

LICENSE WITH CONTRACT AND PRECEDENT: PUBLISHER-LICENSOR PROTECTION CONSEQUENCES AND THE RATIONALE OFFERED FOR THE NONTRANSFERABILITY OF LICENSES UNDER ARTICLE 2B

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ABSTRACT

Several provisions of the proposed draft of Article 2B of the Uniform Commercial Code have the aim and effect of prohibiting transfer of software and information copy use licenses without consent of the copy publisher. This is inconsistent with the increasing emphasis on freedom of transferability in modern contract law, and has the effect of indirectly amending trade secret law, impairing security in debt financing, and undercutting the balances struck in copyright law. Important unintended consequences include a substantial increase in burdens and costs on parties to mergers and acquisitions, business reorganization, and even individual charitable donation transactions. The primary benefit, and purpose, of these rules is statutory and contractual protection of software and information publishers against competition in both the primary and resale markets. Several rationales, not including trade restraint, have been presented as the foundation for the rules. The most prominent of these suggest that the rules are consistent with those of other U.C.C. articles and that they reflect, are constrained by, or are even dictated by federal patent and copyright law. The article shows that these and other rationales do not withstand scrutiny of claimed authority. It is the author's view that the provisions and their rationales have been presented in a manner designed to deflect such scrutiny, and to induce acceptance of the rules without notice and weighing of their extraordinary consequences.

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I. INTRODUCTION

Rules governing transfer of rights are among the most important in any body of contract law. Those contained in Part 5 of proposed Article 2B of the U.C.C. are particularly notable for the fact that they reject the strong concern in modern commercial law for the interests of good faith purchasers, a fact which implies a rejection of concern for the vitality of markets and commerce. The Article 2B rules systematically manifest that legal recognition of third party rights, or even a capacity to acquire rights, arising from a transfer of a copy of software or information obtained under a nonexclusive license is anathema to software and information copy publishers. The rules secure for information publishers both statutory and contractual protection of content not protected by copyright or other intel-

lectual property law, and they allow software and information publishers to erect contractual barriers against competition.

Until recently, Article 2B constructed this protection around a pair of rights transferability provisions and related special rules governing financier acquisition of rights in software and information copy use licenses as collateral. One of the two rights transferability provisions was eliminated by vote of the Drafting Committee at its March 1998 meeting.¹ The other provision remains, recombined with vestiges of the rejected section and reframed in a manner that maximizes the objectives served by the original package.

Part II of this article introduces the current version of these rights transferability provisions. The article then identifies consequences of these measures that, while perhaps not unintended by some, will likely be very unexpected by most who find themselves faced with doing business or advising clients under Article 2B. Part III emphasizes how Article 2B rules affect the interests of third parties in dealings with licensees: one statutory contract rule significantly changes trade secret law; other rules impose new burdens and risks for common business and other transactions; and yet another rule uses state contract law to override specific federal statutory protection of the right of a copy owner to transfer ownership of her copy of a copyright protected work. Part IV discusses potential liability for those who run afoul of the Article 2B rules, and Part V explains how these rules insulate information providers from competition.

Finally, Part VI examines the rationales advanced in support of the relevant rules. First, it demonstrates that the presented rationales do not affirmatively support Article 2B adoption of transferability rules which, contrary to general contract law and other U.C.C. rules, make nontransferability of contract rights the norm. Second, it shows that the Reporter's Notes systematically misuse general contract law principles, other uniform law, and federal intellectual property law decisions to superficially rationalize outcomes desired by publisher-licensors.

Neither the assessment of consequences nor the critique of proffered rationales is intended to suggest that bargaining parties might not contract out of results which the Article 2B rules would otherwise produce. The author's concern is with the discussed provisions as rules of general application. Their identified consequences would be problematic even if Article 2B did not generally make standard form records and their terms enforce-

1. See *infra* note 13.

able. That it does so² makes the rules and their consequences especially important.

II. THE ARTICLE 2B ANTI-TRANSFER PROVISIONS

A. Modern Commercial Law Benchmarks

Transferability of contract rights is the established norm in modern contract law, and under the U.C.C.³ The general rule is stated in section 317(2) of the Restatement (Second) Contracts which states:

A contractual right can be assigned unless:

(a) The substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him, or

(b) the assignment is forbidden by statute or is otherwise inoperative on grounds of public policy, or

(c) assignment is validly precluded by contract.⁴

Subsection (2)(c) is elaborated in section 322 which provides that a term that generally prohibits assignment of a contract is to be treated as prohibiting only the delegation of the performance of a duty or condition,⁵ and a contract term that more specifically prohibits assignment of contract rights makes its violation a breach, but does not render the transfer ineffective.⁶

Section 2-210 of the U.C.C. basically adopts the same principles.⁷ Similarly, while section 2A-303 recognizes that transfer of the possession and use of leased goods adversely affects the lessor's residual ownership

2. See U.C.C. §§ 2B-207, 2B-208 (Aug. 1, 1998 Draft).

3. One of the major themes in modern commercial law is the steady expansion of freedom to alienate interests in property. This principle has moved from operating primarily within real property into tangible personal property law and, more recently, into the law governing choses in action and other intangible personal property. See E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS § 11.2 (2d ed. 1998) and ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 856 (1952) for discussions of this history, the public purposes furthered by legally facilitating commerce, and the factors and rationales considered in choosing to favor freedom to alienate over original proprietary interests.

4. RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981).

5. *Id.* § 322(2)(a).

6. *Id.* § 322(2)(b).

7. Compare U.C.C. § 2-210(2)-(3) (1996) with RESTATEMENT (SECOND) OF CONTRACTS §§ 317(2), 322(2)(b) (1981).

interest, its provisions generally track those of section 2-210 and the Restatement. Recognition of the lessor's interest is expressed in a rule that makes enforceable a lease term that prohibits transfer of the lessee's right to possess and use the lease property.⁸ This reflects that such a transfer necessarily delegates the performance of material duties or obligations with respect to the leased goods, and thus tracks section 2-210 and the Restatement in a manner specified to the particular type of transaction. The general rule of section 2A-303(2) makes it clear, however, that a transfer of rights in breach of an express term prohibiting transfer is effective even though it constitutes a breach by the lessee.

Modern commercial law reflects, in essence, preference for transferor and transferee freedom to contract over seller or lessor freedom of contract. Statutory restriction of transferor and transferee freedom to contract has been shrunk to near nothing. Violation of a contractual prohibition of transfer does not, except in a truly exceptional case, render a transfer ineffective. The remedy is against the transferor for damages resulting from its breach. Indeed, the strength of the policy favoring transferability or alienability of contracts and contract rights is underscored by judicial decisions establishing limited exceptions because failure to do so would frustrate the purposes of a particular statute that creates rights but does not pronounce on their transferability.⁹

B. General Anti-Transferability Rules

Section 2B-502 states a general rule which, at first glance, substantially tracks the prevailing rule in general contract law and commercial law as expressed in the various articles of the U.C.C.¹⁰ and the Restatement (Second) of Contracts.¹¹ It provides:

(1) A contractual interest can be transferred unless the transfer:

(A) is prohibited under other applicable law; or

(B) would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose or threaten to disclose the other party's trade secrets, confidential information or information that is subject to an enforceable non-disclosure agreement, or materially impair the

8. See U.C.C. § 2A-303(3) (1996).

9. See *infra* Part VI.B.

10. See, e.g., U.C.C. §§ 2-210(2), 2A-303(5)(b) (1996).

11. See RESTATEMENT (SECOND) OF CONTRACTS § 317 (1981).

other party's property or its likelihood or expectation of obtaining return performance.¹²

This rule originally was stated in the former section 2B-502, which was eliminated by vote of the Drafting Committee in March 1998.¹³ Its inclusion in a section which otherwise deals primarily with contractual prohibition of transfer was explained by the Reporter's Notes to be essential in order to maintain consistency with the general rule set forth in Article 2 of the Commercial Code, and to avoid the risk of any negative inference being drawn from a failure to include in Article 2B a rule comparable to the general rule statement found in other articles of the code.

Section 2B-502(1)(B) goes well beyond mirroring the rules set out in other U.C.C. articles, however. It adds to the universally recognized limitations on the transferability of rights a new rule that a contract is not transferable if its subject matter embodies trade secret or confidential business information of the publisher-licensor.

The hidden significance stems from the fact that transfer of a trade secret constitutes a disclosure under trade secret law. Sale or other transfer of an article of manufacture that embodies a trade secret ordinarily will not itself constitute disclosure of that secret unless mere observation of the product reveals it.¹⁴ Information, other than software,¹⁵ presents a special case in that its content is self-revealing. Its transfer therefore either discloses, or threatens to disclose, any trade secret or confidential information that it contains. This applies to some subject matter encompassed within the narrower definition of software which is defined to include informational content of a computer program and supporting information, such as documentation, provided with a computer program.¹⁶ The manufactured product paradigm better fits only the residual, knowhow or other trade secrets embodied in computer program object code and discernable only through direct observation of the operation of the program or reverse en-

12. U.C.C. § 2B-502 (Aug. 1, 1998 Draft).

13. See U.C.C. § 2B-502, Committee Vote (Apr. 15, 1998 Draft) ("Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license. ... Voted 10-0 to delete rule on transferability in the absence of relevant contractual terms").

14. Some decisions have stated that the sale itself is a disclosure for purposes of trade secret law. See, e.g., *Roboserve Ltd. v. Tom's Foods, Inc.*, 940 F.2d 1441, 1445-1455 (11th Cir. 1991) (applying Georgia law). The better view, more accurately stated in the same decision, is that sale or other introduction into commerce exposes the secret to discovery by reverse engineering. See *id.* at 1455.

15. It is necessary to draw this distinction in dealing with Article 2B since section 2B-102(a)(24)'s definition of "information" includes software even though the latter is separately defined in more limited terms in section 2B-102(a)(44).

16. See U.C.C. § 2B-102(a)(44) (Aug. 1, 1998 Draft).

gineering of the object code. Transfer in this instance does not itself necessarily disclose trade secret or confidential business information. Whether it threatens to disclose depends on the meaning given to the language of section 2B-502(1)(B).

One fair interpretation of the language is that transfer of a program copy from which a trade secret can be discerned is a transfer that threatens disclosure. Trade secret law speaks only of actual disclosure.¹⁷ Disclosure can be threatened only if the transfer exposes a trade secret to discovery by some other means. Reverse engineering is the most obvious, and perhaps the only, means of discovery that is facilitated by a transfer which does not actually disclose.¹⁸ The author concludes that this is just what the provision is intended to foreclose, given that this seems to be the most plausible interpretation, and that the use of Article 2B contract rules to preclude reverse engineering of computer programs has been a matter of contentious debate throughout the drafting process.

Section 2B-502(1)(B) leverages this by making any disclosing transfer a breach of contract and ineffective as a matter of law,¹⁹ whereas liability exists under trade secret law only where there was knowledge or reason to know that a disclosure or receipt of a trade secret violated a duty of confidence.²⁰

The other primary rule in section 2B-502 is found in subsection (2). It states:

a contractual term prohibiting transfer of a party's interest is enforceable and a transfer made in violation of that contract term is a breach of contract and is ineffective except to the extent:

(A) the transfer is permitted by Section 2B-503; or

(B) the contract is a license that was granted for the purpose of incorporation or use of the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance and the transfer is of the completed combined work.²¹

17. See RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40(b) (1995); UNIF. TRADE SECRETS ACT § 1(2)(ii) (1985).

18. Independent discovery, the other principal basis for loss of trade secret protection, must be eliminated from consideration in this discussion since it results from independent efforts rather than a transfer.

