Rethinking Remedies at the Intersection of Intellectual Property and Contract: Toward a Unified Body of Law

Maureen A. O'Rourke
Boston University School of Law

Follow this and additional works at: https://scholarship.law.bu.edu/faculty_scholarship

Part of the Intellectual Property Law Commons

Recommended Citation
Available at: https://scholarship.law.bu.edu/faculty_scholarship/1550
Rethinking Remedies at the Intersection of Intellectual Property and Contract: Toward a Unified Body of Law

Maureen A. O’Rourke*

Introduction ........................................... 1138
I. A Policy Perspective on the Remedial Provisions
   of Federal Intellectual Property Law and the UCC ............. 1142
   B. The Policies of the UCC ............................. 1150
II. The Problem—Federal Intellectual Property Rights v. the
    Rights of Aggrieved “Sellers” and “Buyers” Under the UCC ... 1160
   A. The Licensee as Aggrieved Seller ....................... 1161
      1. Early caselaw .......................................... 1162
      2. The most recent decision: McCoy v. Mitsuboshi
         Cutlery, Inc. ........................................... 1167
   B. The Licensee as Aggrieved Buyer ....................... 1168
III. Bargaining Against the Backdrop of Current Law ........... 1171
    A. Remedies Under the UCC ............................... 1171
       1. Sellers’ remedies ......................................... 1172
       2. Buyers’ remedies ......................................... 1178
       3. The impact of intellectual property law on the
          aggrieved party’s remedial options under the UCC .... 1184
    B. The Effect of the Collision Between Intellectual
       Property Law and the UCC on Bargaining Behavior ... 1185
       1. Pre-breach Considerations .............................. 1188
          (a) The uninformed licensee ......................... 1188
          (b) The informed licensee who does not
               bargain over remedies ........................... 1189
          (c) The informed licensee who bargains
               over the issue ..................................... 1191
       2. Post-breach considerations ............................ 1196
       3. The impact on intellectual property law ............... 1197

* Associate Professor of Law, Boston University School of Law; J.D. Yale Law School; B.S. Marist College. Thanks to Lisa Bernstein, Robert Bone, Ron Cass, David Dana, Wendy Gordon, Keith Hylton, Leandra Lederman, Steve Marks, Robert Merges, Fran Miller, Wally Miller, James Mollov, Mark Pettit, David Seipp and Manuel Utset. Special thanks to Mary, Tom and Patty O’Rourke and Trish and Eliseo Pena. Finally, thanks to my research assistants Randi Berger, Michael Bowse, and Aaron Moore and the staffs of the Boston University School of Law Copy Center and library.
INTRODUCTION

As society continues to move "on-line" and technology advances in fields such as biotechnology, a paradigm shift is occurring. Investors are focusing less on asset valuations based on the physical goods owned by a particular firm and more on the value of intangibles—the information and know-how possessed by the firm and embodied in its intellectual property rights. Firms and even entire industries have grown up with the primarily paper assets of patents and copyrights.

At first glance, this trend might seem vaguely interesting as a sociological matter, but of scant interest from a legal perspective. After all, the federal intellectual property laws, particularly patent and copyright, have been with us almost since the inception of this country. Therefore, it


2. See generally Gordon V. Smith & Russell L. Parr, Valuation of Intellectual Property and Intangible Assets ix (2d ed. 1994) (noting that intellectual property "has arrived" as the most important corporate asset); Stuart A. Rosenberg, Searching for Value, Legal Times, Oct. 23, 1995, at 44 (demonstrating the increasing need to value intangibles as businesses discover that their assets are undervalued by sole reliance on the valuation of physical property). Of course, intellectual property rights—particularly patent—have historically been important, albeit more so in some industries than others. The point is that intellectual property rights are becoming increasingly important as new technologies develop.

3. For example, the biotechnology industry has historically relied heavily on patent protection to attract investment. The investment dollars generated have enabled the industry to prosper even in the absence of a large number of FDA-approved (i.e., marketable) drugs. See generally Michael J. Malinowski & Maureen A. O'Rourke, A False Start? The Impact of Federal Policy on the Genotechnology Industry, 13 Yale J. on Reg. 163 (1996) (discussing the economic development of the biotechnology industry).

4. When using the terms "intellectual property system" or "federal intellectual property law," this Article is referring to the federal statutes relating to patent, copyright, and trademark protection. There are other statutes, such as The Semiconductor Chip Protection Act, 17 U.S.C. § 901-14 (1996), which also address intellectual property protection. However, the patent, copyright, and trademark schemes are the foundational statutes regarding intellectual property and therefore will be the focus of this Article.

5. The first Copyright Act, (Act of May 31, 1790, ch. 15, 1 Stat. 124-136), and the first Patent Act, (Act of April 10, 1790, ch. 7, 1 Stat. 109-112), were enacted in 1790. The first Trademark Act was enacted in 1870, (Act of July 8, 1870, ch. 230, 16 Stat. 198-217), but was held unconstitutional in Trade-Mark Cases, 100 U.S. 82, 96-99 (1879) (holding that Congress
seems reasonable to assume that most legal issues related to intellectual property have been resolved over time or, if not resolved, at least readily articulated within an established legal framework. New technologies might be dealt with within this existing framework since they present the same issues as conventional works, albeit in different packaging.  

However, new technologies have in fact posed substantial questions for and challenges to the intellectual property system that Congress and the courts have begun to address in a well-publicized manner.


6. See generally Jeffrey Squires, Copyright and Compilations in the Computer Era: Old Wine in New Bottles, 24 Bull. of Copyright Soc'y 18 (1976) (discussing the need for copyright protection for on-line databases analogous to that provided to hard copy compilations).

Unfortunately, the intellectual property system does not exist in a vacuum, but rather coexists with both federal and state legislation and common law. Thus, the debate to date has been incomplete. While the debate is addressing challenges to the intellectual property statutes themselves, it often ignores the question of how to achieve the goals of those statutes within the larger legal framework.

In particular, the exploitation of intellectual property rights increasingly involves the rightholder’s entering into transactions involving commercial law. Yet there is neither a contract nor coherent commercial law of intellectual property—only state common law and the Uniform Commercial Code (UCC)—neither of which has considerations of federal intellectual property law policy at its center. Thus, while the efforts of Congress and the courts to deal with new technologies under the intellectual property statutes are both necessary and desirable, those efforts divert attention from a question which is of equal importance. That question is, “How do intellectual property and contract laws fit together?”

The answer to this question will undoubtedly influence the development of an information-based economy. The relative dearth of legal scholarship addressing this issue is therefore somewhat remarkable and disconcerting; this issue should be considered comprehensively and systematically now before ad hoc judicial decisions impair the market for licensing intellectual property rights.

Any attempt to provide a theoretical framework for integrating intellectual property and contract law must take into account the fact that the two systems of law proceed from different philosophical frameworks.
The analysis should begin by identifying what those frameworks are and the goals which they seek to implement. The analysis should then proceed by trying to fit the two sets of law together in a manner which, to the extent possible, furthers both sets of objectives. The aim of this Article is to use such an analysis to address an important problem at the intersection of intellectual property and the UCC. More specifically, this Article acknowledges that because intellectual property licenses often grant the licensee the right to manufacture a good covered by Article 2 ("Sales") of the UCC, collisions between intellectual property law and the UCC are likely to become more frequent as the sheer volume of transactions traditionally viewed as sales, but also containing an intellectual property component, increases over time. One area of potential conflict is between the remedial provisions of intellectual property law and those of the UCC. Under the UCC, an aggrieved seller has a statutory right to set its damages by entering the market and reselling the contract goods. Likewise, an aggrieved buyer may set its damages by entering the market and making a substitute ("cover") purchase. However, when the aggrieved seller or buyer is also an intellectual property licensee, the aggrieved party's exercise of these UCC remedies may be considered infringement under one or more of the intellectual property statutes.

An intuitive legal response would be to say that a finding of infringement under such circumstances is the correct result. Basic preemption rules require that in the event of a clash, the remedial provisions of the state-law UCC may not displace remedies under the federal intellectual property scheme. However, this intuitive response may be neither legally correct nor otherwise desirable; yet resolution of this issue is important to maintaining a viable licensing market. If intellectual property law is used effectively to remove one or more UCC remedies from aggrieved parties, the entire bargaining structure of transactions changes, and the goals of the UCC, which include encouraging efficient contracting, are threatened. This result might be desirable if allowing a party to exercise a particular UCC remedy would adversely affect the goals of the intellectual property system. However, if those goals are not threatened, removing UCC remedies may result in parties foregoing otherwise socially

10. This, of course, is not to deny the need for a general contract law of intellectual property, but rather to initiate the debate by focusing on one topic which is manageable in scope as well as important to the marketplace. Focusing on this issue helps to establish the framework within which the larger debate may take place.

11. Article 2 "applies to transactions in goods." U.C.C. § 2-102 (1996). Even given this scope limitation, Article 2 has often been applied by analogy to transactions that are similar to sales of goods. For example, Article 2 was often applied to leases prior to the enactment of Article 2A of the UCC ("Leases") and may also be used to address issues arising in bailment or other shared interest transactions. See Alces & See, supra note 9 (discussing "transactions" in goods). See also infra note 69 (defining goods).

beneficial transactions without a concomitant increase in the types of activities that the intellectual property statutes were meant to foster.

This Article argues that federal intellectual property law should support application of the remedial provisions of the UCC in many situations, and that the use of such remedies is fully consistent with the policies of both the UCC and intellectual property law. More specifically, it argues that the default rule should be one which allows an aggrieved licensee to exercise its relevant UCC remedy of resale or cover without being subject to liability for intellectual property infringement. In other words, this Article argues that the property rights granted by the intellectual property statutes do not extend to preventing the otherwise rightful exercise of UCC remedies. This rule is preferable to the current legal uncertainty because it encourages the parties to make efficient decisions regarding whether and under what terms to contract and whether to breach a contract once it is made.

To help frame the ultimate issue, Part I discusses and compares the theoretical underpinnings of both intellectual property law and the UCC, including their respective remedial provisions. Part II then briefly outlines the factual scenarios which seemingly give rise to a conflict between intellectual property law and the UCC and the judicial response in specific cases. Part III discusses the desirability of current law from a policy perspective, arguing that the uncertainty of current law is both inefficient and otherwise undesirable. Part IV proposes revisions to the UCC to help ensure that the appropriate remedial scheme is adopted to foster the goals of both the UCC and federal intellectual property law.

I. A POLICY PERSPECTIVE ON THE REMEDIAL PROVISIONS OF FEDERAL INTELLECTUAL PROPERTY LAW AND THE UCC

Congress, the courts, and scholars often cite an economic basis as the rationale for both federal intellectual property law and the UCC. However, the nuances of that rationale differ substantially in the two contexts. As described below, federal intellectual property law is primarily a response to market imperfections caused by the "public goods" nature of information. The UCC, on the other hand, is grounded in economic considerations of minimizing the costs to contract and maximizing the gains from contracting.

Because these respective statutory frameworks grapple with different economic problems, their statutory remedies are also different. Intellectual property law places more emphasis on the equitable remedy of the injunction than the UCC, which emphasizes fixing damages by resorting to market transactions or market indicators. Moreover, the intellectual

13. See infra notes 20-24 and accompanying text.
property damages scheme might be termed "expectation-plus." While the UCC embodies an "expectation" based damages system. As discussed below, in the more broadly theoretical terms of Calabresi and Melamed, in achieving statutory goals, intellectual property law relies more on property rules and the UCC more on liability rules. It is important to discuss not merely the different policy goals of the laws generally, but also how their remedial provisions help to implement those goals. This understanding helps to clarify the issues involved when federal intellectual property law and UCC remedies collide.

A. The Policies of Federal Intellectual Property Law

The congressional power to enact comprehensive patent and copyright systems is found in Article I, Section 8, Clause 8 of the Constitution which states: "The Congress shall have the power . . . to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries; . . . ." Congress, in enacting the Patent and Copyright Acts pursuant to the constitutional grant of power, was guided primarily by the policy goal of enhancing the public welfare. More specifically, Congress sought to encourage the production and dissemination of information. Left unregulated, the market is unlikely to produce the optimal amount of information because it is difficult to exclude nonpaying persons from benefiting from information once it is marketed—the classic "public goods" problem.

15. However, the remedial scheme of federal intellectual property law historically has been described as compensatory despite the fact that some of the statutes allow for treble damages. See infra notes 51-57 and accompanying text.

16. Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1105-15 (1972) (proposing a legal framework to use when deciding whether a broad property right to exclude through an injunction or a liability rule requiring payment of damages is appropriate under particular circumstances).


19. See, e.g., Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 349-50 (1991) (The primary objective of copyright is not to reward the labor of authors, but "[t]o promote the Progress of Science and useful Arts." . . . . To this end, copyright assures authors the right to their original expression, but encourages others to build freely upon the ideas and information conveyed by a work. . . .)

(citing Harper & Row, Publishers, Inc. v. Nation Enters., 471 U.S. 539, 556-57 (1985)). See also, Robert Patrick Merges, Patent Law and Policy 1-9 (1992) (providing an overview of the evolution of thought regarding how patent laws benefit society from the view that "society's benefit was the introduction of a new art or technology" to the perspective that the "primary benefit . . . [is] the technological know-how behind the inventor's patent. The beneficiaries on this view [are] . . . not just the public at large, but instead others skilled in the technical arts . . . .

For example, an author may invest a large amount of money in developing software. If, when the software were released into the market, others could copy it for free, these copiers could, in turn, market the software in competition with the author. Because these copiers would expend money only to copy the software and not for research and development, they could undercut the author's price. Elementary principles of supply and demand would indicate that purchasers would buy the lower-priced product. Thus, in the absence of some market intervention, the original author who invested in the software's development might never recoup his or her investment. Knowing this, the author might never develop the software, instead investing his or her time and energy in some other endeavor. The net result would be the underproduction of information relative to the social optimum because of the inability of the originator to recoup his or her investment.

Congress has focused on correcting this market imperfection with the ultimate end of enhancing social welfare. The federal patent and copyright laws represent one specific type of market intervention—the grant of a legally enforceable property right to inventors and authors who meet statutory standards. The particular rights granted under the

presented when information is the commodity); Robert Cooter & Thomas Ulen, Law and Economics 108 (1988) (defining a public good as one "for which there is no rivalry in consumption"). For a general economic perspective on copyright law, see William M. Landes & Richard A. Posner, An Economic Analysis of Copyright Law, 18 J. Legal Stud. 925 (1989).

21. See, e.g., O'Rourke, supra note 9, at 486 n.25 (citing authorities who estimate expenditures of as much as $1 billion in developing just one software product).


23. This assumes that there is no product differentiation such that purchasers might prefer the original author's work to that of the copiers. For a discussion of the basic principles of supply and demand, see Paula M. Taffe, Imputing the Wealth Maximization Principle to State Legislators, 63 Chi.-Kent L. Rev. 311 n.17 (1987) (citing Richard A. Posner, Economic Analysis of Law 4-5 (3d ed. 1986)).

24. See Cooter & Ulen, supra note 20, at 109 ("When public goods are supplied by private means, the level of supply is usually deficient."). See generally Arrow, supra note 20, at 615-16 (discussing the allocative difficulties of information markets).

25. See supra note 19 (discussing how patent law benefits society because of the introduction of new technology). See, e.g., Mazer v. Stein, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'").

26. The grant of exclusive rights is by no means the only manner by which the public goods problem may be corrected. For example, government could choose to produce public goods itself, use tax subsidies to encourage private production, or use some combination of exclusive rights, government production, and tax subsidies to correct the incentive structure. See Cooter & Ulen, supra note 20, at 48 (discussing policy means of correcting the public goods problem).

27. Patents are granted for those inventions which are new, useful, nonobvious, and not otherwise barred from patentability under the statute. The applications must comply with the
Patent and Copyright Acts vary, but their essence is the same: they provide the rightholder with the ability to exclude others from undertaking certain activities without a license. By providing rightholders with this ability to exclude others, the Acts provide a means through which the rightholder may recoup his or her investment. Thus, the grant of exclusive rights is intended to overcome the public goods problem inherent in the nature of inventive and creative activity.


28. "Every patent shall contain . . . a grant to the patentee . . . of the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States . . . " 35 U.S.C. § 154 (1994).

29. The owner of a valid copyright has the exclusive rights to do and to authorize any of the following:
   (1) to reproduce the copyrighted work in copies or phonorecords;
   (2) to prepare derivative works based upon the copyrighted work;
   (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
   (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and
   (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly.


30. However, by granting limited statutory monopolies in the form of exclusive rights to correct one market imperfection—the public goods problem—the statutes necessarily introduce their own market imperfections characteristic of monopolies. See Cooter & Ulen, supra note 20, at 38-40 (describing market distortions associated with monopolies including higher prices, lower output, externalities, and overinvestment in industries accorded monopoly rights). In part to alleviate market distortions inherent in monopolies, both the Patent and Copyright Acts contain limits on the exclusive rights granted. The most obvious of these is the time limitations on the rights granted. Patents generally extend for 20 years from the date the application was filed, 35 U.S.C. § 154(a)(2) (1994), and copyrights generally for the life of the author plus fifty years, 17 U.S.C. § 302(a) (1996). Further limitations on copyright, including the fair use exemption, are found in §§ 107-120 of the Copyright Act. Common-law doctrines such as patent and copyright misuse also serve to limit the scope of the exclusive rights granted. See, e.g., Dawson Chem. Co. v. Rohm & Haas Co., 448 U.S. 176, 185-223 (1980) (reviewing the common-law doctrine of patent misuse and congressional limitations on that doctrine as set forth in § 271(d) of the Patent Act); Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 973-75 (4th Cir. 1990) (applying the copyright misuse defense to defeat an infringement claim filed by a plaintiff whose license agreement included a term preventing licensees from selling, producing, or developing any competing products for 99 years). See also Philip Abromats, Comment, Copyright Misuse and Anticompetitive Software Licensing Restrictions: Lasercomb America, Inc. v. Reynolds, 52 U. Pitt. L. Rev. 629, 648-66 (1991) (analyzing misuse in the copyright context); Ramsey Hanna, Note, Misusing Antitrust: The Search for Functional Copyright Misuse Standards, 46 Stan. L. Rev. 401, 410-48 (1994) (arguing against antitrust-based copyright misuse); Mark A. Lemley, Comment, The Economic Irrationality of the Patent Misuse Doctrine, 78 Cal. L. Rev. 1599, 1614-20 (1990) (arguing
Trademark law, unlike patent and copyright, finds its constitutional basis in the Commerce Clause. However, trademark law as embodied in the Lanham Act is also based on a public goods theory, at least in part. Trademark law encourages businesses to invest in symbols to assist the public in differentiating one producer's goods from those of another. A particular symbol helps the consuming public to identify the manufacturer that is the source of a product, thereby providing the public with a means to identify the party responsible for any defect. Thus, the production of such symbols is desirable from an economic perspective because it encourages manufacturers to invest in quality control facilities. Moreover, by indicating a particular level of quality on which consumers may rely, trademarks help consumers save the costs of seeking detailed information about products. A trademark thus functions as a type of "shorthand," indicating the source and quality of a good which bears a particular mark. Trademark law itself functions not through a grant of exclusive rights but by allowing registration of marks and prohibiting others from using imitations of those marks in connection with their goods when such imitation is likely to confuse the public.

Obviously, the patent and copyright grants of exclusive rights and the trademark prohibition against imitation are only one part of the statutory scheme designed to overcome the public goods problem and to encourage investment in certain activities. The remedial provisions which accompany each statute are an integral part of that system. If the statutes imposed no sanctions for their breach, they would function merely as advice.

The equitable remedy of the injunction plays an important role under all three statutes. The injunction is the weapon primarily designed to

---


32. Trademark law could also be viewed as consumer protection law as it seeks to prevent consumer confusion. "The policies of consumer protection, property rights, economic efficiency and universal concepts of justice underlie the law of trademarks." J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition § 2.01[1] (3d ed. 1996).

33. See id. "[T]rademark counterfeiting . . . would eventually destroy the incentive of trademark owners to make the investments in quality control, promotion and other activities necessary to establishing strong marks and brand names." Id.

34. See id. § 2.01[2][a].

35. See id. § 2.01[2][b].

36. See 15 U.S.C. §§ 1051-1052 (1994) (allowing registration of marks by persons with bona fide intentions to use the marks in commerce and placing certain limitations on what marks are registrable, including a ban against registration of deceptive marks).


39. See 15 U.S.C. § 1116 (1994) ("The several courts vested with jurisdiction . . . shall have power to grant injunctions, according to the principles of equity and upon such terms as
enforce the property right to exclude established under the Patent and Copyright Acts and to protect the public from confusion under the Lanham Act. The injunction, common in intellectual property cases, may be used at virtually any stage of the proceedings to stop infringement.

From a theoretical perspective, the ready availability of an injunction is consistent with a property rule regime as defined by Calabresi and Melamed: "An entitlement is protected by a property rule to the extent that someone who wishes to remove the entitlement from its holder must buy it from him in a voluntary transaction in which the value of the entitlement is agreed upon by the seller." The intellectual property statutes confer entitlements on rightholders, and third parties generally have no license to encroach upon these entitlements. To the extent they do, the rightholder has a ready mechanism—the injunction—with which to

the court may deem reasonable, to prevent the violation of any right of the registrant of a mark registered in the Patent and Trademark Office . . . .); 17 U.S.C. § 502 (1996) ("Any court having jurisdiction of a civil action arising under this title may . . . grant temporary and final injunctions on such terms as it may deem reasonable to prevent or restrain infringement of a copyright."); 35 U.S.C. § 283 (1994) ("The several courts having jurisdiction of cases under this title may grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable.").

