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COMMENT

THE PERPETUATION OF LITIGATION WITHIN THE COMMERCIAL INDUSTRY: SOON BROUGHT TO A SCREECHING HALT

We exist in an information era driven by electronics and characterized by the ever-increasing ability of computational machines to process, create and manipulate information.¹

I. INTRODUCTION

Prior to the drafting of Article 2B of the Uniform Commercial Code ("U.C.C."), courts applied Article 2: Sales, by analogy, to transactions that involved licensing of software agreements.² The courts used the "predominant feature test" to reach these decisions.³ This resulted in

1. Raymond T. Nimmer, *Electronic Contracting: Legal Issues*, 14 J. MARSHALL J. COMPUTER & INFO. L. 211, 211 (1996).

2. See generally *Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991) (disputing over whether computer software is a good within the meaning of the Pennsylvania version of the U.C.C.); *Harford Mutual Ins. Co. v. Seibels, Bruce and Co.*, 579 F. Supp. 135 (D. Md. 1984) (concerning whether a licensing of software agreement was subject to the statute of limitations under the U.C.C. or state common law); *Colonial Life Ins. Co. of Am. v. Elec. Data Sys. Corp.*, 817 F. Supp. 235 (D.N.H. 1993) (disputing over whether Article 2 of the U.C.C. applied to a data processing service contract); *Design Data Corp. v. Maryland Cas. Co.*, 503 N.W.2d 552 (Neb. 1993) (concerning the application of the U.C.C. to a computer equipment agreement); *USM v. First State Ins. Co.*, 641 N.E.2d 115 (Mass. App. Ct. 1994) (concerning whether a computer turnkey system was subject to the restrictions of the U.C.C.).

3. *Epstein v. Giannattasio*, 197 A.2d 342, 346 (Conn. C.P. 1963). See also *Perlmutter v. Beth David Hosp.*, 123 N.E.2d 792, 794 (N.Y. 1954). This test dictates that "when service predominates, and transfer of personal property is but an incidental feature of the transaction, the transaction is not deemed a sale" under the U.C.C. and is therefore, governed by contract law. *Id.* Conversely, where "services" are incidental to the sale of goods, the transaction is deemed a sale of "goods" and is therefore, governed by the U.C.C. *Bonebrake v. Cox*, 499 F.2d 951, 960 (8th Cir. 1974). For an alternative approach, see Edward G. Durney, *The Warranty of Merchantability and Computer Software Contracts: A Square Peg Won't Fit In A Round Hole*, 59 WASH. L. REV. 511, 528-30 (1984). This author concluded that the utilization of preexisting legal theories would resolve the issue of which law to

varying decisions among the states which is contrary to the need for uniformity within the software industry.

Pursuant to Article 2B, a license is a "contract that expressly authorizes, prohibits or controls access to or use of information, limits the scope of the rights granted, or affirmatively grants less than all rights in the information, whether or not the contract transfers title to a copy of the information and whether or not the rights granted are made exclusive to the licensee."⁴ A sale, on the other hand, is an exchange of goods, which consists of the passing of title⁵ from the seller to the buyer for a price certain. As can be seen from the very definition of each of these words, the two differ greatly. However, because the law governing licensing of software agreements is scarce, the courts were forced to use what was available.

Distinguishing a license from a sale is critical in light of the intentions of the inventors of the software. Inventors of software desire to retain the power to control the distribution of their software, and favor granting a license, as opposed to making a sale.⁶ Despite this, the need

apply to software transactions. *Id.* For example, tort theories such as professional negligence where liability is imposed where the professionals have not exercised "reasonable care or the measure of skill and knowledge ordinarily possessed by members in good standing of his profession." *Id.* The author also suggested the use of contract theories such as implied warranties of fitness for a particular purpose and express warranties to resolve disputes concerning software transactions. *Id.* The author argued that contract theories can be applied by analogy to software transactions because an express warranty is inherent in all transactions due to its underlying policy, which is similar to a warranty of fitness "to prevent conduct bordering on the deceptive and the fraudulent." *Id.*

4. U.C.C. § 2B-102(25) (Proposed Draft, Sept. 25, 1997). Licensee means a "transferee or any other person designated in, or authorized to exercise rights as a licensee in a contract under this article, whether or not the contract constitutes a license." *Id.* at § 2B-102(26) (Proposed Draft, Sept. 25, 1997). Licensor means a "transferor in a contract under this article, whether or not the contract constitutes a license. The term includes a provider of services. In an access contract, as between a provider of services and a customer, the provider of services is the licensor, and as between the provider of services and a provider of content for the service, the content provider is the licensor. If performance consists in whole or in part of an exchange information, each party is a licensor with respect to the information it provides." *Id.* at § 2B-102(27) (Proposed Draft, Sept. 25, 1997).

5. U.C.C. § 2-401(1) (1997). Passage of title:

Title to goods cannot pass under a contract for sale prior to their identification to the contract (Section 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to the goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

Id.

6. See Durney, *supra* note 3, at 520.

to relate to the "modern information economy" is crucial.⁷

This Comment proposes that Article 2B is precisely what the commercial industry needed, in light of the great influence that the commercial industry has on the economy, and in light of the rapid growth of information technology. Part I of this Comment illustrates the need for Article 2B within the commercial industry. Part II examines the scope of Article 2B and Article 2. Part III analyzes the distinction between the remedies afforded under Article 2B and those afforded under a sales transaction. Finally, this Comment concludes that Article 2B reflects the need for a license-sale distinction by providing remedies that are distinct from the remedies afforded under Article 2.

II. BACKGROUND

One of the purposes of the U.C.C. is to "simplify, clarify, and modernize the law governing commercial transactions."⁸ Furthermore, the U.C.C. attempts to extricate the various facets of a commercial transaction⁹—from a contract for a sale to the acceptance of some form of secur-

7. Raymond T. Nimmer, *U.C.C. Revision: Information Age In Contracts*, 17th ANNUAL INSTITUTE ON COMPUTER LAW 377, (1997).