19. See U.C.C. §§ 2B-502(3), 2B-507(a)(1) (Aug. 1, 1998 Draft).

20. See UNIF. TRADE SECRETS ACT § 1 (1985); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40 (a)-(b) (1995).

21. U.C.C. § 2B-502(2) (Aug. 1, 1998 Draft).

Section 2B-502(2) is particularly significant for its declaration that a transfer in violation of contractual prohibition is not simply a breach, but ineffective. This is a departure from general contract law and the rule that obtains under other articles of the U.C.C.²² The full impact of the rule can be appreciated only by its consideration in the light of sections 2B-207 and 2B-208, which make standard form records and their terms enforceable.²³ Widespread use of standard forms, shrinkwrap or otherwise, inclusive of terms that read on section 2B-502(2) makes it impossible for a third party to acquire a software or information copy from any person without the consent of the publisher-licensor.

C. Anti-Transferability in Secured Financing

Part 5 establishes a special subset of rules applicable to the creation, perfection, and enforcement of a financier's interest in Article 2B subject matter. The principal rules set forth in sections 2B-503, and 2B-502 clearly state that its rules are subject to any exception created by section 2B-503. The specific concern in this article is with licensee creation of a financier's interest that otherwise would be considered a simple security interest in a debtor's business assets.

Section 2B-102(a)(21) defines "financier" as

a person other than a provider of licensed information which provides a financial accommodation to a ... licensee in a transaction otherwise governed by Article 9 or 2A and which obtains an interest in a license or a related contract right of the party to which the financial accommodation is provided.²⁴

The definition includes secured parties and lessors. It excludes publisher-licensors that finance acquisition of their own products. The provisions apply only when the transaction's subject matter is contract rights, and not when it consists of intangible intellectual property rights.²⁵ In

22. The differences are discussed in more detail *infra* Part III.A.

23. See U.C.C. §§ 2B-207, 2B-208 (Aug. 1, 1998 Draft).

24. *Id.* § 2B-102(a)(21).

25. Section 2B-503(b)(2) makes it clear a licensee may not create a financier's interest in any intellectual property rights of the licensor, unless the licensor expressly consents to the creation and perfection of that interest in the license or another record. See also U.C.C. § 2B-102, Reporter's Note 19 (Aug. 1, 1998 Draft). Some changes in section 2B-503 may occur in the process of conforming Article 2B to Revised UCC Article 9. Votes taken with respect to revised section 9-408 during the Final Reading and the vote to approve Revised Article 9 at the July 1998 Annual Meeting of the National Conference of Commissioners on Uniform State Laws will require conforming changes to be made in section 2B-503 due to the close interaction between the sections.

summary, section 2B-503 deals with the instance of licensee creation of a financing party interest in a copy of software or information, or in a contract governing use of such a copy.

Article 2B has evolved from originally making the creation of any such interest wholly ineffective to its present position of permitting its creation and perfection, but regulating its enforcement. The current version of section 2B-503 provides in relevant part:

(b) The following rules apply to the creation, perfection, and enforcement by a financier, other than the licensor, of an interest in a licensee's rights under a non-exclusive license:

(1) A financier's interest may be created and perfected notwithstanding Section 2B-502(1) or any contrary provision of the license. The interest thus created or perfected:

(A) does not entitle the financier to make an actual change of use, possession or control ...;

(B) does not place any obligations on or alter the rights of the licensor; and

(C) is subject to all terms and conditions of the license.

...

(3) The financier may not enforce its interest by taking possession or control, using, selling or taking any other action with respect to the licensed information, the informational rights, or the contractual rights without the licensor's express consent in the license or another record²⁶

Consistent with section 2B-502, this section makes a precluded transfer, made to enforce a financing agreement, a breach of contract and ineffective.²⁷

The most significant rule of section 2B-503(b) is the negation of a financier's right to take possession and control of a use-licensed copy in enforcing its interest in a license or the software or information copy to which it relates. Such a transfer can occur only with the express consent of the licensor in a record. Publisher-licensor consent may be obtained in advance, either in the license or a separate record, or after the fact in a separate record. Advance authorization or consent is given primarily when financing is provided by a financing subsidiary or an agreed upon independent source.²⁸

26. U.C.C. § 2B-503 (Aug. 1, 1998 Draft).

27. *See id.* § 2B-503(c).

28. This is exemplified by an equipment lease finance company that finances the lease of computer hardware and peripherals together with the licensed acquisition of op-

III. (UN)INTENDED CONSEQUENCES OF ARTICLE 2B ANTI-TRANSFER PRINCIPLE

A. Indirect Amendment of Uniform Trade Secrets Act

It is seldom noticed or remarked that section 2B-502(1)(B) states:

(1) A contractual interest can be transferred unless the transfer:

...

(B) would ... disclose or threaten to disclose the other party's trade secrets, confidential information or information that is subject to an enforceable non-disclosure agreement²⁹

This contract law provision appears to indirectly change state trade secret law in three significant respects. First, it makes any transfer which discloses or threatens to disclose a licensor's trade secrets or confidential information a breach irrespective of whether the licensee-transferor knows³⁰ that the transfer will result in or risk such a disclosure. Second, it precludes a transferee from acquiring any rights, inferentially making any use by the transferee a misappropriation of trade secrets or confidential information, regardless of whether the transferee knows that the software or information copy embodies trade secrets or confidential information. Third, an ineffective transfer makes a resulting acquisition of a software copy an acquisition by improper means for purposes of trade secret law, implying that reverse engineering of a software or information copy acquired from a licensee is impermissible unless the licensor gives its express consent in a record.

1. *Article 2B Removes the Knowledge Requirement of the Uniform Trade Secrets Act*

Section 2B-502(1) holds a licensee-transferor of contract rights in breach when the copy transferred therewith embodies publisher-licensor trade secrets.³¹ It creates liability even when the licensee-transferor has no knowledge of the existence of a trade secret. Trade secret law, on the other hand, requires that a trade secret actually exist before protection can be

erating system and other application software. Where the licensor or its subsidiary is the financing source, control over disposition of collateral is inherent. This is recognized by exclusion of licensors from the definition of financier. *See id.* § 2B-102(a)(21).

29. *Id.* § 2B-502.

30. To make the following exposition more readable, I use "know" and "knowledge" to include also "reason to know."

31. *See supra* Part II.B.

claimed,³² and it conditions liability on a defendant's knowing that a trade secret actually existed at the time of making a disclosure by transfer or otherwise.³³

Admittedly, many licenses contain terms warning the transferee against misuse of trade secrets. However, universal use of "top secret" notices in standard form records is not a means for creating, or evidencing the existence of, knowledge that trade secret or confidential information is in fact embodied in a particular copy. It provides no factual basis for an informed determination of rights, or appraisal of potential consequences or alternatives. The significance of this inadequacy is apparent from considering the specific consequences that would result from treating ambient notice as distinct and distinguishing.

Giving legal effect to such notices would entrench section 2B-502(1)(B) as a back-door, de facto statutory prohibition against transfer of any copy. This contravenes the spirit, if not the letter, of the Drafting Committee's decision in March 1998 to cleanse the draft of any such rule. It also would strip from trade secret law the liability condition that a transferor know that the transferred information includes a trade secret or confidential business information. Finally, it would exalt form over substance with respect to the trade secret law requirement that the person who claims trade secret ownership must show that reasonable measures have been taken to protect against disclosure or discovery by improper means.³⁴ A routinely included notice should not be considered a reasonable measure; it does not evidence that some particular matter was considered a trade secret, nor does it provide any factual basis for inferring that a third party improperly obtained access to a claimed trade secret.

32. See *IMAX Corp. v. Cinema Technologies, Inc.*, 152 F.3d 1161, 1164 (9th Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 522 (9th Cir. 1993); *Integrated Cash Management Services, Inc. v. Digital Transactions, Inc.*, 920 F.2d 171, 173 (2d Cir. 1990).

33. Liability exists only when a person knows or has reason to know that she is disclosing trade secret information in violation of an duty or obligation to not disclose. See UNIF. TRADE SECRETS ACT § 1(2)(ii)(B)(II) (1985); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40(b)(1) (1995).

34. See *SI Handling Systems, Inc. v. Heisley*, 753 F.2d 1244, 1256 (3d Cir. 1985) (considering reasonable protective measures as a factor with respect to whether a trade secret existed at the relevant time, and in determining whether the means of acquisition was improper). See also UNIF. TRADE SECRETS ACT § 1(4)(ii) (1985) (taking of reasonable security measures a factor in determining whether a protectable trade secret existed at the relevant time).

2. *Liability of Transferee is Unclear under Article 2B*

Facially, section 2B-502 establishes absolute liability for the ostensible transferee of trade secret-bearing information, while unknowing or innocent receipt and use of trade secrets is not actionable under the common law or the Uniform Trade Secrets Act.³⁵ Section 2B-507(b) is intended to resolve this conflict by deferring to the rule of trade secret law. It states: "Except as otherwise provided under trade secret law, a transferee that acquires information that is subject to the informational rights of a third party acquires no more rights than the contractual rights its transferor was authorized to transfer."³⁶

What remains, however, is a drafting failure. Section 2B-502 leaves the limitation to be unearthed by a diligent lawyer or judge. Even then, section 2B-507(b) is little help. It vaguely refers to trade secret law as an exception to its general rule without indicating how and to what extent

35. The relevant provisions of section 1(2) of the Uniform Trade Secret Act state that "misappropriation" means:

- (i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means;
or
- (ii) disclosure or use of a trade secret or another without express or implied consent by a person who

...
(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was

- (I) derived from or through a person who had utilized improper means to acquire it;
- (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
- (III) derived from or through a person who owned a duty to the person seeking relief to maintain its secrecy or limit its use; or
- (C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

UNIF. TRADE SECRETS ACT § 1(2) (1985).

Sections 40, 41 and 43 of the Restatement (Third) of Unfair Competition somewhat differently define what constitutes actionable conduct, but are intended to be comparable in substance. See RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40, cmt. a (1995). Under either the Restatement or the UTSA, liability is based upon culpable conduct, and the stated conditions are specifically drawn to protect innocent third parties from liability. See RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40, cmt. d (1995).

36. U.C.C. § 2B-507(b) (Aug. 1, 1998 Draft). The same result might be reached through section 2B-105(c), which provides that "principles of law and equity supplement this article" and further states that "laws supplementing, and not displaced by this article are trade secret laws and unfair competition laws." *Id.* § 2B-105(c).

trade secret law is a constraint.³⁷ Thus, even the diligent are sent by the subsection to a wholly different body of law to determine the significance of a few unilluminating words set forth in section 2B-507(b).

3. *Right to Hack*

The third way in which section 2B-501(1) appears to change trade secret law specifically concerns the reverse engineering defense to a claim of misappropriation. If a transfer of a copy that embodies a trade secret is ineffective, then no transferee can claim that a copy it obtained and subjected to reverse engineering was one that it lawfully acquired. Lawful acquisition of a copy is a factual predicate to the legal defense that the claimant's trade secret was acquired through reverse engineering,³⁸ a proper means of discovery under trade secret law.³⁹ Section 2B-501(1) precludes even truly clean room reverse engineering, an effect that invites a very credible federal preemption attack.⁴⁰

B. Business Reorganizations, and Mergers and Acquisitions

The anti-transfer approach of Article 2B does not only affect the law of trade secrets. It also indirectly prescribes substantial changes in common, long-standing and well-established business law practices.

