁴⁶

b) Value and Terms in an Information Transaction Often Do Not Depend on the Intellectual Property Rights

A fundamental fallacy in this context often emerges from those whose experience or interest focuses solely on intellectual property law. That

45. This, of course, is the function of rules such as the doctrines of unconscionability (See U.C.C. § 2-302 (1994)), concepts of duress, fraud and related doctrines. See, e.g., *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 574 (App. Div. 1998) (holding that arbitration clause in standard form contract that was otherwise enforceable is unconscionable because it effectively deprived a computer buyer, through excessive costs, of the ability to pursue a claim); *Intergraph Corp. v. Intel Corp.*, 3 F. Supp. 2d 1255, 1286 (N.D. Ala. 1998) (concluding provision in technology contract permitting termination on little or no notice held unreasonable as a matter of law).

46. Under current law, for example, a "first sale" of a copy of a computer program does not give the owner of the copy a right of public display or public performance or a right to rent the copy to third persons. The first two rights reflect traditional limitations on the copyright doctrine of first sale. The third was added more recently to respond to unique risks involved in digital technology and digital copies. When it was adopted, the transactional leverage of a vendor of copies of works offered for sale was altered. The impact of that change on actual transactions, however, filters through the various market factors and demand issues that shape transactions. If I do not desire to rent my copy to others, the fact that buying ownership of a copy does not give me that right is immaterial. If I desperately desire a right to rent the copy, the change increases what I may be willing to pay or agree to in any particular transaction.

fallacy assumes that the sole or primary value in a transaction involving information lies in the *intellectual property rights*. This has never been true universally true.⁴⁷ It is even less true in modern commerce as other sources of rights and value play an increasingly major role.

Consider the following: I own the sole copy of a national directory of e-mail addresses that I personally compiled. You desire to use the addresses to promote a new product. The list is not copyrightable.⁴⁸ Nevertheless, I may have a valuable asset (or not) and you may be willing to pay for it and accept contractual conditions that I demand. There can be no doubt that the list can serve as a basis for a contract. You, obviously, could independently compile the same list, but you may lack the money, time, or inclination to do so. The transactional value here lies, in part, in my right to use the list on your behalf (or not) or to transfer a copy to you (or not). These rights are absolute without regard to the fact that copyright law gives no protection to this list. The copyright rule that places compiled facts into the public domain does not give you an affirmative right to force access to the information. You cannot enter my house, my office, or my computer without my permission, which I have chosen to condition on your assent to a contract.⁴⁹

The basis of the transaction is premised in part on an evaluation of (i) the value of obtaining data from me as contrasted to (ii) a willingness to either forego use of the data or to obtain it elsewhere. The value can be quite high or quite low. Whatever that value, it provides a structure around which a contract can be formed. What terms will become part of the contract cannot be answered here because it depends on the choice of the parties and their bargaining leverage. However, the terms are likely to go beyond intellectual property rights issues and might include:

- (1) there are no warranties about the completeness of the list;
- (2) Illinois law applies to all disputes about performance of the contract;
- (3) privacy rights and consents have [have not] been fully cleared by licensor;

47. Often, the least complex examples are the most telling. When you purchased the newspaper today, did the price you paid depend on your judgment about whether or not you could make multiple copies of the newspaper for distribution to your commercial clients? I think not.

48. See *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 362-64 (1991).

49. The copyright doctrine works on a different premise. It assumes that information is placed into the public and rejects the existence, under copyright, of any exclusive or preclusive property right that can be asserted against parties in the absence of contract.

- (4) the list can be used only for one "mailing" and any additional use is a breach of contract;
- (5) all copies of the list are to be returned to the licensor after the one authorized use;
- (6) the list will be delivered in object code only and compatible with UNIX;
- (7) purchaser will pay \$— for one use of the list; and
- (8) vendor will [will not] provide assistance in use of the list.

This transaction, of course, is representative of transactions that occur with respect to non-copyrightable lists of e-mail addresses, telephone numbers, and residential home addresses every day, forming the basis for a lucrative and growing commerce in information.

The copyright *property* law principle that denies copyright protection to "facts" does not state the only *property* right applicable to such transactions, let alone the only basis for a commercially valuable transaction.⁵⁰ It is neither essential to, nor decisive about, the parameters of commercialization of the information involved.

3. *Property Law Creates Transactional Default Rule*

In transactional relationships, property rights (including intellectual property rights) may furnish background or default rules that govern the transaction unless otherwise agreed. From a contract *law* standpoint (as compared to contracting practice), setting out background principles is the primary function of intellectual property law. More generally, the essence of any property right is that the owner can transfer or withhold transfer of its property. Transfers, to be effective, implicate contract law as the basis for defining the value received and the interests conveyed.

Perhaps more than in any other property rights regime, the statutory rules of copyright law (and, to a lesser extent, patent law) support and ex-

50. Modern law establishes that property rights in information come from an increasingly wide array of sources. Property rights related to information are characterized by a two-part equation: 1) the presence of specified conditions or circumstances that 2) yield particular rights in reference to identifiable information. See RAYMOND T. NIMMER, INFORMATION LAW 2-14 - 2-28 (1996). The rights come from criminal law, privacy law, and other sources. Writing with reference to this issue, the Ninth Circuit Court of Appeals noted that for a property right to exist in any situation, "first, there must be an interest capable of precise definition; second, it must be capable of exclusive possession or control; and third, the putative owner must have established a legitimate claim to exclusivity." *G.S. Rasmussen & Assocs. v. Kalitta Flying Serv.*, 958 F.2d 896, 903 (9th Cir. 1992). The potential rights recognized in modern law include rights recognized under copyright law and patent law and also rights of commercialization, non-disclosure, control of access, and to prevent or authorize destruction of the information.

PLICITLY relate to this role in reference to contractual relationships. This is due to the central role that contracting has in achieving the basic goals of the copyright. The so-called intellectual property bargain, arguably struck in the political choices made by statute in federal patent, copyright, and trademark law, presumes the transfer and transferability of the information and rights created by these laws.

The Copyright Act enumerates the rights of copyright holders in Title 17 of the United States Code. The range of rights associated with the five fundamental rights enumerated in 17 U.S.C. §106(1-5) have dramatically grown since the promulgation of the 1976 Act.⁵¹ The Copyright Act recognizes that the copyright owner can separately transfer (or withhold) any of the exclusive rights. As a result, a contract ("license") that gives the grantee the right to reproduce and distribute copies does not give the grantee a license to use the other exclusive rights held by the copyright owner (e.g., the rights of public performance or display, the right to make "derivative works" from the original).⁵²

There are many illustrations of this type of interaction.

a) Revision Right

One economically significant illustration arose in the case of *Tasini v. New York Times*.⁵³ That case dealt with the rights of the freelance authors of magazine articles in reference to on-line reproductions of the magazines by the magazine publishers.⁵⁴ Nominally, the case turned on a *property* law issue: does on-line reproduction fall within the "revision right" granted to authors of collective works.⁵⁵ Actually, the case involved the creation and interpretation of a contract default or background rule with great significance in the convergence of information industries.

51. See, e.g., 17 U.S.C. §§ 901-914 (1994) (semiconductor maskwork rights); *id.* at § 104A (1994 & Supp. II 1996) (restored works); *id.* at § 106(6) (1994 & Supp. II 1996) (digital audio rights); *id.* at § 106A (1994) (providing special rights in works of visual art); *id.* at § 1101 (1994) (fixation of live performance); Digital Millennium Copyright Act, H.R. 2281, 105th Cong. (1998). Some might view this expansion unwarranted, but regardless of the characterization, these developments clearly indicate an on-going policy judgment that the contours of the digital information era will be shaped, at least in part, by an expanded and different set of rights in information than existed during the industrial era. The pattern of expansion in the United States has international parallels. See generally NIMMER, *supra* note 50.

52. Cases suggest that interpretations of the scope of a license should be designed to protect the licensor's retention of rights. See generally *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1081 (9th Cir. 1989).

53. 972 F. Supp. 804 (S.D.N.Y.), *reh'g denied*, 981 F. Supp. 841 (S.D.N.Y. 1997).

54. See *id.* at 806.

55. See 17 U.S.C. § 201(c) (1994).

The district court held that the electronic version was a revision of the original work, rather than a new work.⁵⁶ As a revision, it fell within the rights of the author of the collective work under the Copyright Act.⁵⁷ The ruling on whether the electronic version was a mere revision can be debated as a matter of copyright law. But for understanding the relationship of property law with contract law, we can put that issue aside and assume for purposes of argument that the court was correct.

The most important issue for our purpose then concerns the court's treatment of the agreement under which the articles were submitted. Predictably, these were not elaborate written documents. While not fully clear, it is doubtful that they were negotiated by parties of equal bargaining leverage.⁵⁸

One contract granted a right of first publication in the magazine.⁵⁹ The court held that this language did not cover a later electronic publication because, by its own terms, it covered only the "first publication."⁶⁰ An electronic publication, while in the court's view satisfied the statutory reference to a revision, was clearly not the same as the original magazine.⁶¹ This, however, did not completely vitiate the publisher's right to make an electronic revision because other general language in the contract referred to a right to "republish the Story or any portions thereof in or in connection with the Magazine."⁶² This language could cover revisions.

Faced with these arguably conflicting interpretations in the language of the contract, the court reverted to the section 201 presumption. The court's comments are telling:

Just as it is a publisher's burden to demonstrate that it has acquired rights greater than the presumed [statutory] privileges, it is an author's burden to demonstrate that any agreement between the parties limits a publisher to fewer than those privileges. [This] is a burden that plaintiffs failed to meet Section 201(c) [suggests] that the specified privileges represent a floor: i.e., a

56. See *Tasini*, 972 F. Supp. at 827.

57. See *id.* at 814.

58. See *id.* at 807.

59. See *id.*

60. See *id.* at 812.

61. The court observed: "[The electronic publication] strips away many of the elements present in the publishers' hard copy periodicals [and] carries a revised version of that magazine." *Id.* at 846.