40. See, e.g., Century 21 Real Estate Corp. v. Sandlin, 846 F.2d 1175, 1180 (9th Cir. 1988) ("Injunctive relief is the remedy of choice for trademark and unfair competition cases, since there is no adequate remedy at law for the injury caused by a defendant's continuing infringement."); Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 1158 n.5 (6th Cir. 1978). The court stated:
The right to exclude others from free use of an invention protected by a valid patent does not differ from the right to exclude others from free use of one's automobile, crops, or other items of personal property. . . . That one human property right may be challenged by trespass, another by theft, and another by infringement, does not affect the fundamental indicium of all "property," i.e., the right to exclude others.

Id.

41. Both preliminary and permanent injunctions are common in intellectual property cases. See generally McCarthy, supra note 32, § 30.03, at 30-36 ("[A]n injunction is the standard remedy in unfair competition cases."); Melville B. Nimmer & David Nimmer, Nimmer On Copyright, § 14.06[A], at 14-96 (1995) (discussing preliminary injunctions, the authors note that "their issuance is actually quite ordinary, even commonplace"); Robert Merges, Intellectual Property Rights and Bargaining Breakdown: The Case of Blocking Patents, 62 Tenn. L. Rev. 75, 76-78 (1994) (noting that injunctions are routinely granted in patent cases and explaining the rationale supporting such grant of injunctions). For a brief survey of cases which seek or award permanent or preliminary injunctions in intellectual property cases, see Eli Lilly & Co. v. Medtronic, Inc., 496 U.S. 661 (1990); Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984); Cass County Music Co. v. C.H.L.R. Inc., 88 F.3d 635 (8th Cir. 1996); Publications Int'l, Ltd. v. Meredith Corp., 89 F.3d 473 (7th Cir. 1996); Holiday Inns, Inc. v. 800 Reservation, Inc., 86 F.3d 619 (6th Cir. 1996). This list is exemplary, not exhaustive, and although most of the cases are recent, injunctions have been sought or awarded in intellectual property cases since the adoption of the statutes.

42. Calabresi & Melamed, supra note 16, at 1092.

43. But see infra notes 48-50 and accompanying text (noting that the statutes also contain liability rules).
stop the encroachment. The injunction also effectively allows the rightholder to determine the terms of any license agreement entered into with the infringer. The intellectual property statutes, then, fit within the classic definition of a property rules system.

Using the Calabresi and Melamed model, Professor Merges has explained why a property rights regime is appropriate in the case of patents:

In [the Calabresi and Melamed] framework a property rule makes sense for patents because: (1) there are only two parties to the transaction, and they can easily identify each other; (2) the costs of a transaction between the parties are otherwise low; and (3) a court setting the terms of the exchange would have a difficult time doing so quickly and cheaply, given the specialized nature of the assets and the varied and complex business environments in which the assets are deployed. Hence the parties are left to make their own deal.

Similar rationale supports a property rights regime for trademark and copyright. Generally, in both trademark and copyright licensing, there are few parties to the transaction, transaction costs are low, and a court would have difficulty calculating damages.

While the intellectual property statutes primarily implement a property rights regime, there are cases in which the statutes rely instead on liability rules. For example, the Copyright Act contains provisions for compulsory licenses and an exemption from infringement for uses that are deemed "fair" under the statute. These liability rules were adopted in part to account for the fact that there are instances in which transaction costs may be so high that a property rights regime would prevent parties from reaching an agreement.

In addition to the injunction, damages are also available under the intellectual property statutes. Irrespective of whether an injunction is sought or issued, courts are likely to award damages in a successful infringement suit. The particular statutory damage provisions vary.

44. See Merges, supra note 41, at 77.
45. See id.
46. Id. at 78. Merges also notes that strong property rules enforced by injunctions seem to be working as the market for patent licenses is large and thriving, thus indicating parties' willingness to engage in private transactions in their own interests. Id.
47. See, e.g., Century 21 Real Estate Corp. v. Sandlin, 846 F.2d 1175, 1180 (9th Cir. 1988) (stating that no adequate remedy at law exists to remedy continuing trademark infringement).
50. See Wendy J. Gordon, Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors, 82 Colum. L. Rev. 1600, 1601-02 (1982) (noting that it may be appropriate to use fair use to excuse infringing conduct where transaction costs are too high to allow parties to bargain).
51. The statutory damage provisions are somewhat complex. While the statutory language
example, both the Copyright and Lanham Acts allow the aggrieved plaintiff to recover its lost profits and, on an unjust enrichment theory, the defendant's profits from the infringement. In contrast, the Patent Act does not allow for recovery of the infringer's profits, but relies more on compensating the rightholder through awarding the patent owner its own lost profits or damages at an established royalty rate.

A concern often expressed by courts and commentators in intellectual property infringement cases is that if damages represent only what the parties would have agreed to if they had negotiated a license prior to the infringing conduct, they provide no disincentive for infringing activity—instead, they effectively confer compulsory licensee status on the infringer. In starker theoretical terms, an *ex post* award of *ex ante* is relatively straightforward, a number of issues may arise in litigation with respect to damage calculations. This Article focuses not on an examination of those issues, but rather on a broad view of the statutory provisions and their underlying policy rationales.

52. See 15 U.S.C. § 1117(a) (1994) (“When a violation of any right of the registrant of a mark . . . shall have been established . . . the plaintiff shall be entitled . . . to recover (1) defendant’s profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action.”); 17 U.S.C. § 504(b) (1996) (“The copyright owner is entitled to recover the actual damages suffered . . . and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.”). For a description of the theoretical underpinnings of monetary remedies in trademark and copyright cases, see McCarthy, *supra* note 32, § 30.24[2] (noting that insufficient work has been done to understand the public policy underpinnings of trademark remedies but stating that “[i]n modern cases, courts have occasionally awarded monetary recovery on the rationales of preventing unjust enrichment and/or deterrence of defendant and others”); Nimmer & Nimmer, *supra* note 41, § 14.03, at 14-30 ([“Recovery of defendant’s profits and plaintiff’s lost profits] makes any would-be infringer negotiate directly with the owner of a copyright . . . [and, perhaps] some of the ‘windfall’ may actually be profit that the owner would have obtained from [the infringer]”). *See also infra* notes 55-57 and accompanying text (discussing the deterrence goal of damages rules). The Copyright Act also contains provisions for statutory damages. 17 U.S.C. § 504(c) (1996) (“The copyright owner may elect . . . instead of actual damages and profits, an award of statutory damages.”).

53. 35 U.S.C. § 284 (1994) (“Upon finding for the claimant the court shall award . . . damages adequate to compensate for the infringement, but in no event less than a reasonable royalty. . . .”). Originally, claimants were entitled to the infringer's profits but concern over: (i) costs of proof; (ii) delays inherent in the accounting procedures required to compute the profits; and (iii) the difficulty of apportioning an infringer's profits to that attributable to use of the patent at issue, led Congress to delete reference to the infringer's profits in a 1946 revision to the Patent Act. *See generally* H.R. Rep. No. 79-1587, at 1 (1946) (revising the then current statute to provide that damages should be ascertained on a compensatory basis). The reasonable royalty is awarded in cases in which it is difficult to calculate the patentee’s lost profits or the established royalty. The reasonable royalty rate of the current statute is a minimum measure of damages rather than a maximum. For an historical overview of the law’s development, see generally Donald S. Chisum, Patents § 20.02 (1995).

54. *See, e.g.*, Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 1158 (6th Cir. 1978) (The setting of a reasonable royalty after infringement cannot be treated . . . as the equivalent of ordinary royalty negotiations among truly ‘willing’ patent owners and licensees. That view would constitute a pretense that the infringement never happened. It would also make an election to infringe a handy means for competitors
royalties would move the intellectual property scheme away from a property rules system and closer to a liability rules regime.

In part to address this problem, the statutes, in compensating the rightholder, also attempt to include provisions that will function as deterrents against infringement. For example, the Copyright Act includes provisions categorizing certain infringements as criminal.\(^5\) Both the Lanham\(^5\) and Patent\(^7\) Acts provide for treble damages, albeit under the rubric of compensation.

The equitable remedy of the injunction, supported by the legal remedy of damages, provides a mechanism through which the rightholder can be assured of compensation if a person wrongfully appropriates its right. Additionally, and perhaps more importantly, the statutory remedies effectively assure the rightholder that it may choose the parties with whom it will—or will not—deal in licensing its rights.\(^5\) These enforcement mechanisms thereby help to enhance the value of the initial property right. By enhancing the value of the statutory property right, the enforcement mechanisms help to achieve the statutory purpose of encouraging investment in goods that would otherwise be public for the ultimate benefit of society as a whole.

### B. The Policies of the UCC

In contrast to federal intellectual property law, Article 2 of the UCC is a relatively recent innovation\(^5\) promulgated by the National Conference

---

\(^5\) See also McCarthy, supra note 32, § 30.27[4][c], at 30-127

(The problem with using a reasonable royalty as a measure is that it in effect compels plaintiff to license [its trademark] to defendant at a rate that defendant proposed and plaintiff originally refused. Defendant is no worse off than if it had been licensed in the first place, which is exactly what plaintiff refused to do.).

But see Merges, supra note 19, at 787 (questioning whether a patent infringer is really indifferent between an ex post damages award and an ex ante license agreement given the availability of injunctive relief).

\(^55\) See 17 U.S.C. § 506(a) (1996) ("Criminal infringement.—Any person who infringes a copyright willfully and for purposes of commercial advantage or private financial gain shall be punished as provided in section 2319 of title 18.").

\(^56\) See 15 U.S.C. § 1117(a) (1994) ("In assessing damages the court may enter judgment . . . for any sum above the amount found as actual damages, not exceeding three times such amount . . . . Such sum . . . shall constitute compensation and not a penalty."); see also McCarthy, supra note 32, § 30.28[2][b], at 30-133-36 (collecting judicial authority and arguing that "the discretionary power to increase, while it must be 'compensation and not a penalty,' is properly invoked not only to adjust for difficulties in proving amount, but also to deter in egregious cases of infringement").

\(^57\) See 35 U.S.C. § 284 (1994) ("[T]he court may increase the damages up to three times the amount found or assessed.").

\(^58\) Cf. Merges, supra note 41, at 77.

\(^59\) See supra note 5 for a summary of when the federal intellectual property statutes were enacted. Note also that while the codification of commercial law is a relatively recent effort, many of the rules contained therein existed at common law and, in the case of Sales, prior statutory enactments including the Uniform Sales Act. The UCC codified certain parts of the
of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute (ALI). Additionally, the UCC is state law, implemented individually by the legislative action of each state rather than nationally at the federal level.

At a very rudimentary level, the overall goals of the UCC are similar to those of the intellectual property statutes. Both sets of law aim to benefit society—intellectual property law by increasing the production and availability of information; the UCC by encouraging parties to engage in mutually beneficial exchanges. However, the means which intellectual property law and the UCC use to implement this ultimate goal diverge. Intellectual property law functions by a government grant of rights to correct market imperfections. The UCC, rather than affirmatively granting rights, sets forth a statutory framework within which private parties are free to order their dealings as they see fit.

In the same way that Congress considered economic factors in enacting the intellectual property statutes, the UCC drafters saw an economic need for a statutory framework to facilitate commercial contracting. This economic rationale may be inferred from the UCC's statement of its statutory purposes set forth in § 1-102(2):

Underlying purposes and policies of this Act are
(a) to simplify, clarify and modernize the law governing commercial transactions;
(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the


60. See Braucher, supra note 59, at 799-804 (documenting in detail the activities of various interest groups in drafting and revising the first version of the Code).

The drafters attempted to minimize costs of commercial transactions in a number of ways. From a systemic perspective, they sought to decrease reliance on the common law system of precedent that was both cumbersome and lacked uniformity across the various jurisdictions. They planned to achieve this goal by replacing the common law system with a uniform codification. This codification was to address the legal

62. U.C.C. § 1-102(2) (1996). However, note that these goals are to some extent inconsistent with each other. Specifically, it is difficult to implement the flexibility desired while also ensuring uniformity across jurisdictions. For example, that which is commercially reasonable in Texas may not be so in Maine.

63. See William D. Hawkland, Uniform Commercial “Code” Methodology, 1962 U. Ill. L.F. 291, 296 (documenting the development of commercial law through the common law system of precedent:

[T]he commercial law grew along lines which produced gaps and uncertainties in spite of volumes of cases. Indeed, gaps and uncertainties seem to have been generated in direct proportion to the number of published opinions, and this caused a breakdown of our commercial case-law system toward the end of the nineteenth century. A distinguished commercial lawyer, Professor Grant Gilmore, describes this breakdown and its cause as follows:

When the number of printed cases becomes like the number of grains of sand on the beach, a precedent-based-case-law system does not work and cannot be made to work... In this country, it has been a long time since even the best lawyer could make that claim, even in the narrowest field... When it becomes possible to cite to a court not merely two or three prior cases which bear a reasonable relationship to this case, but dozens of cases, many of them so nearly identical on their facts as to be indistinguishable, decided every which way—then what is the court to do?

(citation omitted).

64. See id. at 293 (noting that allowing unguided judges to arrive at odd results was “disastrous to the commercial community,” frustrated the predictability essential to commercial transactions and that the law’s state of flux “began with nonuniform decisions from the several jurisdictions”).

65. See id. (contending that the UCC is a true code in the civil law sense). But see Homer Kripke, The Principles Underlying the Drafting of the Uniform Commercial Code, 1962 U. Ill. L.F. 321, 331 (arguing that, in fact, the drafters had no intention of codifying the law in the “continental sense”). Also note that the Code is not uniform in the sense that not all of its parts have been adopted in all jurisdictions, see Schwartz & Scott, supra note 61, at 2 (noting Louisiana’s failure to adopt Articles 2 and 6); and that not all states have adopted the version promulgated by the NCCUSL without change, see Christian P. Callens, Comment, Louisiana Civil Law and the Uniform Commercial Code: Interpreting the New Louisiana U.C.C.-Inspired Sales Articles on Price, 69 Tul. L. Rev. 1649, 1651 (1995) (noting that although Louisiana declined to enact Article 2, it did revise its civil code to reflect Article 2 principles); Fred H. Miller, The Revision of Article 2 of the Uniform Commercial Code: Consumer Issues and the Revision of U.C.C. Article 2, 55 Wm. & Mary L. Rev. 1565, 1566-68 (1994) (discussing the difficulties encountered in developing a uniform consumer law). In fact, the Code itself provides alternatives from which states may choose. See, e.g., U.C.C. § 2-318 (1996) (providing states with three alternatives from which to choose for defining the set of third party beneficiaries of express and implied warranties). Finally, note that common law rules still apply to the extent not displaced by the Code. See U.C.C. § 1-103 (1996) (“Unless displaced by the particular
aspects of a commercial transaction from beginning to end, providing one source of law with reasonably certain rules as the principle of decision. The drafters intended the increased certainty inherent in a codification of this scope to help realize the desired cost-savings and to implement the statutory goals of simplification, clarification, and uniformity.

The drafters also sought to decrease costs to contracting parties by de-emphasizing certain common law formalities in favor of recognizing commercial realities. Article 2 is limited in scope to goods—tangible items for which there is often a recognizable mass market in which technical and formalistic contract rules were not always observed. Drawing on the legal realist philosophy of Karl Llewellyn, the drafters believed that the law could be, and in fact was, revealed by the practices of commercial parties engaged in trading these goods. Thus, Article 2 often looks to commercial practice in defining the content of a legal rule rather than to provisions of this Act, the principles of law and equity . . . shall supplement its provisions.

66. See Hawkland, supra note 63, at 310-11 ("The Uniform Commercial Code meets [the] test [of comprehensiveness]. It takes as its set the rules which are needed to build the basic legal framework to control the flow of goods from producer to ultimate consumer.").

67. See generally Llewellyn, supra note 14, at 783 ("[The Code] will eliminate something of which [the businessman] isn’t fully conscious—the unnecessary tax on his business that legal uncertainty now imposes.").

68. See id.; see, e.g., U.C.C. § 2-209 cmt. 1 (1996) ("This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments."); Mentschikoff, supra note 59, at 172-75 (noting that the Sales Article was intended to make the law more accessible to merchants, to simplify and clarify certain problems and to free some others from technicalities, e.g., by “eliminating the almost hopelessly technical law on when the seller can or cannot sue for the price”).

69. Goods are defined as “all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action.” U.C.C. § 2-105(1) (1996).

70. See William Twining, Karl Llewellyn and the Realist Movement 302-40 (1973) (discussing the jurisprudence of the UCC and the role Karl Llewellyn and his legal realist philosophy played in developing it); Richard Danzig, A Comment on the Jurisprudence of the Uniform Commercial Code, 27 Stan. L. Rev. 651, 656 (1975) (noting that “Article II frequently speaks as though courts should discover the law merchant from a careful, disinterested examination of custom and fact situations”); Mark D. Rosen, What Has Happened to the Common Law? — Recent American Codifications, and their Impact on Judicial Practice and the Law’s Subsequent Development, 1994 Wis. L. Rev. 1119, 1170 (noting that the Code “bid[s] the legalists to make context-specific inquiries to infer the rules implicit in each situation”) (citation omitted). But see Schnader, supra note 59, at 5 ("I can also state that what Professor Llewellyn believed should be the articles of an ideal commercial code were not the articles as they emerged from the crucible of debate when the Code was promulgated."). In Llewellyn’s own words, "I am ashamed of [the UCC] in some ways; there are so many pieces that I could make a little better; there are so many beautiful ideas I tried to get in that would have been good for the law, but I was voted down." Llewellyn, supra note 14, at 784. However, out of all of the Articles in the Code, Article 2 probably best reflects Llewellyn’s philosophy. See Peter A. Alces, The Revision of Article 2 of the Uniform Commercial Code, 35 Wis. & Mary L. Rev. 1299, 1299 (1994) ("Quite simply, Article 2 of the U.C.C., Sales, is, more than any other article of the Code, Llewellyn’s law.") (citation omitted).
the rules of common law contract. 71 This statutory orientation helps to realize the stated purpose of permitting the expansion of commercial practice by reference to custom and trade usage.

In addition to minimizing costs by modifying some of the formalities of common law and providing a uniform rule of decision, the UCC's drafters intended to decrease costs by giving effect to the agreement of the parties. 72 The drafters built the UCC on a strong belief in freedom of contract. 73 The UCC is based on the assumption that the contracting parties are best situated to allocate the gain from contracting, and that courts should set that allocation aside only in rare circumstances. As a result, Article 2 contains very few mandatory rules. In fact, it more closely resembles a boilerplate contract, providing gap-filling provisions to complete contractual terms that the parties might have left blank. 74 These provisions function as "default" rules around which the parties, with some limitations, may contract. 75 Generally, in formulating these default rules,

71. For example, § 2-202 broadens the common law parol evidence rule, allowing the introduction of evidence of course of dealing, usage of trade and course of performance to explain or supplement even a fully integrated agreement. U.C.C. § 2-202 (1996). This willingness to admit oral evidence was intended to serve as a cost-saving device by importing the commercial context of which both parties were aware into the contract. See Schwartz & Scott, supra note 61, at 50. The parties would no longer need to negotiate and memorialize the assumptions common in the particular trade or deal, thus saving transaction costs. See id.; see also Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions between Express and Implied Contract Terms, 73 Cal. L. Rev. 261, 320 (1985) (suggesting changes to the contractual interpretation process to accommodate new contractual forms and to help correct the tendency of current interpretive rules to create barriers to innovative contractual terms).

72. See Rosen, supra note 70, at 1222-23 (contending that Article 2 is based on an "Agreement" theory with rules aimed toward ensuring enforcement of the parties' agreement); see also U.C.C. §1-201(3) (1996) ("Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances . . . .").

73. See U.C.C. § 1-102 cmt. 2 (1996) ("Subsection (3) [of § 1-102] states affirmatively at the outset that freedom of contract is a principle of the Code: 'the effect' of its provisions may be varied by 'agreement.'").

74. In contrast to the common law rule that all material terms must be agreed upon in order for a contract to exist, under the Code, "[e]ven though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy." U.C.C. § 2-204(3) (1996). The gap-filling provisions of Article 2 help to fill in the terms the parties left open. See, e.g., U.C.C. § 2-305 (1996) ("Open Price Term"); U.C.C. § 2-308 (1996) ("Absence of Specified Place for Delivery"); U.C.C. § 2-309 (1996) ("Absence of Specific Time Provisions; Notice of Termination"). Of course, "[t]he more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement." U.C.C. § 2-204 cmt. 1 (1996).

75. For limitations on contracting around the Code, see, e.g., U.C.C. § 1-102(5):

The 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.
the drafters were guided by the proposition that to realize their goal of minimizing costs, the rules should reflect the terms to which the parties would have agreed had they actually bargained over the issue.76

These goals of freeing the law from certain vagaries of common law and enforcing the parties' agreement are reflected in the UCC's remedial provisions.77 The UCC's general remedial philosophy is that of expectation damages—"[to] put the aggrieved party . . . in as good a position as if the other party had fully performed."78 A good deal of academic commentary supports the view that this expectancy measure of damages is economically efficient because it effectively functions to move resources to their highest valued uses while at the same time compensating the aggrieved party—a "Pareto optimal" solution.79 In keeping with the

See also U.C.C. § 2-302 (1996) (granting courts broad discretion to reform unconscionable contracts or clauses).

76. See Schwartz & Scott, supra note 61, at 21, 23 (stating that the Code should adopt rules parties would have chosen had they bargained over an issue to save the parties negotiation costs); Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L.J. 87, 90 (1989) (contending that the reasons why parties leave gaps in contracts should inform the choice of a default rule and aid in identifying situations in which selection of the rule to which the parties would not agree may be appropriate); Richard Craswell, Offer, Acceptance and Efficient Reliance, 48 Stan. L. Rev. 481, 486 (1996) (discussing the economic support for selecting as default rules those which, if not contracted around, maximize the expected value of the transaction); Alan Schwartz, Proposals for Products Liability Reform: A Theoretical Synthesis, 97 Yale L.J. 353, 361 (1988) (stating that the default rule should be the one which well-informed persons would have adopted if they had bargained over the issue); see also Randy E. Barnett, The Sound of Silence: Default Rules and Contractual Consent, 78 Va. L. Rev. 821, 823-24 (1992) (identifying, evaluating and contributing to the voluminous default rules literature).