37. Reporter's Note 3 to section 2B-507 does provide explanation and guidance, and its substance undoubtedly will be reflected in the yet-unwritten Official Comment to the section. The Reporter's Notes state:

The rule stated in subsection (b) allows for a bona fide purchaser in reference to trade secret claims. ... If a party takes without notice of such restrictions, it is not bound by them; it is in effect a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

Id. § 2B-507, Reporter's Note 3.

This is a statement that will prove helpful to the untutored, yet an affirmative statement in the black letter rather than use of an "[e]xcept as otherwise provided" leader seems feasible and warranted.

38. See *Chicago Lock Co. v. Fanberg*, 676 F.2d 400, 405 (9th Cir. 1982).

39. See *id.* at 404; *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 160 (1989).

40. See *Bonito Boats, Inc.*, 489 U.S. at 160 (holding that state legislative prohibition of most efficient means for copying unpatented boat hull design is preempted by patent law); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476, 490 (1974) (explaining that state law recognition of reverse engineering as lawful means of discovery distinguishes trade secret from patent law, and is important to determination that trade secret law is not preempted by patent law).

1. *Business Reorganization*

Change of a business from a sole proprietorship or partnership to a corporation is frequent in the business world and common fare in supporting business law practice. It often is not a complex matter, but it involves at a minimum two important elements. One is the creation of a corporation. The other is transfer of proprietorship or partnership assets and obligations to the corporate entity. The obligations include Article 2B software contracts and licenses of information, and the assets include software and information copies used in the conduct of the business enterprise.

Even a fairly small sole proprietorship or partnership is likely in today's world to have several personal computers, perhaps linked by a local area network through a shared network server. The installation alone requires licensed use of operating system and network software. Yet there is little utility to the setup unless the business also obtains and uses licensed copies of, at least, word processing, database, spreadsheet, communications, and other very fundamental application software. More likely than not, the system also will be the means for use of information system management, project management, and other software programs and, increasingly, utilization of one or more digital information products. Other information bases may be accessed only on-line.

Publisher-licensor contracts drawn to section 2B-502(2) commonly, though not invariably,⁴¹ will require publisher-licensor consent to sole proprietorship or partnership transfer to the corporation for each license and each software or information copy. Section 2B-501(1)(B) tacitly requires an inquiry of licensors in all other cases to ascertain whether the copy of their software or information embodies any trade secrets, and obtaining consent to transfer if the answer is affirmative. This will require making a full inventory of all software contracts and information licenses, reviewing license terms to ascertain transfer and use restrictions, making trade secret inquiries, and obtaining publisher-licensor consents in records as necessary before going forward to complete an otherwise routine business and legal matter.

41. Licenses sometimes authorize transfer in certain circumstances. See, e.g., *Applied Info. Management, Inc. v. Icart*, 976 F. Supp. 149, 151 (E.D.N.Y. 1997) (interpreting a software license whose terms allowed its transfer in connection with transfer of system acquired from plaintiff); Microsoft Corporation, *End-User License Agreement for Microsoft Software, Microsoft Windows 95* (expressly authorizing transfer of the license in connection with the sale or other disposition of the computer) (on file with Berkeley Technology Law Journal).

The costs and risks associated with this process are not trivial. The ultimate risk is that, despite good faith and substantial effort, an item is missed. Completion of the principal transaction—the reorganization of the business—followed by use of the overlooked software or information will make the corporation liable in damages,⁴² the software's continued use subject to injunction,⁴³ and the entire enterprise potentially held hostage to terms offered for quick settlement of a publisher-licensor's claim.

2. *Mergers and Acquisitions*

Consider first a case not uncommon in the lore of technology development. An individual believes that she has an idea for the design, creation, and marketing of a new and more efficient product. The product is built and demonstrated in prototype, production capability is established, and distribution and marketing are undertaken. By the end of its fifth year, the business outgrows its original garage workshop space and becomes profitable. It and its fifteen employees move into substantially larger new quarters, and the business continues to grow in revenue, profits, employees, and its use of computers, peripherals, software, and information products acquired in the marketplace.

At this point, its founder and sole owner decides to cash out and seek new challenges. Her business now utilizes twenty-five desktop and notebook computers, a network server, a scanner, twenty computer programs (in addition to operating system software for each computer), twelve licenses of CD-ROM information bases, two on-line independent service provider contracts, and six on-line information base subscriptions. The total investment in software and CD-ROM information bases is \$125,000 expended in single payment license fees, \$50,000 expended and contract obligations for \$10,000 per year in periodic payments under long-term software, information database, and system maintenance contracts, and \$500 per month in on-line access contracts. All are contracted pursuant to agreements called a license, and many of the licenses contain a prohibition against transfer of the license without obtaining consent of the licensor in a record.

42. See *infra* Part IV.B.

43. In the case of a computer program protected by copyright, use would constitute infringement. See *id.* Infringement may be enjoined under 17 U.S.C. § 502 (1998). The effects of an injunction with respect to a business usually will not be contained to inability to use a software or information copy in the performance of a particular task. Interdependence of functions is the norm, not the exception, and disruption in one area typically has ripple effects in others.

Section 2B-502(2) makes the transfer prohibitions enforceable, and any attempted transfer a breach of contract and ineffective. In order to transfer the licenses in connection with the sale of the company, publisher-licensor approvals must be obtained for every nonexclusive copy use license that contains such a prohibition.⁴⁴ This is necessary whether the deal is to be accomplished by a sale of assets or the transfer of a majority stock interest.⁴⁵ Alternatively, the business may be disposed of at a discount which reflects the acquiring party's cost of reviewing all licenses, identifying licensors whose consent to transfer must be obtained, inquiring of licensors whether products embody any trade secrets, and obtaining each necessary consent or new license.

Consider next a merger or acquisition involving two sizable business entities, or a leveraged buyout of a business or one of its divisions. The anti-transfer rules in sections 2B-502(1) and (2) significantly complicate and financially burden the transaction. The problems created are the ones described above, but their number and magnitude now are far greater. Additional problems also may be encountered. One possible efficiency gain from a merger is a cost saving resulting from the use of one entity's information processing system, including its previously licensed software, to provide all information management and processing services for the post-merger entity. Use of software to process data of entities other than the licensee has been found to breach a license use restriction,⁴⁶ and this suggests the possibility that use of software to perform information processing functions for an entity distinctly different in size and character might also violate current or yet-to-be fashioned use restrictions.

The rule allows any software or information publisher providing a nonexclusive license containing a transfer prohibition to act as a toll collector on wholly unrelated business transactions. It favors and facilitates publisher-licensor engrossment of the market for software and information copies. This power to regulate and collect a toll on business transactions

44. This a minimum requirement. If section 2B-502(1)(B) is to be given full effect, it also seems prudent—and perhaps necessary—to inquire of all other software and information copy licensors to determine if copies of their products embody any trade secret or confidential business information.

45. See generally *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095 (6th Cir. 1979). See also *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972), *cert. denied* 410 U.S. 929 (1973) (acquisition of business and its assets).

46. See *National Car Rental Systems, Inc v. Computer Associates Int'l, Inc.*, 991 F.2d 426 (8th Cir. 1993), *cert. denied*, 510 U.S. 861 (1993) (finding that use of software copy to process data of other firms, in violation of restriction, constituted a breach of contract, but not copyright infringement).

that only incidentally involve transfer of Article 2B contract rights reduces the cost of monitoring for unauthorized copying, but it has nothing to do with the transfer of intellectual property rights. Article 2B licenses transfer no interest in intellectual property or other informational rights.⁴⁷

In any event, compliance with the rules of section 2B-502 requires an investment of substantial time and effort. Transfer of copies is incidental to the primary purpose of the affected transactions, and the relevance of Article 2B to the transactions is only due to the anti-transfer rules of section 2B-502. The attendant requirements, and the burdens and costs that they impose, will surprise most professionals experienced in these matters.⁴⁸ Indeed, the import of section 2B-502 for mergers, acquisitions, corporate reorganizations, leveraged buyouts, and other corporate enterprise transactions is so little recognized that neither the fact, significance, nor rationale for imposing these costs has been discussed by the Article 2B Drafting Committee, or the membership of the National Conference of Commissioners on Uniform State Laws (NCCUSL) or The American Law Institute (ALI).

C. Business Loan Financing

Section 2B-503 and the cross references from section 2B-502 to section 2B-503 superficially suggest that creation of financier interests is less restricted than creation of third party interests through other types of Arti-

47. See U.C.C. § 2B-501(b)(1) (Aug. 1, 1998 Draft). Indeed, with respect to mere information, no such underlying rights exist at this point in time. See *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340 (1991). Legislation proposed in Congress may eventually regulate use of information acquired from another, and in some sense therefore create rights in information that are not currently recognized in copyright or patent law, and for which protection must be through regulation pursuant to the Commerce Clause rather than legislative articulation of rights under the Patent and Copyright Clause. See H.R. 2281, 105th Cong. (1998).

48. The literature demonstrates awareness of the need to identify, review, and determine the transferability of intellectual property licenses, and does not indicate that it is common practice to similarly identify, review, and determine the transferability of non-exclusive software and information-copy use licenses. See, e.g., Henry Less, *Some Practical Suggestions for the M&A Due Diligence Process*, in *ADVANCED DOING DEALS: A STRATEGIC APPROACH TO COMPLETING THE TRANSACTION*, PLI CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 403 (1998) (Due Diligence Checklist ¶ 11); Catherine H. Stockwell, *A Primer on Due Diligence Reviews of Intellectual Property Assets*, in *HANDLING MERGERS & ACQUISITIONS IN A HIGH-TECH AND EMERGING GROWTH ENVIRONMENT*, PLI CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 303 (1997). Attention to copy use licenses is suggested in Diane W. Savage, *Intellectual Property Due Diligence in Acquisitions of Technology Companies*, in *HANDLING MERGERS & ACQUISITIONS IN A HIGH-TECH AND EMERGING GROWTH ENVIRONMENT*, PLI CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 329 (1997).

cle 2B transfers. It does not require close examination to ascertain that this is an illusion. Section 2B-503(b)(3) states that a financier "may not enforce its interest by taking possession or control ... with respect to the licensed information ... without the licensor's express consent in the license or another record"⁴⁹ This provision severely limits the financier's collection leverage, effectively requiring publisher-licensor consent to financier enforcement by any means other than an action for damages resulting from breach of the financial accommodation agreement.

Rules that limit the utility of secured credit will undoubtedly limit its availability. Granted, the economic effect of this is difficult to assess. If, as Professor Mann suggests, debt financing of sizable businesses is not dependent on the availability of security,⁵⁰ the impact of the anti-transfer rules of section 2B-503(2) may be trivial in that sector.⁵¹ In addition, the importance, or unimportance, of secured credit for small businesses is one of the many issues in the continuing law and economics debate about the role and need for preference of secured over unsecured creditors.⁵² Yet to the extent that secured credit is significant to the establishment, operation, and growth of small businesses, section 2B-503(b) stifles economic growth and vitality by compromising the availability and affordability of credit. The tradeoff (or benefit) is that publisher-licensors enjoy enhanced short-term economic gains, exploiting their license to collect tolls on numerous transactions that are peripheral to the core Article 2B transactions.