62. *Id.* at 807.

minimum level of protection which, if unenhanced by express agreement, publishers are generally presumed to possess.⁶³

This places the copyright rule in a proper context equivalent to a default rule in contract law. The court recognized that the rights in the statute can be waived, restricted, or enhanced between the parties by contract. In a transactional setting, that means simply that the revision right states a default rule. This rule indicates that, unless otherwise agreed, the author of the collective work controls the initial version and any revision or new edition. The rule applies in the absence of other contractual treatment. Indeed, the so-called revision right only applies when a contract exists. It only creates a right when and if a submission occurs under circumstances in which the submitting party allows the other to reproduce its work. In short, the rule applies to licenses. It is a default rule against which bargains are structured.

b) Transferability of Licenses

Under established federal case law, a licensee's rights under a non-exclusive license are not transferable without the consent of the licensor.⁶⁴ This rule flows from the fact that a nonexclusive license is a personal, non-assignable privilege, representing less than a property interest, and conveying less extensive rights to the licensee than other forms of transfer. Also, as described by the Ninth Circuit, allowing "free assignability ... would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee."⁶⁵

The rule preempts contrary state *law*. But, as with the revision right, it is a default rule. It proscribes the effect of an over-riding intellectual property right in a transaction, but allows for a contrary agreement (consent). Express contractual terms on transferability supplant the default rule.

c) Author's Termination Right

The Copyright Act provides that a license of indefinite duration can be terminated by the copyright owner during an interval thirty-five years into

63. *Id.* at 845.

64. See *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673, 679 (9th Cir. 1996); *Unarco Indus., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303, 1335 (7th Cir. 1972); *Harris v. Emus Records Corp.*, 734 F.2d 1329, 1333 (9th Cir. 1984); *In re Alltech Plastics, Inc.*, 71 B.R. 686, 689 (Bankr. W. D. Tenn. 1987).

65. *Everex Systems*, 89 F.3d at 679.

the contract.⁶⁶ One court has held that this rule precludes application to copyright licenses of the common law (and UCC) default rule which makes indefinite term contracts subject to termination at will.⁶⁷ The decision was couched in terms of federal preemption of the underlying common law default.⁶⁸

Importantly, however, the copyright rule only applies where the parties have not contracted for a specific termination date, and at least one court has held that a "perpetual" license is enforceable where evidence establishes an intent to convey renewal rights in the copyrighted work notwithstanding the federal rule.⁶⁹ The rule thus establishes a property law default rule applicable to particular contracts (copyright license of indefinite duration) in the absence of contrary contract terms (e.g., an express choice on the term of the license). The express terms obviate the default rule.

d) First Sale and Copy Ownership

Another default rule exists in reference to the parallel themes of "first sale," "exhaustion of patent," and "ownership of a copy" of a computer program.⁷⁰ These doctrines hold that the "sale" or other transfer of ownership of a copy (goods) gives the copy owner a right to take some actions that would otherwise be precluded by the intellectual property rights of the rights holder. Not all rights pass to the copy owner. The Copyright Act expressly provides that the mere transfer of ownership of a copy does not transfer the entire copyright.⁷¹ Thus, the copy owner does not obtain the right to publicly display or perform the work, nor the right to make additional copies for commercial purposes.

State or common law determines when or whether a sale or transfer of ownership occurs.⁷² Under current law, since copies are typically treated as goods, the determination of when a transfer of ownership occurs will

66. See 17 U.S.C. § 203(3) (1994).

67. See *Rano v. Sipa Press, Inc.*, 987 F.2d 580, 586 (9th Cir. 1993) (holding that copyright law preempts state law regarding contracts (licenses) that are terminable at will because they contain no duration clause; applying 17 U.S.C. § 203(a) (1994)).

68. See *id.* at 583.

69. See *P.C. Films Corp. v. MGM/UA Home Video, Inc.*, 138 F.3d 453, 457 (2d Cir. 1998) (holding that "perpetual" license is enforceable during term of the copyright, but not deciding if it is enforceable after the term expires).

70. See, e.g., 17 U.S.C. § 117 (1994).

71. See *id.* at § 202 ("Ownership of a copyright ... is distinct from ownership of any material object in which the work is embodied."). Copy ownership is distinct from questions of whether the transaction creates a license. See, e.g., *Applied Information Management, Inc. v. Icart*, 976 F. Supp. 149, 153 (N.D.N.Y. 1997); *DSC Communications Corp. v. Pulse Communications, Inc.*, 976 F. Supp. 359, 362 (E.D. Va. 1997).

72. See U.C.C. § 2-401 (1994); *Icart*, 976 F. Supp. at 154.

typically be under Article 2 and Article 2A of the U.C.C.⁷³ Under contract law, a sale consists of a contractual transaction that transfers title to goods for a price.⁷⁴ If title does not transfer, the "first sale" rights do not arise. The contract determines when and whether this occurs, but in the event the contract is silent, title to a copy that is sold passes on delivery of the copy.⁷⁵

More generally, it is clear that a rights owner can refuse to "sell" a copy. Even if a copy is sold, contract terms are not excluded from defining the rights of the parties under contract law, shaping or eliminating the statutory, presumptive allocation of rights.⁷⁶ The statutory rights are a template that can be altered by contract, either expanding or contracting on what the transferee receives. In modern practice, many contracts expand on the statutory allocation for the transferee, granting rights of public display, multiple copying, and other enhanced uses. Some contracts restrict the purchaser's rights below first sale allocations. This is especially true in commercial transactions that license information, but do not clearly dispose of rights of ownership of the copy used to enable use of the information rights that were granted. In either case, the contract commercializes the right by fitting it to the particular deal.

e) Contract Term Interpretation

In any area of contract, there are inevitable questions of interpreting the meaning and effect of the contract terms. Some courts discern a special interface between contract interpretation and copyright policy. Thus, the court in *SOS, Inc. v. Payday, Inc.*⁷⁷ suggested that a general copyright law policy of protecting the rights holder overrides contract interpretation rules when the issue is the scope of the grant.⁷⁸ Because of that policy overlay, the court indicated that the grant should be strictly construed *against* the grantee even though the grantor drafted the contract.⁷⁹ In essence, the rule is that the contract withholds all rights not expressly granted. Not all courts follow this view; most use ordinary contract interpretation and ex-

73. See, e.g., *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 675-76 (3d Cir. 1991). Compare *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 547-48 (9th Cir. 1985) (holding that the determination of whether a software system is a good rather than a service should be decided on a case by case basis).

74. See U.C.C. §§ 2-106, 2-401 (1994).

75. Article 2 provides that, unless there is contrary agreement, title to a good passes when physical delivery occurs. See *id.* § 2-401.

76. See, e.g., *DSC Communications Corp.* 976 F. Supp. at 359.

77. 886 F.2d 1081 (9th Cir. 1989).

78. See *id.* at 1087-88.

79. See *id.*

amine the entire commercial context to discern the intended meaning of the grant.⁸⁰ Article 2B adopts that commercial principle which, at least in contrast to *SOS*, gives far more flexible protection to a licensee than the supposed federal rule.

Both the restrictive analysis and the commercial analysis, of course, recognize that express terms of a contract control; the analyses deal only with ambiguity when a court must interpret intent and legal effect. That nicely defines the interaction of contract and intellectual property. The exclusive rights provide a context against which contract terms and effect are gauged.

III. Limits on Contract

As we have seen, contracts and contract law are inherent to any realistic appraisal of how and why intellectual property law impacts commercial uses of information assets. Contract law implements a party choice regime that interacts with the default positions set out in intellectual property law. This does not mean, of course, that all contracts and all contract terms are per se good or that policy restrictions from contract, intellectual property, or competition law should not place some limits on contract. It does confirm, however, that no claim of general preclusion of contract is sensible as a matter of intellectual property law policy since that policy must be viewed as incorporating commercialization uses of information which entail contracting at various levels. Any change in such position would be a fundamental change of intellectual property policy and a fundamental re-characterization of any balance that has existed.

As a matter of principle, in a market economy system dominated by contractual relationships and an intellectual property rights regime that relies on the ability of parties to contract, rules that preclude contract terms in any situation should be carefully and sharply limited. The norm must be that contracts are enforceable. The exceptions lie in cases where the nature of the competing public interest has sufficient strength and clarity to preclude the exercise of transactional choice by the parties. In fact, this is exactly how modern law approaches the issue of limitations on contract.

80. See, e.g., *Bourne v. Walt Disney Co.*, 68 F.3d 621, 626 (2d Cir. 1995). Proposed Article 2B adopts, to the extent permitted by federal law, this commercial interpretation rule and provides some assumptions about the attributes of an affirmative grant that assure that a licensee receives the capability to enjoy use of the expressly granted rights. See U.C.C. § 2B-307(a) (Aug. 1, 1998 Draft).

At this point, we turn to what limits on contract and contracting do, or should, exist. In this, it is important to define the terms of our focus. This portion of the paper does not discuss the default rules of copyright, patent and other intellectual property law which can routinely be, in effect, waived or modified for purposes of a given transaction through the agreement of the parties. Rather, in discussing limits on contract, we refer to rules or policies that preclude or invalidate contracts or contract terms. In effect, the theme here asks what rules of preclusion allow a court to deny enforcement of a particular term of a contract.

The following subsections discuss limitations on contract terms from three different perspectives: intellectual property oriented concepts of preemption or misuse, contract law exclusions of terms that over-reach, and a new argument that theories of fair use or first sale themselves directly restrict a party's right to contract.