77. For example, the Code relaxes the common law rule that damages be proved with certainty: "The third purpose of subsection (1) [of § 1-106] is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more." U.C.C. § 1-106 cmt. 1 (1996). However, the Code does continue most of the fundamental principles of common law regarding remedies, although its provision for the buyer's right to cover is an innovation over the common law. See infra note 85. Thus the Code did not create the problem discussed in this Article — it existed at common law contract as well. However, the Code may have exacerbated the problem by introducing the cover remedy. Additionally, the Code is the primary law governing remedies with respect to contracts for the sale of goods. Therefore, this Article continues to focus on the UCC rather than common law contract.

78. U.C.C. § 1-106(1) (1996). This ex post view of damages is the opposite of that taken by the intellectual property statutes which focus on a restitution—putting the aggrieved party in the same position as if no infringement had taken place—rather than an expectation theory. See, e.g., Chisum, supra note 53, § 20.01, at 20-7:

The goal of the law of monetary relief for patent infringement is to provide full compensation to the owner of a patent. The primary award should be the best approximation of the amount necessary to restore the owner to the financial position he would have enjoyed had the infringer not engaged in unauthorized acts in violation of the owner's exclusive patent rights.

79. Calabresi & Melamed, supra note 16, at 1093-94 define Pareto optimality:

Economic efficiency asks that we choose the set of entitlements which would lead to
expectancy theory, the UCC does not support the award of supercompensatory damages unless such damages are specifically authorized under the UCC or other law. Damages in excess of the compensatory amount could lead to inefficient decisionmaking regarding breach.  

The UCC remedial scheme is comprehensive in its implementation of the expectancy measure of damages, offering both aggrieved sellers and buyers a number of options from which to choose. Of these options, the two which present the most potential for conflict with the intellectual property laws are the aggrieved seller’s right to resell under § 2-706 and the aggrieved buyer’s right to cover under § 2-712. These particular remedies may collide with intellectual property rights because they may require the aggrieved party to exercise rights which it may no longer

that allocation of resources which could not be improved in the sense that a further change would not so improve the condition of those who gained by it that they could compensate those who lost from it and still be better off than before. Prof. Merges has noted that damages for breach of contract are relatively easy to determine and that awarding expectancy damages . encourages breach where the breaching party can both fully compensate the injured party and enter into a substitute transaction with someone else who values the breaching party’s performance more highly. This is an efficient breach: a compensatory remedy predicated on the ease of valuing the costs of breach and the desirability (i.e., Pareto optimality) of having the breaching party’s performance go to the other party who values it most highly. Merges, supra note 41, at 77. But see generally Daniel A. Farber, Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract, 66 Va. L. Rev. 1445, 1450 (1980) (contending that compensatory damages, while efficient if transaction costs are zero, will not necessarily be efficient where transaction costs are positive); Alan Schwartz, The Case for Specific Performance, 89 Yale L.J. 271, 278-98 (1979) (arguing that expectation damages may often be undercompensatory and that specific performance should be awarded more often); Thomas S. Ulen, The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies, 83 Mich. L. Rev. 941, 966-71 (1984) (contending that courts should consider transaction costs in deciding between specific performance and monetary damages); Edward Yorio, A Defense of Equitable Defenses, 51 Ohio St. L.J. 1201 (1990) (demonstrating the usefulness of equitable doctrines like specific performance).

80. See U.C.C. § 1-106(1) (1996) ("[N]either consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law."). Thus, the UCC does not contain provisions analogous to the treble damages sections of the Lanham and Patent Acts. See supra notes 56-57.

81. See Posner, supra note 22, at 116 (noting that penalties deter both efficient and inefficient breaches by making the cost of breach greater to the breacher than to the victim and giving an incentive to the victim to provoke breach). But see generally Farber, supra note 79 (arguing that compensatory damages may in fact be less efficient than supercompensatory ones). See also Richard Craswell, Contract Remedies, Renegotiation, and the Theory of Efficient Breach, 61 S. Cal. L. Rev. 629, 662-63 (1988) (citing Farber and noting that remedies that may appear overcompensatory may in fact be closer to compensatory than expectation damages).

82. U.C.C. § 2-703 (1996) (listing remedies available to aggrieved sellers including, as appropriate, withholding or stopping delivery of the goods, canceling the contract, and recovering damages or the price); U.C.C. §2-711 (1996) (listing remedies available to an aggrieved buyer including, as appropriate, recovering the goods and/or damages).
have. While the right to resell existed at common law, the right to cover was a major UCC advance over the common law remedy of the contract-market differential. Simply put, it seemed that the best way to ensure that the aggrieved seller or buyer would receive its expectancy would be to allow the aggrieved party to continue to conduct its business through self-help recourse to the relevant market and then to award damages, if appropriate. Thus, Article 2 allows the aggrieved seller to resell the goods in a commercially reasonable manner and receive damages representing the difference between the contract and resale prices. Similarly, Article 2 allows the aggrieved buyer to enter the market and make a substitute—or “cover”—purchase, awarding the difference between the cover and contract prices as damages. The aggrieved party under Article 2 is not required to accept the contract-market differential as its damages, although it may opt to do so. Thus, in negotiating a contract

83. See infra notes 99-102 and accompanying text (explaining why this might be the case).
84. See Mentschikoff, supra note 59, at 172 (“The Code simplifies, broadens, and clarifies the seller’s remedy of resale . . . .”); see also U.C.C. § 2-706 cmt. 1 (1996) (“The only condition precedent to the seller’s right of resale . . . is a breach . . . . Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article . . . .”).
85. See White & Summers, supra note 59, § 7-6, at 369 (“The analogue to the buyer’s right to cover under 2-712 is the seller’s right to resell under 2-706 . . . . Like the “cover” provision for the buyer, 2-706 is an important Code innovation.”); Melvin Aron Eisenberg, The Responsive Model of Contract Law, 36 Stan. L. Rev. 1107, 1142-43 (1984) (discussing the reasons for the resell and cover Code sections). While the resale remedy existed at common law and in prior statutory enactments, the Code simplified and clarified it. Note also that some courts did allow the cover remedy even at common law. See Moore & Mayfield, supra note 9, at 8 n.5.
87. U.C.C. § 2-706(1)-(4) (1996) (setting forth the requirements for a complying resale including its conduct in good faith and a commercially reasonable manner and notification to the breaching buyer and setting damages as “the difference between the resale price and the contract price together with any incidental damages . . . but less expenses saved in consequence of the buyer’s breach”).
88. U.C.C. § 2-712(1)-(2) (1996) (setting forth the requirements for an effective cover including that the substitute purchase must be reasonable, made in good faith and without unreasonable delay and setting damages as “the difference between the cost of cover and the contract price together with any incidental damages . . . but less expenses saved in consequence of the seller’s breach”).
89. However, the Code’s treatment of seller’s and buyer’s remedies is not exactly analogous. The aggrieved seller may choose to recover under either § 2-706 or § 2-708(1), irrespective of whether or not it resells the goods. See, e.g., Sprague v. Sumitomo Forestry Co., Ltd., 709 P.2d 1200, 1204-05 (Wash. 1985) (holding that where the aggrieved seller resells but fails to comply with the requirements of § 2-706, the seller may still recover under § 2-708(1)). Under § 2-708(1), contract-market damages are defined as “the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages . . . but less expenses saved in consequence of the buyer’s breach.” U.C.C. § 2-708(1) (1996). Section 2-706 and § 2-708(1) are likely to be approximately the same in
governed by Article 2, the parties know that in the absence of a contrary agreement, in the event of breach, the aggrieved party will be able to choose to recover its resale or cover damages, the contract-market differential or other damages as appropriate. The availability of this choice helps to assure the contracting party at the time of negotiations that it will be fully compensated in the event of breach.

This flexible remedial scheme seems to have been successful in helping to achieve the UCC's goals of minimizing the costs to contract while maximizing the parties' collective surplus. The expectancy principle of damages allows for efficient breach so that resources will move to their highest valued uses. Mitigation of damages principles which are built into the UCC provisions and also incorporated from common law help to minimize any loss from breach. Finally, contracts often do not provide for specific remedies, but rather rely on the UCC default rules, including the rights of resale and cover. This silence gives credence to the inference that parties are satisfied with the UCC remedies. This satisfaction translates into lower transaction costs as the parties are able to rely on the UCC remedial scheme rather than negotiating their own.

The theoretical framework of the UCC is different from that of the cases where the resale price and the market price at the time and place for tender (which is assumed to be the relevant resale market) are the same. In cases in which they are not, the seller may attempt to "game" its recovery as it can do better than its expectancy where the resale price under § 2-706 exceeds the § 2-708(1) market price at the time and place of tender. There is dispute among the commentators and courts as to whether the seller can manipulate its choice of remedy to do better than its expectancy. The Code does not address this issue. See White & Summers, supra note 59, § 7-7, at 376-83 (setting forth the statutory history and arguing that despite legislative history to the contrary, sellers should be limited to their expectancy). But see Ellen A. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 260-61 (1963) (making the opposite argument). In the same way, the buyer's cover damages will only incidentally equal its contract-market differential damages. Under § 2-713(1), the buyer's contract-market damages are defined as "the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages ... and less expenses saved in consequence of the seller's breach." U.C.C. § 2-713 (1996). Thus, in cases in which the market price exceeds the cover price, the buyer too could do better than its expectancy. However, unlike the case with the seller, the Code comments specifically provide that the contract-market differential is available to the buyer only "when and to the extent that the buyer has not covered." U.C.C. § 2-713 cmt. 5 (1996). But see Peters, supra at 260 (arguing for consistent rules for both buyers and sellers and allowing buyers to choose either their cover or contract-market damages).

90. See, e.g., U.C.C. § 2-706 (1996) (requiring commercial reasonableness); § 2-712 (1996) (prohibiting unreasonable delay); § 2-715(2)(a) (1996) ("Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements ..., and which could not reasonably be prevented by cover or otherwise ... "). See also U.C.C. § 1-103 (1996) ("Unless displaced by the particular provisions of this Act, the principles of law and equity ... shall supplement its provisions."). Section 1-103 thus incorporates common law mitigation principles.

91. Admittedly, it may just as well mean that the parties have no idea what remedies will apply in the event of breach.

92. See supra note 76 (citing default rules literature).
intellectual property statutes. In Calabresi and Melamed terms, the UCC scheme sets up a liability rule system as both the seller and buyer may purchase the right to breach by paying the applicable UCC damages. This is in sharp contrast to the property rights system of intellectual property law and can be explained by the differing nature of the transactions covered by the UCC. As noted earlier, intellectual property transactions often have only two readily identifiable parties, transaction costs that are relatively low and damages that are difficult to value, all of which justify a strong property rule to help realize the purposes of encouraging inventive and creative activity. In contrast, although commercial transactions often involve only two parties—buyer and seller—many transactions are faceless, making it both more difficult to identify particular parties and expensive to contract on an individual basis. Moreover, as a general rule, Article 2 goods are readily valued, making damages easy to calculate and helping to justify a liability rule.

As intellectual property, despite its property rights orientation, contains some liability rules, the UCC, despite its liability rules bent, contains some property rules. Where the buyer is unable to make itself whole through resort to a market transaction, it may be entitled to specific performance under § 2-716. Similarly, where the seller is unable to resell the goods, it may be entitled to recover the price under § 2-709. These "specific performance" remedies are rarely awarded because market transactions should suffice to make the aggrieved party whole in the

93. Calabresi & Melamed, supra note 16, at 1092 ("Whenever someone may destroy the initial entitlement if he is willing to pay an objectively determined value for it, an entitlement is protected by a liability rule."); see also Merges, supra note 41, at 77 (explaining that because it is normally easy to value a contracted-for exchange by resort to an objective market price, courts are able to measure damages accurately, and a liability rule is therefore appropriate). Perhaps the most extreme statement of the liability principle in contracts, made by Oliver Wendell Holmes, substantially pre-dates Calabresi & Melamed. As stated:

If we look at the law as it would be regarded by one who had no scruples against doing anything which he could do without incurring legal consequences, it is obvious that the main consequence attached by the law to a contract is a greater or less possibility of having to pay money.

Oliver Wendell Holmes, The Common Law 247-48 (Mark D. Howe ed., 1963); see also Oliver Wendell Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, —and nothing else.").

94. See supra notes 46-47 and accompanying text.

95. See Merges, supra note 41, at 77-78 ("Because it is relatively easy in most cases to determine the value of the contracted-for exchange by reference to an objective market price, it is possible for a court to accurately calculate the appropriate compensation for the injured party.").

96. See supra notes 48-50 and accompanying text (explaining the liability rules contained in the intellectual property statutes).

97. See infra notes 208-11 and accompanying text (describing the specific performance remedy).

98. See infra notes 183-86 and accompanying text (describing the seller's remedy for the price).
majority of circumstances.

Analyzed separately then, both federal intellectual property law and the UCC represent reasoned responses to particular economic problems. Those responses include the remedial provisions which are closely connected to realizing the overall statutory goals. In a generic case that addresses only intellectual property infringement or a UCC breach of contract, there is no difficulty in giving effect to the remedial provisions of the separate statutes and therefore no difficulty in effectuating the respective statutory purposes. However, there are certain cases that implicate both intellectual property infringement and a UCC breach of contract action. The issue in such cases is whether a remedy may be fashioned which will uphold the goals of both statutory schemes. Therefore, this Article now turns to specific cases in which courts have addressed that question.

II. THE PROBLEM—FEDERAL INTELLECTUAL PROPERTY RIGHTS V. THE RIGHTS OF AGGRIEVED “SELLERS” AND “BUYERS” UNDER THE UCC

Under the Patent and Copyright Acts, if a person exercises one of the rightholder’s exclusive rights without a license or exceeds the scope of the license it does have, that person is an infringer and may be enjoined from further infringement and held liable for substantial damages.99 Likewise, under the Lanham Act, a person who uses a registered mark in commerce in a manner likely to cause confusion or who exceeds the scope of its trademark license, is liable for infringement.100

Infringement liability seems, at first glance, to present no conflict with ordinary contractual considerations. However, it is common for the rightholder (licensor) to enter into license agreements with one or more other parties (licensee(s)), authorizing the licensee to utilize one or more

---

100. Any person who shall, without the consent of the registrant —
(a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or
(b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive shall be liable in a civil action by the registrant for the remedies hereinafter provided.

of its intellectual property rights in producing and/or marketing Article 2 goods. If the rightholder wrongfully terminates the license agreement or otherwise breaches, leading to termination, under intellectual property law, this termination ends the licensee's right to exercise the intellectual property rights granted in the agreement. Thus, the licensee may be unable effectively to utilize its applicable UCC remedy of resale or cover because the relevant remedy would require the licensee to exercise rights which it no longer has, and therefore may constitute infringement.

A. The Licensee as Aggrieved Seller

Patent, trademark, or copyright owners may choose to license some or all of their rights to others for a number of reasons. Perhaps chief among these is maximization of profit. Often the owner of the intellectual property right does not possess the manufacturing facilities to produce the profit-maximizing level of output of the patented, trademarked or copyrighted article. The rightholder will maximize the value of its federal right by licensing third parties to manufacture the article under state contract law.

These licenses vary in form but may be characterized for simplicity's sake as involving either an outsourcing or a resale arrangement. Under an outsourcing arrangement, the licensee manufactures the product for resale to the rightholder/licensor who in turn markets to the public. The
licensor pays the licensee for the goods that it manufactures. This arrangement is attractive when the licensor lacks sufficient productive capacity to manufacture the article cost-effectively and expansion of that capacity would be more expensive than contracting with another party to manufacture the goods.

Alternatively, the licensor may authorize the licensee not only to manufacture the product but also to resell it directly to customers. The licensee then usually pays the licensor a royalty on each unit sold. This arrangement eliminates the costs of the licensee's shipping the product back to the licensor as well as the licensor's resale costs. However, the licensor may lose some control over the quality of the finished product unless it retains the right to conduct meaningful periodic inspections.\(^{105}\)

The ostensible collision between the remedial provisions of federal intellectual property law and the UCC occurs when the licensor wrongfully terminates the license agreement or otherwise breaches, leading to termination. On breach by the licensor, the licensee in either an outsourcing or resale arrangement is in the position of an aggrieved seller. If intellectual property rights were not involved, the licensee-seller would be free to resell the goods in the market as a self-help remedy. However, because the termination of the license also terminates the right to sell the goods, any resale could be considered infringing. Thus, federal intellectual property law may function to limit the remedial options which would otherwise be available to the aggrieved licensee.

1. Early caselaw

Cases addressing the relationship between UCC remedies and infringement actions are relatively few in number. In 1963, the Second Circuit, in \textit{Platt \& Munk Co. v. Republic Graphics Co.},\(^{106}\) addressed the question under the UCC's predecessor, the Uniform Sales Act. Platt \& Munk had licensed certain of its copyrights to Republic Graphics so that Republic could produce educational toys for resale to Platt \& Munk.\(^{107}\) Platt \& Munk alleged that the goods Republic had delivered were defective and refused to accept delivery of later shipments for the same reason.\(^{108}\) Republic sought to resell the goods that it had manufactured while Platt \& Munk brought suit seeking an injunction to stop the resale as well as damages for copyright infringement on those goods that Republic had already resold.\(^{109}\) In upholding the injunction, the court noted that Republic might have had a contractual right to sell the goods, but stated that affording the manufacturer the self-help remedy of resale under state

\(^{105}\) Another way to express this idea is that the licensor will incur some costs in policing its licensee/agent.

\(^{106}\) 315 F.2d 847 (2d Cir. 1963).

\(^{107}\) See \textit{id.} at 849.

\(^{108}\) See \textit{id.} at 849-50.

\(^{109}\) See \textit{id.}
RETHINKING REMEDIES

contract law would impair the federally granted rights of copyright in a case in which the copyright owner alleges in good faith that its failure to pay is justified.\textsuperscript{110}

The \textit{Platt \& Munk} case is interesting primarily for its dicta suggesting that in an appropriate case, the aggrieved manufacturer should be given the right to resell:

We see no reason why the copyrighted character of the goods should preclude these remedies when—and the qualification is vital—the person for whom the goods were being made unjustifiably declines to pay the price. In such event... the copyright owner has received "his reward;" if consent on his part is needed, there would be at least as much basis for implying it, or for holding him estopped to deny it.\textsuperscript{111}

\textit{Platt \& Munk} was the first case to suggest that despite the existence and termination of a license of federally created rights, the state law remedy of resale may still be available to an aggrieved seller based on an implied license theory.\textsuperscript{112} However, the \textit{Platt \& Munk} court was quite vague about whether the aggrieved seller could exercise its resale remedy without a prior adjudication of some type that its breach of contract claim had merit. A requirement that the aggrieved licensee first obtain such an adjudication would devalue the self-help nature of the resale remedy by increasing the aggrieved party's costs and delaying its ultimate compensation.

In the trademark context, the court in \textit{Burberrys (Wholesale) Limited v. After Six Inc.},\textsuperscript{113} took a less generous view in considering whether an aggrieved seller should be entitled to a resale remedy under an implied license theory.\textsuperscript{114} Burberrys had granted a trademark license to Abraham

\begin{itemize}
  \item \textsuperscript{110} See \textit{Platt \& Munk}, 315 F.2d at 855.
  \item \textsuperscript{111} \textit{Id.}
  \item \textsuperscript{112} The doctrine of implied licenses is less well developed in copyright law than under patent law. \textit{See infra note} 199 (discussing implied patent licenses). Copyright licenses may be implied in particular circumstances. \textit{See, e.g.}, IA.E., Inc. \textit{v. Shaver}, 74 F.3d 768, 776-77 (7th Cir. 1996) (implying a license in favor of defendant construction companies for preliminary drawings of an airport hanger where the architect prepared the drawings for a fixed fee, gave the drawings to others intending that they be copied in connection with the building project, the contract did not contemplate copyright, and the architect delivered the designs without warning that he would consider further use to be copyright infringement); Effects Assocs. \textit{v. Cohen}, 908 F.2d 555, 556-59 (9th Cir. 1990), \textit{cert. denied}, Danforth \textit{v. Cohen}, 498 U.S. 1103 (1991) (implying a license to use special effects footage created at the defendant's request and given to the defendant with the intent that the defendant copy and distribute it); Oddo \textit{v. Ries}, 743 F.2d 630, 632-34 (9th Cir. 1984) (holding that plaintiff partner impliedly licensed partnership to use a manuscript based on the plaintiff's pre-existing articles prepared as part of partnership duties but limiting the scope of the license); \textit{American Inst. of Architects v. Fenichel}, 41 F. Supp. 146, 147-48 (S.D.N.Y. 1941) (holding that where the plaintiff put a book of forms on the general market, the plaintiff impliedly authorized private use of the forms by book purchasers). \textit{See also} MacLean Assocs. \textit{v. Mercer-Meidinger-Hansen, Inc.}, 952 F.2d 769, 778-79 (3d Cir. 1991) (holding the scope of an implied license to be exceeded).
  \item \textsuperscript{113} 471 N.Y.S.2d 235 (1984).
  \item \textsuperscript{114} The grant of implied licenses is perhaps more restrictive under trademark than under
Zion Corp. to manufacture 30,000 raincoats bearing the "Burberrys" mark.\textsuperscript{115} Zion manufactured 22,000 of the raincoats and shipped them to Burberrys' retailers expecting Burberrys to pay for the coats.\textsuperscript{116} Because of an unspecified dispute, Burberrys did not give cutting orders to Zion for the remaining coats.\textsuperscript{117} When Zion sought to manufacture and resell the remaining coats, Burberrys sued for an injunction to prevent the manufacture and resale, contending that any trademark license that had existed had been canceled.\textsuperscript{118}

The court began with the premise that "continued use of a trademark by the licensee after its expiration constitutes an infringement."\textsuperscript{119} It implied that the goals of trademark law would be undermined by allowing Zion to manufacture and resell the coats even under Burberrys' specifications:

In trademark infringement cases the likelihood of confusion is inherent in the infringement itself because the consumer would be misled into believing that the trademark owner either manufactured or authorized the use of the product. Thus, it is no excuse that the item is manufactured with the same quality as the trademark product for plaintiff is still entitled to have its reputation within its control.\textsuperscript{120}

The court rejected Zion's reliance on § 2-706 of the UCC, stating that "a sale by the defendant could not be considered to be made in good faith and to be commercially reasonable. Section 2-706 does not purport to grant a trademark license...."\textsuperscript{121} The court did not seem concerned about Zion's receipt of its expectancy damages as it noted that Burberrys was solvent and "[could] respond in money damages to any claim made by [Zion]."\textsuperscript{122} The court also stated that Zion might "resort to its other

either patent or copyright law. Trademark law imposes a quality control requirement on the trademark owner that neither patent nor copyright requires. According to one commentator, a trademark license may be implied where the licensor purports to grant rights that it does not have but later acquires them. See Dratler, supra note 103, §§ 3.04(8), at 3-66. McCarthy seems to take a broader view than Dratler, contending that "[s]ome courts will imply both a trademark license and a requirement for quality control from the dealings of the parties." McCarthy, supra note 32, § 18.14[2], at 18-67. See generally Bill Blass, Ltd. v. Saz Corp., 751 F.2d 152, 154-56 (2d Cir. 1984) (refusing to imply a license where the original license had expired even though the defendant would have to remove plaintiff's labels from clothing prior to sale to avoid infringement); Birthright v. Birthright, 827 F. Supp. 1114, 1135 (D.N.J. 1993) (noting that a license may be implied where both parties understand the arrangement but that such a license also may be terminable at will).