The financier interest rules do indirectly enhance protection against infringement of intellectual property rights. Precluding realization of a use-licensed copy as collateral restricts competitor opportunities to legally acquire a computer program copy for the purpose of subjecting its code to reverse engineering in order to ascertain embodied trade secrets. Pub-

49. U.C.C. § 2B-503(b)(3) (Aug. 1, 1998 Draft).

50. Ronald J. Mann, *The Role of the UCC in Facilitating the Financing of Software Licenses*, (unpublished manuscript, on file with *Berkeley Technology Law Journal*) (Mar. 30, 1998).

51. Furthermore, larger enterprises may be more likely to acquire expensive, high-end software financed under arrangements in which the publisher-licensor is a participant, thus avoiding the effects of section 2B-503.

52. The literature is extensive and growing. Rather than gather and list numerous citations to various symposia and articles, I direct attention to recent *University of Virginia Law Review* and *Cornell Law Review* symposium issues for their inclusion of diverse views, and to one of many contributions to the dialogue by Professor Ronald J. Mann, a contributor to this symposium. *Symposium on the Revision of Article 9 of the Uniform Commercial Code*, 80 VA. L. REV. 1783 (1994); *Symposium on the Priority of Secured Debt*, 82 CORNELL L. REV. 1279 (1997); Ronald J. Mann, *The Role of Secured Credit in Small Business Lending*, 86 GEO. L.J. 1 (1997).

lisher-licensor preference for such a rule is understandable since introduction of useful articles into commerce does increase the risk of loss of secrecy through reverse engineering of a product unit that was lawfully acquired. Yet this is a risk in all product markets, and no compelling reason has been shown for changing trade secret law for the particular benefit of software and information publishers. If the Uniform Law Commissioners and the ALI in fact intend to effect such a change, this should be made explicit and be effected by changes in the Uniform Trade Secrets Act and the Restatement (Third) of the Law of Unfair Competition.

A secondary intellectual property protection that may result from section 2B-503 is a reduction in costs of monitoring compliance with use restrictions, and policing against the making of unauthorized copies. Using contract, and the regulatory rules of Part 5, to assure that every user is a direct licensee assures that the knowledge base of identifiable users is more complete and accurate. This would aid licensors in monitoring for license term compliance and unauthorized copying. Although this may be seen as a public as well as a private benefit, it nevertheless is but one factor to consider in determining whether state law should externalize those industry-specific costs and require them to be borne by users in particular, and society more generally. Neither this question, nor questions of the kind, have been addressed within the Drafting Committee or in the Reporter's Notes.

D. Other Common Transactions

Section 2B-102(a) broadly defines "information" to mean "data, text, images, sounds, mask works, or works of authorship"⁵³ and "license" to mean "a contract that authorizes access to or use of information or of informational rights and expressly limits the contractual rights or permissions granted, expressly prohibits, limits, or controls uses, or expressly grants less than all informational rights in the information ... whether or not the contract transfers title to a copy."⁵⁴ Section 2B-103 declares that Article 2B applies to:

- (1) any transaction that creates a software contract, access contract, or license; and
- (2) any agreement to provide support for, maintain, or modify information related to a contract within the scope of this article.⁵⁵

53. U.C.C. § 2B-102(a)(24) (Aug. 1, 1998 Draft).

54. *Id.* § 2B-102(a)(28).

55. *Id.* § 2B-103(a).

Nothing in the definitions of information, license, or software contract and nothing in the statement of scope limits application of Article 2B to digital electronic subject matter or transactions. Article 2B therefore establishes the basis for extension of copy use licensing into book and all other forms of information publishing or distribution.

In short, section 2B-502(2) contemplates distribution of a book accompanied by a standard form license, perhaps kept with the book by use of a shrinkwrap. The license may state that use of the book is pursuant the license's terms, and that the book may not be transferred to any person or organization in any manner and by any means without first obtaining consent of the publisher in a record. This has particularly interesting implications for, among others, college and university textbook distributors. Because many texts are rather expensive when purchased new, reasonably clean used copies are quite marketable. Bookstores thus set out previously used copies of books repurchased from prior owner-users alongside new copies ordered from book publishers. Article 2B presents publishers with a means to use contractual prohibitions against transfer to preclude bookstores from offering used books for sale in competition with new copies. Section 2B-502(2) makes original purchaser-licensee resale in violation of a contractual prohibition against transfer a breach, and declares that any such attempted transfer gives no rights to the ostensible transferee, whether a bookstore or an individual. Ineffectiveness of a transfer to another individual prevents a bookstore from acting merely as consignee for sale of used texts that original purchaser-licensees wish to dispose of through the marketplace.⁵⁶

The statute does not discriminate between different types of transactions. It equally includes the disposition of the course textbook and a library of books. It comprehends transfer by gift as well as in exchange for payment or other consideration. Turning back to software contracts, which very often contain transfer restrictions, the law makes ineffective the sale of an old desktop computer system to the extent that the "sale" includes a licensed copy of operating system software and, perhaps, a word process-

56. In fact, the definition of "license" in section 2B-102(a)(28) and "nonexclusive license" in section 2B-102(a)(34) both explicitly include consignments. This would make consignment of a copy by the licensee an attempted creation of a sublicense. The definition of "transfer" in section 2B-102(a)(48) offers some basis for claiming that consignment is not a transfer, but that is limited to cases in which the consignee is exercising contractual rights of its consignor. Transfer of the license and copy to a third party is something which the example specifically makes an act outside the scope of the license.

ing application program if the license prohibits its transfer.⁵⁷ It has exactly the same effect if the system and software are donated to a school or a charitable organization. Perhaps the latter consequence will lead the Internal Revenue Service to become the agent for eventually bringing to public attention the import and consequences of the Article 2B transfer rules.

E. Sections 109 and 117 of the Copyright Act

Section 117 of the Copyright Act expressly qualifies the copyright owner's rights in a computer program and declares that the owner of a computer program copy may make or authorize the making of a copy for archival purposes or in connection with adaptation of the computer program.⁵⁸ Any such copy "may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, ... as part of the lease, sale, or other transfer of all rights in the program."⁵⁹ The lease, sale, or other transfer of the owned copy to which section 117 refers is a transaction which is the subject matter of section 109(a) of the Copyright Act. It states:

Notwithstanding the provisions of section 106(3), the owner of a particular copy ... is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy⁶⁰

Prior sections 2B-502(2)(B)(iii) and 2B-503 operated together to expressly prevent even the owner of a copy of software or information from transferring it in violation of a contractual prohibition against transfer, making such an attempt a breach of contract and ineffective.⁶¹ The current version of section 2B-502(2) produces the same effect without so directly reading against the language of the federal statute. Section 2B-502 now makes no express reference to the owner of a copy. It simply provides that

57. It is to be noted that my Microsoft Windows 95 license does expressly authorize transfer of the license in connection with the sale or other disposition of my computer, provided that I do not make or retain a copy of the software. Microsoft Corporation, *supra* note 41.

58. 17 U.S.C. § 117 (1998).

59. *Id.*

60. *Id.* § 109(a).

61. Curiously, the provision in former section 2B-502 was touted as recognizing and effectuating the copy owner's right under section 117 of the Copyright Act. See U.C.C. § 2B-502, Reporter's Note 3(a) (Mar. 10, 1998 Draft). More importantly, it stated that this rule applied in the absence of a contract term to the contrary, and elsewhere directly provided that such a contractual prohibition is enforceable and a transfer made in violation of the term is a breach and ineffective. U.C.C. § 2B-503(2)-(3) (Mar. 10, 1998 Draft).

a contractual prohibition against transfer of a nonexclusive license is enforceable against both a licensee-transferor and a transferee. However, Article 2B's definition of "license" includes a contract under which ownership of a copy is transferred,⁶² and "licensee" is defined to include any transferee of information or informational rights regardless of whether the contract is a license.⁶³ This indirectly makes a sale of a copy subject to a contractual prohibition of transfer a license rather than a sale for purposes of state law.

In this instance, it is posited that state contract law controls with respect to characterization. Hence, the transfer is not a sale for purposes of section 109(a), and a copy owner—who has no right under state law to transfer the copy—is not the kind of owner contemplated by section 117. This legerdemain suffices in the minds of many, but it by no means precludes judicial determination that contractual prohibition of what section 109 expressly permits and section 117 contemplates is preempted by federal law.⁶⁴

Assertions that federal law does, or may, preempt state contract law enforcement of prohibitions against transfer of owned copies have been challenged on two grounds. The first ground is that contract terms and their enforcement under state law are not preempted by section 301(a) of the Copyright Act. The second is that an original conveyance subject to a contractual restriction is merely a license, not a sale, irrespective of whether title to a copy is thereby acquired.

The more specific of the two arguments made in support of enforceability of contractual prohibitions against sale of a copy is the second: a license is not a sale, and the first sale doctrine expressed in section 109(a) therefore is inapplicable. This often-discussed claim is not here revisited,⁶⁵ except to note that a belief that form controls over substance in this matter

62. U.C.C. § 2B-102(a)(28) (Aug. 1, 1998 Draft).

63. *Id.* § 2B-102(a)(29).

64. Preemption in this instance more likely would be based in the Supremacy Clause, not section 301(a) of the Copyright Act. It is arguable that state law is creating rights in copyright subject matter equivalent to those created by federal law, in that contract is used to expand the rights created by section 106 through elimination of one of the statutory limitations to which those rights are expressly subject. This would make section 301(a) applicable. Still, the more general argument based on state law intruding into a domain created and defined by federal law, and altering the operation of express provisions of a federal statute, seems the more direct approach. For a discussion of constitutional preemption, see P. GOLDSTEIN, COPYRIGHT § 15.3.3 (2d ed. 1996).

65. The author published one of the early papers on the subject: David A. Rice, *Licensing the Use of Computer Program Copies and The Copyright Act First Sale Doctrine*, 30 JURIMETRICS J. 157 (1990) [hereinafter Rice, *Licensing*].

is the veritable and vulnerable cornerstone of Article 2B. The other position advanced in support of section 2B-502(2) is that federal law permits contractual alteration of sections 107 to 120 as limitations on copyright owner rights created by section 106. The decision of the Seventh Circuit Court of Appeals in *ProCD v. Zeidenburg*⁶⁶ on the issue of copyright preemption of contractual restrictions of copy use provides substantial new support for this view; however, the new round of debate kindled by the decision has raised the profile of the issue instead of settling it. It thus far is a shaky foundation for widespread state enactment of section 2B-502(2).⁶⁷

IV. LIABILITY CONSEQUENCES

A. Licensee's Liability for Breach of Contract

The applicable liability rules for licensee breach of contract are found in Part 7 of Article 2B, and particularly sections 2B-707 and 2B-708. Section 2B-708 does not provide a particularly apt remedy, except in that the residual measure of damages in Subsection (a)(1)(D) and (2) provide that breach of contract by a licensee entitles the licensor to

(a) ... recover compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, the following ...:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and market value of consideration required under the contract for the performance that was the subject of the breach: ...

(D) damages calculated in any manner that is reasonable;
and

(2) subject to 2B-707(b), any consequential and incidental damages.⁶⁸

Subsection (b)(2) of section 2B-707 precludes consequential damages in this context to the extent that they are speculative.

66. 86 F.3d 1447 (7th Cir. 1996) (holding that standard form license terms not available for review until after purchase are nonetheless enforceable).