A. Preemption of Contracts

One possible source of limits on contract comes from the idea of federal preemption of contracts or contract terms. The difficulty of applying this theme to the task of limiting contracts is that it entails an explicit mismatch of concepts. Federal preemption focuses on disallowing state laws or regulations that conflict with federal law or, in some limited cases, federal policy. It operates on state laws. Contracts, on the other hand, while they occur within a general framework of supportive law, involve transactional choices made by private parties and enforce those choices. Most courts immediately recognize and rely on this mismatch of concepts to reject alleged preemption. Thus, preemption of private behavior is seldom a tenable issue.

1. *Preemption Based on the Copyright Act*

In the intellectual property field, two sources of potential preemption claims are most commonly cited in reference to contract and intellectual property law issues.⁸¹ The first comes from the Copyright Act section 301 which provides that:

[All] legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright ... are governed exclusively by this title. [No] person is entitled to any

81. Of course, nothing precludes Congress from enacting a third type of preemptive rule within the scope of its legislative competence: an express preclusion of particular terms of a contract. *See Rano v. Sipa Press, Inc.*, 987 F.2d 580, 585-86 (9th Cir. 1993) (invalidating state rule on termination at will based on conclusion that it was preempted by express copyright statutory provision).

such right or equivalent right in any such work under the common law or statute of any State.⁸²

The jurisprudence of section 301(a) has become formidable because its preemption concept entails potentially breath-taking scope when applied to an economy increasingly dependent on handling information as a source of significant value.

Yet, the cases fall into a relatively stable pattern for purposes of our analysis. There have been no cases in which section 301 preemption was used successfully to challenge and invalidate a contract term that was enforceable as a matter of general state contract law.⁸³ However, there have been a few decisions that preclude particular types of claims brought under the guise of a contract cause of action, but which, in fact, state claims that parallel claims of infringement.⁸⁴

The fact that contracts or contract terms are not subject to section 301(a) preemption reflects, in part, that the very idea of preemption does not readily apply to private conduct or transactional choices. Equally significant, section 301(a) refers to the preclusion of rights that are equivalent to the exclusive rights of copyright law.⁸⁵ The test that has developed under this language holds that state law is not preempted if it requires an "extra element" to establish the cause of action. This was described by a leading treatise in the following terms:

[If] under state law the act of reproduction [etc.] ... will in itself infringe the state-created right, then such right is preempted. But if qualitatively other elements are required, instead of or in addition to, the acts of reproduction [etc.] in order to constitute a state-created cause of action, then the right does not lie "within the general scope of copyright," and there is no preemption.⁸⁶

Under this characterization, successful preemption claims are typically limited to cases where there was no contractual or otherwise special rela-

82. 17 U.S.C. § 301(a) (1994).

83. The case to come closest to this result was the lower court decision in *ProCD v. Zeidenberg*, 908 F. Supp. 640, 657-59 (W.D. Wis. 1996). The District Court opinion, however, was expressly over-ruled on this point by the Seventh Circuit Court of Appeals. *ProCD*, 86 F.3d at 1447.

84. See, e.g., *Benjamin Capital Investors v. Cossey*, 867 P.2d 1388, 1391 (Or. App. 1994) (concluding damage claim as formulated was preempted by copyright).

85. 17 U.S.C. § 301(a) (1994).

86. M. NIMMER & D. NIMMER, *NIMMER ON COPYRIGHT* 1.01[B] (1994).

relationship between the parties,⁸⁷ while contract, trade secret and similar relational claims are not within the broad scope of section 301(a).⁸⁸ In reference to the relationship-based claims, the extra element consists of proof of the relationship, its terms, and the conduct that violates those terms as applicable to the particular parties.

Contracts do not involve the same basic scope or impact as do property rights established directly by operation of common law or state statute. This point was made in *ProCD, Inc. v. Zeidenberg*.⁸⁹ Among other issues, that case involved the claim that a contractual restriction on the use of an uncopyrighted database was preempted because the subject matter of the transaction was unprotectable under copyright law.⁹⁰ The court correctly rejected this argument. It drew an explicit distinction between a property right (potentially preempted) and a contract right. "A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create 'exclusive rights.'"⁹¹ This reflects the transactional base of a contract and draws an important, relatively explicit line for purposes of preemption claims. Enforcing a contract between two parties leaves the subject matter of the contract (whether copyrighted or not) entirely unencumbered by any contract issue as to others not party to the transaction. Property rights and contract rights are simply not equivalent.⁹²

This analysis, of course, depends on there being an actual contract between the parties. If there is no enforceable contract, but state law nevertheless imposes terms on a parties, the law creating those imposed terms is subject to preemption. The limitation on this principle, of course, is that the rules of contract law typically operate only within a relationship estab-

87. See generally *National Basketball Ass'n v. Motorola, Inc.*, 105 F.3d 841 (2d Cir. 1997); *United States ex. rel. Berge v. Board of Trustees of the Univ. of Alabama*, 104 F.3d 1453 (4th Cir. 1997).

88. See, e.g., *Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693, 721 (2d Cir. 1992) (trade secret); *National Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc.*, 991 F.2d 426, 431 (8th Cir. 1993) (contract); *Data General Corp. v. Grumman Sys. Corp.*, 36 F.3d 1147, 1165 (1st Cir. 1994) (trade secret); *ProCD*, 86 F.3d at 1455 (contract).

89. 86 F.3d 1447 (7th Cir. 1996).

90. See *id.* at 1453-55.

91. *Id.* at 1454.

92. It can be argued that this might change if, in effect, no third party can avoid being bound by the contract terms in order to use the information. How or why this would affect a preemption analysis as compared to a misuse or antitrust claim is not clear. The fundamental fact is that the restrictions (whatever they might be) are grounded in a separately viable contractual relationship. If there is no such contractual relationship, of course, the issue is not one of preemption, but simply a question of how copyright affects the party's right to use the information.

lished by an agreement and, thus, most often the absence of an enforceable agreement vitiates any application of the contract principle.

*Vault Corp. v. Quaid Software Ltd.*⁹³ dealt with a rule imposed by a state statute in the absence of a valid contract. The Fifth Circuit in *Vault* invalidated part of a state statute that expressly validated a list of specific terms in a shrink-wrap license.⁹⁴ This decision was premised on a ruling by the trial court that the underlying relationship was *not* an enforceable contract.⁹⁵ Given that there was no contract, the statute in effect imposed terms on persons in the absence of contract that included explicit limitations on a purchaser's right to adapt and make back-up copies of the software. According to the Fifth Circuit, these statutory restrictions conflicted with section 117 of the Copyright Act.⁹⁶ Thus, according to the appellate court, the statute improperly "touched on" a matter dealt with by copyright and was preempted.⁹⁷

Regardless of whether *Vault* was correctly decided at either the district court or the appellate level, the eventual preemption analysis was a pure *property* law analysis that proceeded on the assumption that *no enforceable contract* existed between the parties. Given this assumption, the analysis was straightforward: state law set out rules creating a property right that did not depend on contract and the right thus created was precluded by section 301. The case did not have reason to address the idea that copyright might preempt the very contract law on which it often depends. Had it been required to do so, one can expect that it would have followed the consistent line of authority that holds that contracts are not preempted by copyright law.

2. Preemption Based on the Supremacy Clause

The theme followed in *ProCD* and *Vault* focuses preemption theory on state laws that limit or restrict a person's use of information independent of any relationship between the person seeking to enforce those limits and the person against whom they operate. This focus captures the concept and

93. 655 F. Supp. 750, *aff'd*, 847 F.2d 255 (5th Cir. 1988). The lower court had held that the underlying contract would have been invalid as a contract of adhesion under Louisiana law. *See id.* at 761. This result was reached with little or no analysis and represents one of the very few reported decisions relying on a theory of adhesion to invalidate a contract. *See id.* The more normal analysis of an adhesion contract is that, if the court encounters one, it more closely scrutinizes the terms of the agreement under standards of unconscionability and other contract law doctrines to protect the adhering party.

94. *See Vault*, 847 F.2d at 268-69.

95. *See id.* at 269.

96. *See id.*

97. *See id.*

tone of property rights in general and carries over to a second form of potential preemption emanating from intellectual property law. This is a more general preemption argument based on the Supremacy Clause of the U.S. Constitution⁹⁸ and its role in precluding any state laws that conflict with expressed federal policy in fields where the federal government has exercised substantial control and involvement.

The earliest cases dealing with this type of preemption were a cluster of decisions by the United States Supreme Court. In two controversial decisions, the court invalidated aspects of state unfair competition law as applied to claims that a defendant had wrongfully copied devices marketed by other companies.⁹⁹ In both cases, the Court held that state law could not be invoked to bar copying in a context in which federal patent law left the copied article unprotected.¹⁰⁰

Importantly, the defendants in these cases were not in breach of any contractual or confidentiality obligation created between them and the plaintiffs. A decade later, the Supreme Court confirmed that this was significant. In *Kewanee Oil Co. v. Bicron Corp.*¹⁰¹ the Court held that there was no federal policy preemption bar to enforcing an injunction under trade secrecy law against former employees with respect to technology that was not patented.¹⁰² The Court indicated that preemption occurs only if the state law erects an obstacle to the accomplishment of the objective of Congress.¹⁰³ This was not true of trade secret law which has at its core the enforcement of standards of commercial ethics and encouraging invention through enforcing agreed to or otherwise established confidentiality restrictions.¹⁰⁴

The Court returned to its fundamental preemption theme in *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*¹⁰⁵ It there invalidated a state law

98. U.S. CONST. art. VI, cl. 2.

99. See *Sears, Roebuck & Co. v. Stiffel*, 376 U.S. 225, 231 (1964); *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234, 237-38 (1964). During this period, the Court expressed in its decisions a hostility to intellectual property rights and their commercialization that it has seldom returned to since. See also *Lear, Inc. v. Adkins*, 395 U.S. 653, 674 (1969) (invalidating state common law doctrine of licensee estoppel based on conflict with alleged federal patent policy encouraging challenges to the validity of a patent). Compare *Aaronson v. Quick Point Pencil Co.*, 440 U.S. 257, 265-66 (1979).