\textsuperscript{115} See Burberrys, 471 N.Y.S.2d at 236.
\textsuperscript{116} See id.
\textsuperscript{117} See id.
\textsuperscript{118} See id.
\textsuperscript{119} Id. (citations omitted).
\textsuperscript{120} Burberrys, 471 N.Y.S.2d at 237 (citations omitted).
\textsuperscript{121} Id.
\textsuperscript{122} Id. The court also noted that Zion would not be penalized for any failure to mitigate its claim since the case was grounded in trademark infringement rather than contract law. Id.
remedies under the Uniform Commercial UCC."^{123}

In contrast to *Burberrys*, in *Monte Carlo Shirt, Inc. v. Daewoo International Corp.*, the Ninth Circuit held that there was no trademark infringement under the California common law of trademark where a manufacturer resold trademarked shirts without permission.^{125} The Ninth Circuit ruled in this manner even though a court had adjudicated the manufacturer/licensee to be in breach of the contract with the trademark owner. Monte Carlo had contracted for Daewoo to manufacture men's shirts bearing Monte Carlo's trademark.^{126} Monte Carlo rejected the shirts because they would not be available for sale in time for the Christmas shopping season.^{127} Daewoo's American subsidiary resold the shirts bearing the Monte Carlo trademark to discount retailers.^{128}

In earlier proceedings, a jury had awarded Monte Carlo damages for breach of contract and common law trademark infringement.^{129} On appeal, the court framed the issue as "whether the unauthorized sale of a genuine, unaltered product initially manufactured for the plaintiff can form the subject of a trademark claim."^{130} The *Monte Carlo* court took a different approach from the *Burberrys* court and held that the trademark policy of preventing public confusion about the source of goods was not implicated because the shirts sold by Daewoo "were the genuine product, planned and sponsored by Monte Carlo and produced for it on contract for future sale."^{131} The fact that Daewoo had breached its contract with Monte Carlo, thus probably terminating its license to Monte Carlo's trademark, did not factor in the court's decision on the trademark issue.^{132}

The *Burberrys* and *Monte Carlo* cases are difficult to reconcile, as the former suggests that the sale of even the genuine article after the expiration of the trademark license constitutes infringement while the latter suggests the opposite. This difference could be attributable to the fact that *Burberrys* was decided under the Lanham Act and *Monte Carlo* under California's common law of trademark. In fact, the Ninth Circuit has implied in a later case that Monte Carlo might have been decided differently under the Lanham Act.^{133}

---

123. *Id.*
124. *707 F.2d* 1054 (9th Cir. 1983).
125. *See id.* at 1056-58.
126. *See id.* at 1055.
127. *See id.*
128. *See id.*
129. *See Monte Carlo, 707 F.2d* at 1056. However, the jury denied relief on the California Unfair Practices Act claim, and the court directed a verdict for Daewoo on the Lanham Act claim. *See id.*
130. *Id.* at 1057 n.3.
131. *Id.* at 1058.
132. However, the court did note that Daewoo's unauthorized sale might give rise to a claim in contract but that Monte Carlo did not plead the case in that manner. *Id.* at 1057.
133. *See Intel Corp. v. Terabyte Int'l, Inc., 6 F.3d* 614, 620 (1993) ("In *Monte Carlo*, we were
Trademark law under the Lanham Act is unsettled with respect to the circumstances under which a licensed manufacturer may resell the goods after a dispute.\textsuperscript{134} The issue is perhaps more difficult under trademark law than either patent or copyright law because of trademark's consumer protection goal.\textsuperscript{135} In part to effectuate that goal, the Restatement drafters have adopted the view that a manufacturer may not resell trademarked goods even if the trademark owner wrongfully rejected them.\textsuperscript{136}

Thus, the law with respect to the aggrieved seller in the context of both copyright and trademark is unclear. There is some suggestion that courts will imply a license to allow an aggrieved licensee to exercise its UCC remedy of resale, but the scope of such a license as well as the circumstances under which it would arise remain in doubt. The courts have not yet addressed in detail the underlying policy considerations of

\begin{itemize}
\item not construing the Lanham Act, rather we were applying California state common law. More importantly, on the facts of that case we determined that the products in question were genuine, both as to source and, most notably, as to quality.
\item see also Alces \& See, supra note 9, at 492-94 (criticizing Monte Carlo, contending that the court misstated the test for trademark infringement and stating that the goods were not genuine because they were not within the control of Monte Carlo). However, the fact that the Monte Carlo court directed a verdict for Daewoo on Monte Carlo's Lanham Act claim suggests that the result would have been the same even under the Lanham Act.
\item These cases often involve "gray market goods." "Gray market goods are goods produced abroad under a trademark that properly identifies the source of the goods in the country of origin, but which are subsequently marketed in [the U.S.] without the consent of the owner of the trademark in the United States." Restatement (Third) of Unfair Competition § 24 cmt. e (1995). For good discussions and reviews of cases in this area, see Theodore H. Davis, Jr., Lever Bros. v. United States and the Legality of Gray Market Imports: A New Shield for United States Trademark Owners in Transnational Markets, 28 Wake Forest L. Rev. 571 (1993); Deborah B. Levine, Gray Skies for the Gray Market in the Wake of Lever Brothers v. United States, 24 U. Tol. L. Rev. 943 (1993); Shira R. Yoshor, Competing in the Shadowy Gray: Protecting Domestic Trademark Holders from Gray Marketeers Under the Lanham Act, 59 U. Chi. L. Rev. 1363 (1992). The gray market goods cases involve breach by the licensee. This Article does not advocate that the licensee be allowed to exercise its UCC remedies of resale or cover where the licensee itself has breached.
\item See supra notes 31-37 and accompanying text (discussing the purposes of trademark law).
\item Trademarked goods produced by a manufacturer under contract with the trademark owner should not be considered genuine goods until sale of the goods under the mark has been authorized by the trademark owner. Thus, if the trademark owner rejects the goods, the manufacturer may not use the mark in reselling the goods to others. This principle should apply without regard to whether the rejection constitutes a breach of contract by the trademark owner.
\end{itemize}

\textit{Restatement (Third) of Unfair Competition § 24, cmt. e (1995).}

The Restatement drafters believed that this rule best protected consumers. \textit{Id.} (acknowledging that while a tenable argument exists for allowing resale by the aggrieved manufacturer, the better policy is to protect consumers from the confusion that may result if the goods are sold without the trademark owner's authorization). \textit{See also infra} notes 285-91 and accompanying text (acknowledging that because trademark has a consumer protection rationale, it may be appropriate to award the price or specific performance).
intellectual property and contract law in an attempt to formulate a logical, consistent rule for contracting parties to consider when negotiating agreements.

2. **The most recent decision: McCoy v. Mitsuboshi Cutlery, Inc.**\(^{137}\)

The Federal Circuit has injected some certainty into the debate at least with respect to patent law\(^{138}\) by recognizing that where the licensor has breached the contract, the licensee may have an implied license to resell under the UCC.\(^{139}\) In *McCoy v. Mitsuboshi Cutlery, Inc.*, the court addressed a case in which McCoy had licensed its patents and trademarks on certain shrimp deveining knives to Mitsuboshi.\(^{140}\) Mitsuboshi was to manufacture the shrimp knives and resell them to McCoy’s marketing agency, A.T.D. Marketing, Inc. (ATD).\(^{141}\) ATD refused to accept conforming knives.\(^{142}\) McCoy failed to pay for the knives or to instruct Mitsuboshi as to their disposition.\(^{143}\) Mitsuboshi then resold the knives.\(^{144}\) McCoy sued Mitsuboshi for patent and trademark infringement and Mitsuboshi counterclaimed for breach of contract.\(^{145}\) The jury

---

138. Congress established the Federal Circuit in an attempt to bring some uniformity to patent law decisions. “[T]he Federal Circuit follows the guidance of the regional circuits in all but the substantive law fields assigned exclusively to it by Congress.” Robert L. Harmon, Patents and the Federal Circuit, § 15.2(b), at 585 (2d ed. 1991). The court considers the grant of preliminary injunctions against patent infringement as one such substantive issue reserved to it. See *id.* at 584 (noting that “assignor estoppel and separation of inequitable conduct issues for nonjury trial” are considered substantive issues reserved to the Federal Circuit). It is expected that lower courts will still look to the Federal Circuit for guidance even in cases where the Federal Circuit’s holding does not officially bind them. See *id.* at 585.
139. The law of implied licenses is fairly well developed under patent law. Implied patent licenses have been granted in situations involving the sale of nonstaple components, the use of purchased items in a patented process, authorized modifications to patented items, after-acquired patents and shop rights circumstances. See Dratier, *supra* note 105, § 3.04[3]-[7], at 3-37 to 3-60 (explaining circumstances in which each situation is likely to arise and collecting cases); Moore & Mayfield, *supra* note 9, at 4-5 (reviewing the fact patterns in which courts have granted implied licenses). Courts have also found implied licenses in cases not fitting comfortably within Dratler’s paradigm. See, e.g., De Forest Radio Tel. Co. v. United States, 273 U.S. 236, 241 (1927) (holding that conduct may constitute consent and thereby a patent license in circumstances in which AT&T assisted the U.S. in making patented audions and furnished necessary information for such manufacture: “No formal granting of a license is necessary in order to give it effect. Any language used by the owner of the patent, or any conduct on his part exhibited to another from which that other may properly infer that the owner consents to his use of the patent ... constitutes a license ...”); Wilder v. Kent, 15 F. 217, 219-220 (C.C.W.D. Pa. 1883) (holding that the law may imply a license in the case of an involuntary sale such as a sheriff’s foreclosure sale).
140. *Mitsubishi*, 67 F.3d at 919.
141. *See id.*
142. *See id.* “The record contains no suggestion that the knives were defective.” *Id.*
143. *See id.*
144. *See id.*
145. *Mitsubishi*, 67 F.3d at 919. Mitsuboshi also sued under both federal and Texas unfair competition law and for recovery under Texas tort law. *See id.*
returned a verdict against Mitsuboshi on the infringement claims and in Mitsuboshi's favor on the breach of contract claim. 146

The Federal Circuit, drawing on the Platt & Munk case and other earlier implied license cases, held that Mitsuboshi had implied patent and trademark licenses under the UCC to resell the knives. 147 The implied licenses ostensibly arose from the long-term relationship between McCoy and Mitsuboshi and from the former's wrongful refusal to pay or accept the knives or to give reasonable instructions for their disposition. 148 Moreover, clarifying an issue left in doubt by Platt & Munk, the court held that "Mitsuboshi's right to resell under Texas law . . . did not require a prior adjudication that McCoy acted wrongfully in refusing to pay for the knives." 149 Without going into a detailed policy discussion, the court noted that its implied license "does not offend the protection afforded patent and trademark rights by federal law" as the enforcement of the contract (license) is a matter of state contract law which is generally not preempted by the federal intellectual property statutes. 150

Currently then, the licensee as an aggrieved seller is faced with legal uncertainty. Burberry's and the Restatement suggest that the resale of a trademarked product after breach by the licensor will constitute trademark infringement while Mitsuboshi suggests otherwise. Platt & Munk and Mitsuboshi taken together suggest that an aggrieved licensee/seller may resell under copyright or patent law but the law is by no means certain. This legal uncertainty makes the resale remedy less attractive for the licensee than it otherwise would be because the licensee's damages for breach of contract may be offset by infringement damages which it must pay to the licensor.

B. The Licensee as Aggrieved Buyer

Depending on the form of the license agreement, the licensee may be characterized in UCC jargon as a buyer rather than a seller. However, it is much less common for the licensee to be in the position of an aggrieved buyer than an aggrieved seller. The primary situation in which the licensee would be in the position of an aggrieved buyer is when it requires the

146. See id. at 919-20 (noting that the jury also found against Mitsuboshi on the unfair competition and tortious interference causes of action).
147. See id. at 920-22 (reviewing cases finding implied licenses in voluntary and involuntary sales:
In the case of the self-help [re]-sale, the patent holder has defaulted on a contractual obligation based on patented merchandise. Under commercial law, the aggrieved seller can sell the merchandise and recover any losses from the breaching buyer. Absent an implied license . . . , patent holders could frustrate otherwise available commercial remedies.).
148. See id. at 922.
149. Id.
150. Mitsuboshi, 67 F.3d at 922 ("Intellectual property owners 'may contract as they choose,' . . . , but their intellectual property rights do not entitle them to escape the consequences of dishonoring state contractual obligations.") (citation omitted).
licensor's intellectual property rights to manufacture the protected product for its own internal use rather than for resale to the rightholder or the public.\footnote{151}

In other cases, the buyer is just that—a buyer rather than a "true" licensee. For example, resale arrangements often call for the licensor to manufacture the product and market it to or through the buyer. In such cases, the buyer is not a licensee.\footnote{152} It has not purchased a license to the underlying intellectual property; rather, it has purchased the good which embodies that intellectual property. However, in the event of breach by the rightholder, the buyer may seek an implied license to exercise its right to cover and to obtain exactly the goods for which it had contracted.

The judicial authority in these contexts is even more sparse than where the licensee may be characterized as an aggrieved seller. Additionally, the cases involve buyers rather than true licensees.\footnote{153} In \textit{Finley v. Asphalt Paving Co.}, a 1934 Eighth Circuit case, Finley held patents on certain machines used for paving.\footnote{154} St. Louis adopted exclusive specifications for paving requiring use of the Finley patents,\footnote{155} of which National Fin-Mix Corp. was the exclusive licensee.\footnote{156} Asphalt Paving won a paving bid relying on representations by National Fin-Mix that the required machine would be delivered in time for it to complete its contract with the city.\footnote{157} When National Fin-Mix did not deliver the machine, Asphalt Paving contracted with another firm to construct the required mixer.\footnote{158} This construction and the subsequent production of cement required that the contractor and Asphalt Paving practice Finley's patents.\footnote{159} Finley and National Fin-Mix sued Asphalt Paving for patent infringement.\footnote{160}

\footnote{151. \textit{See}, e.g., \textit{Finley v. Asphalt Paving Co.}, 69 F.2d 498 (8th Cir. 1934). For an analysis of \textit{Finley}, see \textit{infra} notes 154-63 and accompanying text.
152. Thus, the cover cases are qualitatively different than the resale cases. In the resale cases described above, the aggrieved seller was a true licensee. In the cover cases, the buyer is often not a true licensee.
153. There is a quite tenable explanation for this. Intellectual property, as a public good, has the property of inexhaustibility. \textit{See supra} note 20 and accompanying text (noting the public goods problem inherent in intellectual property). Therefore, unlike the resale cases where the licensor may be buying goods back from the licensee and has an incentive to breach if it finds a third party able to sell the goods to it at a lower price, the licensor has less incentive to breach the agreement with its buyer/licensee even if a third party offers to pay more for a license. The licensor will simply license the same information to the third party at the higher rate because the supply of the information is not exhausted by the first license or any subsequent license. This assumes, of course, that the licensor has not entered into an exclusive agreement with a particular licensee.
154. \textit{Finley}, 69 F.2d at 498.
155. \textit{See id.} at 504.
156. \textit{See id.} at 498.
157. \textit{See id.} at 501.
158. \textit{See id.} at 502.
159. \textit{See Finley}, 69 F.2d. at 505.
160. \textit{See id.} at 498.
The Eighth Circuit could not look to the UCC for guidance in fashioning a remedy because the UCC had not been promulgated at the time of the court's decision. The court focused on patent law, and held that the plaintiffs had granted Asphalt Paving a license under its patents in a letter agreement:

When the plaintiff proposed in writing to furnish a mixer on certain terms of royalty and deposit and the defendant, in writing, agreed to the proposal and fixed the time of delivery, and the plaintiff indicated its acceptance, there was a completed contract and an effective grant of license.

The court implied that if the letter agreement were insufficient, the plaintiffs had impliedly licensed the patents under the circumstances.

In 1983, the Federal Circuit more specifically addressed the relationship of patent law and the cover provisions of the UCC in H.M. Stickle v. Heublein, Inc. Stickle owned certain patents related to taco shell frying machines. Heublein acquired a number of Stickle fryers and contracted with Stickle for the design of an automated production line that included a high speed four-row fryer. Later, Heublein planned to build two additional production lines that would require additional fryers. Heublein offered to do the design work and have Stickle's company, La Hacienda, or a third party manufacture the fryers. After failing to enter into a satisfactory licensing agreement with La Hacienda, Heublein contracted with Heat and Control, Inc. (HCI) for the manufacture of the fryers, indemnifying HCI against infringement of Stickle's patents.

When Stickle's estate sued Heublein for patent infringement, Heublein defended by asserting an implied license under the UCC's cover provisions. Specifically, it alleged that La Hacienda had repudiated its

---

161. See supra note 59 (discussing the history of the UCC).
162. Finley, 69 F.2d at 504.
163. See id. at 505. "The conclusion of the trial court that the default of the plaintiff corporation in furnishing the defendant a mixer as agreed by the terms of the contract gave the defendant the right to procure it elsewhere and use the method, is fully sustained by the authorities." Id.
164. 716 F.2d 1550 (Fed. Cir. 1983).
165. See id. at 1553-54.
166. See id. at 1554 (noting that Heublein acquired a number of fryers when it acquired Zapata Foods, Inc., a taco shell production facility which used Stickle fryers. Heublein later purchased additional fryers from Stickle.).
167. See id. at 1555.
168. See id. ("Heublein was prepared 'to do all the design work itself and reserve only the fabrication of the fryers to La Hacienda, [or]... to have a third party vendor supply the fryers, for which Heublein would pay a royalty to La Hacienda.").
169. See Stickle, 716 F.2d at 1556.
170. See id. (arguing in the alternative, Heublein asserted the invalidity of Stickle's patent claims, "den[ied] that its fryers fell within the claims... [and] further asserted as affirmative defenses that it had a valid license and/or that it had been induced to infringe with Stickle's full knowledge and approval and that the plaintiffs were therefore estopped to accuse
obligation under the original contract to supply additional fryers and that this repudiation gave Heublein the right to cover to mitigate damages.\textsuperscript{171}

The court rejected the breach of contract claim, holding that the original contract did not create an obligation on the part of La Hacienda to furnish the fryers for the new production lines.\textsuperscript{172} The court stated that because "no anticipatory breach [had] occurred, Heublein had no right to 'cover' the contract and, thus, no implied license."\textsuperscript{173} This language leaves the inference that had an anticipatory breach occurred, Heublein would have been granted an implied license to cover.

Thus, the law with respect to the licensee as an aggrieved buyer is perhaps even more unclear than where the licensee is an aggrieved seller. There is no authority holding that an implied license will be granted to allow an aggrieved licensee to exercise its right to cover either internally or by authorizing a third party to produce the good at issue. Additionally, the courts have failed to recognize the difference between a true licensee who relied on an ability to exercise an intellectual property right and a mere buyer who did not, and to consider whether this difference should affect the remedial options available to the aggrieved party.

III. BARGAINING AGAINST THE BACKDROP OF CURRENT LAW

The relative scarcity of case law addressing the relationship of intellectual property law and UCC remedies might be interpreted to suggest that the issue has had and will continue to have little impact on technology licensing. However, that conclusion is by no means compelled. In fact, the legal rule on remedies affects the structure of negotiations. This Section argues that the uncertainty of the current legal rule is inefficient and may prevent technology licensing deals that would otherwise be desirable from being concluded at all. Even in deals which are concluded, the uncertainty of the rule introduces inefficiencies by increasing bargaining costs. Therefore, this Article now turns to an analysis of how the uncertainty of the legal rule affects the parties' negotiations.