67. The law journal case comments, notes, and articles on the *ProCD* decision substantially outnumber citations to the decision in published judicial decisions. It appears that the commentators generally supporting the court's reasoning and outcome are substantially fewer than those who are critical of either or both the enforceability of standard form agreements or copyright preemption issues.

68. U.C.C. § 2B-708(a) (Aug. 1, 1998 Draft).

Section 2B-708(a)(1)(D) appears to make the licensee-transferor liable in damages for any injury resulting directly from the ostensible transferee's use of copy-embodied trade secrets. It does so without regard to whether the third-party use was innocent or knowing, and irrespective of whether the licensee-transferor knew of the existence of the trade secrets. This is contrary to general trade secret law.⁶⁹ Although modern trade secret law treats a transfer of trade secret subject matter as a disclosure,⁷⁰ not every disclosure or receipt of trade secret or confidential business information is actionable. Transferor liability attaches only when the transferor knows at the time of transfer that she is disclosing the trade secret of another, and doing so in breach of a duty of confidence owed to another.⁷¹ Section 2B-502(1)(B) goes well beyond this by legislating that a transfer made without knowledge that a software or information copy embodies a publisher-licensor trade secret is an actionable disclosure.⁷² It compounds this by substituting a mere contract relationship, which often will be quite remote, for a relationship giving rise to a duty of confidence as the source of obligation whose breach is actionable. The *coup de grace* is delivered by section 2B-708, which attaches a tort-law-influenced measure of damages for any resulting harm. This outcome is not trivial, probably is neither understood nor intended by most Drafting Committee members, and may be just what proponents of the section 2B-501(1)(B) trade secret provision seek.

B. Ostensible Transferee's Liability Risk

Superficially, the outcome for the ostensible transferee is that she gets nothing from the licensee-transferor and has a claim against the licensee-transferor to recover any amount paid. A closer look at the statute shows that this is wrong. Serious copyright liability exposure is created by Article 2B when a transfer of copyright-protected software is not permitted under section 2B-502(1) or is contractually prohibited pursuant to section

69. See *supra* Part III.A.1.

70. It is clear that transfer of trade secret information constitutes a "disclosure." See RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40, cmt. a (1995). The liability of a transferee who subsequently uses or discloses that information turns on whether she knew or had reason to know at the time of the transfer that the information was transferred or disclosed in breach of a licensee-transferor duty not to disclose, or that the licensee-transferor utilized improper means to acquire the trade secret. See UNIF. TRADE SECRETS ACT § 1(2)(ii)(B) (1985); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40(b)(3) (1995).

71. See UNIF. TRADE SECRETS ACT § 2(b)(2)(B)(ii) (1985); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 40(b)(1) (1995). Comment c indicates that disclosure is a "use," but not the contrary. *Id.* § 40 cmt. c.

72. See discussion *supra* Part III.A.

2B-502(2). This is because each instance of the program's use involves making a copy of the program for the purposes of copyright law.⁷³ Since an ostensible transferee acquires none of the licensee-transferor's rights to use the program,⁷⁴ every use by the transferee constitutes an infringement of the publisher's copyright. The Copyright Act provides that any further use of the program may be enjoined,⁷⁵ and that the publisher may recover its actual damages and the transferee's profits attributable to the infringement.⁷⁶ Alternatively, the publisher may elect to recover statutory damages of not less than \$500 or more than \$20,000.⁷⁷ Finally, irrespective of whether the relief sought is equitable or legal, it is within the court's discretion to award full costs and a reasonable attorney's fee.⁷⁸

Different rules apply if the information content is not protected by copyright. The action in that case most likely would be in tort for conversion. Cases decided to date under section 301(a) of the Copyright Act indicate that this state law cause of action generally is preempted,⁷⁹ but this holding offers little solace for those who cannot afford litigation, the only means by which to assert this defense. More to the point, creating a problem in a uniform law and then deliberately handing it off to the courts for later correction is to fall far short of the sponsoring organizations' high standards.

A licensor also might seek injunctive relief and damages for misappropriation of trade secrets under state tort and unfair competition law or, in an increasing number of states, under sections 2 and 3 of the Uniform Trade Secrets Act.⁸⁰ Sections 2B-507(b) and 2B-105(c) probably preclude

73. See *MAI Systems Corp. v. Peak Computing, Inc.*, 991 F.2d 511, 518 (9th Cir. 1993) (holding that loading a program into memory constitutes making a copy for purposes of copyright law. Such copying is a necessary antecedent to running any program in a modern computer.).

74. See U.C.C. § 2B-507(a)(1) (Aug. 1, 1998 Draft).

75. See 17 U.S.C. § 502 (1998).

76. *Id.* § 504(a)(1), (b).

77. *Id.* § 504(a)(2), (c).

78. *Id.* § 505.

79. See *United States ex rel. Berge v. Board of Trustees of the University of Alabama*, 104 F.3d 1453, 1462-65 (4th Cir. 1997), *cert. denied* 118 S.Ct. 301 (1997); *Taquinio v. Teledyne Monarch Rubber*, 893 F.2d 1488, 1501 (5th Cir. 1990); *Patrick v. Francis*, 887 F. Supp. 481, 482-484 (W.D.N.Y. 1995).

80. Section 2(a) of the Uniform Trade Secrets Act states that "[a]ctual or threatened misappropriation may be enjoined" Section 3(a) states that "[e]xcept to the extent that a material and prejudicial change of position prior to acquiring knowledge of reason to know of misappropriation renders a monetary recovery inequitable, a complainant is entitled to recover damages for misappropriation"

UNIF. TRADE SECRETS ACT § 3(a) (1985).

the damages action, but continued possession and use still would be enjoinable on the ground that the transfer was wholly ineffective. As previously noted, however, the conclusion that damages are not recoverable because trade secret law trumps Article 2B is reachable only through unguided search of several sections and further research in trade secret law.⁸¹

V. THE PRINCIPAL EFFECT: UNIFORM STATE LAW PROTECTION OF PUBLISHER-LICENSORS FROM COMPETITION

Common to the described particular effects of the anti-transfer rules of Article 2B is the protection of publisher-licensors against competition. The benefits to publisher-licensors consist of limiting direct competition from other publisher-licensors, and protection against competition in the secondary resale market.

A. Direct Competition

Article 2B makes back-door changes in trade secret law for the purpose, and with the effect, of protecting publisher-licensors against competition from other publisher-licensors, including potential new entrants into competition. Use of trade secret law, or its modification by state law, to accomplish this end falls squarely within *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*,⁸² in which the Supreme Court struck down a Florida boat hull plug molding statute because it extended beyond traditional trade secret law by excluding competition rather than regulating conduct.

Limitation of direct competition is the aim and effect of Article 2B enhancement of trade secret and know-how protection. Trade secret protection is an important element of a software publisher's competitive strategy and success. Historically, software copy use licensing depended heavily on the existence of embodied trade secrets as a foundation for crafting contract-based protection of software at a time when patent protection appeared unavailable and copyright protection was doubtful.⁸³ Currently, trade secret misappropriation claims sometimes are the primary claims, or are coupled with copyright infringement claims, in software protection litigation.

81. See *supra* Part III.A.2

82. 489 U.S. 141 (1989).

83. See David A. Rice, *Public Goods, Private Contract, and Public Policy: Federal Preemption of Software License Prohibitions Against Reverse Engineering*, 53 U. PITT. L. REV. 543, 552-55 (1992) [hereinafter Rice, *Public Goods*]; Mark A. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1245 (1995).

Given judicial limitation of copyright protection for computer programs,⁸⁴ it is unsurprising that publisher-licensors, as sources of technology-rich articles of commerce, would support efforts to strengthen trade secret law or seek enactment of contract rules that enhance trade secret protection. The identified Article 2B reinforcement of trade secret protection goes too far, however. Article 2B's approach would do much to make trade secret and related law more a barrier, and less a sieve.⁸⁵ It also would do much to change its character and the balance of interests it effects.

Trade secret law, like other intellectual property law, expresses an accommodation of interests. Its rules have evolved over time, deliberated on by judges and scholars and within the NCCUSL and the ALI.⁸⁶ Broadly speaking, trade secret law functions within well-established limits to encourage innovation by providing protection against certain information-seeking conduct of others, while leaving open diverse other means for wider diffusion of knowledge and know-how developed through investment in innovation.⁸⁷ Paramount among those lawful means for wider diffusion is reverse engineering of a lawfully acquired article of commerce in which the trade secret or know-how is embodied.

Heretofore it has been perfectly lawful to overtly acquire an article of commerce in the marketplace and ascertain trade secrets which it embodies through reverse engineering.⁸⁸ Section 2B-502(1)(B) introduces into contract law a totally new rule, the primary effect of which is to preclude

84. See *Computer Assoc. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693 (2d Cir. 1992) and *Lotus Dev. Corp. v. Borland Int'l, Inc.*, 49 F.3d 807 (1st Cir. 1995), *aff'd by an equally divided Court*, 116 U.S. 804 (1996).

85. The Supreme Court has contrasted patent and trade secret law in these terms, stating, "[w]here patent law acts like a barrier, trade secret law functions relatively as a sieve." *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 490 (1974).

86. Congress recently made a limited entry into the field when it enacted the Economic Espionage Act of 1996, 18 U.S.C. § 1831 (1996).

87. See generally RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39, cmt. a (1995).

88. See, e.g., *SI Handling Systems, Inc. v. Heisley*, 753 F.2d 1244 (2d Cir. 1985); *Chicago Lock Co. v. Fanberg*, 676 F.2d 400 (9th Cir. 1982). State trade secret law recognition of this principle was a key consideration in the Supreme Court's rejection of the argument that state trade secret law conflicts with and is preempted by federal patent law. See *Bonito Boats*, 489 U.S. at 160; *Kewanee*, 416 U.S. at 476, 490. Whether, or to what extent, various rules of Article 2B may be preempted by federal law has been vigorously disputed throughout the Article 2B drafting process, and provisions related to trade secret law have been one of the topics in this continuing debate. It is beyond the scope of this comment to describe the various issues and debates or to identify and assess the legal arguments. Analyses and expressions of the author's views on the topic include Rice, *Public Goods*, *supra* note 83, and David A. Rice, *Digital Information as Property and Product*, 22 U. DAYTON L. REV. 623, 646 (1997).

reverse engineering of a computer program copy by a third-party transferee of a copy use license. Equally, statutory validation of contractual prohibition against transfer to forestall reverse engineering creates grounds for arguing that otherwise legally permitted reverse engineering is unlawful because the transferee had no legal right to possess the copy subjected to study through reverse engineering.

B. Secondary Competition

The other major effect of the Article 2B anti-transfer rules is to exclude licensee competition with publisher-licensors in the distribution of lawfully acquired copies of software and information. Under Article 2B, competition through secondhand distribution of an infinitely reusable copy is statutorily foreclosed in some instances and subject to contractual foreclosure in any event. The actual effect on the primary retail market may be insubstantial even if the volume of neighbor-to-neighbor and flea market transactions in used software and information product copies is numerically sizable. Monitoring transactions and collecting transfer fees, or tolls, in this diffuse market is difficult, costly, and not likely to produce revenues that exceed costs.