8. U.C.C. § 1-102(2). In addition, the purpose of the U.C.C. is: "(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; (c) to make uniform the law among the various jurisdictions." *Id.* The Official Comment to § 1-102 reads:

This Act is drawn to provide flexibility so that, since it is intended to be a semipermanent piece of legislation, it will provided its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

Id.

9. U.C.C. General Comment of National Conference of Commissioners on Uniform State Laws and the American Law Institute (1997), *available in* SELECTED COMMERCIAL STATUTES 19 (West 1997).

A single transaction may very well involve a contract for sale, followed by a sale, the giving of a check or draft for a part of the purchase price, and the acceptance of some form of security for the balance.

The check or draft may be negotiated and will ultimately pass through one or more banks for collection.

If the goods are shipped or stored the subject matter of the sale may be covered by a bill of lading or warehouse receipt or both.

Or it may be that the entire transaction was made pursuant to a letter of credit either domestic or foreign.

Obviously, every phase of commerce involved is but a part of one transaction, namely, the sale of and payment for goods.

Id.

ity for the balance due on the purchase price.¹⁰ Pursuant to this purpose and the varying transactions that the U.C.C. attempts to govern, most

10. See *supra* note 9 and accompanying text. In addition, the U.C.C. encompasses five basic principles. First, there is the principle of liberal construction, which states that the U.C.C. is to be liberally construed and applied so as to promote the underlying purposes and policies of the U.C.C. U.C.C. § 1-102(1). This principle functions as a reminder to the courts that they should not narrowly construe the Code. ANN LOUSIN, COURSE MATERIALS ON SALES TRANSACTIONS 16 (11th ed. 1997).

Second, there is the principle of freedom of contract, which states that: "(3) [t]he effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable. (4) The presence in certain provisions of this Act of the words 'unless otherwise agreed' or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3)." U.C.C. § 1-102(3) & (4). This principle allows for a considerable amount of variation by agreement. *Id.* The freedom of contract principle establishes the "liberal free enterprise principle that the parties ought to be able to write their own agreement unhampered by legislative restrictions as far as possible." *Id.*

Third, there is the supplementary principles of law, which states that: "[u]nless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." U.C.C. § 1-103. With the use of this principle courts are allowed to use pre-code contract law and equity to explain a Code provision, provided that the Code has not overruled it. LOUSIN, *supra* at 17. See generally *Manchester Pipeline Corp. v. Peoples Natural Gas Co.*, 862 F.2d 1439 (10th Cir. 1988) (holding that a buyer was equitably estopped from denying the existence of a contract where he induced the seller to believe that he would buy the gas for which they had started negotiations).

Fourth, there is the principle of commercial reasonableness, which requires an exercising of the standard of due care. LOUSIN, *supra* at 18. Lousin also noted that although, commercial reasonableness is not defined, "one could extrapolate a constructive definition from an analysis of the situations in which it is used." *Id.*

Finally, there is the inherent principle of good faith. U.C.C. § 1-203. This principle mandates that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." *Id.* Good faith is defined as "honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19). Furthermore, the status of the contracting parties dictates the standard of good faith that each party is held to. For example, a merchant is:

[A] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

U.C.C. § 2-104.

If a party to a contract is a merchant, then that party is held to a good faith standard that requires that the merchant acts with honesty in fact and "the observance of reasonable commercial standards of fair dealing in the trade. U.C.C. § 2-103(1)(b). Thus, the good faith standard of a merchant is different from that of a non-merchant.

states have adopted the U.C.C. as the dominating law in the commercial industry to the extent that related state statutes are secondary.¹¹

A. THE SCOPE OF ARTICLE 2

Article 2 is limited to "transactions in goods."¹² Goods are "all things (including specially manufactured goods) which are movable at the time of identification of the contract for sale."¹³ Thus, in order for a contract to be governed by Article 2, the goods must be movable, and mobility must occur once the goods are "identified to the contract."

Despite this, some courts have held that bailments and leases fall within the realm of Article 2 by analogy.¹⁴ While other courts have ap-

11. LOUSIN, *supra* note 11, at 6. However, New York did not adopt Article 5—Letters of Credit and Louisiana has adopted all of the Code, with the exception of Article 2. *Id.* Louisiana did not adopt Article 2 because their sales law is quite similar to Article 2, thus they found no need. *Id.*

12. U.C.C. § 2-102. *But see* Note, *Disengaging Sales Law From The Sale Construct: A Proposal to Extend The Scope Of Article 2 Of The U.C.C.*, 96 HARV. L. REV. 470, 471 (1982) (advocating the extension of the scope of Article 2 because of the difficulty in adherence to the sale construct.) *See also* Skelton v. Druid City Hosp. Bd., 459 So.2d 818, 820 (Ala. 1984) (noting that Article 2 applies to transactions in goods, which is broader than the sale of goods); Wells v. 10-X Mfg. Co., 609 F.2d 248, 254 n.3 (6th Cir. 1979) (finding that the use of the term transaction rather than sale in § 2-102 is significant because it indicates that Article 2 reaches beyond those transactions where there is a transfer of title); *In re Beck*, 25 B.R. 947, 951 (N.D. Ohio 1982) (holding that Article 2 applies to transactions in goods unless the context requires otherwise).