100. See *Sears, Roebuck & Co.*, 376 U.S. at 231-232; *Compco Corp.*, 376 U.S. at 238.

101. 416 U.S. 470 (1974).

102. See *id.* at 498-99.

103. See *id.* at 479.

104. See *id.* at 492-93.

105. 489 U.S. 141 (1989).

that restricted duplication of vessel hulls or component parts by means of any "direct molding process."¹⁰⁶ The state law was obviously designed to protect vessel developers against a particular form of competition that was apparently cost effective. The Court properly recognized that the statute created a property right because the rights created applied to third parties regardless of there being any relationship between the right owner and any third party desiring to copy the hull design.¹⁰⁷ This right applied to designs that, under patent law, were unprotected.¹⁰⁸ Because the state law conflicted with a federal policy that public domain material that is, in fact, distributed to the general public may be reproduced through any means, the state law was preempted.¹⁰⁹

The Court in *Bonito* indicated that the decision in patent law not to grant rights to unpatented technology was an important facet of what it described as the intellectual property law "bargain."¹¹⁰ In essence, this hypothetical bargain entails creating rights good against the world in general, even for publicly distributed products. However, those rights are limited to selected inventions while the public's right of use for non-patented products are preserved. This, according to the Court, preserves an incentive to obtain a patent which, in turn, involves a public disclosure of the basic technology.¹¹¹ According to *Bonito*, the attractiveness of patent rules to inventors depends on a background of free competition in unpatented goods and technology that have been distributed to the public.¹¹² This competition presumably creates an incentive to develop patentable technology and obtain patents for that technology. Guided by this pop art characterization of commercial and creative incentives, the Court indicated that the state law attempted to create rights for the hull designer that were good "against the world" and similar to patent rights.¹¹³ The state law was preempted because it improperly "prohibits the entire public from engaging in a form of reverse engineering of a product in the public domain."¹¹⁴

Of course, however, *Bonito* by its very terms does not state a principle that pertains to state laws that enable parties to enforce relationships they

106. *See id.* at 143.

107. *See id.* at 159-62.

108. *See id.* at 162-64.

109. *See id.* at 160-61.

110. *See id.* at 150-51.

111. *See id.*

112. *See id.* at 151.

113. *See id.* at 142.

114. *Id.* at 160.

have created. Trade secret law, contract law, and similar relational contexts fall well outside the parameters of the decision in *Bonito*.

B. Intellectual Property Misuse and Related Doctrines

A second, more directly applicable, body of law affecting contract practice involves the idea of intellectual property misuse. Unlike preemption law, the doctrine of misuse focuses on contract or relational terms. It provides a basis with respect to some terms in some contexts to impose severe sanctions on the rights owner because of its imposition of particular terms on a transferee.¹¹⁵ As with preemption rules, this doctrine stems from federal law and, thus, cannot be altered by a state contract law rule. Article 2B expressly recognizes this and points out that, to the extent a term is precluded under misuse or similar theories, Article 2B does not alter that result.¹¹⁶

In formal terms, "misuse" doctrine is a defensive doctrine, rather than an affirmative cause of action. It precludes enforcement of a patent or copyright against any party until the misuse has been corrected (purged). There are, however, some closely related doctrines that have different impacts. Thus, for example, some decisions hold that an express or implied contract term that improperly extends a patent's influence beyond the patent term is invalid.¹¹⁷ Similarly, under antitrust law, some uses of patent or copyright leverage to attain extraneous, anti-competitive results leads to potential liability for violation of antitrust law.¹¹⁸

The common theme that joins these bodies of law is that there was improper use of the leverage created by an intellectual property right and the use of a judicial sanction to eliminate the effect or to deter such conduct. This is clearly the case with misuse law, which focuses squarely and almost exclusively, on prohibiting the use of leverage to extend intellectual

115. See *DSC Communications Corp. v. DGI Techs., Inc.*, 81 F.3d 597, 601 (5th Cir. 1996) (dictum) (discussing the possible availability of a copyright misuse defense in forthcoming trial in decision on preliminary injunction issue); *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970, 979 (4th Cir. 1990) (holding anticompetitive language in software licensing agreement to be a copyright misuse).

116. See U.C.C. § 2B-105 Reporter's Note 2 (Apr. 15, 1998 Draft).

117. See *Brulette v. Thys Co.*, 379 U.S. 29, 33-34 (1964). Compare *Aaronson*, 440 U.S. at 265-66.

118. See, e.g., *Digidyne Corp. v. Data Gen. Corp.*, 734 F.2d 1336, 1344 (9th Cir. 1984) ("requisite economic power[, necessary to establish one element of an illegal per se tying claim,] is presumed when the tying product is patented or copyrighted"); cf. *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 676 (6th Cir. 1987) (stating "we find the pronouncement in [*United States v. Loew's*] to be overbroad and inapposite to the instant case. Accordingly, we reject any absolute presumption of market power for copyright or patented product [sic].").

property rights to control unrelated products or services.¹¹⁹ The policy interest is closely allied with antitrust tying doctrines and permits the rights owner use of its intellectual property rights so long as it does not reach out with those rights to control other markets.

I. Origins of the Misuse Doctrine

The origins of misuse law lie in the area of patent licensing. The doctrine flourished during an era in which judicial hostility characterized the approach of courts to the commercialization of intellectual property. The leading and first patent case was decided by the Supreme Court in *Morton Salt Co. v. GS Suppiger Co.*¹²⁰ In *Morton Salt*, the licensee of a patented salt tablet dispenser was contractually bound to purchase all of its salt tablets from the licensor.¹²¹ The tablets were not patented.¹²² The licensee refused to comply with this part of the license and was sued for infringement based on its continued use of the patented dispenser technology.¹²³ Although the case presented an antitrust tying issue (patented technology license tied to acceptance of another product), the Supreme Court elected to deny enforcement of the patent on equitable grounds relating to what it perceived as a misuse of the patent rights.¹²⁴ It held that the patent rights had been misused by conditioning the license on acceptance of an obligation to acquire unpatented, generally available items from the patent holder.¹²⁵

The doctrine of patent misuse flourished during a period in which the Department of Justice also seemed anxious to deploy antitrust theories to restrict intellectual property licensing practices.¹²⁶ In 1988, however, the doctrine's scope was legislatively truncated by enactment of a rule providing that no patent misuse occurs simply because a patent owner conditions a license for a patent or a sale of a product on the buyer's purchase of another product or technology.¹²⁷ Rather, such practices only constitute

119. A recent illustration of this theme, although grounded entirely in antitrust law, comes in the appellate court ruling in the Kodak case. See generally *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

120. 314 U.S. 488 (1945).

121. See *id.* at 489.

122. See *id.* at 491.

123. See *id.* at 489.

124. See *id.*

125. See *id.* at 493-94.

126. See Roger B. Andewelt, *Department of Justice Antitrust Policy*, 1 DOMESTIC AND FOREIGN TECH. LICENSING L. 401 (1982). Compare U.S. DEPARTMENT OF JUSTICE, ANTITRUST GUIDELINES FOR THE LICENSING AND ACQUISITION OF INTELLECTUAL PROPERTY (1994).

127. 35 U.S.C. § 271(d)(5) (1994).

misuse if "the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned."¹²⁸ This statute did not alter other patent policy positions that prohibit some contract terms. It simply placed misuse law squarely in the context from which much of the doctrine arose: as an adjunct and kindred spirit of antitrust law, whose doctrines limit liability for linking products to cases where the provider has actual market power to force the other party to comply with the linkage.

2. *Copyright Misuse.*

The leading case on copyright misuse is *Lasercomb America, Inc. v. Reynolds*.¹²⁹ In *Lasercomb*, the "abuse" sprung from a computer program license that contained terms that restricted the licensee from writing, developing, or producing computer-assisted die-making products for a period of ninety-nine years.¹³⁰ The copyright owner brought an action for infringement against a third party who was not subject to the allegedly abusive license agreement.¹³¹ Even though this third party was not subject to the license, the court created a theory of copyright misuse that allowed it to prevent the copyright owner from enforcing its right.¹³² The court held that copyright misuse is on the same footing as patent misuse (although it did not adopt the patent misuse statutory rule) and that efforts to extend contract terms beyond the limited grant of copyright could be barred.¹³³ In this court's view, the license terms went too far to control competition in fields beyond the scope of the copyright.¹³⁴

The role of copyright misuse theory in modern law is suspect.¹³⁵ Importantly, however, the clearest focus of the doctrine is on leveraging a property right to control a different product or service in commerce. The clearest illustration of this occurred in the Fifth Circuit in *DSC Communi-*

128. *Id.*

129. 911 F.2d 970 (4th Cir. 1990).

130. *See id.* at 973.

131. *See id.*

132. *See id.* at 979.

133. *See id.* at 976.

134. *See id.* at 979.

135. *See generally* Reliability Research, Inc. v. Computer Assocs., Int'l, Inc., 793 F. Supp. 68, 69 (E.D.N.Y. 1992) (mem.) (denying copyright holder's pre-discovery motion to strike licensee's affirmative defense of misuse as issue is a disputed issue of law); *Broadcast Music, Inc. v. Hearst/ABC Viacom Entertainment Servs.*, 746 F. Supp. 320, 328 (S.D.N.Y. 1990). In most reported cases in which the doctrine is raised, its application is rejected. *See generally* James A.D. White, *Misuse or Fair Use: That is the Software Copyright Question*, 12 BERKELEY TECH. L.J. 251 (1997).