Quite a different case is presented by transactions in which the focus is transfer of the ownership of a business. Transfer of rights in various individually licensed software and information copies, and even site licenses, is ancillary to the primary purpose of transferring business ownership. Yet transferability is the key to recovery of the residual value of copy use licenses for which payment has been made or, in the case of periodic payment licenses, is current. This value is transferred in whole or in part to the publisher-licensor when, on the authority of sections 2B-502(1) and (2), a publisher-licensor conditions consent to transfer on payment of a fee or insists on purchase of a new license. Nontransferability of use licenses provides a means to price discriminate by effectively terminating the useful life of the original license and exacting a new price for a future use license.⁸⁹ Indeed, high switching costs create the potential for setting the new price substantially higher than that charged for the original license.⁹⁰

89. The point owes much to a recent discussion with Professor Wendy Gordon. Concerning copyright ownership itself conferring the ability to price discriminate by making arbitrage by licensees of statutory rights profitless, see Wendy Gordon, *Price Discrimination Redux*, 73 CHI-KENT L. REV. (forthcoming 1998).

90. Switching costs, inclusive of those for a license to use an alternative computer program, migration of systems and data, and retraining of personnel will be substantially higher than payment for the transfer or a new license. See, e.g., Mark A. Lemley & David McGowan, *Legal Implication of Network Economic Effects*, 86 CALIF. L. REV. 479, 532-

The market effect is that publisher-licensors are insulated against competition in the market for copies of their products. Article 2B's bold characterization of a sale as a license so long as the contract prohibits transfer is directed to contracting around the statutory expression of the venerable first sale doctrine,⁹¹ which is based on the notion that the first sale of a copy exhausts all of the copyright owner's rights in the particular copy.⁹² Federal copyright law creates a monopoly over first distribution of a copy according to this principle, and not over further resale or other transfer except as the statute otherwise expressly provides.⁹³

Public policies favoring individual freedom to contract and to alienate personal property are implicated, as is competition policy to which the limited monopolies created by copyright and patent law are exceptions.⁹⁴ It is these policies that section 2B-502(2) rejects. It empowers publisher-licensors to extend control over transfer of copies as a primary, not an ancillary, restraint on competition from copy resale or other transfer. This copy distribution monopoly achievable through use of contract is the private benefit that section 2B-502(2) holds out as the return for the loss which nontransferability visits on copy use licensees. The end result is publisher capture of consumer surplus, a reallocation of gains resulting from the merger or other business transaction to publishers of software and information copies.

VI. THE RATIONALE ... AND A BRIEF CRITIQUE

The rationale advanced for the anti-transfer rules is substantively unfounded. Its presentation is superficially convincing, but its assertion of authority does not withstand scrutiny. The Reporter's Notes represent that

34 (1998); Peter S. Menell, *An Analysis of the Scope of Copyright Protection for Application Programs*, 41 STAN. L. REV. 1329, 1357-58 (1987).

91. See Rice, *Licensing*, *supra* note 65.

92. The landmark decision is *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908), but the principle was followed in lower federal courts prior to that decision. *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 118 S.Ct. 1125, 1128 n.4 (1998).

93. Prohibition of computer program rental by the owner of a copy is a primary example of such an exception. See 17 U.S.C. § 109(b)(1)(A) (1998).

94. Patent and copyright are instrumental exceptions to the competition-favoring policy expressed in antitrust laws. See, e.g., *United States v. Paramount Pictures, Inc.*, 441 U.S. 1, 157-58 (1948) (holding block booking to be illegal because, among other things, it added to or extended the statutory copyright monopoly); *United States v. Singer Mfg. Co.*, 374 U.S. 174, 196 (1963) (finding no exemption from antitrust law and policy beyond the limits of the patent monopoly); *Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964) (clarifying that patent laws are to be construed together with antitrust laws and modify them to the extent necessary).

the anti-transfer rules reflect existing law (or are even prescribed by it), rather than a reasoned choice among alternatives. Resort to this characterization effectively forecloses identification and weighing of unintended, and even untoward, consequences in the course of Drafting Committee, NCCUSL, and ALI deliberations.

A. Divergence of Section 2B-501(1)(B) from Sections 2-210, 2A-303, and Other Contract Law

Section 2-210(2) of the U.C.C. states, with respect to contracts for the sale of goods, that:

all rights of either buyer or seller can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining a return performance.⁹⁵

This language reflects established contract law as stated in the Restatement (Second) of Contracts section 317(2), and it echoes U.C.C. section 2A-303(5)(b).⁹⁶

The Reporter's Notes indication of uniform law sources for section 2B-502(1) reference section 2A-303 but not section 2-210. Reporter's Note 1 to section 2B-502, however, states that the language of subsection (1) "follows existing Article 2."⁹⁷ The Reporter's Notes generally characterize the stated limitations on transfer as ones determined "by reference to standards that protect the non-transferring party's interest"⁹⁸ and further state:

The concepts here seem especially relevant to licensing where, in many transactions outside retail markets, important reliance and confidentiality interests are involved that may be compromised by a transfer of the contract. In practice, under federal law, many

95. U.C.C. § 2-210(2) (1996).

96. Section 2A-303(5)(b) provides that, in the case where a personal property lease is silent with respect to the right to transfer, the transferor is liable in damages for loss suffered by the other lease party if the transfer "materially impairs the prospect of obtaining a return performance ..., materially changes the duty of [the aggrieved party], or materially increases the burden or risk imposed on [the aggrieved party]" U.C.C. § 2A-303(5)(b) (1996).

97. U.C.C. § 2B-502, Reporter's Note 1 (Aug. 1, 1998 Draft).

98. *Id.*

licenses may not be transferable without licensor consent even in the absence of a contract provision to that effect.⁹⁹

This explanation indicates no legal authority or rationale for adoption of section 502's statutory declaration that a transfer of contract rights to use subject matter that embodies a trade secret or confidential business information of the publisher-licensor is a breach of contract and ineffective as a matter of law. There is, in fact, no non-federal law authority for addition of trade secret and business information protection to the restated general contract law and other U.C.C. articles' limitations on transferability of rights.¹⁰⁰

That the concepts "seem" relevant is scant justification, and empty authority, for insinuating into contract law a statutory prohibition against transfer of contract rights to possess and use a copy if it embodies trade secret or confidential business information. This is especially so given that it clearly is lawful under trade secret and general contract law to acquire an article of commerce in which a trade secret or confidential business information is embodied.¹⁰¹

The basic contract rules expressed in sections 2-210 and 2-303 of the U.C.C. and section 317 of the Restatement recognize that commerce and trading in articles of commerce is the norm. They establish immutable limits on transferability only for the purpose of assuring that a transfer of contract will not defeat party-specific expectations for performance or materially increase the performance burdens or risks of nonperformance of the other party to the contract.¹⁰² Courts typically seek on the facts and law to avoid imposing limitations on transfer even under these rules.¹⁰³

The prototypical case, put forth by comment 4 to section 2-210, is an output or exclusive dealing contract in which personal discretion with respect to performance is implicated, but even then the comment indicates a transfer is not ineffective so long as good faith conditions established by

99. *Id.*

100. Further, the general statement that federal law may in fact prohibit transfer which lacks at least implied consent is erroneous. See discussion *infra* Part VI.B.

101. See *supra* Part V.A.

102. Article 9 in fact adopts a far stronger pro-transfer rule in providing that the debtor's rights in collateral may be voluntarily or involuntarily transferred "not withstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." U.C.C. § 9-311 (1996). The function is to make the transfer effective, even though possibly actionable as a breach.

103. See generally FARNSWORTH, *supra* Note 3, § 11.4; CALAMARI & PERILLO, THE LAW OF CONTRACTS §§ 18.2 & 18.12 (4th ed. 1998).

section 2-306 are met.¹⁰⁴ In fact, commercial contract law has so dramatically moved away from negation of transfer that delegation of performance is generally permitted "unless the other party has a substantial interest in having the original promisor perform or control the acts required by the contract."¹⁰⁵

These provisions strongly evidence modern disfavor of statutory, and even contractual, restraints on the alienability of contract rights. Section 2B-501(1), in contrast, ingeniously transforms these limitations on the enforceability of contractual prohibitions against transfer into statutory prohibitions against transfer. Addition of the new rule proscribing transfer if a licensed copy embodies a trade secret is independently remarkable, as discussed earlier, for the way in which it indirectly amends trade secret law.¹⁰⁶ The whole is a sophistic *tour de force*.

Neither rejection of well established commercial law principles nor back-door statutory revision of trade secret law can be based on mere assertion that the license model of transactions requires or justifies this. Equally, it is wholly insufficient simply to declare that divergence from both general contract and trade secret law is called for because Article 2B contracts are affected with "important reliance and confidentiality interests ... that may be compromised by a transfer of the contract."¹⁰⁷ It is unspecified, and unclear, what constitutes or gives rise to the reliance interest or confidentiality interest. There surely is no interest based upon action taken in reliance on offers or promises made by others with intention or expectation of inducing action. Moreover, an open market transaction in which the licensor and licensee have no direct relationship, and in which the contract is a widely used standard form, is not one in which an obligation of confidentiality inheres or can be contractually prescribed by mere recitation that it exists.¹⁰⁸

104. See U.C.C. § 2-210, cmt. 4 (1996).

105. *Id.* § 2-210(a). In the case of a personal property lease, transfer is allowed except when "an actual delegation of a material performance" is effected by a lessee's violation of a contract term that prohibits creation of a security interest in its leasehold interest. *Id.* § 2A-303(3).

106. See *supra* Part III.A.

107. U.C.C. § 2B-502, Reporter's Note 1 (Aug. 1, 1998 Draft).

108. It is interesting to observe that the quoted Reporter's Notes justify the rule by reference to characteristics of non-retail transactions and that the rule itself applies to all transactions, retail and non-retail alike.

B. (Mis)Use of Intellectual Property Exception to General Contract Law As Justification, or Prescription, for Section 2B-502(2)

Preemptive prescription by federal intellectual property law previously was explicitly stated as the source of the rules contained in former section 2B-502.¹⁰⁹ It now is alluded to in the Reporter's Notes to current section 2B-502 as a determinant and it is stated in the Reporter's Notes to section 2B-503 to be that section's foundation. Specifically, the Reporter's Notes to original section 2B-502 and current section 2B-503 present that *Everex Systems, Inc. v. Cadtrak Corp.*,¹¹⁰ and kindred federal court decisions preclude transfer of a nonexclusive software or information copy use license without obtaining the consent of its publisher-licensor.¹¹¹ Examination of the decisions demonstrates that they have nothing to say about transfer of nonexclusive copy use licenses. They create and narrowly apply a federal rule governing only the transfer of a nonexclusive license of federally-created patent and copyright rights. This departure from the freedom-to-transfer norm of modern commercial law is explained as essential to, and solely for the purpose of, preserving the limited monopoly rights created by the patent and copyright statutes.

Everex, Harris v. Emus Records Corp.,¹¹² and other decisions relied upon at various times in the Reporter's Notes hold that a nonexclusive license of rights created by federal patent or copyright law is not transferable.¹¹³ The soundness of the decisions so far as they concern only transfer of rights, or hypothecation of rights, created by federal statute is itself questioned by Professor Rochelle Cooper Dreyfuss.¹¹⁴ Further, one recent

109. See U.C.C. § 2B-502, Reporter's Note 3 (Mar. 10, 1998 Draft).

110. 89 F.3d 673 (9th Cir. 1996).

111. The limited extent to which Article 2B permits any such transfer without first obtaining express consent apparently is grounded in surmise that implied consent exists in certain types of transactions unless a contract term expressly provides that the copy use license is not transferable.

112. 734 F.2d 1329 (9th Cir. 1984).