13. U.C.C. § 2-105(1). Goods are "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than money in which the price is to be paid, investment securities (Article 8) and things in action." *Id.* Goods also includes the "unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107)." *Id.* "Goods must be both existing and identified before any interest in them can pass." § 2-105(2). However, goods that are not both "existing and identified are 'future' goods." *Id.* A purported present sale of future goods or of any interest therein operates as a contract to sell." *Id.*

See, e.g., Foster v. Colorado Radio Corp., 381 F.2d 222, 225 (10th Cir. 1967) (making a distinction between the res, which is a good and goodwill, personal property licenses, and accounts receivable which are non-goods); Miller v. Belk, 207 S.E.2d 792, 795 (N.C. Ct. App. 1974) (concluding that goodwill and real property are non-goods, but a sale of a laundry is a sale of goods); Zamore v. Whitten, 395 A.2d 435, 441-43 (Me. 1978) (concluding that stocks are goods because a certificate is a movable and tangible piece of paper recognized as an exchangeable item of commerce); Tomb v. Lavalle, 444 A.2d 666, 667-68 (Pa. Super. Ct. 1981) (holding that a liquor license, which is a general intangible, is not a good under the U.C.C.); Peterson v. Wildcat Mountain Management Corp., 34 U.C.C. Rep. Serv. 1127, 1133 (D.R.I. 1982) (concluding that the sale of a ski lift ticket is the sale of a non-good).

14. *See, e.g.,* Mieske v. Bartell Drug Co., 593 P.2d 1308, 1311 (Wash. 1979) (holding that Article 2 applied to a bailment where photographic film that was to be processed was destroyed). *But see, e.g.,* Collins v. Click Camera and Video Inc., 621 N.E.2d 1294, 1298 (Ohio Ct. App. 1993) (holding that Article 2 did not apply to a bailment where the plaintiff's film was to be developed by the defendant); Mason v. General Motors Corp., 490 N.E.2d

plied Article 2 hybrid contracts,¹⁵ where, for example, software is sold in conjunction with computer hardware.¹⁶ In reaching these conclusions, many courts have turned to the predominant feature test (PFT).¹⁷

1. *The Predominant Feature Test*

PFT is used when disputes arise in hybrid contracts for both the sale of goods and services. This test consists of four factors: (1) the terms describing the performance and the relationship of the parties; (2) the circumstances and the primary reason the parties entered into the contract; (3) the final product the purchaser bargained for and whether that product may be described as a good or a service; and (4) the costs involved for the goods and services and the charge to the purchaser for the

437, 441 (Mass. 1986) (holding that Article 2 was applicable to a bailment transaction arising from a car dealer lending a customer an automobile for a test drive). *See also*, Hertz Commercial Leasing Corp. v. Transp. Credit Clearing House, 298 N.Y.S.2d 392, 396 (N.Y. Civ. Ct. 1969) (holding that Article 2 applied to an equipment lease by analogy), *rev'd* on other grounds, 316 N.Y.S.2d 585 (N.Y. App. Div. 1970); Owens v. Patent Scaffolding Co., 376 N.Y.S.2d 948, 949 (N.Y. App. Div. 1974) (holding that Article 2 was applicable to lease even though it was not analogous to a sale); Capital Ass., Inc. v. Hudgens, 455 So.2d 651, 654 (Fla. Dist. Ct. App. 1984) (holding that an equipment lease that gave lessee no right to purchase or acquire title to equipment was within purview of Article 2 although Article 2 does not cover leases). *But see* OJ & C Co. v. General Hosp. Leasing, 578 S.W.2d 877, 878 (Tex. App. 1979) (holding that Article 2 was not applicable to computer lease since Article 2 is expressly limited to sales); Westmont Tractor Co. v. Viking Exploration, Inc., 543 F. Supp. 1314, 1317 n.3 (D. Mont. 1982) (holding that a lease of business equipment that gave lessee an option to purchase at the end of lease was the equivalent of a sale under Article 2 of U.C.C.); *Skelton*, 459 So.2d at 820-21 (holding that Article 2 applied to a lease despite conclusion that there was not a sale involved).

15. *Kirkpatrick v. Introspect Healthcare Corp.*, 845 P.2d 800, 803 (N.M. 1992). Hybrid contracts are contracts that involve both the sale of goods and services. *Id.* Hybrid contracts are also called mixed contracts, as in *Kirkpatrick*. *Id.*

16. *See, e.g.*, *Colonial Life Ins. Co. of Am. V. Elec. Data Sys. Corp.*, 817 F. Supp. 235 (D.N.H. 1993) (holding that where the principal object of the contract was to provide for a license to use computer software, Article 2 of U.C.C. applies); *Design Data Corp. v. Maryland Cas. Co.*, 503 N.W.2d 552 (Neb. 1993) (holding that where hardware and software sold as a bundled unit, the sale of goods—the hardware—was the predominant feature in the transaction, therefore, the transaction was governed by the U.C.C.); *Pentagram Software Corp. v. Voicetek Corp.*, 22 U.C.C. Rep. Serv. 2d 646 (Mass. 1993) (holding that a turnkey computer system constituted a good, thus, the contract for the system was governed by the U.C.C.); *USM v. First State Ins. Co.*, 641 N.E.2d 115 (Mass. App. Ct. 1994) (holding that a turnkey system is a combination of both hardware and software, and is therefore, subject to the U.C.C.).