*cations Corp. v. DGI Technologies, Inc.*¹³⁶ The court there relied on the possibility of a misuse defense to affirm the lower court's denial of a preliminary injunction where there seemed to be an extension of leverage from a copyrighted product to a second product market.¹³⁷ The vendor of a communications switching system also licensed software for the system.¹³⁸ The software licenses precluded use of the software in anything other than processors supplied by the licensor.¹³⁹ The alleged infringement occurred when a competitor, attempting to develop a compatible processor, tested its product by downloading the software onto its own product.¹⁴⁰ The competitor had acquired copies of the software from a licensee in violation of the license.¹⁴¹ The Fifth Circuit concluded that:

DGI may well prevail on the defense of copyright misuse, because DSC seems to be attempting to use its copyright to obtain a patent-like monopoly over unpatented microprocessor cards. Any competing microprocessor card developed for use on DSC phone switches must be compatible with DSC's copyrighted operating system software. In order to ensure that its card is compatible, a competitor such as DGI must test the card on a DSC phone switch. Such a test necessarily involves making a copy of DSC's copyrighted operating system.¹⁴²

Because of the nature of the marketplace, potential competitors could not compete with the unprotected product without at least temporarily copying the copyrighted software.¹⁴³

Although the congressional action on misuse law focused on patent misuse, the principle enacted there should also apply to claims of copyright misuse.¹⁴⁴ That is, a claim of misuse does not arise simply because of the existence of an intellectual property right, but requires the presence and exercise of market power in the relevant market for the patent or the patented product on which the license or sale is conditioned.¹⁴⁵ The prin-

136. 81 F.3d 597 (5th Cir. 1996).

137. *See id.* at 601.

138. *See id.* at 599.

139. *See id.*

140. *See id.*

141. *See id.*

142. *Id.* at 601.

143. *See id.* at 599.

144. The patent misuse statute was enacted in the 1980s, before the doctrine of misuse was first applied to copyright claims in the *Lasercomb* decision, thus explaining the omission of a copyright misuse statute.

145. *See, e.g., In re Independent Serv. Org. Antitrust Litig.*, 989 F. Supp. 1131, 1135 (D. Kan. 1997).

principle of misuse does not lie in constraining contractual choices to a narrow band confined by the terms of the Copyright Act, but on giving courts a tool to prevent over-reaching by the use of leverage to achieve anti-competitive results.

3. *Direct Policy Restraints.*

Misuse law, while grounded in equity theory,¹⁴⁶ focuses on competition law themes. It does not set out a principled basis to restrain contracting practices beyond the applicable limits of competition law.

There does exist, however, some federal case law analogous to misuse concepts that apparently places direct restraints on some terms of patent licenses. This case law developed during a period in the 1960's when courts were clearly hostile to intellectual property rights and their commercialization. The decisions have not been broadly applied or extended. Indeed, most (maybe all) of the competition related law principles on which this hostility was erected and that were articulated during this period have subsequently been reversed by Court decision or legislation.

The primary case for this variation of misuse theory is *Lear, Inc. v. Adkins*.¹⁴⁷ *Lear* held that a state common law contract principle creating a theory of licensee estoppel was invalidated because of an alleged federal policy of encouraging challenges to the validity of a patent.¹⁴⁸ The estoppel theory, which was followed in some, but not all state contract law systems, held that a licensee could not simultaneously accept the benefits of a patent license and challenge the validity of the underlying patent.¹⁴⁹ The Court concluded that the primary goal of federal intellectual property policy was to encourage the dedication (by choice or by law) of even highly inventive technologies to the public domain.¹⁵⁰ Based on that premise, it held that a licensee could not be estopped from contesting the validity of the patent that it had licensed.¹⁵¹ Such estoppel would frustrate the federal policy that patents should be invalidated if possible.¹⁵²

During that same era, the Court held that a patent license could not create an obligation to make royalty payments that extend beyond the term

146. See, e.g., *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F.2d 832, 846 (Fed. Cir. 1992) (holding that defense not available where defendant had unclean hands because of fraud on Copyright Office).

147. 395 U.S. 653 (1969).

148. See *id.* at 673-74.

149. See *id.* at 662-68.

150. See *id.* at 673.

151. See *id.*

152. See *id.*

of the relevant patent.¹⁵³ The rationale was that the prolongation of royalty obligations effectively extended the patent term.¹⁵⁴ Of course, that could not be true, except with respect to the contracting parties. For them, this could only be the case because this was part of the agreed consideration for the license.

One decade after *Lear*, and fifteen years after the royalty case, a differently comprised Supreme Court held that there was no similar restriction in a trade secret license with respect to the obligation to pay royalties.¹⁵⁵ In this latter context, the Court suggested, the contractual consideration arose on disclosure of the information, and there was no right to reverse a contractual commitment simply because the disclosed information had become public knowledge.¹⁵⁶

This branch of misuse theory, which erupted in the 1960's and was truncated a decade later, would, if pursued, place courts in the position of restraining contractual choices based on their own assessment of what, in the current context, represents appropriate intellectual property theory. We can debate in theory why the Court in the 1960's focused on estoppel and the extension of royalties in *patent* licenses and whether these same rulings should extend to *copyright* or *software* licenses. We can debate whether a software, multimedia, database or similar contract is more like the patent license in *Lear* or the trade secret license in *Aaronson*. We could do all of this, but that would be beside the point for our present discussion. The basic fact is that theories that allow courts to apply their version of pop art or pop culture to invalidate party's contract choices can never be acceptable. Beyond their many other faults, they contradict the basic theme of intellectual property law: society benefits by the commercialization use of information and that use is undermined by allowing a court to render the contract choices invalid after the fact based on its view of what proper policy should be.

C. Contract Law Limits

Contract doctrine presumes the dominance of, and facilitates the exercise of, the choices of the transacting parties. Given that premise, the limitations it imposes focus on over-reaching and circumstances where the basics of choice, interpreted in light of the recognized existence of standard form practice, are over-ridden to an objectionable degree. As a result, contract-law restrictions on enforceability have a flavor and focus that is

153. See *Brulette v. Thys Co.*, 379 U.S. 29, 33-34 (1964).

154. See *id.* at 31.

155. See *Aaronson v. Quick Point Pencil Co.*, 440 U.S. 257, 265-66 (1979).

156. See *id.* at 266.

not present in property rights or regulatory law. In general, they focus on rectifying extreme dysfunctions in the transactional process. The core contract law principle remains stable: even though most parties neither read nor negotiate most terms of most contracts, they are bound by the contract terms. Secondary themes hold that this core principle should be discarded in the occasional case in which the contract term in context is abusive.

1. *Unconscionability.*

The most widely used restrictive theme holds that a court may invalidate a contract term or an entire contract if the court finds that the contract term was unconscionable.¹⁵⁷ When first adopted in U.C.C. Article 2, this was a revolutionary principle. It is now a common doctrine. Outside of Article 2, the concept has not been universally adopted.

Unconscionability as a theory lacks substantive or thematic focus. As initially promulgated, it centered on building an important organizing principle that established the right of courts to "police" against what they regarded to be abusive contract terms.¹⁵⁸ The theory thus sets out a limited right of a court to rewrite contracts. As unconscionability doctrine evolved, it came to focus on the right of a court to exclude contractual clauses that reflect a combination of procedural unconscionability (adhesion contracts) and substantive unconscionability (oppressive terms).¹⁵⁹ As the comments to the Article 2 provision that innovated the concept indicate, the "basic test is whether, in 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."¹⁶⁰ We could spend many hours discussing the scope and application of unconscionability as a contract law theme without ever placing firm limits on the scope of the doctrine. It is, in fact, a general overview standard within which courts can police contracting practice to avoid extreme abuses. Within that over-all standard, the fundamental case law pattern that has developed invalidates a term of a contract only if based on a conjunction of procedural problems and substantive abuses.

157. U.C.C. § 2-302 (1962).

158. *Id.* at § 2-302, cmt. 1.

159. See generally Arthur Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967) (setting out ideas of procedural and substantive unconscionability);

160. U.C.C. § 2-302, cmt. 1 (1962).

Because of the focus of the doctrine, the majority of reported decisions use it to invalidate contracts dealing with consumer transactions or other cases in which there are extreme imbalances in bargaining leverage and sophistication in commercial contracting. The goal and the effect is to preclude cases of abuse resulting from breakdowns in the contracting process.

2. *Restatement Section 211.*

The Restatement (Second) of Contracts sets out a standard that substantially overlaps with unconscionability doctrine, but does so in different terms and under different language. The basic Restatement principle focuses on the treatment of standard forms and was initially set out in section 211 of the Restatement (Second) of Contracts.¹⁶¹ While the standard was first stated in the 1970s, it has been adopted in fewer than ten states in cases outside the area of insurance contracts.¹⁶²

The Restatement "rule" proposes that a person who manifests assent to a standard form is bound by the terms of that form, except with respect to terms that the party proposing the form has reason to believe would cause the other party to reject the writing if it knew that the egregious term were present.¹⁶³

In form, this "refusal term" concept extends beyond the idea of unconscionability by creating an *additional* basis for avoiding some terms in a contract. It proposes that those terms can be avoided by a court even if the term itself is not unconscionable. While the letter of the Restatement refers to "refusal terms," some courts in the few states that adopt the theory go further and allow a court to avoid any term that the judge believes is outside the "reasonable expectations" of the other party, whether or not that other party is a consumer or a business.¹⁶⁴ The comments to the Restatement mention this phrase, but focus more on other issues. They state in relevant part:

Although customers typically adhere to standardized agreements and are bound by them without even appearing to know the standard terms in detail, they are not bound to *unknown* terms which are beyond the range of reasonable expectations. ... Reason to believe may be inferred from the fact that the term is bizarre or oppressive, from the fact that it eviscerates the non-standard

161. See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

162. See James J. White, *Form Contracts Under Revised Article 2*, 75 WASH. U. L.Q. 315, 324 n.17 (1997).

163. See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

164. See generally White, *supra* note 162.

terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction.¹⁶⁵

The interest that is being protected here is associated with the bargaining process itself. The Restatement recognizes, as any contract law must, that parties agree to and are bound by standard forms every day. This is central to modern commerce. The section goes beyond the idea of unconscionability, however, to deal with further concerns about the risk of unfair surprise. Basically, the goal seems to be to give a party an opportunity to convince a court that the term was not known to it and that the other party should have known that the adhering party would refuse the contract had the term been disclosed.