113. See *Everex*, 89 F.3d at 679-80 (patent); *Harris*, 734 F.2d at 1333-34 (copyright); *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972), cert. denied 410 U.S. 929 (1973) (patent); *In re Patient Educ. Media, Inc.*, 210 B.R. 237, 242 (S.D.N.Y. 1997) (copyright).

114. See Rochelle Cooper Dreyfuss, *Do You Want to Know a Trade Secret? Licensing Under Article 2B of the Uniform Commercial Code*, 87 CALIF. L. REV. 191 (forthcoming 1999). This article does not address whether *Everex* and related decisions are correct in concluding that the usual state contract law rule of free transferability must be supplanted by a contrary federal law in certain instances. It assumes, solely for the sake of argument, their substantive correctness. It shows, even so, that the courts' opinions and the Constitution strictly limit application of the nonassignability rule to nonexclusive licenses of property rights created by federal statute. These authorities offer no guidance

decision has limited their application by holding that transfer of assets as a step essential to corporate reorganization does not require a patent rights licensor's consent where there is substantial identity of ownership of the licensee-transferor and its transferee.¹¹⁵ Yet, it is clear that the federal common law decisions generally apply to transfers of nonexclusive patent and copyright licenses in merger and acquisition cases.¹¹⁶

Far more importantly, *Everex* and other cases relied upon by the Reporter's Notes recognize that the patent and copyright license transactions with which they deal are different in fact and law than the vast majority of transactions that will be governed by Part 5 of Article 2B. They clearly and carefully limit application of the federal common law rule which they adopt to contracts involving the transfer, without licensor consent, of a nonexclusive license of federally-created copyright and patent rights.¹¹⁷ Indeed, the only justification for judicially creating the rule is to assure that the state contract law that makes contract rights transferable does not compromise the intellectual property rights scheme created by a federal statute.

The courts explain that state contract law ordinarily governs construction and interpretation of agreements involving transfer of rights created by the patent and copyright statutes.¹¹⁸ This is a product of constitutional law as expressed in *Erie Railroad Co. v. Tompkins*.¹¹⁹ *Everex*, *Harris*, and related decisions identify two exceptions to this rule. The first is that state

for—let alone prescribe the content of—Article 2B rules governing the transfer of nonexclusive licenses to use a software or information copy.

115. See *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 494-95 (1st Cir. 1997), *cert. denied*, 117 S. Ct. 2511 (1997). Facially, this seems a sufficient response to one of the previously identified consequences of the Article 2B anti-transfer rules. See *supra* Part III.B.1. However, it merely offers potential relief in select cases and does not deal with the fact that the relied upon federal court decisions have nothing to do with mere copy and use license transfers on their facts or as a matter of law.

116. See *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090 (6th Cir. 1979); see also *Unarco*, 465 F.2d at 1306 (acquisition of business and its assets).

117. See *Everex*, 89 F.3d at 677 (citing *McCoy v. Mitsuboshi Cutlery, Inc.*, 67 F.3d 917, 920 (Fed. Cir. 1995)); *Unarco*, 465 F.2d at 1306; *In re Patient Education Media*, 210 B.R. at 242 (citing *Bourne v. Walt Disney Co.*, 68 F.2d 621, 631 (2d Cir. 1995), *cert. denied*, 517 U.S. 1240 (1996)).

118. See, e.g., *Everex*, 89 F.3d at 678; *Unarco*, 465 F.2d at 1305; *In re Patient Educ. Media*, 210 B.R. at 242.

119. 304 U.S. 64 (1938). Several of the cases expressly refer to *Erie* as the foundation for the rule that state law ordinarily governs interpretation and construction of patent and copyright licenses, and in stating that exceptions created in order to deal with conflict between state contract law and federal law and policy are special and specific exceptions. See, e.g., *Everex*, 89 F.3d at 678; *Unarco*, 465 F.2d at 1305; *In re Alltech Plastics, Inc.*, 71 Bankr. 686, 689 (W.D.Tenn. 1987).

contract law does not apply if the underlying federal statute specifically states an applicable federal rule.¹²⁰ The second is that state contract law is inapplicable if it would conflict with patent or copyright law or be inconsistent with the underlying federal policy.¹²¹ If the federal statute is silent, a court first must determine whether a substantive federal common law rule must be created in order to avoid conflict between state contract law and federal law or policy.¹²² If a rule is judicially created, it supersedes state contract law only to the extent necessary to resolve the identified conflict.¹²³ The judicially created rule is one of federal common law which the courts have only limited power to create in order to assure that "a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules."¹²⁴

Licensing of software or information copy use is a transaction wholly different in subject matter and purpose. A license governed by Article 2B may include a nonexclusive license of a federal intellectual property right, but section 2B-501(b)(1) makes it clear that this is not what Article 2B is about. It declares that "[t]ransfer of a copy does not transfer ownership of informational rights in the information."¹²⁵ This has two obvious implications. First, federal law does not control: the transaction does not transfer or hypothecate any right created by federal statute, nor does it authorize a licensee to engage in any activity expressly reserved to a patent or copyright owner. Second, federal patent and copyright policy is not even illuminating, as it concerns the creation, scope, and limits of a statutory monopoly created by Congress as an exception to the norm of competition and freedom to contract.¹²⁶

The monopoly-focused rationale for the federal anti-transfer rule is unique to the patent and copyright statutes and it has no application to the

120. See *Everex*, 89 F.3d at 679; *Unarco*, 465 F.2d at 1306.

121. See *Lear, Inc. v. Adkins*, 395 U.S. 653, 661-62 (1969).

122. See *Everex*, 89 F.3d at 679.

123. See *id.* (criticizing the opinion in *Unarco* for not taking care to make clear that application of a federal common law rule is limited, and that state contract law otherwise governs construction of patent licenses).

124. *Sola Elec. Co. v. Jefferson Co.*, 379 U.S. 173, 176 (1942). See also *O'Melveny & Myers v. Federal Deposit Ins. Corp.*, 512 U.S. 79, 87 (1994).

125. Notably, the distinction is made clear in cases relied upon in the Reporter's Notes for the proposition that the federal patent and common law rule that a license of federal rights is nonassignable. See *Harris*, 734 F.2d at 1334; *SQL Solutions, Inc. v. Oracle Corp.*, No. C-91-1079 MHP, 1991 U.S. Dist. LEXIS 21097, at *15 (N.D. Cal. Dec. 18, 1991).

126. Monopoly in most other contexts is, of course, anathema and its creation or preservation by contract is generally unlawful. This is the essence of the Sherman Anti-trust Act, 15 U.S.C. § 1 (1998).

transfer of Article 2B contract rights. Federal law grants the owner of a patent or copyright the right to exclude others from doing those things that the respective statutes expressly reserve to the owner. The owner of a patent in an article of manufacture has the exclusive right to make, use or sell that article, and a person who obtains a nonexclusive license to manufacture the article is but one of many to whom such a license might be granted.¹²⁷ Allowing a licensee to transfer its nonexclusive license would encroach upon the exclusive statutory right of the patent owner to license others to make, use, or sell, since that would permit any licensee to compete against the patent owner in licensing the right. This would undercut the patent owner's statutory monopoly rights. Similarly, the Copyright Act gives a copyright owner the exclusive right to make copies and distribute, or authorize others to make or distribute copies.¹²⁸ Permitting a nonexclusive licensee of the reproduction or distribution right to transfer that license to another would undermine the statutory right of the copyright owner alone to determine who may make or distribute copies.

Everex and other federal court decisions thus reason that a rule permitting transfer of a nonexclusive license to make, use or sell an article or to make or distribute copies¹²⁹ would transform the statutory rights of the patent or copyright owner from exclusive into nonexclusive.¹³⁰ Since this would directly conflict with the express language and the clear intent of the federal statutes, the courts hold that a nonexclusive license to make, use or sell an article, or to make and distribute copies, is nontransferable absent the consent of the patent or copyright owner.¹³¹ No similar trade secret, informational content, or copy use monopoly exists under federal or state law, and section 2B-501(b) makes it clear that an Article 2B license conveys no patent, copyright, or other informational right that is not expressly granted.

Article 2B's adoption of the federal rule would in fact conflict with the public policy favoring competition. State enactment of contract rules,

127. See 35 U.S.C. § 271(a) (1998).

128. See 17 U.S.C. § 106(1), (3) (1998).

129. The author's intention is to use "make or distribute copies" as illustration of the more numerous exclusive rights of a copyright owner under section 106 of the Copyright Act. The limited purpose is to avoid cumbersome repetition of an exhaustive listing of statutory rights in the text.

130. See *Everex*, 89 F.3d at 679. See also *Unarco*, 465 F.2d at 1305 (where the would-be transferee of licensed patent rights was in fact a party to whom the patent holder had consistently refused to grant a license).

131. See, e.g., *Everex*, 89 F.3d at 679 (patent); *Institut Pasteur*, 104 F.3d at 492 (patent); *Harris*, 734 F.2d at 1333 (copyright); *In re Patient Educ. Media*, 210 B.R. at 242 (copyright).

whose purpose is to prevent licensee competition, uses state law to create a publisher-licensor monopoly in the distribution of software and information copies. The subject matter of the monopoly is not limited to patent and copyright. Patent and copyright are themselves limited statutory exceptions to the policy favoring competition and freedom to compete,¹³² and even federal legislative authority to protect subject matter within the scope of patent and copyright is constitutionally limited.¹³³ This suggests something far different than what has been claimed. Instead of being prescribed or supported by federal patent and copyright law, the Article 2B anti-transfer rules in fact run afoul of federal intellectual property and competition law and policy. The Reporter's Notes draw upon *Everex* and kindred decisions by highlighting superficial similarities; for instance, contracts governed by Article 2B are characterized as licenses and the subject matter of Article 2B contracts sometimes, but not always, are intellectual property. This ignores how the courts' limit application of the substantive federal common law rule that they have created, and that intellectual property is legally distinct from intellectual property rights.¹³⁴ The Reporter's Notes do not heed the constitutional limitations imposed by the *Erie* doctrine and its definition of the provinces of federal and state law, nor do they heed the careful judicial explanation that the rule being adopted differs from otherwise applicable state contract law under which contract rights are transferable.¹³⁵ Quite to the contrary, the Reporter's Notes once went so far as to assert that an earlier draft provision that made mass market licenses transferable so clearly conflicted with federal law and policy expressed in *Everex* that this consumer interest provision risked preemption.¹³⁶

Reporter's Notes to more recent drafts have moderated the strong claim that federal patent and copyright law dictate the content of Article 2B rules. The rules themselves, however, remain substantially unchanged

132. See *supra* note 94.

133. See, e.g., *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340 (1991).

134. This is the essential point of section 202 of the Copyright Act, 17 U.S.C. § 202, which provides that transfer of a copy of a book, computer program, or other work conveys no rights in the copyrighted work itself.

135. This failure is particularly striking because *Everex*, the decision most heavily relied upon and even extensively quoted in Reporter's Notes when representing that federal law requires or supports Article 2B adoption of anti-transfer rules, is the case that most carefully and fully develops this point. See *Everex*, 89 F.3d at 678.