A. Remedies Under the UCC

Any analysis of this issue must begin with an overview of UCC remedies to understand their importance in the overall UCC scheme. The remedial provisions of the UCC were designed in an effort to implement

\textsuperscript{171} See id. at 1558 ("Heublein first contends, as a basis for an implied license, that La Hacienda repudiated the October 5, 1976 agreement to supply additional [fryers], thereby giving Heublein the right to cover the contract through the use of a third party.").

\textsuperscript{172} See id. at 1558 ("In sum, there can be no breach of an agreement to provide certain goods where the goods sought by the vendee are different from those covered by the agreement.").

\textsuperscript{173} Id. at 1558-59. The court also held that the entire course of conduct of the parties did not support the finding of an implied license based on consent. See id. at 1559; see also supra note 139 (setting forth the implied license doctrine).
the UCC's goals as set forth in § 1-102(2). In particular, the UCC drafters sought to provide maximum flexibility for aggrieved parties by providing that remedies should be "liberally administered" and "cumulative in nature." Further, the drafters explicitly adopted the expectation theory of damages in § 1-106(1) and through their implementation of particular damage provisions, intending to encourage efficient breach. The following analysis considers in detail how the UCC's damage rules help to encourage efficient breach and, more specifically, why the remedies of resale and cover are important in helping the UCC realize its goals.

1. Sellers' remedies

Consider a simple hypothetical example: Patentee owns a patent on key components of a particular type of machine. Patentee does not have sufficient productive capacity to maximize the profits that may be reaped through exploitation of the patent. Patentee contracts with Licensee under an agreement which authorizes Licensee to manufacture 15,000 units of the machine, with Patentee to pay Licensee $100 per unit. At the simplest level, Patentee's expectation is to spend $1,500,000 and receive 15,000 machines while Licensee's expectation is to receive $1,500,000 in payment from Patentee for the sale of 15,000 units. Under the UCC's remedial philosophy then, in the event of a breach by Patentee, any remedy should result in Licensee receiving $1,500,000 for the sale of 15,000 units.

Assume that Patentee finds another supplier willing to manufacture the machines for $70 per unit. Assume further that Licensee has completed manufacture of the 15,000 units and that Patentee breaches after taking delivery of 7,500 units. Also assume that Licensee can resell the remaining 7,500 units at a commercially reasonable price of $80 and that the market price at the time and place of tender is $75. Because

174. See supra notes 59-98 and accompanying text (setting forth the Code's goals and explaining how the drafters implemented them).
176. U.C.C. § 2-703 cmt. 1 (1996) ("This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature . . . .").
177. See supra notes 79-81 (describing efficient breach).
178. The Licensee also expects to make a profit from this deal. For example, if Licensee spends $80 to produce each unit, it expects a net profit of $300,000 on completion of the contract ($1,500,000 received from Patentee - 1,200,000 cost of production ($80/unit X 15,000 units)).
179. This assumes that Licensee does not seek to recover lost profits as its measure of damages. See infra notes 192-95 (discussing when lost profits would be the appropriate remedy).
180. Note that three scenarios are possible: (i) Licensor breaches before Licensee begins production; (ii) Licensor breaches after Licensee has manufactured some but not all of the machines; or (iii) Licensor breaches after Licensee has manufactured all of the machines. The text primarily addresses the third scenario. See infra notes 194-95 and accompanying text (describing likely remedies under the first two sets of circumstances).
181. The resale and market prices are often different. See supra note 89 (discussing the
Licensee has already realized $750,000 of its expectancy from the 7,500 units for which Patentee has paid, an expectancy remedy should award Licensee $750,000 on the sale of 7,500 units.

Ignoring the considerations of intellectual property infringement liability that are introduced below, in the event of Patentee’s breach, the UCC would afford Licensee a number of remedies as an aggrieved seller.\(^{182}\) Intuitively, the most obvious way of assuring the seller its expectancy is to order performance of the contract. If the contract is performed, the licensor receives the goods and the licensee the contract price. In this case, Patentee would have to pay Licensee the remaining $750,000 and Licensee would deliver to Patentee the remaining 7,500 units.

This “specific performance” remedy—the aggrieved seller’s action for the price—is, however, rarely awarded because of efficiency considerations. Often, if the buyer has breached the contract, it no longer wants the goods. If the buyer were forced to pay the price and to accept the goods, it would most likely scrap or resell them. However, between the buyer and the seller, the seller is usually in a better position to maximize the amount received on resale of the goods as the seller knows more about the market.\(^{183}\) In keeping with the principle of mitigation of damages then, § 2-709 of the UCC awards the price in circumstances in which, as a general rule, the seller’s advantage in resale is missing:\(^{184}\) where the buyer has accepted the goods,\(^{185}\) the goods have been lost or destroyed after their risk of loss has passed to the buyer, or the seller is unable to resell the

possibility for the aggrieved seller to “game” its recovery). The market price is measured at a snapshot in time and is thus unlikely to match the resale price, particularly in a rapidly changing market. Additionally, the seller may be able to find an idiosyncratic buyer willing to pay more than the market price. Finally, an obvious question would be why the second supplier would manufacture and sell the machines to Patentee at $70 per unit when it could sell them on the market for $75. The easy answer is that the supplier has no right to the patent and therefore cannot manufacture the machine without entering into a deal with Patentee. Additionally, the license with Patentee may offer other benefits—e.g., rights to patented improvements—that make the $70 price worthwhile to the supplier.


183. See Schwartz & Scott, supra note 61, at 356 (“A broad rationale for limiting an action for the price is that the seller generally can resell the goods more efficiently because selling is his business.”). For a more detailed economic explanation, focusing on the costs of bribery and negotiation, of the Code’s reluctance to award the price, see Schwartz, supra note 79, at 286 n.48.

184. Schwartz & Scott, supra note 61, at 356 (“In sum, section 2-709(1)(a) applies whenever the assumption that sellers have a superior ability to resell seems invalid.”).

185. Acceptance is defined under the UCC:

   (1) Acceptance of goods occurs when the buyer
   (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
   (b) fails to make an effective rejection . . . or
   (c) does any act inconsistent with the seller’s ownership. . . .

goods at a reasonable price.\textsuperscript{186}

None of the cases addressing the remedies available to the licensee in the position of an aggrieved seller have considered whether the price should be awarded under § 2-709. At first glance, the factual situations in which licensees are seeking a remedy do not seem to fit within the literal wording of § 2-709.\textsuperscript{187} Thus, a party considering entering into a license transaction is not likely to consider the price to be a meaningful remedy in the event of breach. However, other UCC remedies—particularly those requiring resort or reference to the market—will play a key role in the negotiations.

Under § 2-706, (the seller's right to resell), Licensee resorts to the market and sets its damages by reselling the goods. In this example, Licensee's damages would be:

\begin{tabular}{|l|c|}
\hline
Contract Price & 7,500 units x $100 = $750,000 \\
- Resale Price & - 7,500 units x $80 = 600,000 \\
+ Incidental Expenses & + Incidental Expenses \\
- Expenses Saved & - Expenses Saved \\
\hline
Damages & $150,000 + Incidentals - Expenses Saved \\
\hline
\end{tabular}

Thus, § 2-706 awards Licensee its expectancy as Licensee sold 7,500 units to Patentee for $750,000 and sold 7,500 units on the market for $750,000 after the award of damages ($600,000 resale price + 150,000 damages). Licensee ends the transaction having manufactured and sold 15,000 units for $1,500,000—exactly where it expected to be when it entered into the contract.\textsuperscript{188} Moreover, Patentee has done better than its expectancy.

\textsuperscript{186} See U.C.C. § 2-709(1) (1996).

\textsuperscript{187} But see infra notes 292-93 and accompanying text (discussing the possible extension of § 2-709(1)(b) to licensors). A strong case may be made that the price should be awarded in many of these transactions.

\textsuperscript{188} However, note that Licensee's receipt of its expectancy depends on its full recovery of incidental and other damages. See Craswell, \textit{supra} note 81, at 637 ("[E]xpectation damages as awarded in law often fall short of a truly compensatory measure due to the exclusion of such items as attorneys' fees, unmeasurable subjective losses, and 'unforeseeable' damages.") (footnote omitted). As Professor Schwartz notes in the case of the aggrieved buyer:

In many cases damages actually are undercompensatory. Although promisees are entitled to incidental damages, such damages are difficult to monetize. They consist primarily of the costs of finding and making a second deal, which generally involve the expenditure of time rather than cash; attaching a dollar value to such opportunity costs is quite difficult.

Schwartz, \textit{supra} note 79, at 276 (footnote omitted). This concern also applies to aggrieved sellers. Moreover, unlike buyers, sellers are not explicitly awarded consequential damages under the Code which leads to a further risk of undercompensation. See \textit{generally} White & Summers, \textit{supra} note 59, § 7-16, at 287-90 (contending that the omission of recovery of consequential damages for sellers may be attributable to the drafters' failure to consider the possibility of sellers incurring such damage).
Rather than paying $1,500,000 for 15,000 machines, it has paid $1,425,000 ($750,00 of the contract price to Licensee + 150,000 in damages to Licensee + 525,000 to the new supplier (7500 units X $70/unit)). Section 2-706 thus encourages efficient breach—Licensee has received its expectancy and Patentee is better off.\(^8\) If the resale were held to be infringing, Licensee’s damages would be offset by those which it must pay Patentee for infringement. In such a case, Licensee would receive something less than its expectancy while Patentee would fare even better than it already is. The UCC’s goal of encouraging efficient breach would be undermined because damages which undercompensate the aggrieved party encourage excessive amounts of breach.

Under § 2-708(1), Licensee may seek instead to refer to market indicators and recover the contract-market differential. In this case, Licensee would then receive:

<table>
<thead>
<tr>
<th>Contract Price</th>
<th>7,500 units x $100 = $750,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Market Price</td>
<td>- 7,500 units x $75 = 562,500</td>
</tr>
<tr>
<td>+ Incidentals</td>
<td>+ Incidentals</td>
</tr>
<tr>
<td>- Expenses Saved</td>
<td>- Expenses Saved</td>
</tr>
<tr>
<td>----------------</td>
<td>------------------</td>
</tr>
<tr>
<td>----</td>
<td>----</td>
</tr>
<tr>
<td>Damages</td>
<td>$187,500 + Incidentals - Expenses Saved(^9)</td>
</tr>
</tbody>
</table>

Again, Licensee should eventually receive its expectancy—$750,000 on the sales to Patentee plus $750,000 under the damages award of § 2-708(1) ((Resale at $562,500) + 187,500 damages = $750,000) on the sale of 15,000 units.\(^1\) Also, again, this rule encourages efficient breach as Licensee has received its expectancy and Patentee has done better. Rather than paying $1,500,000 for 15,000 units, Patentee has paid $1,462,500 ($750,000 of the contract price to Licensee + 187,500 in damages to Licensee + 525,000 to

---

8. There is some dispute as to whether allowing the breaching party to capture all of the gains from breach is appropriate. For example, some would argue that the $75,000 gain from breach ($1,500,000 - 1,425,000) should be allocated between the breaching and aggrieved parties.

9. These incidental expenses and expenses saved are unlikely to equal those under § 2-706. In fact, they are likely to be larger simply because of the lapse of time. A quick resale often avoids the accrual of incidental damages.

1. This assumes that Licensee resells at the market price of $75 per unit. If Licensee resells at $80 but recovers under § 2-708(1), then it may actually do better than its expectancy: $750,000 on the sales to Patentee plus $787,500 from the damages award under § 2-708(1) (Resale at $600,000 + 187,500 damages), leaving Licensee with a total of $1,597,500 on the sale of 15,000 units, $37,500 better off than its $1,500,000 expectancy. The Code does not explicitly state whether sellers should be allowed to “game” their recovery and receive more than their expectancy. See supra note 89. If the Licensee eventually resells for less than the market price, it will do worse than its expectancy under § 2-708(1) and may seek instead to recover under § 2-706 or its lost profits under § 2-708(2).
the new supplier (7,500 units x $70/unit)). However, note that Licensee only receives its expectancy under § 2-708(1) if it in fact resells the goods. Thus, § 2-708(1) may present the same problem for the licensee in the position of an aggrieved seller as § 2-706: Licensee can only be made whole if it infringes. However, in fact, it will not be made whole. The damages it would have to pay for infringement offset the contractual award of damages, leaving Licensee worse off than its expectancy position and Patentee even better off. The UCC's goal of encouraging efficient breach would again be undermined.

There is somewhat more leeway for a court to fashion damages under § 2-708(1) than under § 2-706. The market price or the amount of incidental damages in the § 2-708(1) damages calculation could be adjusted to account for the fact that the resale would be infringing. This would bring the § 2-708(1) contract-market differential damages much closer to a § 2-709 action for the price.

Another alternative for an aggrieved seller would be to sue for its lost profits. Under § 2-708(2):

If the measure of damages provided in § 2-708(1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article... due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.\footnote{192}

Under a conventional application of this provision, in this hypothetical, lost profits would be the appropriate measure of damages if the licensee had not yet begun production.\footnote{193} If the licensee had manufactured some of the machines before the licensor breached, and on breach made a commercially reasonable decision to stop manufacture,\footnote{194} it would be entitled to lost profits on those machines which were never completed.\footnote{195}

\footnote{192} U.C.C. § 2-708(2) (1996).

\footnote{193} See White & Summers, supra note 59, §7-10, at 264-66 (describing when the award of lost profits is appropriate, including when the seller has never acquired the goods and makes a commercially reasonable decision not to acquire them after hearing of the breach — the "jobber" seller). The licensee who has not yet purchased the materials to begin production is like White's & Summers' jobber.

\footnote{194}

Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

\footnote{195} U.C.C. § 2-704(2) (1996).

\footnote{195} See White & Summers, supra note 59, § 7-10, at 264-66 (describing the "components" seller as one who has the components required for the manufacture of the product on hand when the buyer breaches and stating: "[t]he drafters indicated a second situation as appropriate for the profit remedy of 2-708, namely the situation where a seller-manufacturer... learns of the buyer's breach while in the process of manufacturing the contract
The licensee might also be able to make an argument for lost profits based on its inability to be made whole by recovering the contract-market damages under § 2-708(1). As demonstrated above, the contract-market measure of damages gives the seller its expectancy if the seller actually resells the goods. However, if a resale would be infringing, then the § 2-708(1) remedy may not be adequate to give the seller its expectancy and an award of lost profits might be appropriate.

The licensee in the position of an aggrieved seller must consider that any § 2-706 resale may be infringing, relegating it to § 2-708 to seek damages or § 2-709 to sue for the price. Under § 2-708, the contract-market differential may be available. If the contract-market differential will not put the licensee in its expectancy position, lost profits may be awarded under § 2-708(2). The price is unlikely to be available under current law.

If both § 2-706 and § 2-708 give an aggrieved seller its expectancy, then a logical assumption would be that sellers are indifferent regarding under which section they recover. In fact, a closer look at the two sections demonstrates that there may be many situations in which sellers would prefer to recover under § 2-706. This preference springs from the fact that in some circumstances, there is a greater risk of undercompensation under § 2-708 than under § 2-706.

Under § 2-706, the aggrieved seller will probably maximize its compensation for breach if there is a risk of the buyer's insolvency, in part because § 2-706 is a self-help remedy. The aggrieved seller may minimize costs by immediate resort to the market. Also, the aggrieved seller may never incur litigation costs including attorneys' fees. Admittedly however, if the aggrieved seller proceeds under § 2-706 and the amount received on resale is less than the contract price, it may have to bring suit to collect damages. Additionally, under both § 2-706 and § 2-708(1), the seller may never have to commence litigation because, if the figures are reasonably certain, both parties would be better off settling for the UCC damages and avoiding the litigation expenses of a suit.196

Under § 2-706, the aggrieved seller will probably maximize its compensation for breach if there is a risk of the buyer's insolvency, in part because § 2-706 is a self-help remedy. The aggrieved seller may minimize costs by immediate resort to the market. Also, the aggrieved seller may never incur litigation costs including attorneys' fees. Admittedly however, if the aggrieved seller proceeds under § 2-706 and the amount received on resale is less than the contract price, it may have to bring suit to collect damages. Additionally, under both § 2-706 and § 2-708(1), the seller may never have to commence litigation because, if the figures are reasonably certain, both parties would be better off settling for the UCC damages and avoiding the litigation expenses of a suit. Under § 2-708(2), proving lost profits may be quite expensive

196. See Schwartz & Scott, supra note 61, at 354 (noting that because Code rules may be easily applied, "they importantly affect settlement negotiations").

197. See id. at 363 ("By reselling under section 2-706, the seller can fix his damages with certainty and avoid the proof difficulties of establishing the market price under section 2-708(1).""). This contention is less persuasive for standard, mass marketed goods since the market price should be readily available. See Schwartz, supra note 79, at 285 ("The difference between the contract and market prices is often easily determined, and breaching sellers have an incentive to pay it promptly so as not to have their extra profit consumed by lawyers'
as it requires detailed information regarding the aggrieved seller's cost structure. To the extent that the proof under § 2-706 is less expensive to establish than under § 2-708, litigation costs, including attorneys' fees, should be reduced. Moreover, courts do not uniformly award prejudgment interest, which may result in the seller's being deprived of the time value of money unless it may immediately resort to the market to resell the goods under § 2-706. Courts also do not uniformly award attorneys' fees. As an aggregate matter then, aggrieved sellers seem likely to prefer the § 2-706 remedy as it is more likely fully to compensate them for the breach.

Although there is an absence of empirical evidence proving that sellers prefer to recover under § 2-706, the importance of the resale remedy should not be overlooked. Put simply, the availability of a number of remedial options, including resale, helps to decrease the seller's risk by increasing the probability that the seller will recover its expectancy in the event of breach. The seller's ability to obtain its expectancy is a key factor in encouraging efficient breaches. To the extent that the law's uncertainty reduces the number of remedial options available to an aggrieved party, the UCC's goals are frustrated.

2. Buyers' remedies

For each seller's remedy, there is a counterpart for the buyer. Thus, a consideration of a similar hypothetical helps to illustrate the buyer's remedies. For example, assume that Licensee is engaged in a business which utilizes a particular type of machine. Licensee seeks to practice the patent owned by Patentee in the hypothetical above to produce 15,000 of the patented machines for its own internal use. Licensee agrees to pay Patentee a lump sum of $2,250,000 in exchange for the right to use Patentee's patent in producing the machines. Under the UCC's

---

188. See White & Summers, supra note 59, § 7-13, at 276 (noting the difficulty of the seller's establishing its profit, including what a reasonable amount of overhead would be: "[t]he seller must establish 'the profit (including a reasonable overhead).’ This phrase is likely to be the scene of bloody battles between the accountants of the various parties. One can expect no unanimity among accountants about what is overhead and what is not or about how the overhead is to be allocated to the seller’s various contracts").

189. See Schwartz & Scott, supra note 61, at 363.

190. See Farber, supra note 79, at 1450 (noting that foregone interest usually cannot be recovered as part of a breach of contract damages award).

191. See id. (noting that attorneys' fees are not normally awarded as part of a breach of contract damages award).

192. It is difficult to make any categorical statement about sellers' preferences as litigation over remedies is relatively infrequent, in part because of the certainty of Code rules. See Schwartz & Scott, supra note 61, at 354.

203. Licensee might agree to do this because, for example, the use of the machines may
expectation theory of damages, in the event of Patentee's breach, any remedy should result in Licensee paying $2,250,000 for 15,000 machines.204

Assume that Patentee finds another buyer—Buyer 2—who is willing to pay $2,750,000 for the right to practice the patent for the same number of machines but only if Patentee agrees to license Buyer 2 exclusively. Assume further that Licensee can purchase reasonable substitutes for the machines for $2,400,000205 and that the market price at the time and place at which Licensee learned of the breach was $2,450,000.206

As in the case set forth above discussing the remedies of an aggrieved seller, there is an intuitively obvious means of awarding Licensee its expectancy. As a court can award the aggrieved seller the price under certain circumstances, so too can a court award the aggrieved buyer specific performance.207 If the contract were specifically performed, Licensee would receive a license to practice the patent and pay Patentee the $2,250,000 contract price. Licensee could then produce the 15,000 machines.

As in the case of the seller’s remedy of the price, the buyer’s remedy of specific performance is rarely awarded, again because of efficiency considerations. Generally, the seller will perform the contract unless performance becomes more expensive than breach.208 The buyer can be

allow it to realize production cost savings. For example, assume that Licensee produces a product it resells to consumers. It uses certain machines in the production of this product. By replacing its current machines with the patented machines, Licensee can save $3,000,000 in production costs. It would therefore be worthwhile for Licensee to license the patent: $3,000,000 anticipated cost savings - 2,250,000 paid to Patentee = $750,000 net benefit to Licensee.204

For simplification, this assumes that Licensee does not incur additional costs beyond the license fee in manufacturing the machines.

An obvious question is why would Buyer 2 pay Patentee more than the cover or market price? Buyer 2 may be willing to pay more because it will be the exclusive licensee to the particular patent. Also, the "reasonable" substitutes which Licensee purchases are just that—substitutes which are not identical to the machines it expected to obtain. Licensee will seek to recover the difference in value as part of its damages. The more unique the patented machine, the more likely it is that the prices would diverge. Finally, the point would still hold if the market and cover prices were higher than the price offered by Buyer 2.

In the same way that the resale and market prices are often different, see supra note 181, the cover and market prices are often different. See infra note 216 (discussing possibility for aggrieved buyer to "game" its recovery). The market price is measured at a snapshot in time and is thus unlikely to match the cover price, particularly in a rapidly changing market. Additionally, the buyer may be able to find a bargain or have to pay more than market because it needs the goods quickly.