17. *Insul-Mark Midwest Inc. v. Modern Materials, Inc.*, 612 N.E.2d 550, 554 (Ind. 1993) (rejecting a “bifurcation” approach and adopted the “predominant thrust” approach); *Kirkpatrick*, 845 P.2d at 804 (noting that the “predominant feature” test is still the majority approach). The “predominant feature” test is sometimes called the “predominant purpose,” the “primary purpose,” the “primary thrust,” the “predominant factor,” or the “predominant thrust” test. *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974).

selected goods or service.¹⁸

Accordingly, if the sale of services predominates the contract, and the sale of goods is incidental to the contract agreement, then the contract is for the sale of services and is, therefore, governed by the common law of that state.¹⁹ If, however, the sale of goods predominates the contract and the sale of services is incidental to the contract agreement, then the contract is for the sale of goods and is, therefore, governed by the U.C.C.²⁰

2. *PFT in Action*

In *Insul-Mark Midwest, Inc., v. Modern Materials, Inc.*,²¹ the Supreme Court of Indiana held that the contract was for the sale of services where Insul-Mark sent roofing fasteners to Modern Materials for application of fluorocarbon coating to increase the rust-resistance of its screws.²² The court concluded that the "specifications regarding rust-resistance related to the quality of the screws after application of a fluorocarbon coating material, and not to the quality of the coating material itself."²³ Thus, the court concluded that the contract was one for the sale of services.²⁴

Conversely, in *St. Anne-Nackawic Pulp Co. v. Research-Cottrell, Inc.*,²⁵ a New York District Court held that the predominant feature in a transaction for the sale of a pollution control system was for the system itself and not for air-cleaning services.²⁶ In so holding, the court reasoned that any services rendered were incidental to the primary purpose of the transaction which was to acquire the system.²⁷ In light of this

18. *Insul-Mark*, 612 N.E.2d at 555.

19. *Zeno Buick-GMC, Inc. v. GMC Truck and Coach*, 844 F. Supp. 1340, 1348 (E.D. Ark. 1992).

20. *St. Anne-Nackawic Pulp Co. v. Research-Cottrell, Inc.*, 788 F. Supp. 729, 734 (S.D.N.Y. 1992).

21. 612 N.E.2d at 554.

22. *Id.*

23. *Id.* The court applied the four factors of the "predominant feature" test and reasoned that: (1) the president of Insul-mark stated, "I had a service that I needed to be performed on my product, and we mutually agreed . . . Modern Materials could do the service for me.;" (2) the main purpose for entering into the transaction was to improve the rust resistance of the screws; (3) the record indicated that Insul-Mark was more concerned with the finished, rust-proof screws, than with the material used to cover the screws and (4) Insul-Mark was charged by the pounds of screws covered and not the gallons of coating used. Therefore, if the material itself was the predominant feature, Insul-Mark would have paid the price for the gallons used. *Id.* at 555-56.

24. *Insul-Mark*, 612 N.E.2d at 555-56.

25. 788 F. Supp. 729 (S.D.N.Y. 1992).

26. *Id.* at 733.

27. *Id.* at 734. The court reasoned that: (1) the title, "Proposal for the Supply and Installation of a Teller Crossflow Nucleation Scrubber and Roy-Lin Venturi with expansion

fact, a contract that involves a sale and the predominant feature of that transaction was the sale of the goods, the contract is governed by Article 2 of the U.C.C.²⁸

B. SCOPE OF ARTICLE 2B

Article 2B applies to licenses of information and software contracts.²⁹ Article 2B also applies to "any agreement related to a license or software contract in which a party is to provide support for, maintain, or modify information."³⁰ Because this article covers licensed "information," it encompasses much more than software.³¹

According to Section 2B-102(22), "information" means "data, text, images, sounds, computer programs, databases, literary works, motion pictures, mask works, or the like, and any intellectual property or other rights in information." For example, multimedia products such as the text that is retrieved after accessing a Westlaw search program is within this definition.³² Moreover, this definition is intended to cover materials whose ordinary use communicates knowledge to a human or an organization.³³

1. *Hybrid Contracts Under 2B*

Pursuant to Article 2B, where a contract involves both information and goods, Article 2B applies to the information and to the physical medium containing the information, that is, its packaging and documentation.³⁴ However, Article 2 or 2A applies where standards of performance of goods other than the physical medium containing the information, packaging, or documentation pertaining to the information.³⁵ If a transaction includes information covered by Article 2B, and services outside of the scope of Article 2B or transaction expressly excluded from this article, Article 2B only pertains to the information aspect of the

Joint and Supply only of Hydroclones . . ." indicated that the plaintiff was acquiring a pollution control system; (2) the contract showed that the parties contemplated that the defendant would start-up the system and plaintiff would operate it, without the assistance of the defendant; and (3) sixty-four percent of total contract price was for equipment. *Id.* Thus, the contract was one for the sale of goods. *Id.*

28. *Id.* at 734.

29. See U.C.C. § 2B-103 (Proposed Draft, Sept. 25, 1997).

30. U.C.C. § 2B-103(a).

31. Holly Keesling Towle, *Licensing and the Uniform Commercial Code*, 454 *PLI/PAT* 353, 357 (1996).

32. U.C.C. § 2B-102 Cmt. 15 (Proposed Draft, Sept. 25, 1997).

33. *Id.* As another example, consider the images contained on a CD-ROM along with a program which allows display of those images, the program is not information content, but the images are. *Id.*

34. U.C.C. § 2B-103(c) (Proposed Draft, Sept. 25, 1997).

35. *Id.*

transaction.³⁶

2. *Transactions Beyond the Scope of 2B*

Since Article 2B governs numerous transactions that were historically covered by common law, various exclusions have been specified by the Article's exclusionary provisions. For example, a contract for employment of one that is not an independent contractor; contracts for performance of entertainment services by an individual or group; and contracts for performances of professional services by members of regulated professions, are all beyond the scope of 2B.³⁷ Moreover, licenses of trademarks, trade names, trade dress or patents, and sales or leases of a copy of computer programs not specifically developed for a certain transactions are also beyond the scope of 2B.³⁸

III. ANALYSIS

This Comment proceeds by examining Article 2: Sales as the law that governed licensing of software contracts prior to Article 2B. Then an analysis of the remedies of Article 2 and Article 2B, and the benefits conferred upon the interested parties as a result of the necessary distinction is discussed. Ultimately, this Comment will conclude by proposing that the license-sale distinction was long over due.