Few states adopt the basic premise of the Restatement. In those states, there is a significant difference in the two views of how the rule is defined. The black letter of the Restatement invalidates only "refusal" terms—that is, terms that were unknown to the party and that would have caused it to refuse the contract if they had been made known.¹⁶⁶ Furthermore, the rule examines this issue from the perspective of the person proposing the form and examines whether it had reason to believe that the clause would cause refusal of the contract. This limits the scope of the doctrine to seriously over-reaching terms, creating at least the inference that the doctrine very much overlaps unconscionability doctrine to the point of being indistinguishable. On the other hand, the Restatement comment quoted above refers to terms "which are beyond the range of reasonable expectations."¹⁶⁷ This is a far looser standard and more aggressive standard of avoidance and focuses on the perspective of the person receiving the form. It has been adopted by some courts.¹⁶⁸

3. *Article 2B and Unconscionability Limitations.*

Both the Restatement rule and the doctrine of unconscionability give courts tools to correct serious breakdowns in the contracting process and resulting over-reaching. Each has had an impact on the development of Article 2B.

Initially, Article 2B follows U.C.C. traditions and adopts the doctrine of unconscionability as applicable to all contracts within its scope.¹⁶⁹ Additionally, the concept is expressly mentioned with respect to mass market licenses. The comments to the relevant section note:

165. RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. f (1981).

166. *Id.*

167. *Id.*

168. See generally White, *supra* note 162.

169. See U.C.C. § 2B-110 (Aug. 1, 1998 Draft).

The doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. For example, a term in a mass market license that default [sic] on the mass market contract for \$50 software [sic] cross defaults on all other licenses between two companies may be unconscionable if there was no reason to expect the linkage of the small and larger licenses. Similarly, a clause abrogating all responsibility for intentional wrongful acts buried in a license form violates public policy and, in addition to being unenforceable on that basis, might also be unconscionable.¹⁷⁰

The Restatement concept was experimented with in early drafts of Article 2B with respect to mass market-licenses.¹⁷¹ Neither consumer nor business interests supported the concept. This reflects, in turn, the view from commercial law practitioners that the concept went too far toward broadly jeopardizing the enforceability of contracts, and the view from consumer interests that the concept did not go far enough.¹⁷² A similar, but more expansive concept was suggested in proposed draft revisions of U.C.C. Article 2, though limited solely to consumer contracts.¹⁷³ The Article 2B concept of mass market, in contrast, applies to purchases in the retail market, whether made by a consumer or a business purchaser.¹⁷⁴ The Article 2 version has since been refocused.¹⁷⁵ What, if any language will eventually survive is not clear.¹⁷⁶

One fundamental flaw with the Restatement approach is that it is a *disclosure* rule that fails to give any guidance on what is to be disclosed. As a result, all terms of every contract are at risk. It is a disclosure rule in the first instance because it focuses on cases of unfair surprise. As the comments indicate, the desire to avoid unfair surprise focuses the rule on invalidating some terms that were *unknown* to the party at the time of contract, even though they are contained in a form to which the party as-

170. *Id.* § 2B-208, cmt. 3(b).

171. *See, e.g.*, U.C.C. § 2B-208 (Nov. 1, 1997 Draft).

172. *See* Comments of various parties on this issue posted on <<http://www.2bguide.com>> (visited Nov. 15, 1998).

173. *See* U.C.C. § 2-206 (July 25-Aug. 1, 1997 Draft).

174. *See* U.C.C. § 2B-102 (Aug. 1, 1998 Draft).

175. *See* U.C.C. § 2-206 (Mar. 1998 Draft).

176. In Article 2B, a subcommittee of the American Bar Association recommended that the concept be deleted and replaced with a refund right applicable to mass market transactions where terms are proposed after the initial payment. The Drafting Committee adopted that proposal, but added express language about the relationship between negotiated terms and terms of the standard form that responds to the policy issue underlying the Restatement rule. *See* U.C.C. § 2B-208(a) (Aug. 1, 1998 Draft).

sented.¹⁷⁷ For a lawyer planning a transaction or a transactional framework under the "guidance" of this rule, this means that the risk of term avoidance can be eliminated only by disclosure. Under the Restatement standard, what terms should be disclosed explicitly to the other party in order to preclude their invalidation? No reasonable answer was ever developed to that question (obviously, one cannot disclose every clause in any effective way since that is what in fact occurs in simply presenting the form). The issue is especially important in information contracts since, as we have seen, terms relating to scope of use are critical to defining the product being transferred but would, under this standard, be subject to invalidation based on claims of "unfair surprise" concerning a "refusal term."

The risk of unfair surprise in fact does exist in commerce, of course. Article 2B deals with this in two ways. First, section 2B-208 expressly recognizes that a court can invalidate terms here (as in other contexts) if the terms are unconscionable. This responds to the idea of excluding a "bizarre or oppressive" term as described in the Restatement comments.¹⁷⁸ Second, section 2B-208 provides that, subject to the parol evidence rule, a mass market license cannot contradict terms to which the parties expressly agreed.¹⁷⁹ This latter premise, which benefits licensees, deals with the concern that the term of a standard form not eviscerate the actual deal of the parties.¹⁸⁰

4. *Invalidation on Public Policy Grounds.*

As the foregoing illustrations suggest, general contract law restrictions on the scope of a bargain focus on breakdowns in the bargaining process that cause grossly unfair terms to be putatively adopted by the adhering party. This in general is the approach of contract law to curtailing abuse. It flows from a general recognition of the validity of contracts and the desirability of not permitting courts to review and remake the terms of transactions agreed to by the parties. As should be clear, in any case where a court invalidates a contract term but leaves the remaining agreement in place, the court in effect rewrites the contract for the parties. That, under contract law, should seldom occur.

177. The theory invalidates only terms that the party has reason to believe would make the contract unacceptable if they were known to the adhering party. Obviously, one way to defeat a claim of reason to know of the adverse impact of a term is to make the party aware of it and rely on the fact that it, in fact, did not refuse the contract.

178. See RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. b (1981).

179. See U.C.C. § 2B-208 (Aug. 1, 1998 Draft).

180. See RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. f (1981).

There are cases, however, where under the guidance of specific regulatory statutes or through the application of otherwise clearly expressed public policy, courts may invalidate a contract or a term on grounds that it violates fundamental public policy of a state. Often, this comes in the context of specifically applicable regulatory statutes that preclude agreements that contain specified terms. These include, for example, bankruptcy prohibitions on enforcement of certain types of termination clauses.¹⁸¹ Regulation of specific terms, however, does not typically occur in the U.C.C. or in the general common law of contracts because of the fundamental policy favoring party autonomy and freedom of contract. When it occurs, it flows from narrowly crafted and specifically identified policy interests that override the general contract law premise of contract autonomy.

In the general area of intellectual property practice, lawyers are most familiar with contract case law that in many states restricts enforcement of contract terms dealing with non-disclosure, non-competition and similar contract clauses. The policy here emanates from competition law, concepts against undue restraints on trade and, in the employment setting, the basic fairness notion that a person should not ordinarily be denied the ability to practice her trade or profession using the general knowledge and skill that has been acquired.¹⁸² The cases on these issues are as diverse as they are voluminous.

An infrequently used section of the Restatement places this case law in a contract law context. It states:

A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is *clearly outweighed* in the circumstances by a public policy against enforcement of such terms. (emphasis decided)¹⁸³

The Restatement refers to established policies regarding *restraint of trade* and long-standing policies protecting particular identified interests, such as the policy against contracting to permit a tort, inducing a violation of fiduciary duty, and the like.¹⁸⁴

181. See, e.g., 11 U.S.C. § 365(c) (1994).

182. See generally MELVIN F. JAGER, TRADE SECRET LAW (1997); GALE PETERSON, TRADE SECRET PROTECTION IN THE INFORMATION AGE (1997).

183. RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981).

184. See *id.* §§ 179, 186-88, 192-96 (1981).

Fundamental state policies are most commonly stated by the legislature.¹⁸⁵ In the absence of legislation specifically invalidating a term, courts ordinarily are reluctant to override a contract term and do so infrequently on the basis of general public policy. A decision as to enforceability is reached only after a careful balancing, in light of all the circumstances, of the interest in the enforcement of the particular contract against the policy against enforcement of such terms. The strength of the public policy against enforcement is a critical factor in the balancing process. Enforcement is denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in the enforcement of the particular term.¹⁸⁶

This Restatement formulation, although not generally or widely adopted as a principle, identifies two very explicit concepts about how contract themes approach this issue. The first is that the balancing test proposed here requires that the countervailing interest in non-enforcement clearly outweigh the interest in enforcement that generates from the common base of contract law. This recognizes the acceptance of the fundamental policy that, in general, contracts govern the relationship of parties according to their own terms. Secondly, the concept applies to particular cases, rather than to broadly phrased bans on particular clauses. In that regard, it clearly parallels the general approach used throughout general, non-regulatory contract law and deviates from any concept of a statutory or regulated mandated exclusion of the enforceability of terms in all cases.

The fundamental public policy theme is a general principle of law. Under Article 1 of the U.C.C., the provisions of its articles are supplemented by general common law and equity concepts unless expressly displaced.¹⁸⁷ Article 2 does not deal with this issue (although under current law, books and software are considered to be goods). Article 2B expressly brings forward and refers to, without altering, the background law that invalidates some contract terms on such public policy grounds.¹⁸⁸ The comments to the relevant section emphasize both the limited role it plays, but also its importance in avoiding enforcement of some contract clauses that purport to restrict rights of fair comment and the like.