208. Stated another way, while there are generally any number of reasons for a seller to breach the contract, the most likely one is that the seller has found someone willing to pay more for the goods as in the hypothetical here. Because of the inexhaustibility of intellectual property rights, the licensor generally would not have to breach the original license agreement unless that agreement were exclusive or the new licensee demands an exclusive arrangement as in the textual hypothetical.
made whole by resort to the market, either by making a cover purchase and receiving damages or by receiving the contract-market differential as a damage measurement. However, where the goods are "unique" in the sense that no market for them is readily ascertainable, the courts may lack sufficient information to be able to calculate an accurate amount of damages. Under such circumstances, there is a risk that the buyer will be undercompensated. Thus, under § 2-716 of the UCC, the buyer may be awarded specific performance "where the goods are unique or in other proper circumstances."  

None of the cases addressing the remedies available to the aggrieved buyer have considered whether specific performance should be awarded under § 2-716. In intellectual property cases, the buyer's argument for specific performance under the literal wording of the statute is more obvious than the seller's argument for the price. The fact that a good is patented, copyrighted, or trademarked may be some indicia of uniqueness. However, there is a lack of authority which supports an award of specific performance merely by virtue of the fact that the good is protected by an intellectual property right.

As is the case with aggrieved sellers, the primary remedial framework on which the buyer relies in entering into a contract with the seller is the market damages available under the UCC. Under § 2-712 of the UCC, Licensee resorts to the market and sets its damages by making a cover purchase. In this hypothetical, damages would be calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>$2,400,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Cover</td>
<td>$2,400,000</td>
</tr>
<tr>
<td>- Contract Price</td>
<td>- 2,250,000</td>
</tr>
<tr>
<td>+ Incidentals</td>
<td>+ Incidentals</td>
</tr>
<tr>
<td>+ Consequential</td>
<td>+ Consequential</td>
</tr>
<tr>
<td>- Expenses Saved</td>
<td>- Expenses Saved</td>
</tr>
<tr>
<td>Damages</td>
<td>$150,000 + Incidentals + Consequentials - Expenses Saved</td>
</tr>
</tbody>
</table>

Thus, after breach, Licensee receives its expectancy - 15,000 machines for $2,250,000 ($2,400,000 cover purchase price - 150,000 damages).

209. See Schwartz, supra note 79, at 273-75 (noting the availability of specific performance in cases such as those involving land and long-term requirements contracts).

210. See id. ("Courts will grant specific performance when they perceive that damages will be inadequate compensation.").

211. U.C.C. § 2-716 (1996). According to the Code comments, other proper circumstances may include "[o]utput and requirements contracts involving a particular or peculiarly available source or market," also "inability to cover is strong evidence of 'other proper circumstances.'" U.C.C. § 2-716 cmt. 2 (1996).

212. See infra notes 295-96 and accompanying text (discussing the feasibility of the specific performance option).

213. Two things are noteworthy about the buyers' damages generally. The first is that as is
Moreover, Patentee has done better than its expectancy. Rather than receiving $2,250,000 for a license to build 15,000 machines, Patentee has received $2,600,000 ($2,750,000 price received on the license to the second buyer - 150,000 damages paid to Licensee).\textsuperscript{214} This is an example of the efficient breach\textsuperscript{'} that the UCC remedial rules were designed to encourage.

There is an obvious difference between Licensee's exercising its right to cover in this hypothetical and Licensee's exercising its right to resell in the former hypothetical. When Licensee was the aggrieved seller entering the market to resell the patented item, it was doing an act which would be unauthorized absent a patent license. In contrast, here, the Licensee was able to go into the market and buy reasonable substitute machines. This remedy does not require that Licensee actually practice the patent and therefore presents no conflict with intellectual property law.

Any collision between § 2-712 and intellectual property remedies should occur relatively infrequently. In this example, Licensee will require a license from Patentee in the event of Patentee's breach only if Licensee seeks to cover internally by manufacturing the machines itself or if Licensee opts to cover by licensing the patent to a third party to manufacture the machines. In the former case, internal cover in this context is really synonymous with specific performance. The availability of that remedy is likely to be assessed under § 2-716 rather than § 2-712. The latter case would present the only set of circumstances in which Licensee would require a patent license in order to exercise its cover remedy. Assuming that Licensee paid a third party $2,400,000 to manufacture the machines, the cover damages would be the same as those calculated above. However, the Licensee would do worse than its expectancy if it had to offset its cover damages by the damages it would have to pay Patentee for infringing its intellectual property rights. Again, the UCC's goal of encouraging efficient breach would be undermined by the award of undercompensatory damages.

To the extent Licensee does not cover, it is entitled to damages under § 2-713 of the UCC.\textsuperscript{215} Under that section, Licensee's damages would be:

\textsuperscript{214} This assumes that Patentee has made the decision that it is better off exclusively licensing Buyer 2 than licensing Licensee and others.

\textsuperscript{215} Note the distinction between the seller's and buyer's options. The seller may choose to sue for the § 2-708(1) contract-market differential even if it has conducted a § 2-706 resale. However, the buyer may sue for the § 2-713 contract-market differential only to the extent it has not covered. See supra note 89.
Again, the buyer should be made whole. It receives damages sufficient to allow the purchase of the machinery at a $2,250,000 out of pocket expenditure ($2,450,000 market purchase price - $200,000 damages). 216 Under § 2-713, Patentee does better than its expectancy. Instead of receiving $2,250,000 for a license to build 15,000 machines, it receives $2,550,000 ($2,750,000 price to the second buyer - 200,000 damages paid to Licensee). 217 However, note that Licensee only receives its expectancy under § 2-713 if it in fact covers. Thus, § 2-713 may present the same problem for the licensee in the position of an aggrieved buyer as § 2-712: it can only be made whole if it infringes and, in fact, it will not be made whole because the infringement damages which Licensee would have to pay would offset the contractual award of damages. Again, the UCC's goal of encouraging efficient breach is frustrated.

However, § 2-713 itself may account for this problem. The buyer is entitled to consequential damages under that section. Consequential damages are defined to include "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover. . . . " 218 The seller/licensor would know at the time of contracting of the buyer/licensee's inability to cover without infringing the seller's intellectual property rights. Thus, under § 2-713, the damages calculation could be adjusted to reflect this fact.

The licensee in the position of an aggrieved buyer must consider that any § 2-712 resale may be infringing, relegating it to § 2-713 to seek damages or § 2-716 to sue for specific performance. Under § 2-713, the

216. In cases in which the market price exceeds the price at which the buyer makes a substitute purchase, the buyer theoretically could do better than its expectancy. For example, if it purchased a substitute for $2,400,000, it would spend only $2,200,000 ($2,400,000 - $200,000 received in damages) for the machine it expected would cost $2,250,000. However, this "expectancy plus" remedy is barred by the Code because the buyer cannot recover contract-market damages where it has covered. See supra note 89. This may help to account for the large volume of cases discussing whether a particular purchase is a "cover" purchase. See Annotation, What Constitutes "Cover" Upon Breach by Seller Under UCC § 2-712(1), 79 A.L.R. 4th 844, 865-90 (1990) (collecting a large number of cases on what constitutes cover).

217. See supra note 79 (discussing efficient breach).

contract-market differential may be available. If the contract-market
differential will not put the licensee in its expectancy position, the licensee
will seek specific performance which may be awarded if the goods are
“unique.”

A similar question to that presented in the context of the licensee as
seller now arises. If §§ 2-712, 2-713 and 2-716 all give an aggrieved
buyer its expectancy, the logical assumption is that buyers are indifferent
regarding which section they recover. However, there seems to be a
greater risk of undercompensation under § 2-713. Section 2-712, like § 2-
706, is a self-help remedy which helps to protect the aggrieved buyer
against the seller’s insolvency, to minimize incidental and consequential
damages, and to decrease the chance that the aggrieved buyer will incur
litigation costs including attorneys’ fees. Even if litigation were to
occur, expenses are likely to be lower under § 2-712 than either § 2-713 or
§ 2-716.

Again, however, other circumstances may indicate that these factors
do not compel the conclusion that aggrieved buyers would always—or even
more often than not—prefer to cover than to recover under another UCC
section. As is the case with the seller, the availability of a number of
remedial options decreases the buyer’s risk by increasing the probability
that it will recover its expectancy in the event of breach. The buyer’s ability
to obtain its expectancy is a key factor in encouraging efficient breaches.
To the extent that one or more remedies become infeasible because of the
law’s uncertainty, the UCC’s goals are frustrated.

The difference between the account of the licensee as an aggrieved
seller and that of the licensee as the aggrieved buyer is one of volume. The
sheer number of transactions involving licensees as aggrieved sellers is
likely to be much larger than that involving licensees as aggrieved buyers.
When the licensee is in the position of an aggrieved seller, it generally is in
possession of the goods covered by the intellectual property right and
needs a license in order to be able to resell them. When the licensee is in
the position of an aggrieved buyer, it requires a license only if it cannot
make a reasonable substitute purchase. If it cannot, then the remedy which
it seeks is usually specific performance rather than cover. Cover would be
implicated only if the licensee sought to have a third party manufacture
the good.

219. See supra Part III.A.1.
220. Of course, if the cover price exceeds the contract price, the buyer may have to sue
for damages.
221. See, e.g., Schwartz & Scott, supra note 61, at 403 (noting that in cases where the seller
repudiates the contract, the contract-market differential damages are difficult to calculate
because of the difficulty in establishing market price at the time and place buyer learned of
breach). The covering buyer’s proof entails merely proving the contract and cover prices
which are objectively verifiable.
3. The impact of intellectual property law on the aggrieved party’s remedial options under the UCC

The comprehensive UCC remedial scheme is designed to encourage the parties to make efficient choices by providing aggrieved parties with their expectancy. An integral part of that scheme is to allow the particular aggrieved party to choose whether to make itself whole through a market transaction, an award of damages representing the contract-market differential, lost profits, or specific performance. In many cases, the most efficient solution and the one preferred by the aggrieved party is resort to a market transaction of resale or cover.

Thus, whether by its own terms or because it is uncertain, any legal rule which would make these remedies relatively unattractive should be closely scrutinized. If parties believe that they risk receiving less than their expectancy by exercising their rights of cover or resale, those remedies may effectively be removed from the parties’ remedial options. Removal of one of the remedial options designed to ensure an aggrieved party its expectancy changes the bargaining structure of negotiations by increasing the probability that an aggrieved party will be undercompensated in the event of breach. In turn, this may lead to inefficient breaches.

In fact, as seen in the Burberry v. Burberry case, intellectual property law has been used as an instrument effectively to remove the option of the aggrieved party's resorting to a market transaction to fix damages. If the licensor wrongfully terminates the agreement or otherwise breaches, leading to termination of the underlying intellectual property license, then the aggrieved licensee (who may, depending on the circumstances, be in the position of an aggrieved seller or buyer) will be subject to the threat of infringement liability if it chooses to fix its damages by resort to its resale or cover remedies.

In the usual case, the mere threat of intellectual property damages, which are often quite large, effectively eliminates the options of resale or cover for the aggrieved party. For example, in Mitsuboshi, the trial court awarded $89,337 in breach of contract damages to Mitsuboshi and $2.6 million to the breaching party for infringement and commission of various business torts based on the nonbreaching party’s resale of patented and trademarked items.

When the aggrieved party runs the risk of being held liable for

222. See supra notes 113-123 and accompanying text.
223. See McCoy v. Mitsuboshi Cutlery, Inc., 67 F.3d 917, 919 (Fed. Cir. 1995), cert. denied, 116 S. Ct. 1268 (1996). The award reflected damages for patent and trademark infringement, tortious interference with prospective business relations, unfair competition, punitive damages, attorneys' fees, costs, and prejudgment interest. See id. While the court did not specifically indicate the amount of damages allotted to each element of recovery, even if the infringement damages represented only 1/3 of the judgment, they would still substantially exceed damages for breach of contract. Moreover, all of the damages reflect the lower court's belief that the resale of the knives under the UCC was wrongful.
infringement in the event of its resale or cover, those remedies become unattractive. This is particularly true for patent and copyright licensees. A trademark licensee does have the ability to avoid infringement damages simply by removing the trademark before it resells. However, removing the trademark will increase the amount of the licensee’s incidental damages. There remains a risk of undercompensation for such a licensee if its incidental damages are difficult to prove or are undervalued.

The 

Mitsuboshi 
case suggests that, in fact, intellectual property law will not function to limit the availability of UCC remedies. However, this law is neither uniform nor certain. The uncertainty of the legal rule, then, is likely to impact the negotiating strategies of the parties both prior to entering into the contract and after breach occurs. This uncertainty is likely to create inefficiencies in their conduct at both stages, suggesting the need for a change in or at least a clarification of existing law.

B. The Effect of the Collision Between Intellectual Property Law and the UCC on Bargaining Behavior

In the language of entitlements, the collision between intellectual property and UCC remedies might be conceptualized as follows: in the event of the licensor’s breach, does the licensor have an entitlement under the intellectual property laws to stop the licensee from exercising its relevant UCC remedy of resale or cover and recover damages for infringement, or does the licensee have a UCC entitlement to resell or cover free of infringement liability? The answer to this question helps to define the scope of the licensor’s property right and thereby define the boundary line between intellectual property and contract.

Of course, according to Professor Coase, in a world of no transaction costs, the parties will bargain to the efficient allocation of entitlements, irrespective of the legal rule. Thus, the initial assignment of an entitlement is immaterial because it will eventually wind up with the party who values it most—the efficient solution. Therefore, if transaction costs were zero, it would not matter whether the licensee began negotiations with its UCC rights to resell or cover in the event of the licensor’s breach intact, or whether they began the negotiations without such rights. The end result would be efficient. Moreover, as already noted, one reason why property rules make sense in the context of the intellectual property statutes is because of the low transaction costs that characterize

224. See supra Part II.A.2.
225. See R.H. Coase, The Problem of Social Cost, 3 J.L. & Econ. 8 (1960); see also Craswell, supra note 81, at 632 (noting that the same proposition does not hold true for ex post negotiations: “If ex ante negotiations are costless, then any legal rule may indeed be consistent with efficiency. . . . However, the same conclusion does not follow from the costlessness of ex post negotiations”).
226. See supra note 79 (defining efficiency as state in which a resource winds up in the hands of those who value it most).
intellectual property licensing. This suggests that the assignment of the entitlement at issue should not be a major concern for the law because transaction costs are low enough to enable the parties to negotiate to the efficient solution.

Even if this were the case, an entitlement with the licensee to resell or cover free of infringement liability as a default rule may still be appropriate. Such a rule would help to define the scope of the intellectual property right and thereby the intellectual property-contract boundary. Besides low transaction costs, one of the justifications for a strong property right in intellectual property transactions was that it allowed the licensor to choose with whom it would deal. Where the licensor has already entered into a license agreement, it has chosen with whom to deal and, in breaching, is seeking to escape that bargain by using its property right as a club. Its property right should not extend that far.

Also, as formerly explained, the law has always recognized the fact that there are times when even intellectual property licensing transactions have been characterized by high transaction costs. Those instances are likely to increase as new technologies evolve. Moreover, there are transaction costs involved in any negotiation—it is the magnitude of those costs that matters. If the initial entitlement is so assigned that the parties must incur the transaction costs of negotiating to place a particular remedial option in the hands of the party who values it the most, contracts which otherwise might be efficient may never be concluded. In such circumstances, transaction costs that would not be incurred under a default rule which initially placed the entitlement with the party who valued it most must now be expended. The addition of these transaction costs may

227. See supra notes 42-47 and accompanying text.
228. See supra note 58 and accompanying text.
229. See supra note 50.
230. For example, the vast quantity of information required for today's multimedia software packages presents daunting problems for potential licensors. See Marshall Leaffer, Protecting Authors' Rights in a Digital Age, 27 U. Tol. L. Rev. 1, 11 (1995); Michael D. Scott, Frontier Issues: Pitfalls in Developing and Marketing Multimedia Products, 13 Cardozo Arts & Ent. L.J. 413, 414 (1995). However, note that technology may itself decrease transaction costs. For example, a number of commentators have noted that transaction costs on the Internet are quite low. See, e.g., Trotter Hardy, Property (and Copyright) in Cyberspace, 1996 U. Chi. Legal F. 217, 235-37 (noting that transaction costs are generally lower for cyberspace transactions); Eric Schlachter, The Intellectual Property Renaissance in Cyberspace: Why Copyright Law Could be Unimportant on the Internet, 12 Berk. Tech. L.J. 15, 22 (1997) ("While transaction costs are not zero, the Internet has significantly reduced transaction costs.").
cause the negotiations to fail as the costs of concluding the deal may now exceed the gains from trade.\textsuperscript{232}

Therefore, the Coase theorem's primary importance is not in asserting that the legal assignment of entitlements doesn't matter but in emphasizing that "we pay attention to transaction costs in assigning initial rights to make it more likely that the rights will wind up in the hands of the party with the best use for them."\textsuperscript{233} The following argues that the practical implementation of the Coase theorem argues for allowing the seller and buyer to enter the negotiations with their rights to resell and cover intact.\textsuperscript{234}

This assignment of entitlements should be the default rule because it reflects the assignment which the parties would have bargained to had they negotiated the issue.\textsuperscript{235} Of course, it is always speculative to attempt to divine the rule to which the parties would have agreed. For this reason, legislative drafters often use surrogates such as usage of trade in defining the parties' intent.\textsuperscript{236} In the absence of relevant usage of trade, drafters may look to the efficient economic solution as a proxy for the parties' intent and may also choose to introduce more abstract notions such as justice and fairness.\textsuperscript{237}

In the context which the Article addresses, there is little evidence of relevant usage of trade.\textsuperscript{238} Thus, aggregate economic efficiency may stand as a proxy for the rule to which the parties would have agreed. As already noted, maintenance of the entire menu of UCC remedial options is efficient.\textsuperscript{239} The following section supports this proposition by demonstrating that holding one of the remedial options to be infringing introduces inefficiencies into the bargaining process. Finally, this Article argues that maintaining the entire set of remedial options is also fair.

\textsuperscript{232} Cf. Ellickson, supra note 231, at 613 ("[I]n situations where law actually governs entitlements, the conferral of a legal entitlement may affect the allocation of resources . . . when the transaction costs of transferring the entitlement to a person who values it more highly would exceed the gains from that trade.").

\textsuperscript{233} Merges, supra note 41, at 82 (footnote omitted).

\textsuperscript{234} See Moore & Mayfield, supra note 9, at 6 (stating that if the burden were placed on the buyer to negotiate a license to cover, the UCC's goal of reducing transaction costs by providing default provisions would be frustrated).

\textsuperscript{235} See supra note 76 (citing default rules literature which contends that default rules should reflect the legal rule to which the parties would have agreed).

\textsuperscript{236} See Barnett, supra note 76, at 906-07 (noting the importance of express terms, course of dealing, and usage of trade in understanding the parties' intents).

\textsuperscript{237} See id. at 907-10 (stating that in the absence of market choices demonstrating the parties' intent, moral theory and economic analysis may provide guidance as a reflection of the common sense of the particular community involved).

\textsuperscript{238} The terms of most license agreements are not a matter of public record. The evidence of the form books and other published contracts is inconclusive. See infra note 268 (discussing boilerplate forms).

\textsuperscript{239} See supra Part III.A (demonstrating how UCC remedies attempt to ensure efficient breach).
1. Pre-breach considerations

The relative scarcity of caselaw addressing UCC remedies is somewhat remarkable. As Judge Friendly stated in 1963 in *Platt & Munk*:

> Whether the lack of precedent [in these cases] is attributable to an unusually high standard of dealing, and of solvency, on the part of [intellectual property] proprietors and those manufacturing for them, or to an unaccustomed and unexpressed previous consensus in the profession as to the applicable rule of law, it is none the less remarkable.\(^{240}\)

The relative scarcity of caselaw might also imply that informed licensees are accounting for this risk in their contracts. Two other categories of licensees include: (i) those who are uninformed about the uncertainty of the legal rule and believe that their UCC remedies will apply on breach;\(^{241}\) and (ii) those who know of the uncertainty of the legal rule but consider the probability of its becoming an issue too low to justify the cost of negotiating to clarify it in the contract. A closer analysis of all three of these contexts suggests that all of them argue for clarifying the law to adopt expressly a default rule allowing resale or cover without liability for infringement.

(a) The uninformed licensee

If the licensee is uninformed about the uncertainty of the law and assumes that its full panoply of UCC remedies will be available in the event of the licensor’s breach, it will pay too much for the rights to which it is licensed. The price that the licensee is willing to pay is influenced by a number of factors, including the nature and availability of remedies in the event of breach.\(^{242}\) As discussed above, the objective of UCC remedies is to put the aggrieved party in the position it would have been in had the other party performed. The uninformed licensee thus contracts assuming it will be made whole in the event of breach. It would not pay as much for a contract under which it may or may not be made whole—one in which it may have to surrender its right to resale or cover to avoid damages for infringement.

\(^{240}\) Platt & Munk Co. v. Republic Graphics Co., 315 F.2d 847, 849 (2d Cir. 1963).
\(^{241}\) This, of course, assumes that the parties know of the UCC remedies but not of the risk that they may be effectively negated by liability for intellectual property infringement. This assumption is not farfetched as the licensee in the position of an aggrieved seller is engaged in manufacturing and selling goods on a daily basis and is therefore likely to know the governing law—the UCC. In comparison to its main business of marketing goods, the licensee is likely to enter into licensing transactions on a much smaller, more infrequent scale. Of course, to the extent a license is required to manufacture the licensee’s key product, the licensee would have an incentive to be informed about the relevant intellectual property rules.
\(^{242}\) See Craswell, supra note 81, at 630-31 (noting that remedial options influence a number of contracting decisions including “whether to agree to the contract in the first place, and at what price”).
The licensee's valuation of the contract is thus incorrect. In such a case, it would be appropriate to set the default rule in favor of the one which the uninformed party would desire—which in this context is also the rule which is efficient and thus desirable to both parties. Setting the rule in this manner helps to correct problems of informational asymmetry. The licensor who wishes the option of preventing the licensee's resale or cover must disclose that desire during the contractual negotiations. This disclosure will both inform the licensee of the relevant law and help it more accurately to assess the desirability of entering into the contract under either the default rule or that which the licensor desires.