A. THE FAILURE TO MAKE THE LICENSE-SALE DISTINCTION

Recognizing the need for a distinction between a license and a sale is of great significance in light of the rapid growth and change of technology. Historically, this distinction was nonexistent. Consequently, the

36. *Id.* The Comment to this section notes that, for transactions governed by the trio of U.C.C. transactional articles (2, 2A and 2B), the primary rule applies to its particular subject matter. U.C.C. § 2B-103 Cmt. 4 (Proposed Draft, Sept. 25, 1997). This is the "gravamen of the action" test. *Id.* Ironically, this section rejects the PFT, which was the major tool that courts have historically used to apply Article 2 to hybrid contracts, by analogy. *Kirkpatrick v. Introspect Healthcare Corp.*, 845 P. 2d 800, 804 (N.M. 1992).

37. U.C.C. § 2B-103(d)(1) (Proposed Draft, Sept. 25, 1997). Furthermore, the entertainment services exclusion "covers both direct contracts with individuals and the various structures under which a party hires services of an individual or group through a loan contract with a legal entity with whom the individual or group is employed." See U.C.C. § 2B-103 Cmt. 5a (Proposed Draft, Sept. 25, 1997). In addition, the exclusion of professional services only pertains to regulated services, not other contracts or services. *Id.*

38. U.C.C. § 2B-103(d)(2) & (d)(3) (Proposed Draft, Sept. 25, 1997). The rationale behind the (d)(2) exclusion lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. U.C.C. § 2B-103 Cmt. 5b (Proposed Draft, Sept. 25, 1997). Patent licensing relating to biotech, mechanical, and other industries entails varying assumptions and practices that were not contemplated by this draft. *Id.* The same holds true for trademark licensing. *Id.* Also, the (d)(3) exclusion excludes software programs like airplane navigation or operation software. *Id.*

creators of software have suffered irreplaceable losses. However, with the advent of Article 2B, these losses will be no more.

1. *Elements of a License*

A license³⁹ consists of a limited or conditional grant from the licensor⁴⁰ to the licensee,⁴¹ who obtains "a privilege or right to exercise rights in information or to access a facility or system the transfer controls."⁴² A license also gives the licensee the ability to exercise those rights.⁴³

The grant here involves using, copying, modifying, displaying, disclosing, performing, and accessing the use of the intangible by the licensee.⁴⁴ Per the license, the licensee is also allowed to communicate know how to staff, convey a diskette copy of the software, provide an access code for a remote database, furnish access to the master copy of a motion picture, give forth specifications and designs, etc.⁴⁵ Thus, evidencing the fact that the licensee's rights to and in the software are limited principally by the fact that a license was granted.

Hence, the licensee acquires the right to the copy of the information, and not the information itself. Accordingly, the licensee does not acquire the rights of making more than a backup copy, making non-essential modifications, publicly performing or displaying the work, distributing

39. U.C.C. § 2B-102(25) (Proposed Draft, Sept. 25, 1997). A license is:

[A] contract that expressly authorizes, prohibits, or controls access to or use of information, limits the scope of the rights granted, or affirmatively grants less than all rights in the information, whether or not the contract transfers title to a copy of the information and whether or not the rights granted are made exclusive to the licensee. The term includes an access contract and a consignment of copies of information. The term does not include a contract that assigns ownership of intellectual property rights, that reserves or creates a financier's interest, or a transfer by will or operation of law.

Id.

40. U.C.C. § 2B-102(27) (Proposed Draft, Sept. 25, 1997). "Licensor" means:

[A] transferor in a contract under this contract under this article, whether or not the contract constitutes a license. The term includes a provider of services. In an access contract, as between a provider of services and a customer, the provider of services is the licensor, and as between the provider of services and a provider of content for the service, the content provider is the licensor. If the performance consists in whole or in part of an exchange of information, each party is a licensor with respect to the information it provides.

Id.

41. U.C.C. § 2B-102(26) (Proposed Draft, Sept. 25, 1997). "Licensee" means:

[A] transferee or any other person designated in, or authorized to exercise rights as a licensee in a contract under this article, whether or not the contract constitutes a license.

Id.

42. Nimmer, *supra* note 7, at 390.

43. *Id.*

44. *Id.*

45. *Id.*

copies, or renting the copy that the licensee possesses.⁴⁶ Moreover, federal law prohibits the licensee from obtaining any rights to or in the copy where the licensee does not own the copy expressly or impliedly, vis a vis the terms of the contract.⁴⁷

2. *Hub of the Deal*

Software is a computer program that embodies the thoughts of the computer programmer.⁴⁸ When a licensee purchases software, the most important aspect of that transaction is the acquisition of the thoughts that have been transposed onto the diskette. For without these thoughts the diskette is useless to the purchaser.⁴⁹ Thus, the licensee is seeking to obtain the thoughts, not the disk.

Moreover, the diskette that the information is transposed onto generally costs less than ten dollars.⁵⁰ While the program that the copy contains may have more than one million dollars worth of commercial value to each user.⁵¹ In light of all of this, the licensor is seeking to retain control over the use of the software by granting a license, as opposed to selling the software. Thus, the hub of the deal for the licensor is to retain control of the software, not to relinquish control.

3. *License v. Sale—Definitions*

The commercial setting of a sale differs greatly from that of a license.⁵² Licenses restrict and impede the sale of commerce, while sales allow goods to flow freely and unimpeded in the commerce industry.⁵³ A sale is defined as “the passing of title from the seller to the buyer for a price.”⁵⁴ This passage of title confers upon the buyer all of the bundle of

46. *Id.*

47. *Id.* at 390. See also U.C.C. § 2B-102 Cmt. 16 (Proposed Draft, Sept. 25, 1997) (stating that in the instance of a license it is of no consequence as to whether or not ownership has transferred from the licensor to the licensee, the licensee remains subject to restrictions or grants provided within the contract).