185. *See, e.g.*, *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 908 (1998) (invalidating contract choice of law because of conflict with fundamental California policy on non-competition clauses expressed in state statute).

186. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 178, cmt. b (1981).

187. *See* U.C.C. § 1-103(b) (1994).

188. *See* U.C.C. § 2B-105(a)(b) (Aug. 1, 1998 Draft).

D. Fair Use and First Sale Policies.

We come now to a final point in the public debate about the relationship of contract and intellectual property law and about the role of proposed Article 2B in defining that relationship. This lies in the argument that, despite the interaction described in this article, copyright policies associated with fair use and first sale should control and preclude contracting that conflicts with the property law policies they represent.

1. *Fair Use, First Sale and Preemption*

Although they include some detailed copyright law provisions concerning library uses, the fundamental references used to make arguments to restrict the enforcement of contracts based on copyright policy focus on four provisions of the Copyright Act. These are the exclusion of copyright for facts or ideas,¹⁸⁹ the first sale doctrine,¹⁹⁰ the treatment of owners of copies of computer programs,¹⁹¹ and the concept of fair use.¹⁹² Taken together, these doctrines state that, as a matter of property law, it is not an *infringement* to:

- make copies or other uses of facts or ideas
- distribute a copy one owns as a result of a first sale of the copy
- transfer, or make modifications, back-ups or essential copies of, a copy of a computer program that you own
- engage in uses of the expression of a work that, on balance, constitutes a "fair use"

These are clearly important doctrines that balance, as a matter of property law, interests of property ownership against interests of third party use. That being said, however, the basic argument in our setting is that, as drafted, these principles preclude contrary contractual arrangements. This is clearly not true as a general matter.

For example, an entire, major industry in this country exists based on licensing of customer lists for limited periods of use for a specific fee. A customer list, of course, is a collection of mere facts (names, addresses)

189. See 17 U.S.C. § 102(b) (1994). The only case squarely dealing with the issue has held that this statutory exclusion does not bar the creation of contracts regarding such subject matter, a conclusion that is a relatively obvious inference from the fact that such contracts have been used commercially for generations under the realm of trade secret law and from the general right of a person to not disclose information that it holds unless it receives adequate contractual support for the disclosure. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

190. See 17 U.S.C. § 109 (1994).

191. See *id.* § 117.

192. See 17 U.S.C. § 107.

that is unlikely to qualify for copyright protection. Copyright law, however, does not prevent licenses that grant a restricted right of use of the list. Yet, the creation of licenses with respect to use of these lists is common. Similar observations can be made about other types of data-based industries. The copyright law proposition that "facts" cannot be copyrighted means simply and only that: no copyright protection attaches to pure facts not organized in a creative manner. It does not say that facts are not subject to contractual or other forms of control. There is no basis to claim the property principle preempts the contract practice.

Similarly, the ideas of a sale or ownership of a copy creating first sale or other exclusions from a claim of infringement both focus on a particular type of transaction in the absence of other contract provisions. They do not speak to transactions where no sale or transfer of ownership occurs. They do not say that one cannot couple a sale of a copy with a restriction on its use.¹⁹³ More importantly, they do not *require* a copyright owner to sell copies, but merely state a default rule that applies in the absence of contrary agreement if there is a decision to sell. The language of the two sections, in fact, gives no indication that an inalienable right is being created in the transferee. They simply state that it is not an infringement for the owner of a copy to do the stated acts. Contractual restrictions on doing those acts cannot turn them into infringement, but the property law theme does not foreclose the contract practice.

Finally, the idea of fair use is based on equity concepts and sets out important protections for certain type of uses of copyrighted works that on balance do not harm the copyright owner sufficiently to allow an infringement claim. This doctrine does not encompass a right to force the other person to allow that use, but an ability to avoid liability for infringement if, on balance, the use is fair.

As we have discussed, section 301 of the Copyright Act provides that the Act does not annul or limit any activity "violating legal or equitable rights that are not equivalent to any of the exclusive rights within the general scope of copyright."¹⁹⁴ It is clear that, when they desire to do so, legislators in Washington know how to draft a statute that precludes contrary activity and that preempts contract practice. These sections do not do so. That being the case, the clearly correct interpretation is that contracts, which do not involve rights equivalent to the property rights of copyright law, are not preempted by it.

193. See *Applied Info. Management, Inc. v. Icart*, 976 F. Supp. 149, 152-53 (E.D.N.Y. 1997).

194. 17 U.S.C. § 301(b) (1994).

A general, contrary reading would annul wide ranges of modern and traditional contracting practice including, essentially, all trade secret licensing (very few secrets are any longer conveyed purely in oral form; most are delivered in digital or written form). There is little doubt that no one would argue for this scope of the copyright doctrines. What in fact the argument typically focuses on is that these rules preempt contract *in some limited subset* of the cases where contracts are used. That, of course, stretches the statutory analysis even thinner.

On the other hand, there may be a kernel of an important theme embedded in these sections used for these discussions. These sections (other than section 102) state that it is *not an infringement* to engage in fair use, distribute an owned copy, or make a back-up of an owned copy of a computer program. Consider the language: it is not an infringement. Contract cannot alter that result with respect to intellectual property law. The protected activity is not an infringement, regardless of whether the contract permits or precludes it. On the other hand, the conduct may be a breach of the contract if it is inconsistent with the contract terms.

2. *First Sale and Fair Use as Over Riding Policy.*

The more refined argument is that the policies incorporated in the sections mentioned above involve a sufficiently strong public policy interest that *should* override contrary contract terms. Before discussing this proposition, it is important to focus on exactly what this means if viewed in full context and what policies result. If one looks at the issue from the perspective of placing restraints on a rights owner, the proposition that the copyright policies should over-ride contract terms might appear to be premised on a policy of preventing abuse by the rights owner. The nature and extent of the projected abuse lie in determining 1) the likelihood that there will be an effort, accepted in the marketplace, to over-ride the copyright policies, and 2) the likelihood that the benefit of preventing that abuse will offset the disruption that the rule would create in the basic balance achieved through traditional reliance on commercialization, as well as open forum uses of information.

I believe that this balance leans in favor of not prohibiting contract terms. But there is also an important insight if we look at the effect of the proposed policy rule on the end user recipient of the information. The proposed rule would in effect create a right (property?) in the holder of a copy *that cannot be the subject of contract or be waived*. This creates, of course, a very unusual right since non-transferability vitiates much of the value of the right for the person who owns it and entirely contradicts the notion that a person with a right can use that right in a manner it chooses

so long as the use does not injure a third party. It proposes that the end user *cannot* bargain away an aspect of a first sale right in return for a price or other concession. The reason to do so lies not in protecting the end user, but in seeking a purported social goal independent of the individual's interest.

The overall argument makes little sense if applied to *all* transfers of information. Rather, it focuses (or should focus) on a limited subset of transactions, presumably those that place copies of information in the hands of the general public. The argument is that, as a matter of policy, when this occurs, contract terms that conflict with the four stated sections should be made inoperative as a matter of federal policy.

At one level, this cannot be true. As I mentioned earlier, the "first sale" policy assumes that I have a right to transfer a copy that I own. Does or should that policy prevent a person from transferring copies to the general public on other than an ownership basis? Clearly not, since the video rental business depends on that type of distribution and, I would think, is not under attack in this forum. If that is true, then it is true that not all distributions to the general public are sales invoking the "first sale" right under copyright law. But, of course, that means that a person who owns the copyright can elect different modes of distribution to the general public based on how it chooses to market its copies. It makes those commercialization choices through contract.

It does not work to focus the proposed restraint on "mass markets." The video illustration shows that much. More importantly, to implement that focus, the rule would be required to reach further up the chain. Suppose that I own the copyright in a very valuable work. To distribute that work to the public, I contract with ABC Distributorship. I could sell copies to ABC, but instead I prefer to license ABC to make copies and only distribute them under conditions that I specify. ABC, which has great bargaining strength, nonetheless agrees. It makes the copies and provides them by license to the general public under an agreement that allows the end user to display the digital work on a computer. This includes display to general commercial audiences, but not modification of the images or transfer of the copy to any other person. This is a fairly common form of digital product licensing in the modern marketplace and characterizes many "clip art" licenses.

Now let us apply the "first sale" argument to the foregoing transaction. If copyright (or contract) precludes anything other than a sale of copy in the mass market, what is the effect on the end user or on ABC, the distributor? Clearly, the end user cannot be prevented from distributing the copy it owns (a right created under first sale and under section 117). On

the other hand, can the end user make a public display of the work? That is not, of course, a first sale privilege. If contract cannot alter first sale rights, the public performance or display is an infringement. There is, of course, no sense to that result. From the vantage point of the end user, a rule which states that the applicable property rights cannot be altered in the mass market means that the purchaser *cannot*, as a matter of law, waive its "right" to transfer the copy in return for a grant of a particular price or a grant of a right to make a public display of the work. Why? Clearly, the answer is not, as is normal in restrictive rules applicable to contract, any desire to protect the end user because its result is just the opposite.

There is a similar, perhaps even more inexplicable effect if we examine the impact of the proposed rule from the perspective of my contract with ABC. Limits on what terms are permitted in a mass market end user transaction in effect limit what contract a copyright owner can make with a publisher, a manufacturer, or a distributor. The copyright owner cannot make and enforce a license agreement with its distributor unless the license agreement authorizes sales of copies in the mass market. In effect, that rule would fundamentally alter the balance of copyright (and all intellectual property law) by indicating that the rights owner cannot make certain choices in how (if it so chooses) it will commercialize the information in a purely commercial transaction. Rather than preserving the status quo, the theory radically alters it.