Additionally, setting the default rule to allow the licensee to resell or cover without incurring infringement liability would enhance the efficiency of the decision to breach. The uncertainty of current law may in fact encourage inefficient breach by providing an overincentive for the licensor to terminate the contract wrongfully or otherwise breach it in hopes of receiving a windfall. As already noted, damages for infringement will often outweigh damages for breach of contract, leaving the aggrieved licensee substantially undercompensated. Undercompensatory damages lead to inefficient decisionmaking regarding breach by encouraging too much of it.

Of course, most intellectual property licensees are probably not uninformed for at least two reasons. First, many are large commercial companies with competent counsel. Second, even if a licensee begins as an uninformed party, if it is held liable for infringement damages just once in the event of the licensor's breach, it will become informed quite quickly. Thus, most licensing transactions are likely to involve informed licensees.

(b) The informed licensee who does not bargain over remedies

The informed licensee may quite rationally decide not to raise the issue of clarifying the legal uncertainty regarding remedies. It may simply decide to take its chances in the event of the licensor's breach. This strategy would be rational if the cost of negotiating the issue exceeded the benefit. Moreover, it presents the paradigmatic example cited as

---

243. Cf. Barnett, supra note 76, at 888-89 (arguing that it makes sense to adopt a default rule that reflects the expectation of the rationally ignorant party to create incentives for the rationally informed party to express its preferences). Since the licensee may enter into only one such transaction, it may be uninformed relative to the licensor who enters into many license agreements.

244. See id.

245. See supra note 223 and accompanying text (setting forth damages awarded in the Mitsuboshi case at the trial level).

246. There are ample statements to this effect in the law and economics literature. For one example, see Farber, supra note 79, at 1445 (arguing that where contracts are underenforced, "a number of economically undesirable results [occur], including an excessive level of breach").

247. See Ayres & Gertner, supra note 76, at 92 & n.30 (explaining that one reason for
justifying the adoption of a default legal rule which reflects what the parties would have bargained to had they negotiated the issue.\textsuperscript{248} Thus, in this context as well, it would be appropriate to clarify the law by making the default rule one that allows the aggrieved licensee to resell or cover without liability for infringement.

While the strategy of not negotiating over this particular issue may be rational for individual transactors, its aggregate effect on the judicial system may be substantial and undesirable. By opting to defer the issue of remedy, the parties are effectively imposing the costs of fashioning an adequate remedy on the courts.\textsuperscript{249} Yet the parties would seem to be in a better position to select a remedy, as they are more familiar with the markets for both the underlying intellectual property right and the particular good which embodies that right.\textsuperscript{250}

In such circumstances, it might be desirable to set the default rule at exactly what the parties would not have agreed to had they bargained over the issue—the so-called "penalty default."\textsuperscript{251} In this context, the penalty default would be set to allow damages for infringement if the aggrieved licensee resells or covers. The penalty default would give the licensee the incentive to raise and resolve the issue and prevent the parties from foisting costs off on the courts \textit{ex post}.

However, the penalty default is not appropriate in all circumstances.\textsuperscript{252} In particular, default rules should be set in such a manner as to

---

\textsuperscript{248} See id. at 93

(The "would have wanted" approach to gap filling is a natural outgrowth of the transaction cost explanation of contractual incompleteness. Lawmakers can minimize the costs of contracting by choosing the default that most parties would have wanted. If there are transaction costs of explicitly contracting on a contingency, the parties may prefer to leave the contract incomplete. Indeed, as transaction costs increase, so does the parties' willingness to accept a default that is not exactly what they would have contracted for. Scholars who attribute contractual incompleteness to transaction costs are naturally drawn toward choosing defaults that the majority of contracting parties "would have wanted" because these majoritarian defaults seem to minimize the costs of contracting.).

\textsuperscript{249} See id. (noting that costs of ex ante bargaining may encourage parties to leave gaps for a court to fill in and contending: "[i]f it is costly for the courts to determine what the parties would have wanted, it may be efficient to choose a default rule that induces the parties to contract explicitly").

\textsuperscript{250} See generally Merges, supra note 41 (contending that one reason a property rights regime is appropriate in the case of patents is that it is difficult for courts to set damages).

\textsuperscript{251} See Ayres & Gertner, supra note 76, at 95-100.

\textsuperscript{252} See id. at 127 (noting that penalty defaults are not always appropriate and the decision
give an incentive to the relatively informed party to disclose information to the relatively uninformed: in other words, default rules should be drawn against the informed party.\textsuperscript{253} Between the licensor and licensee, the licensor is likely to be relatively more informed. Licensors are probably more often "repeat players" in these types of transactions, if only because of the inexhaustibility which characterizes intellectual property rights.\textsuperscript{254} Given the fact that licensors are likely to be more informed than licensees or at least no less informed, this context also argues for setting the default rule at no damages for infringement when the aggrieved licensee exercises its right to resell or cover.\textsuperscript{255}

Moreover, the costs which the parties foist off on the court system in calculating damages are likely to be small under a default rule allowing the licensee to resell or cover without infringement. One of the innovations of the UCC remedies is their certainty—often cases will not even proceed to trial because damages are quite simple to calculate. This is particularly likely when the object of the damage claim is an Article 2 good. While the intellectual property right itself is likely to be unique, the product which embodies it often is not. In such cases, the parties are not foisting an insuperable burden onto the courts and the regular default—that to which the parties would have agreed—is appropriate.

\textit{(c) The informed licensee who bargains over the issue}

The informed licensee may decide instead to negotiate over remedies in light of the legal uncertainty that it will be liable for infringement damages if it exercises its resale or cover remedies in the event of the licensor's breach. There are a number of ways in which the parties might take this legal risk into account.

Perhaps the most obvious solution for the licensee is to bargain for a resale or cover right free of infringement liability as part of the contractual negotiations.\textsuperscript{256} Of course, the licensee, in obtaining a right which it is not clear it possesses at law, will have to pay for that right either in the

\textsuperscript{253}See id. at 98 ("[W]hen the rationale is to inform the relatively uninformed contracting party, the penalty default should be against the relatively informed party.").

\textsuperscript{254}See id. ("If one side is repeatedly in the relevant contractual setting while the other side rarely is, it is a sensible presumption that the former is better informed than the latter."). See generally Barnett, supra note 76, at 887-88 (noting that repeat players can amortize the cost of obtaining knowledge of the relevant legal rules over a large number of transactions while a one-time entrant cannot and therefore may rationally choose not to inform itself of the legal rule).

\textsuperscript{255}Cf Craswell, supra note 81, at 633 (summarizing the default rules theory of selecting a legal rule that reflects what the parties would have agreed to and noting that such a selection may be justified as avoiding negotiation costs, drafting costs, and difficulties caused by strategic bargaining).

\textsuperscript{256}See id. at 633 (noting that the parties have the ability to escape an inefficient remedy by contracting around it).
price directly or by acceding to the licensor's demands on some other issue.

Alternatively, it may simply adjust the price to account for the risk of the licensor's breach and the effective elimination of a UCC remedy that would otherwise have protected the licensee against that breach. The magnitude of the premium or discount which the licensee could charge would be a function of the competitiveness of the market and other manufacturers' assessments of the magnitude of the risk created by the legal rule.

Alternatively or in addition, the licensor could attempt to allay the licensee's fears by agreeing to a liquidated damages clause. There are some drawbacks to this approach from the licensee's perspective. First, it lacks the precision of the resale and cover remedies as it may be difficult ex ante to approximate damages which will result from breach. Second, while liquidated damages are authorized under the UCC, courts continue to construe such clauses strictly. Thus, the licensor may agree to such a clause during negotiations but later successfully challenge it in litigation. Therefore, the licensee might instead attempt to provide for alternative dispute resolution or for the licensor to agree at the outset not to challenge the liquidated damages clause.

257. See infra notes 267-70 and accompanying text (discussing the effect of the legal rule on price).

258. A closely related alternative would be for the parties to agree to a limitation of remedies provision. Section 2-719 of the Code states:

Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages, (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; . . . .

U.C.C. § 2-719(1)(a) (1996). A limitation of remedies provision may, however, be set aside in favor of the default Code remedies where the provision "fail[s] of its essential purpose."


259. Liquidated damages are available under § 2-718 of the Code:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

U.C.C. § 2-718(1) (1996). Courts have construed this clause strictly and often seem to read it as requiring that the liquidated damages be reasonable in light of the actual harm, regardless of its reasonableness in light of the anticipated harm. See, e.g., Charles J. Goetz & Robert E. Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Mode and a Theory of Efficient Breach, 77 Colum. L. Rev. 554, 559 (1977) (noting that courts will not uniformly find liquidated damages clauses enforceable unless certain requirements have been met).

260. Depending on the particular arrangement, such provisions are likely enforceable. See Dan B. Dobbs, § Dobbs Law of Remedies § 12.23, at 504-05 (2d ed. 1993) (discussing the enforceability of arbitration agreements); 15 Samuel Williston, Williston on Contracts § 1823
Another contract solution would be to make the license grant irrevocable such that the license would continue in the event of termination of the underlying agreement. Licensors are generally wary of such agreements as they may effectively relinquish a substantial amount of control over the exploitation of their intellectual property right by granting an irrevocable license. For this reason, the licensee would probably have to pay a substantial premium in exchange for the grant of irrevocability. Less drastic approaches would include allowing the license to continue only until the inventory on hand at the time of breach is sold or shortening the contract term.

To hedge its risk, where the licensee is effectively a seller, it might underinvest in transaction-specific assets. It may seek to perform its contract with the licensor by using equipment and parts which may be used for a variety of purposes rather than just to meet the specific requirements of the licensor. From the licensor’s perspective, this may be undesirable if it impacts the quality of the finished product. The licensor therefore may seek to lease machines to the licensee or otherwise attempt to encourage investment.

The licensee might also seek to purchase insurance against the licensor’s breach. However, because the breach is within the licensor’s control, the premiums on such insurance are likely to be substantial. Another, perhaps less expensive way for the licensee to insure against losses from the licensor’s breach would be for it to diversify away some of its risk by entering into a number of different transactions with a number of different licensors. However, this may effectively increase costs to the licensor who now may have to enter into an agreement with multiple licensees. Moreover, this option may not be available at all if there is no close substitute for the licensor’s product.

As set forth above, in contexts in which the licensee is uninformed,
there is an efficiency argument for clarifying the default rule to allow the aggrieved licensee to resell or cover without incurring liability for infringement. The same clarification also is appropriate in cases in which the parties are informed but choose not to negotiate over the particular issue. The remaining question then becomes: is that default still appropriate if parties are accounting for this risk in their contracts? This Article asserts that the answer to this question is "yes," because current law allocates remedial rights inefficiently by making the resale and cover remedies unattractive and, in the worst case, may discourage parties from reaching agreement at all despite the fact that both could realize a gain from contracting.\textsuperscript{266}

This assignment of entitlements reverses the normal UCC scheme which, as noted, was designed to encourage efficiency. Making one of the remedies routinely available to aggrieved parties unattractive frustrates the flexibility which the UCC incorporated in order to encourage the parties to act in an efficient manner. Moreover, even if the parties are able to reach an agreement, this risk allocation skews the bargaining process by allowing the licensor to capture more of the surplus than it otherwise might. Simply put, instead of the licensor, who would otherwise have to raise the issue of eliminating an already existing UCC remedy and bargain away something in return for its elimination, the burden is on the licensee to raise the issue and bargain away something else to reinstate remedies which it thought it already had until the Burberry case. The result is that the bargaining process is skewed in favor of the licensor. This analysis suggests that even in cases in which there is an underlying intellectual property license, normal UCC remedies should be available as long as they do not adversely impact the goals of intellectual property law.

There is a fairly forceful objection to this analysis. Economics is not concerned with the allocation of the surplus between the parties.\textsuperscript{267} Whether the licensor or licensee is able to capture more of the contracting

\textsuperscript{266} Of course, even where there would be a surplus from cooperation and the market is not distorted, the parties still may not reach agreement. The point is that they are likely to reach agreement in even fewer instances under the current damages scheme. This is particularly likely in cases involving a bilateral monopoly. Bilateral monopoly describes a market in which there is only one buyer and one seller. See Cooter & Ulen, supra note 20, at 37 n.8. The seller/licensor may be in a monopoly position given its intellectual property right while it is also possible that the buyer/licensee may be the only firm able fully to exploit or in need of the intellectual property right. In the best of situations, bilateral monopolies are characterized by high transaction costs and hard bargaining. See Richard A. Posner, Economic Analysis of Law 54 (3d ed. 1986) (noting that with property rights in ideas there may be excessive investment). Despite the fact that an exchange might generate a surplus, "each party may be so determined to engross the greater part of the potential profits from the transaction that they never succeed in coming to terms." Id. (footnote omitted).

\textsuperscript{267} See, e.g., Thomas S. Ulen, The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies, 83 Mich. L. Rev. 341, 383 (1984) (asserting that economics is not concerned with the division of the surplus from exchange but with ensuring that assets move to their highest valued use at the least cost).
surplus in the negotiation over UCC remedies is a distributive rather than an allocative concern. Moreover, one might expect that if the licensee’s retention of the right of resale or cover is the efficient allocation of remedial rights, then that term will become the standard, particularly in a case in which the law is uncertain. In other words, there is a price attached to the menu of remedial options. If the licensee’s having the right to cover or resell is efficient, the licensor will agree to it because the licensor will then be able to obtain a higher price for the intellectual property it is licensing. Thus, it will be in the interest of both parties to bargain to the efficient result.

Although this objection has force, it ignores the transaction cost considerations mentioned above. Transaction costs could be saved by setting the default rule at the efficient outcome rather than by forcing the parties to bargain to it. It would take some time before any contractual term would gain such universal acceptance as to merit its becoming a standard. It therefore seems sensible to save those interim transaction costs by clarifying the legal rule.

Additionally, it is not at all clear that the parties would necessarily arrive at the efficient allocation of remedial provisions. In deciding whether a particular outcome is efficient, the law looks to aggregate efficiency. The parties to specific transactions, however, are concerned not with aggregate efficiency but rather with capturing as much of the surplus as possible to enhance their own individual returns. When the legal rule gives the licensor a sword to attempt to capture more of the surplus, the deal becomes relatively less attractive to the licensee. While the parties might bargain to the efficient risk allocation, they might also fail to reach agreement at all as they engage in strategic behavior. Thus, it seems preferable to have the parties start the negotiations with the efficient allocation of remedies.

Finally, in some cases, parties will opt to adjust other aspects of the bargain to account for the law’s uncertainty rather than to negotiate to the efficient remedial allocation. However, there are costs associated with such adjustments. For example, the licensee may overinvest in precaution to help assure that it will be protected in the event of breach. Alternative-

---

268. The form books are inconclusive. See, e.g., Lindey & Landau, supra note 101, at Form 13.01-6, 13-55 (providing for licensee to continue to sell inventory on hand at time of termination for three months after termination); Milgrim, supra note 101, at VIIIB, VIII-8 (providing for the licensee to continue to sell inventory on hand at the time of termination for six months after termination); id. at VIIIB, VIIIB-14 (providing for a patent licensee to dispose of patented products for a defined period after termination if the products were manufactured prior to termination). But see Raymond C. Nordhaus, Patent License Agreements Form 40.03, at 40-11 (providing a number of alternatives from which the parties may choose including immediate termination of the license with no right to resell goods on hand and termination with a limited right to resell).

269. See id. at 646-47 (contending that where damages are overcompensatory, the party paying such damages has an incentive to overinvest in precaution relative to the efficient level).
ly, or in addition, the licensee may alter its decisions about with whom it will deal to select licensors who are unlikely to breach and seek large infringement damages. These steps increase costs and skew decisionmaking and could be avoided merely by clarifying the law.

2. Post-breach considerations

The parties' pre-breach treatment of the remedial issue will also affect their post-breach stance. In cases in which the parties at the outset failed explicitly to address the issue, whether because of lack of information or because to do so would not be cost-effective, their post-breach negotiations will be affected. The UCC damage provisions have, in addition to making the law more flexible, provided parties with some degree of certainty. This certainty translates into a framework which informs the parties' post-breach negotiations. For example, in a general UCC transaction, an aggrieved seller and breaching buyer know with some measure of precision the damages which the buyer would have to pay under either § 2-706 or § 2-708. This provides the parties with the background against which they can engage in post-breach settlement negotiations.

In contrast, if there is a risk that a § 2-706 remedy will be held infringing, there is a large disparity between the relative positions of the parties under § 2-706 and § 2-708. When the seller/licensee has the goods, the breaching buyer/licensor's negotiation stance is improved because it may credibly threaten suit for infringement if the licensee resells, exercising the licensor's intellectual property rights. As in the case of negotiations prior to the conclusion of the contract, the unavailability of the resale and cover remedies alters the bargaining position of the parties after breach by giving the breaching party a weapon which it otherwise would not have. Again, this analysis suggests that even in cases in which there is an underlying intellectual property license, normal UCC remedies should be available.

Of course, the same objections raised above might equally apply post-breach. In a world without transaction costs, parties would bargain to the efficient post-breach outcome so the legal rule does not matter. Moreover, economics is not concerned with the distribution of the gains on breach between the parties.

These objections are easily answered. First, there are transaction costs involved in any negotiation, including a renegotiation after breach. Second, the remedial rule affects the parties' relative risk and this effect

270. See supra note 265 (describing "selection" decision).
271. Cf. supra notes 91-95 and accompanying text.
272. See Moore & Mayfield, supra note 9, at 3 (noting that post-breach, "[A] seller who is an astute negotiator may be willing to grant a license, but only at an unreasonably high cost from the buyer. Such a seller might use the threat of an infringement suit as leverage to force a renegotiation of its underlying sales contract with the buyer").
273. See Craswell, supra note 81, at 640 ("[R]emedies can still produce distributional effects by affecting the parties' bargaining status in post-breach negotiations.").
obtains even when *ex post* renegotiation is costless.\textsuperscript{274} Third, there may be no gain to distribute on breach—the licensor may breach simply to obtain large infringement damages or to renegotiate the contract by threatening an infringement suit, not because it has found another licensee who values the product more.\textsuperscript{275}

3. The impact on intellectual property law

If the maintenance of all UCC remedies were adversely to impact the goals of the intellectual property system, then it might be preferable to adopt a rule providing that the aggrieved party's exercise of an intellectual property right under the UCC is infringement. The primary goal of the intellectual property system is to enhance the public welfare by encouraging the production and dissemination of information. A state law remedy should not frustrate this federal policy.

Allowing all UCC remedies to apply should not discourage authors and inventors from investing in new works. In the cases under consideration, the licensee has not breached; the licensor/rightholder has. Because the licensee has not breached, it follows that the goods which it has produced under license are the genuine articles. Allowing the licensee to minimize its damages by placing those articles in the stream of commerce should not affect the licensor's initial decision to invest in innovation. The value of its right is not devalued by marketing a product that is genuine.

Additionally, it seems intuitively unfair essentially to penalize the aggrieved party who has performed under the contract by removing one of its remedial options. In more concrete terms, because intellectual property damages would be offset against and may even outweigh damages for breach of contract, the aggrieved party could be in the anomalous position of having to pay damages to the breaching party. This would strike most as unfair unless there is some compelling policy reason to support such a result.

\textsuperscript{274} See id. at 645. 

(The level of contract damages will have an effect on the distribution of risks between the parties, and this effect will be independent of the ease of ex post renegotiation when the seller is considering whether to breach. Even when ex post renegotiation is costless, the choice of contract remedies can still make a difference.)

\textsuperscript{275} See supra note 9 (citing Moore & Mayfield). Note, however that reputational effects may limit the licensor's ability to breach opportunistically. See Farber, supra note 79, at 1464 (reviewing the potential problems with selecting legal enforcement mechanisms and stating that "[t]he reason [that people still contract despite the inadequacy of legal remedies] is that other powerful incentives for performance exist. . . . Unreliable firms lose good will. . . . [Such] sanctions arguably make legal incentives to perform unnecessary").
IV. THE PROPOSAL—AMENDING THE UCC TO CLARIFY THE RIGHTS OF RESALE AND COVER

The above analysis suggests that the Article 2 remedies of resale and cover should routinely be available for the goods aspects of intellectual property transactions and that the law should be clarified to implement a default rule to this effect. As this Article discusses below, that implementation may require a nuanced approach in which, under certain circumstances, UCC remedies sounding more in a property rules theory than liability rules theory may be appropriate.

A. The Proposal—Rethinking §§ 2-706 and 2-712

Perhaps the best way to clarify the law is to modify Article 2 to ensure that the default remedial scheme which it has set up specifically applies to the types of intellectual property transactions described in this Article.\(^{276}\) Both §§ 2-706 and 2-712 could be amended quite simply through the addition of one section.\(^{277}\) Section 2-706(7) could be added, stating that "In cases in which the seller is also an aggrieved licensee under an intellectual property license, the seller has an implied intellectual property

---

276. As a general rule, it is very difficult to amend the UCC because any amendment normally requires action by the NCCUSL and ALI to draft and to promulgate the change and then by the states to enact it. However, Article 2 is currently in a state of flux as the NCCUSL grapples with a number of issues, including the widespread use of computer technology in conducting commercial transactions. The NCCUSL is currently discussing revisions to Article 2 as well as a new Article 2B to deal specifically with licensing transactions. Thus, the proposal here is particularly timely because it has a reasonable chance of being acted upon because the NCCUSL's drafts are still in flux and, even after the draft is promulgated to the states, the state legislatures are unlikely to adopt it without discussion of the issues in this Article.