48. Wharton Management Group v. Sigma Consultants Inc., No. C.A. 89C-JA-165, 1990 WL 18360, *1, *3 (Del. Super. Ct. Jan. 29, 1990), *aff'd*, 582 A.2d 936 (Del. Sept. 19, 1990).

49. *Id.*

50. Boona Lynn Horovitz, *Computer Software As A Good Under The Uniform Commercial Code: Taking A Byte Out Of The Intangibility Myth*, 65 B.U. L. REV. 129, 133 n.27 (1985).

51. Nimmer, *supra* note 7, at 390.

52. See Durney, *supra* note 3, at 520.

53. *Id.*

54. U.C.C. § 2-106 (1997). Various sections of Article 2 limits its application to a sale. For example, U.C.C. § 2-313 Express warranties: “(1) Express warranties by the seller are created as follows: (a) any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise. . . .” U.C.C. § 2-313.

rights that flows with a transferable piece of property. With a license, on the other hand, the only right conferred upon the licensee is the right to the copy.⁵⁵

4. *Software as an Intangible Service v. Software as a Tangible Good*

Due to the scarcity of law governing a licensing of software contract, court decisions pertaining to the tangible and intangible nature of software has varied. For example, in *Wharton Management Group v. Sigma Consultants Inc.*,⁵⁶ the Superior Court of Delaware held that a contract for customized computer software constituted a service contract.⁵⁷ The court reasoned that the primary purpose of the contract was for the skill and knowledge of the programmer, not the diskette that

In addition, there is § 2-314 Implied warranty: Merchantability; Usage of trade: "(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind" U.C.C. § 2-314. Also, there is U.C.C. § 2-315 Implied warranty: Fitness for a Particular Purpose: "Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment" U.C.C. § 2-315.

55. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). In this case, ProCD, the plaintiff, compiled more than 3,000 telephone directories unto a computer database. *Id.* at 1449. ProCD sells a version of the database as SelectPhone on CD-ROM discs. *Id.* This program, which is copyrighted, searches the database in response to the user's criteria. *Id.* The resulting list can be manipulated by other software. *Id.* ProCD shrinkwrapped the CD with a license agreement, which, in sum, stated that if the user breaks the seal of the shrinkwrap, that user is agreeing to the terms of the license contained therein. *Id.* at 1448-49. Upon installation of the software one of the screens before actual installation, set out the terms of the license once again. *Id.* at 1450. Defendant, Zeidenberg, purchased a consumer package, but then decided to ignore the license agreements. *Id.* He, then, developed a corporation to resell the information in the SelectPhone database. *Id.* The corporation made the information available on the Internet to anyone who was willing to pay its, which was lower than ProCD, of course. *Id.* ProCD discovered this and commenced an action against Zeidenberg for an injunction against further dissemination of ProCD's software. *Id.*

Judge Easterbrook, of the seventh circuit, reversed the district court by holding that pursuant to the U.C.C. shrinkwrap licenses in mass-market consumer transactions are enforceable "unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable). *Id.* at 1449. In so holding, the court reasoned that Zeidenberg had notice of the license and had ample opportunity to reject the license prior to accepting ProCD's product. *Id.* at 1452-53. Thus, Zeidenberg was in violation of the license between himself and ProCD. *Id.* at 1455. See also Joseph C. Wang, *ProCD V. Zeidenberg & Article 2B: Enforcement of Shrink-Wrap Licenses Has Been Validated*, 16 J.MARSHALL J.COMPUTER & INFO. L. (forthcoming 1997).

56. *Wharton Management Group v. Sigma Consultants Inc.*, No. C.A. 89C-JA-165, 1990 WL 18360, *1, *3 (Del. Super. Ct. Jan. 29, 1990), *aff'd*, 582 A.2d 963 (Del. Sept. 19, 1990).

57. *Id.*

stored the software.⁵⁸ Thus, the court held that the contract was one for services, not goods.

In contrast, in *Design Data Corp. v. Maryland Cas. Co.*,⁵⁹ the Supreme Court of Nebraska held that the primary reason the parties entered into the agreement⁶⁰ was to acquire the hardware and software, which was sold as a bundled unit.⁶¹ The court concluded that the agreement was not for the installation of the hardware, nor was the agreement for any other "peripheral items, and therefore, was one for the sale of goods."⁶²

The non-uniformity among the various jurisdictions is inconsistent with the very nature of the U.C.C. To remedy this, Article 2B was developed.

B. THE LONG-AWAITED ANSWER

1. *The Goal and The Purpose of Article 2B*

The goal of Article 2B is to foster and support the expansion of the information industry within the commercial industry,⁶³ while, according to Professor Nimmer,⁶⁴ the purpose of Article 2B is to represent an "effort to develop transactional law relating to the modern information economy and the increasingly important use of digital technology as a commercial focal point of commerce."⁶⁵ Thus, as an intricate part of the economy,⁶⁶ uniformity in this area is a must.

Today, businesses are concentrated in a multi-faceted industry with common concerns. This concentration goes well beyond the sector of the

58. *Id.* See also *Geotech Energy Corp. v. Gulf States Telecommunications & Information Sys., Inc.*, 788 S.W.2d 386 (Tex. Ct. App. 1990). Here, the court held that a contract for the installation of a used telephone system was one for services, not goods. *Id.* at 389. In so holding, the court reasoned that the telephone services were an essential part of the installation of the telephone equipment (the hardware), because without the services the hardware alone would be useless to the buyer. *Id.* Furthermore, the service of writing the software was the essential aspect of the agreement which made the telephone system operable. *Id.*

59. 503 N.W.2d 552 (Neb. 1993).