The argument essentially urges that copyright owners (or other information holders) are, or should be, by law restricted to traditional means of distributing their works. These means are characterized by sales of copies to distributors who then distribute the work by sales of copies to the general public. This argument states an impossibility and also misrepresents the status quo. The impossibility lies in the fact that digital distribution systems that do not involve tangible copies are already in place and widely used; access contracts are an increasingly common mode of distribution. Congress cannot legislate them away. The misstatement assumes that all information was yesterday distributed to the public in copies that are sold to the public. My most recent visit to Blockbuster video belies that idea. They would be surprised to learn that I own and can resell the copy of "Florida Sunset" that I rented yesterday. Westlaw would be equally surprised to learn that I own a copy of its database with rights of fair use when I sign my license with it.

The case for preservation of general ("fair use") rights, rather than for banning specific terms is far stronger. Let us suppose that the idea of fair use means that, for publicly distributed works, I can make a limited, non-competing quotation from the work that I have acquired access to by a

valid contract. Suppose further that the publisher acting *against its own* economic interests, requires that I agree contractually to not make any quotations from a published work distributed pursuant to contract. Next, suppose that I ignore my agreement and freely quote from the work. What result?

Initially, we need to recognize that this is a law school exam hypothetical; given market and other forces, it is a highly unlikely mass market scenario.¹⁹⁵ Yet, to meet the issue, we can make several simple observations. First, the contract cannot create an infringement claim where none exists under copyright law. If fair use concepts apply, the contract terms do not change that result. Indeed, the belief that a form contract in a mass market can over-ride a fair use policy analysis as to infringement issues seems superficially wrong. The point of fair use analyses is to allow a court to look at all the factors of an alleged infringement. To assume that, from the copyright framework, a court presented with that statutory mandate will necessarily look only at one factor (the contract) strains mightily against what we know of how judges function.¹⁹⁶

Second, if violation of the contract terms is asserted as the basis for a breach of contract claim, there are ample general themes of contract law that permit a court to review whether the particular clause over-reached and should, therefore, be precluded in context.¹⁹⁷ If there are overriding public policies that favor the ability to quote and otherwise use aspects of a copyrighted work distributed in a public market, those policies can be brought to bear on a particular contract claim. Those theories are present in general contract law and are preserved by Article 2B.¹⁹⁸

Third, if no contractually cognizable limitation applies and quoting from a work is treated as a breach of an enforceable contract term, what are the damages for the breach? Without delving deeply into the facts, my

195. That being said, at least one commercial publisher has for years attempted to place quasi-contractual restrictions on the right to quote from a published source. The Consumers Union magazine contains a statement, arguably binding, that the user of the magazine is not allowed to quote data or rankings for commercial purposes without written consent. The enforceability of the clause is suspect on both contractual grounds (there is no effort to call it to the attention of the magazine buyer) and First Amendment grounds. See *Consumers Union v. General Signal Corp.*, 724 F.2d 1044, 1046 (1983).

196. Indeed, after this was written, the point was seemingly confirmed in the court's discussion of infringement of free shareware in *Storm Impact, Inc. v. Software of the Month Club*, 13 F. Supp. 2d 782, 787-91 (N.D. Ill. 1998), where despite an enforceable term that precluded commercial use, the court engaged in a full fair use analysis on the infringement (as compared to contract breach) claim.

197. See discussion at notes 154 to 163.

198. See U.C.C. § 2B-105(b) (Aug. 1, 1998 Draft).

prediction in most cases is that they would be next to nothing so long as there was no proof of resulting and *foreseeable* loss of profits or other cognizable damages from the *fair* comment. In a trade secret or other license of confidential material, of course, damages may be easily proven based on loss of the confidential nature of the material because of the licensee's breach. In mass market transactions, no such confidential material exists, and the damages would ordinarily be negligible.

This brings me to the final point. The doctrines that underlie the fair use and first sale theories of overriding contract are contextual protections, rather than absolute values. They are more than adequately accommodated by the common law (preserved by Article 2B) and by copyright analyses. If the goal is to retain the flexibility inherent in these doctrines and the flow of information they support, the solution is not to alter the basic formula of the relationship between contract and copyright, but to recognize that the ability to contract exists and has existed for generations. The doctrines co-exist, rather than conflict. The idea of a broadly stated defense to contract based on generalized fair use policy argues for a basic and fundamental change of the relationship and a restructuring of the basic deal. The empirical basis for such drastic change has not been made.

3. *Article 2B and the Fair Use Debate.*

The debate described above about the allegedly mandatory nature of the first sale and fair use doctrines in fact extends beyond issues pertaining to the interaction of contract and intellectual property and has been actively engaged in general copyright legislation and in discussion about the effect of digital distribution systems on traditional intellectual property law principles. It has been engaged in reference to the development of the Article 2B proposal, even though Article 2B properly understood does not affect the issue and has adhered to a neutral position.

There are aspects of the "fair use" debate with which Article 2B could not deal, even were it inclined to do so. For example, the argument that copyright law preempts here, while unfounded, cannot be addressed in state law. If fair use preempts contract, that fact cannot be changed by Article 2B.¹⁹⁹ Of course, as we have seen, fair use and first sale concepts are not preemptive in nature as applied to contractual relationships. An argument that contract terms that limit fair use constitute copyright misuse similarly does not state an issue that can be addressed in a state law contract code. It is a federal policy issue.

199. In a statement of the obvious, Article 2B expressly acknowledges that preemptive federal law controls over state law. See U.C.C. § 2B-105 (Aug. 1, 1998 Draft).

This does not trivialize the issue from the perspective of state contract law. There is a strong social policy, especially in this country, which holds that the flow of information to and from the public should not be stifled. That policy lies at the core of our culture. Within Article 2B, it focuses debate on a conflict of two premises.

One premise argues that a new state law rule should be created to ban contract terms that either conflict with a stated pattern of rights in the mass market, or conflict with "fair use" or similarly stated general policy. This is an affirmative term avoidance approach.

The alternative premise argues that Article 2B should carefully retain the doctrines that have long been in place under state law to deal with alleged abuses, but take no position regarding the issues in general.

Article 2B adopts the latter of these approaches. In part, this choice is based on contract law traditions within the commercial code. In part, it is based on the premise that state contract law cannot effectively and affirmatively resolve a debate about general copyright issues that is ongoing in Congress and internationally.

To restate the obvious: Article 2B does not create contract law in this field. Contracts already exist and are pervasive. They function well because they are buttressed by an assumption of marketplace adjustments and party choice, bounded by doctrines that allow courts to adjust circumstances to prevent substantial abuse. There are important policy issues here, but they cannot be approached in a blunt-edged manner. The idea that fair comment and other fair uses are politically and socially important does not extend to the idea that the person who holds the information *must* distribute it and *cannot* control the manner of its dissemination. They cannot be approached under the assumption that all rights owners are evil and all copy recipients must be protected against themselves. They cannot be approached on the assumption that law can in some manner legislate the status quo from years ago.²⁰⁰ They must be approached in a manner that

200. Indeed, there is an ironic twist and internal contradiction in some of the arguments for controls. The fundamental social policy pertaining to free speech may seem to mean, for example, that the soap box speaker in a park whose purpose is to reach and affect the largest possible audience, should not be able to use contract to prevent his listeners from repeating what he said. It may seem to mean that the book publisher whose profits thrive on a book being discussed and cited should not be allowed to use contract or property rights to prevent that from occurring. But of course, these illustrations (and others that readily come to mind) prove the converse point. The risk they assume is that the public speaker who has elected to make an open forum use of information may to-

recognizes the fundamental right to make choices and implement them by contract or not by contract. The role of law should be to monitor against the abuses, if and when they occur.

In my view, the only conceivable approach that state contract law can take with respect to these issues is an approach that emphasizes neutrality. That is exactly the approach that Article 2B has adopted. Any other attitude would ask state law to rewrite the intellectual property law bargain, a large part of which has been traditionally a federal policy issue and a larger part of which has depended on the ability of rights owners to contract to disseminate their property as they choose.

E. Conclusion

Without doubt, the most significant insight that one can take from reviewing the relationship of contract and intellectual property is that, rather than fields in newly-found conflict, these are two areas of law that have long co-existed. At least with respect to copyright, these areas of law depend on each other for support in the goals purportedly at the core of copyright law regime. Copyright and other forms of intellectual property law cannot, and have never been able to, foster active development and distribution of information products in society without relying extensively on contracts. Indeed, as we have seen, commercialization, which depends on contractual relationships, constitutes one of the core mechanisms by which information is developed and distributed. It is a central part of the intellectual property law "bargain" and should be recognized as such.

This is not to say that there are never points of tension or of potential conflict. Yet, those points of tension have always been resolved by contextually nuanced analyses of particular cases and particular claims of abuse. That is as it should be. The idea that property rights law, with its concentration on vested rights and positions stated against third parties, can ever provide an adequate template for the complex and increasingly diverse information economy borders on the absurd and certainly entertains the impossible. One may wish that old distribution systems and older models of how the public receives and uses information would remain intact. But wishing does not stem a vibrant economic and technological revolution that surrounds us all today.

morrow invoke a format that specifically prevents exactly what the speaker desires (that people will discuss her expression and ideas). The risk is that the publisher whose market values a right to discuss and quote from its published product will elect to market its works in a way that specifically precludes that value from being realized. Neither is likely to occur in an actual, as compared to a law school hypothetical, marketplace.

If one were to wager on the one hand for a fight to preserve the status quo through legislation action or, on the other, for a reliance on markets and sensitive judicial analysis of particular cases, I would place my wager on the side of the markets. Commercialization is an affirmative and positive aspect of the intellectual property regime with which this country has thrived, and commercialization functions on the basis of contractual relationships that tailor to the ever-changing marketplace. The fact that in some limited cases, contracts may be used for improper purposes does not change the importance of their overall role in commerce and intellectual property. The abuses must be dealt with by a sensitive review focused on particular contexts to achieve valid and sustainable balances. Indeed, I can imagine no other viable response to the challenges of the modern era for contract and intellectual property.