136. This is the position presented in Reporter's Note 2 to former section 2B-502 and echoed in Reporter's Note 2 to former section 2B-504 of the February and March 1998 Drafts. It is to be noted that this provision was made expressly subject to any contract term that prohibited transfer. See U.C.C. § 2B-502(c) (Mar. 10, 1998 Draft).

except that they no longer make nonexclusive copy use licenses nontransferable as a matter of law. The Reporter's Notes still draw upon *Everex* and other decisions as support for Article 2B's remaining anti-transfer rules. In that respect, misuse of the federal cases originally secured adoption of statutory and contractual transfer prohibition rules favorable to publisher-licensors. It now provides window dressing and rationalization for the retention of the anti-transfer rules. *Everex* has served particularly well in that it provided very quotable language that could be used in Reporter's Notes to show how federal law preemptively prescribed anti-transfer rules, without disclosing that the nonexclusive license at issue was not the stuff of Article 2B. Alas, it simply does not serve.

C. (Mis)Use of Freedom of Contract as A Rationale for Making Contractual Prohibitions Against Transfer Enforceable

Reporter's Note 2 to section 2B-502 propounds that making contractual prohibitions against transfer of nonexclusive software and information copy licenses enforceable "is consistent with ... the underlying theme of this article recognizing contractual choice"¹³⁷ This is sheer rationalization, or at best a bizarre rationale. Section 2B-502, after all, *restricts* freedom of licensees and others to contract.

Article 2B may be about contract, although many argue that it is about transactions and their terms rather than bargained-for exchange. A non-drafting party who objects to a standard form term at the time it is made available for review has limited choices under Article 2B. The three options are (1) request the drafting party to eliminate or amend the term, (2) refuse the entire deal, or (3) accept the term in order to obtain the software or information. In practice, the only real choices are the second and third.

In the immediate case, the relevant term would be a contractual prohibition of transfer. Transfer is not the use for which most licensees acquire software and information copies, so the significance—as opposed to existence—of the term may not seem clear at the time of product acquisition. Yet a person who has no hope of being able to bargain over this or any other non-price term of the license is further surrendering under the non-transferability term the freedom to contract with others. Contractual choice is first illusory and then killed.

Statutory validation of contractual restraint on alienation is antithetical to competition policy and individual autonomy. It is totally blind to modern commercial contract law, represented by a long line of judicial decisions and other uniform laws, which makes prohibitions against the as-

137. U.C.C. § 2B-502, Reporter's Note 2 (Aug. 1, 1998 Draft).

signment or other transfer of contract rights, real property, or tangible personal property unenforceable. "Contractual choice" and "freedom of contract" are perhaps even more the foundation of these rules than they are the basis for contract law's giving parties freedom to shape delivery, performance, and other terms. More generally, competition and other public policies have come to trump the policy favoring contractual choice in this area. Contract terms that prohibit assignment or otherwise restrain alienation ordinarily are not enforced, or are narrowly construed, even when set forth in non-standard form contracts of parties who are known to and directly dealing with each other.¹³⁸ To dismiss this by ritual recital that section 2B-502(2) expresses recognition of the principle of contractual choice is to hollow that principle.

D. (Mis)Use of Authority in Rationale for Anti-Financing Rules

The first rationale presented for section 2B-503(b)(2)'s divergence from the Article 9 model is the same as that given for the prior section 2B-502's statutory prohibition against transfer of a nonexclusive license. Financier enforcement by taking possession for use is barred because (1) a license authorizes use of intellectual property, (2) a copy embodies intellectual property, and (3) *Everex* and related federal patent and copyright decisions prevent transfers of intellectual property rights without consent.¹³⁹ This argument's illusory quality and lack of legal merit already have been discussed and demonstrated.¹⁴⁰

One section 2B-503 Reporter's Note presents a further rationale for the rule stated in section 2B-503(b)(3). It advances an analogy between personal property leases and Article 2B licenses as an additional and independent reason for the rule stated in section 2B-503(b)(3). It reasons that restriction of transferability

is also constrained by a general state law policy, reflected in Article 2A, that in three party transactions of this type, the rights owner is entitled to protection. Article 2A-303(3) limits the enforceability of lease provisions restricting security interests, stating: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other than the lessee from pos-

138. See generally FARNSWORTH, *supra* note 3, § 11.2.

139. Section 2B-503, Reporter's Note 2 states: "For non-exclusive licenses, the transferability of a licensee's rights is constrained in law by federal policy limitations that presume non-transferability without licensor consent." U.C.C. § 2B-503, Reporter's Note 2 (Aug. 1, 1998 Draft). See *id.* § 2B-502(1); *Everex*, 89 F.3d at 673. See also *In re Patient Educ. Media*, 210 B.R. 237 (copyright license).

140. See *supra* Part VI.B.

sessing or using them." Article 2A-303, *Comment* 3. As in Article 2A, the licensor has a right to control who is in effective possession (including use and access) of the subject matter of the license. This policy has been enforced by a number of courts in reference to assignments of a licensee interest to third parties, either by contract or by operation of law.¹⁴¹

The first difficulty with this statement is that section 2A-303(c) does not preclude transfer of an interest in leased property as a matter of law. Indeed, as the Reporter's Note correctly states, "Article 2A-303(3) limits the enforceability of lease provisions restricting security interests" in the subject matter of the license.¹⁴² It limits enforcement of a contract term restricting transfer to those cases in which the lessee's transfer of interest includes transfer of actual possession or use of the leased goods to another.

The second problem with the stated reason is that personal property leases and licenses differ in important respects. Their principal commonality is that both lessors and licensors retain a residual interest in the original transaction's subject matter. Yet, a lease requires a series of payments, and establishes other continuing performance obligations of an affirmative nature concerning matters such as maintenance and insurance. In contrast, many software and information copy use license transactions involve single payments and create continuing obligations of only a negative nature, such as not using a copy for any purpose other than those permitted by the terms of the license.

In summary, this review indicates that section 2A-303 is not authority for legislating a general statutory prohibition against financier enforcement by taking possession and disposing of a licensed copy. It also shows that section 2A-303 is not compelling authority for Article 2B adoption of such a rule. Section 2A-303 presents a relevant model for consideration, together with the Article 9 model and perhaps others. Relevance and application ought not to be determined, however, based solely on the preferences expressed by one of several classes of persons whose interests may be at stake.

VII. CONCLUDING OBSERVATIONS

The National Conference of Commissioners on Uniform State Laws and The American Law Institute launched the Article 2B project in recog-

141. U.C.C. § 2B-503, Reporter's Note 2 (Aug. 1, 1998 Draft).

142. *Id.*

dition of the importance of software and information as the subject of commerce. Drafting Committee meetings have been heavily attended by observer-participants, and their active participation in discussion of drafts has aired differences on many issues. Even so, the process is as much political as participatory.¹⁴³ Industries and interests whose principal activities involve subject matter and transactions within the scope of Article 2B have been well represented, and those whose core activities fall outside its scope were not at the table.

Many of the unrepresented are destined to discover that they will be significantly affected. Awareness of potential effects has been expressed by some during annual meetings of the NCCUSL and ALI. Concerns about pro-licensor imbalance were expressed as early as the 1996 Annual Meeting of the NCCUSL, at its 1997 Annual Meeting, and in floor motions presented at its 1998 Annual Meeting and at the 1997 and 1998 Annual Meetings of the ALI. The basic importance and persistence of some concerns is manifested by the fact that issues presented to the full membership of the sponsoring organizations typically are ones raised and vigorously debated, and then rejected, at Drafting Committee meetings. Most are positions that have been rejected by the Drafting Committee in the face of strong opposition expressed by representatives of directly affected industries. Some industry representatives who have fought hard and prevailed on these issues at Drafting Committee meetings sometimes view this oversight or scrutiny as "above-the-fray tinkering."¹⁴⁴

143. The drafting process is inherently political, and the more so because Drafting Committee meetings are open. Success of the project ultimately turns on the enactability of the final product, so the views of industry representatives and other observer-participants have great sway. Predictably, the meetings are attended primarily by representatives of affected interests, and especially publisher-licensor representatives. Lawyers and others primarily involved in practice areas such as general business or mergers and acquisition are not a presence because software and information copy distribution is not central to their work.

Participation, its nature, and its effects recently have been the subject of several significant law review articles dealing with the U.C.C. drafting process. A selective sample includes Kathleen Patchell, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993); Donald J. Rapson, *Who is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249 (1994); Alan Schwartz, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

144. American Law Institute 1998 Annual Meeting motions and votes were so characterized in a July 15, 1998 memorandum addressed to the members of the National Con-

Review in this article of the Article 2B rules governing the transfer of contract rights demonstrates that oversight, and even tinkering, by the co-sponsoring organizations is essential. Article 2B's rejection of modern contract and commercial law rules that strongly favor the transferability of contract rights is so striking that it would be surprising if it did not attract attention. Representation that fidelity to the principle of contractual choice underlies statutory regulation, and contractual prohibition, of the freedom of licenses and others to contract with one another in fact begs scrutiny. It is widely recognized that the generally prevailing rule that Article 2B rejects, like the anti-transfer view which it adopts, impinges on the contractual freedom of one or another class of persons. It is empty to argue in this instance that the principle of contractual choice points toward one rule rather than the other, or justifies rejection in this particular instance of the policy choice and resulting rule that otherwise generally obtains. The burden of justifying departure from the established norm is on those who would change how the law regulates contractual choice, a burden clearly not met by claiming the policy favoring contractual choice as a justification.

Likewise, crafting changes in trade secret law in the guise of legislating contract law rules, and doing so without expressly disclosing that purpose and effect, warrants inquiry and debate within the organizations that produced the Uniform Trade Secrets Act and the Restatement (Third) of the Law of Unfair Competition. External review is equally begged when federal court decisions that are factually and constitutionally limited in their application to the transfer of nonexclusive patent and copyright licenses are represented to compel state contract law to restrict or prohibit transfer of contract rights in copies of software and information.

Spotting and addressing differences between Article 2B and other contract law is made difficult because of differences between the subject matter, transactions, and language of Article 2B and its antecedents. A compounding difficulty is that Article 2B has been a moving target, a lengthy and complex document that has gone through a minimum of eight drafts and considered at more than one dozen Drafting Committee meetings since January 1996. Focusing on why a provision states a particular rule has been compounded by frequent shifts in offered rationales. For example, the anti-transfer rules have been presented as prescribed by federal patent and copyright law, later explained in terms of federal law con-

ference of Commissioners on Uniform State Laws by the Business Software Alliance, Software Publishers Association, and Information Industry Association. The memorandum is available on the 2B Guide at <<http://www.2BGuide.com/docs/amemo981.html>> (visited Nov. 5, 1998).

straining choice of a rule more favorable to licensees and third parties, and still later presented—albeit wrongly—as modeled on other U.C.C. rules and consistent with the federal law which no longer is claimed to be prescriptive. Most remarkable is that outcomes tend to remain very much the same, even after a vote to remove a rule. Publisher-favoring rules whose ostensible legal foundations are questioned tend to survive, sometimes moved elsewhere and, more generally, accompanied by a different supporting explanation.

It is not just instrumental misuse of legal principles, precedent and reasoning that commands attention. Propounding rules directed to limiting contractual choice and freedom of those who, in this information age, contribute to expansion of the information sector by their productive use of software and information products, invites challenge. Rules that impose substantial new transaction costs on other business transactions, and loss of value on businesses and individuals, in order to secure protection against competition and maximum returns for publishers ought to be debated on their merits. One cannot fault publisher-licensors for seeking such gains through new contract 2B rules. It would be surprising if they did not do so. This does not answer whether it is wise for the projects' sponsoring organizations and state legislatures to satisfy that quest. The author trusts that, in this, the membership of the sponsoring organizations will indeed stand tall—and, if necessary, tinker—above the fray.