60. *Id.* at 556. The agreement, based on testimonial evidence, stated that the purchase was for a complete system—the hardware and the software; a license to use the software; a three-day training seminar; and installation of the hardware and the software. *Id.*

61. *Id.* at 557-58.

62. *Id.*

63. Nimmer, *supra* note 7, at 396.

64. Raymond T. Nimmer, the Reporter of Article 2B, is the Leonard Childs Professor of Law at the University of Houston Law Center.

65. Nimmer, *supra* note 7, at 379.

66. See U.C.C. Article 2B (Proposed Draft, Sept. 25, 1997). Information technologies account for over six percent of the GNP. *Id.* With the addition of other industries, the economic contribution of information technologies continues to swell to a large part of the economy. *Id.*

economy that manufactures goods.⁶⁷ Therefore, upon completion of Article 2B, a framework will be established for the contractual relationships that are at the forefront of this, the information era.

2. *Distinction Between the Remedies of 2 and 2B*

The remedies of Article 2B reflect the elusive and intangible nature of software.⁶⁸ This is in contrast to Article 2, which focuses on the handling of tangible, identifiable goods. The licensor's remedies ruminates the principle that an "infinite number of transfers of rights can be made from the same copyright or patented software."⁶⁹ Whereas the licensee's remedies focus on any effects that a breach of contract has on the licensee's purpose of entering into the license agreement.⁷⁰

Unlike in sales, a licensor may be damaged beyond that of the contract price. Thus Article 2B, per the old common law rule, gives the licensor the right to consequential damages.⁷¹ The remedies of Article 2B allows flexibility in defining the remedies of a contract.⁷² However, absent an agreement, two distinctions are made: (1) a distinction between a material breach and a non-material breach; and (2) a distinction between default with respect to a certain aspect of the contract and default with respect to the entire contract.⁷³

67. See U.C.C. Article 2B (Proposed Draft, Sept. 25, 1997). For instance, today, motion pictures, books, films and records are digitally developed and presented. *Id.* One example is the animated motion picture, *Toy Story*, which was a lengthy computer program that was very successful at the box office. *Id.*

68. Nimmer, *supra* note 7, at 433.

69. See U.C.C. Article 2B (Proposed Draft, Sept. 25, 1997).

70. *Id.*

71. Nimmer, *supra* note 7, at 434. See, e.g., U.C.C. § 2B-703(d) (Proposed Draft, Sept. 25, 1997). Consequential damages and incidental damages may be excluded or limited by agreement unless the exclusion or limitation is unconscionable. *Id.* A conspicuous term enforceable under this section is not subject to invalidation under U.C.C. § 2B-308(b). *Id.*

72. See, e.g., U.C.C. § 2B-701, Remedies In General (Proposed Draft, Sept. 25, 1997):

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury.

(b) Unless the contract contains a term liquidating damages, a court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) If a party is in breach of contract, whether or not material, the other party has the rights and remedies provided in the agreement and this article, but the aggrieved party must continue to comply with contractual use restrictions. Unless the contract so provides, the party also has the rights and remedies available to it under the law.

Id.

73. Nimmer, *supra* note 7, at 434.

a. General Remedies

Section 2B-706 adopts the answerable rules of Article 2, Section 2-607. However, it differs in that, under Section 2B-706, with respect to intellectual property rights, where the issue revolves around a non-exclusive license or an obligation to the license, the licensor's interest in protecting against infringement is dominant.⁷⁴ This section allows the party to assert a right to control the case.⁷⁵ Moreover, unlike Article 2, this section illustrates that indemnity provisions and answer over obligations applies to both the licensor and the licensee, in information contracts.⁷⁶

b. Damages

In licensing contracts, reliance on formula-driven damage computation is often inappropriate. This is due to the fact that a breach does not always entail defects or failures to pay.⁷⁷ Consequently, the damages provided in Article 2B allow the court to resort to general, common sense for calculating damages.⁷⁸ Furthermore, these sections allow a court to consider cost savings and alternative transactions made by the breach.⁷⁹

74. See U.C.C. § 2B-706, Reporter's Note 1 (Proposed Draft, Sept. 25, 1997).

75. *Id.*

76. *Id.* See U.C.C. § 2B-706(a)(1)-(a)(2) (Proposed Draft, Sept. 25, 1997) (defining "indemnified party" as the party that has a right of action over against another party based on a claim brought by a third party; and defining "indemnifying party" as the party liable to the indemnified party due to the third party claim).

77. U.C.C. § 2B-707, General Notes (Proposed Draft, Sept. 25, 1997).

78. See U.C.C. § 2B-707 (Proposed Draft, Sept. 25, 1997):

(a) If there is a breach of contract, an aggrieved party may recover as [direct] [general] damages, compensation the loss resulting in the ordinary course from the breach as measured in any reasonable manner, together with the present value of any incidental and consequential damages, less expenses avoided as a result of the breach of contract.

(b) The remedy for breach of contract relating to disclosure or misuse of information in which the aggrieved party has a right of confidentiality or which it holds as a trade secret may include compensation for the benefit received by the party in breach as a result of the breach. A remedy under the agreement or this article for breach of confidentiality or misuse of a trade secret is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.

(c) Except as otherwise provided in the agreement or this article, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(d) In a case involving published informational content, neither party is entitled to consequential damages unless the agreement expressly so provides.

Id.

79. See U.C.C. § 2B-708, Licensor's Damages (Proposed Draft, Sept. 25, 1997):

Moreover, these sections recognize that the obligations of the parties do not cease upon transfer of the goods and payment, they are continuous and often go back and forth in complex ways.⁸⁰

The remedies in Article 2B demonstrate that information is very different from the goods that Article 2 governs. Thus, the remedies of Article 2 are insufficient in reflecting the very delicate, transient nature of information technology.

C. THE BENEFITS OF ARTICLE 2B

1. *Licensor*

The licensor benefits in that Article 2B offers guidance in the meaning of the license grants.⁸¹ Thus, Article 2B solidifies the idea that the licensor is giving the licensee limited access and use of the software, and

(a) Except as otherwise provided in subsection (b), for a material breach of contract by a licensee, the licensor may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, the value accrued and unpaid contract fees or other consideration for any performance rendered by the licensor for which the licensor has not received the contractual consideration, plus:

(A) the present value of the total unaccrued contract fees or other consideration required for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;

(B) the present value of the profit and general overhead which the licensor would have received on acceptance and full payment for the performance that was to be delivered to the licensee under the contract and was not accepted to or delivered to the licensee because of an improper refusal or a repudiation of the contract; or

(C) damages calculated pursuant to Section 2B-707; and

(2) the present value of any consequential and incidental damages, as permitted under the agreement or this article, determined as of the date of entry of the judgment.

Id.

80. U.C.C. § 2B-710, Reporter's Notes (Proposed Draft, Sept. 25, 1997). *See also*, U.C.C. § 2B-710(a), Recoupment: "If a party is in breach of contract, the other party in breach of its intention to do so, may deduct all or any part of the damages resulting from breach from any part of payments still due and owing to the party in breach under the same contract." *Id.*

81. *See supra* note 39 (defining a license). *See also* U.C.C. § 2B-310(a) (Proposed Draft, Sept. 25, 1997):

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

Id.

not relinquishing title to the software. Article 2B also establishes control and protections of the transferability of the license.⁸² Ultimately, Article 2B confirms that exceeding a license is a breach of contract. Prior to Article 2B, the licensor was being robbed of a very valuable asset—her thoughts. However, these benefits confers upon the licensor the benefit of her bargain.

2. *Licensee*

The licensee, on the other hand, is entitled to quiet enjoyment of the information that has been licensed.⁸³ Article 2B recognizes implied licenses.⁸⁴ Thus, intent is not a prerequisite for the granting of a license. This forces the licensor to be cognizant of their actions.

Article 2B further requires that a written disclaimer be in the record for an implied warranty to arise.⁸⁵ Moreover, Article 2B confers upon

82. See U.C.C. § 2B-502, Transfer of Party's Interest (Proposed Draft, Sept. 25, 1997):

(a) Except as otherwise provided in subsection (b), a party's rights under a contract may be transferred, including by an assignment or through a financier's interest, unless the transfer would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, cause a delegation of material performance, disclose or threaten to disclose trade secrets or confidential information of the other party, or materially impair the other party's likelihood or expectation of obtaining return performance.

(b) A transfer of a licensee's contractual rights under a nonexclusive license is ineffective unless the licensor consents to the transfer or the transfer is subject to the terms of the license and:

(1) the contract is a mass-market license and the licensee received delivery of a copy of the information, and transfers or destroys the original copy and all other copies made by it; or

(2) the licensee received title to the copy of the information by a transfer authorized by the party that holds intellectual property rights in the information, the license did not preclude transfer of the licensee's rights, and the transfer of the licensee's rights complies with applicable provisions of federal law for the owner of a copy to make the transfer.

(c) Subject to subsection (a), either party may transfer the right to receive payment from the party.

(d) A transfer made in violation of this is ineffective.

Id.

83. See U.C.C. § 2B-508(a) (Proposed Draft, Sept. 25, 1997):

In a license, a creditor or other transferee of a licensee acquires no interest in information, copies, or rights held by the licensee unless the conditions for an effective transfer under this article and the license are satisfied. If the transfer is effective, the creditor or other transferee takes subject to the terms of the license.

Id.

84. See U.C.C. § 2B-202(a) (Proposed Draft, Sept. 25, 1997):

A contract may be made in any manner sufficient to show agreement, including by offer and acceptance, conduct by both parties or the operations of an electronic agent which recognize the existence of a contract.

Id.

85. See U.C.C. § 2B-406(b)(4) (Proposed Draft, Sept. 25, 1997):

the licensee the right to demand a cure for imperfect tender that was accepted in a commercial contract.⁸⁶ These benefits allow for a greater willingness to become a part of a license agreement. Prior to Article 2B, a licensee assumed that the only rights conferred were those that were in the license agreement, which were forced upon them upon opening the software package or installing the program.

IV. CONCLUSION

Since the law governing licensing of software was so scarce prior to the drafting of Article 2B, the judiciary adopted a variety of approaches to the governance of licensing of software agreements. The most problematic area for the judiciary was determining whether or not a license is the functional equivalent of a sale, and whether not software was a good or a service. The varying judicial treatment of these areas created great confusion and unpredictability in this area of the law. Hence, Article 2B has been drafted in an effort to facilitate uniformity in this area.

Article 2B allows the intentions of the inventors to be honored. As a result, the inventors of software will not have the notion that a license is the functional equivalent of a sale forced upon them. Moreover, the remedies that are provided in Article 2B differs significantly from that of Article 2, thus recognizing the intangibility of the information that has been licensed. Furthermore, Article 2B provides the necessary guidance that this area needs in light of the rapid growth of information technology.

Rhonda Salleé

Unless the circumstances indicate otherwise, all implied warranties are disclaimed by language stating that the information is provided "as is" or "with all faults," or other language that in common understanding calls the licensee's attention to the exclusion of all warranties and makes plain that there is no implied warranty.

Id.

86. See U.C.C. § 2B-619(b) (Proposed Draft, Sept. 25, 1997):

If a licensor, other than in a mass-market license, receives timely notice of a specified nonconformity and a demand for a cure from the licensee that was required to accept a performance consisting of an initial activation of rights because a nonconformity was not material, the licensor promptly and in good faith shall make an effort to cure unless the cost of the effort would be disproportionate to the adverse effect of the nonconformity on the licensee.

Id.