277. As written, there is nothing in § 2-706 or § 2-712 that specifically prevents an aggrieved licensee from reselling or covering with respect to the goods. As noted above, the doubt arises from an interpretation of the UCC in conjunction with intellectual property law. At first glance, it would seem that the most appropriate place for change would be the intellectual property statutes because any change to state law is subject to preemption by federal law. This Article, however, concentrates on amending the UCC for several reasons. First, the uncertainty in the transactions at issue arises largely because it is within the court's discretion as to whether a license will be implied under particular circumstances. Once a license is implied, there is no conflict with intellectual property law. Thus, because the right to resell or cover arises in these transactions from an implied license which is a matter of state law, a logical starting point for change is the UCC. By granting the implied license within the statutory wording of the UCC, the proposal removes the court's discretion beyond determining whether or not a breach has occurred. Second, as a practical matter, the chances for actual change to the UCC are fairly good at this time because the NCCUSL, ALI and states are all discussing major changes. See supra note 276. It would be difficult to successfully convince Congress to tackle this issue despite the fact that the changes to the intellectual property statutes would probably be quite minimal. The best way to implement the clarification would be under the infringement sections of each statute. These sections could be amended by adding a provision indicating that a licensee's continued exercise of its license rights is not an infringement when the licensor has breached the contract, unless the licensor breached the agreement because the agreement purported to grant rights the licensor did not have.
license under the contract to resell the goods under this Section.” Similarly, § 2-712(4) could be added stating that “In cases in which the buyer is also an aggrieved licensee under an intellectual property license, the buyer has an implied intellectual property license under the contract to cover under this Section.” To prevent confusion, definitions of “intellectual property right” and “intellectual property license” could be added to § 1-201 or § 2-103.

These changes should effectively preserve the Article 2 remedies of resale and cover. The breaching licensor could not successfully bring an action for intellectual property infringement because the aggrieved seller or buyer would have an implied license to resell or cover under the UCC. These implied licenses would be available as a matter of course whenever a breach occurred, rather than based on a court’s subjective evaluation of all the facts and circumstances. Additionally, these clarifications would work as most Article 2 rules do—as default rules. The parties would remain free to contract around them. A licensee could give up its UCC rights to resell or to cover in its contract with the licensor. The difference is that the initial assignment of the entitlement would now be with the party who values it the most.

B. An Evaluation of the Proposal

While the proposal set forth above may be intuitively appealing because of its simplicity, it warrants closer evaluation to determine whether its impact on the parties, the courts, and the goals of intellectual property law and the UCC is desirable. This analysis suggests that courts, in addition to giving effect to the new statutory language, should also begin invigorating the actions for the price and specific performance in transactions involving goods protected by intellectual property rights.

As a practical matter, the suggested changes would probably be most evident at the preliminary injunction stage. Particularly when the licensee is in the position of an aggrieved seller, it is very likely that the licensor will know of the licensee’s attempts to resell. The licensor may then

278. These definitions could be analogous to those proposed in Article 2B: “Intellectual property rights includes all rights in information created under patent, copyright, trade secret, trademark, and any similar state or federal law,” U.C.C. § 2B-102(20) (Proposed Official Draft 1996) [hereinafter Revised UCC];

“License” means a contract for transfer of rights in information which expressly makes the rights conditional or limited, whether or not it provides for delivery or sale of a copy of the information. The term includes an access contract, a data processing contract, but does not include a software contract which transfers ownership of the intellectual property rights in the software. The term does not include the reservation or creation of a security interest in information.

Id. at § 2B-102(22).

279. Of course, there may be circumstances in which a court may want to scrutinize the licensee’s relinquishment of these rights. Courts already have this power under other UCC provisions. See supra note 75 (identifying some Code sections limiting parties’ ability to contract around the Code).

280. To comply with § 2-706, the aggrieved seller must notify the buyer of the seller’s
sue for a preliminary injunction to stop the resale. Courts then may have
to consider the merits of the breach of contract claim more closely in
preliminary injunction phases to determine whether, in fact, the licensee's
claim of breach is likely to succeed. This does not present an insuperable
burden, especially because courts have the institutional competence with
which to address breach of contract claims. More difficult questions arise,
however, when the validity of the resale or cover is contested only after it
has occurred.

1. Preemption and breadth concerns

When the resale or cover is contested only after it has occurred and is
then found wrongful, the intellectual property rightholder may be
irreparably damaged. This possibility, along with the chance that a court
might err in refusing to grant a preliminary injunction, may discourage
licensing transactions. This in turn may result in inefficiencies other than
those which the resale and cover rules were trying to overcome. By
operation of the state law rule, rightholders may be unable to appropriate
the maximum return on their investment in the information for which the
particular federal right has been granted. In the worst case, the underlying
goal of intellectual property law may be frustrated as society will not
benefit from the production and dissemination of information because of
underinvestment. Authors and inventors may underinvest in developing
information if they believe that the value of the resulting intellectual
property rights have been eroded by a state law contract remedy.

This series of concerns sounds mostly in preemption. Under the
Supremacy Clause of the Constitution, a state law rule may be preempted if
it "stands as an obstacle to the accomplishment of the full purposes and
objectives of Congress."\(^2\) Preemption under the Patent and Lanham
Acts is solely constitutionally based while preemption under the Copyright
Act may be based on the Constitution or on § 301 of the Act itself.\(^2\)

Under either a constitutional or statutory preemption analysis, the
suggested changes should survive. They do not directly conflict with any
provision of the intellectual property statutes. The conflict arises in the
event that courts erroneously deny preliminary injunctions or licensees

\(^2\) Hines v. Davidowitz, 312 U.S. 52, 67 (1941).
\(^2\) 17 U.S.C. § 301(a) (1996) provides:

On and after January 1, 1978, all legal or equitable rights that are equivalent to any
of the exclusive rights within the general scope of copyright as specified by section
106 ... and come within the subject matter of copyright as specified by sections 102
and 103 ... are governed exclusively by this title.

Even after the enactment of § 301, constitutional preemption is still likely to apply in
copyright cases. See Wendy J. Gordon, On Owning Information: Intellectual Property and the
Restitutionary Impulse, 78 Va. L. Rev. 149, 156 n.22 (1992) (stating that inquiry whether state
law interferes with congressional intentions should survive existence of § 301).
exercise the self-help remedies of resale or cover wrongfully. There is always a chance that courts will be mistaken in their decisions, so that does not seem a particularly compelling reason for a preemption finding. It is also possible that a licensee may wrongfully exercise the resale or cover remedies. However, both the UCC, with its good faith requirements, and intellectual property law, with its injunction and damages provisions deterring infringement, would serve to discourage such conduct. In other words, the damage to the rightholder should not ultimately be irreparable even if it occurs.

However, the suggestion that allowing all UCC remedies will discourage licensing transactions is not so farfetched as to be dismissed out of hand. Licensing transactions often involve the exchange of confidential information from the licensor to the licensee. If the licensor is faced with the possibility that, in the event of its breach, its confidential information will be placed in the hands of some third party unknown at the time the original license is concluded, the licensor may be wary of ever entering into licensing transactions. Moreover, if the licensor breaches because it does not actually have the rights it purported to license, the true rightholder would undoubtedly object to the licensee's pointing to the UCC as authority for it to exercise rights which it never had.

In fact, these examples only serve to illustrate the UCC's flexibility. Under § 2-706, any resale must be made in good faith and be commercially reasonable. Under § 2-712, any cover purchase must be made in good faith and must be reasonable. These requirements could help ensure that any third party is bound by the confidentiality requirements of the original license. A resale or cover purchase which did not so bind the third party would be unreasonable and in bad faith. In like manner, a licensee's resale or cover under circumstances in which the licensor was not authorized to grant the rights conveyed would not be commercially reasonable.

It seems more likely that the suggested changes would be fully consistent with the goals of intellectual property law. The changes encourage licensees to enter into licensing transactions without discouraging licensors. The initial right allocation—a licensee with a right of resale or cover unless expressly negated—would now be the efficient one, thus advancing the goals of the UCC. This result also seems fair because the aggrieved party would not be put in a position in which it would be open to potentially large liability as an infringer and perhaps

283. See supra notes 55-57 and accompanying text (discussing deterrence goal).
284. See Moore & Mayfield, supra note 9, at 3 (advocating an implied patent license to cover internally and stating:
Inventors will not avoid the patent system simply because they know aggrieved buyers will be able to practice the inventors' patents if the inventors breach sales contracts. On the contrary, ensuring internal cover as a remedy will merely bring certainty into planning transactions relating to patented goods. This certainty will presumably facilitate the parties' involvement in such transactions and, thereby, indirectly foster economic exploitation of patented inventions).
have to pay the breaching party rather than being compensated itself.

(a) *Trademark v. patent and copyright*

This reasoning may be more persuasive with respect to the patent and copyright laws than trademark law. Trademark law embodies a consumer protection goal that the other two statutes do not.\(^{285}\) The Restatement drafters opted for a legal rule which finds trademark infringement whenever the licensee sells without authorization, irrespective of which party breached the contract.\(^ {286}\) In contrast, the *Mitsubishi* court held that where the licensor had breached the contract, the licensee was granted an implied trademark license to resell the genuine goods.\(^ {287}\) The *Monte Carlo* court expansively held that even when the licensee had breached the contract, the licensee could still resell the goods as long as the goods were genuine.\(^ {288}\)

The Restatement drafters proceeded under the assumption that the protection of an implied license and the right to resell was not necessary for an aggrieved trademark licensee because the trademark may always be removed and the goods then resold.\(^ {289}\) An aggrieved patent or copyright licensee is not in the same position. It would be a rare case in which the licensee could remove the material relating to the patent or copyright and still have a product left to resell. In contrast, the trademark licensee can almost always remove the trademark and recover its costs in so doing as incidental damages.

Arguably, the Restatement, by focusing primarily on a consumer protection goal, overlooks the damage mitigation goals of contract law. It is wasteful to force an aggrieved licensee to expend the resources to remove the trademark prior to resale, particularly because: (i) if the licensor has breached, there is no issue regarding the genuineness or quality of the goods;\(^ {290}\) and (ii) the licensee's recovery of the money spent on such an effort is speculative. The end result may be to introduce market

\(^{285}\) "The rules governing the protection of trademarks are intended to prevent the diversion of trade or harm to reputation that is likely to result if consumers are confused as to the source or sponsorship of goods and services." Restatement (Third) of Unfair Competition \$ 24, cmt. b (1995).

\(^{286}\) See supra note 136 and accompanying text (quoting the language of \$ 24 of the Restatement (Third) of Unfair Competition).

\(^{287}\) See supra note 147.

\(^{288}\) See supra notes 124-31 and accompanying text (discussing the facts and view of the court in *Monte Carlo*).

\(^{289}\) "Because a trademark owner who wrongfully rejects trademarked goods will be liable for any reduction in resale value caused by removal of the mark, the better policy is to protect consumers from the confusion that results if unauthorized goods are sold under the mark of the trademark owner." Restatement (Third) of Unfair Competition \$ 24, cmt. c (1995).

\(^{290}\) Trademark licenses normally contain detailed quality requirements to help assure the continuing validity of the mark. If the licensee has not breached the contract, it must still be complying with those quality requirements.
inefficiencies that only serve to frustrate the consumer protection goal the Restatement was meant to advance. Moreover, the proposal advanced here does consider consumer protection by adopting *Mitsubishi* but rejecting *Monte Carlo*—there is no right to resell with the trademark attached when the licensee itself breaches.

(b) Alternative approaches

If policymakers were concerned about the resale and cover remedies unduly discouraging licensing transactions, investment in developing information, or frustrating the consumer protection goal of trademark law, they might consider changes alternative to or in addition to those suggested above. More specifically, policymakers might encourage granting the price under §2-709 to licensees in the position of aggrieved sellers and specific performance under §2-716 to licensees in the position of aggrieved buyers. These UCC sections more closely resemble property rules than the rest of the UCC remedial provisions.

In the case of the licensee as aggrieved seller, the overall premise for denying the price in most cases may be missing. The UCC normally awards the price to an aggrieved seller when the seller’s presumed advantage in resale is missing. In the context of intellectual property transactions, it is reasonable to assert that the licensor/buyer who owns the particular intellectual property right has at least as much market knowledge as the licensee/seller. The licensor has probably researched the market prior to deciding to invest in the particular innovative activity and has also likely researched it again in searching for the licensee. Thus, the licensee/seller’s advantage in resale may be missing, and it may be appropriate to award the price to the aggrieved licensee. The licensor would then receive and resell or scrap the goods. A rule awarding the price would not have the potential to discourage licensing transactions or investment in innovative activities in the same way that a rule permitting resale might. If the aggrieved seller receives the price, the licensor/buyer would receive the goods, and therefore would not be concerned that its intellectual property rights would somehow be devalued by the licensee’s resale.

There is no statutory provision which currently would award the price to the aggrieved licensee in these circumstances. From a licensee’s

---

291. See supra notes 59-81 and accompanying text (explaining the reasons for creating the UCC).
292. See supra notes 182-86 and accompanying text (discussing the seller’s remedy of the price).
293. Perhaps the price could be awarded under §2-709(1)(b):
When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price . . . (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.
perspective, the price may be a less desirable remedy if it increases the chance that it will have to resort to litigation rather than a self-help resale. However, allowing the seller to recover the price is less likely to frustrate the underlying goals of the intellectual property system. Therefore, such a rule might be more likely to survive a preemption analysis.

When the licensee is an aggrieved buyer, it may be appropriate to award specific performance under § 2-716 as a matter of course. The licensee would receive the goods for which it contracted and the licensor would not run the risk of being damaged by an inappropriate cover. As noted above, the remedy of specific performance could be justified under current statutory wording because goods in which an intellectual property right inheres could be considered “unique” within the ordinary meaning of that word. It may be very difficult either to cover or to fix damages because a substitute purchase may not approximate the item contracted for, particularly where the item is patented.

Generally, an action for the price or specific performance would be most appropriate when damages are difficult to calculate—one of the traditional justifications for using property rules. Thus, if the Article 2 good embodying the intellectual property right—as distinct from the property right itself—were truly unique, then it might be appropriate to award damages under the UCC’s property rules.

Such damages also may be appropriate when the parties are engaged in a one-time or end-game deal. If the parties expect to have an ongoing relationship, there is every reason to expect that in the event of a particular breach, they will negotiate to settle it. However, if the parties do not expect to deal with each other again, they may have an incentive to behave opportunistically, and the chances that the intellectual property right may be devalued through a wrongful resale or cover seem higher in those circumstances.

As a general rule, preemption concerns should not be implicated if


This section was intended to deal with circumstances in which, for some reason, the seller’s resale market had disappeared. It could be extended to deal with circumstances in which the licensor has breached an intellectual property license, but the courts fear that allowing resale would damage the licensor, or more broadly, discourage others from entering into licensing transactions. In such cases, the language “the circumstances reasonably indicate that such effort will be unavailing” could be interpreted to allow the licensee to recover the price. Admittedly, this approach stretches the ordinary meaning of the words but could be simply implemented through a comment to § 2-709 or a Permanent Editorial Board Commentary.

294. See supra notes 283-84 and accompanying text.

295. Cf. Merges, supra note 41, at 77 (“[B]y definition each asset covered by a patent is in some sense unique — a characteristic guaranteed by various requirements for protectability in the patent statute. . . . ”); Schwartz, supra note 79, at 276 (“As product differentiation becomes more common, the supply of products that will substitute precisely for the promisor’s performance is reduced.”); Paul DeAngelis, Note, Computer Resale Contracts: The Case for Adopting a Buyer’s Lost Profit Remedy under the Uniform Commercial Code 7 & n.21 (1995) (on file with author) (noting that customers often will not accept substitutes when contracting for brand name computers).
the proposal were implemented. However, if recognizing UCC remedies should, in practice, adversely impact the incentives for licensing, the drafters should encourage courts to award the price or specific performance routinely.

Finally, the breadth of the proposed revision should be addressed. It deals only with intellectual property licensees, not mere sellers and buyers. The proposal here is limited to granting implied licenses to intellectual property licensees, not generic buyers. Under the proposal, in the *Finley* case, Asphalt Paving, a generic buyer of a patented cement mixer, would be relegated to (a) making a cover purchase of another cement mixer which did not practice the Finley patents; (b) seeking specific performance; or (c) practicing Finley's patents in covering and relying not on the statutory wording of the UCC but rather a court's discretion in implying a license (as it did in the *Finley* case).

The proposal is framed in this manner to recognize both the theoretical considerations of intellectual property law and practical commercial realities. Almost every mass-marketed product is patented or otherwise protected by an intellectual property right. Many of these products have close substitutes such that a reasonable cover purchase without implicating intellectual property rights is not merely likely, it is probable. For example, if Coca-Cola had a patent on its formula and were to breach a contract to supply a restaurant with Diet Coke, the restaurant could cover by purchasing Diet Pepsi. Coca-Cola would likely be both shocked and dismayed if the UCC were to be interpreted as authorizing the aggrieved restaurant to license its patents to a third party to produce the Diet Coke. The remedy in these cases could have a significant chilling effect not just on commerce, but also on the goals of the intellectual property system. Every buyer would essentially become a compulsory licensee.

In contrast, when there is an actual license transaction, it is much more likely that the licensee is relying on the specific goods. The licensee has entered into the transaction relying on an ability to exercise the rights of the licensor rather than merely to purchase a good from a seller. It seems appropriate in those cases to allow cover by use of the intellectual property rights or to compel specific performance. The same need does not obtain in the generic sale of a patented, copyrighted, or trademarked item.296 In idiosyncratic circumstances in which it would be appropriate to allow a generic buyer to exercise the seller's intellectual property rights, a court would be free to imply such a license after a consideration of all the facts. The license, however, would not be granted by statute.

---

296. Of course, a buyer may still be entitled to specific performance if it is unable to cover because the item is covered by the intellectual property right and there is no viable substitute.
2. Analogies to other law

The problem of determining the appropriate remedy in intellectual property licensing transactions is currently being considered by the drafters of proposed Article 2B of the UCC. Article 2B is intended to apply to the licensing of information. Information is defined to include "data, text, images, sounds, computer programs, software, databases, and the like, and any associated intellectual property rights." However, it does not apply to intellectual property rights "to the extent not related to computer software or databases." Thus, Article 2B does not grapple with the question of the appropriate remedy when the license includes a right to manufacture goods covered by Article 2. The draft remedies are nonetheless useful to consider in evaluating the revisions proposed herein.

Under Article 2B, the aggrieved licensee may select to recover the contract-market differential as damages or the "difference between the value of the performance accepted, and the value if there had been no defect." However, the licensee, rather than opting for a damages remedy, may continue to use the information under the contract terms. Proposed § 2B-716 states:

On breach by the licensor, the licensee may continue to exercise rights under the contract. If the licensee elects to continue to exercise rights, the following rules apply:

1. The licensee is bound by all of the terms and conditions of the contract, including restrictions . . . and any obligations to make license fee or royalty payments.

2. The licensee may pursue remedies with respect to accepted transfers or performance.

3. The licensor's rights and remedies in the event of breach remain in effect as if the licensor had not been in breach.

The draft does not indicate the relationship between termination of the license on breach by the licensor and the remedy of continued use. The remedy of continued use, though, does seem to be analogous to the remedy proposal suggested in this Article. In the same way that the drafters of Article 2B would allow the licensee to exercise rights under the contract in the event of the licensor's breach, the proposal at issue would also allow the licensee a limited license to continue to exercise its rights under the contract in order to fix its damages. Additionally, in the same way that Article 2B would require the licensee to continue to comply with its obligations, the suggested changes would at least require the licensee to safeguard any confidential information under the rubrics of "good faith" and "reasonableness."

Article 2B then offers indirect support for the proposal suggested

297. Revised UCC, supra note 278, at § 2B-102(18).
298. Id. at § 2B-103(d)(4).
299. Id. at § 2B-709(a)(1)(c).
300. Id. at § 2B-716.
here. It adopts a remedy similar in effect to the proposal outlined above. Presumably, the drafters have concluded that such a remedy will further the statutory goals of modernization, flexibility, and uniformity as outlined in § 1-102(2).

The proposal here also bears some resemblance to § 365(n) of the Bankruptcy Code. Prior to the enactment of § 365(n), intellectual property licensees ran the risk of being unfairly surprised by the termination of their licenses in bankruptcy. If the licensor were to go bankrupt, the license might be deemed an executory contract which the trustee could set aside if its operation would be burdensome for the bankruptcy estate. Section 365(n) modified the prior law by allowing intellectual property licensees to elect to retain their license rights in the event of the licensor's bankruptcy. If a licensee opts to retain its rights, the licensee is still obligated to make payments due under the contract. The underlying purpose of § 365(n) was to "promote the development and licensing of intellectual property by providing certainty to licensees in situations where the licensor files bankruptcy and seeks to reject the license agreement as an executory contract." \(^{302}\)

The proposal suggested here is somewhat similar, again because it allows the licensee a limited right of continued use. It too is targeted towards providing certainty in the law so that the parties to a negotiation understand the pre- and post-breach remedial framework. It also should work towards promoting licensing transactions by assuring licensees that all UCC remedies will be available to them.

**CONCLUSION**

As society becomes more dependent on information technologies, previously separate spheres of law are likely to collide with increasing frequency. A case in point is intellectual property law and contract, particularly the UCC. Each law has its own underlying rationale to which its remedial provisions help to give effect. Thus, any case in which one set of remedies is given precedence over another should be closely scrutinized for its impact on underlying statutory goals.

This Article has identified one such collision—that between intellectual property liability for infringement and UCC remedies for aggrieved licensees. It has suggested that allowing UCC remedies essentially to trump intellectual property remedies in such cases is not merely appropriate, it is also desirable. Allowing UCC remedies to continue to apply furthers underlying UCC goals while not frustrating the intellectual property scheme.

The analysis employed in this Article should prove useful in helping to develop a comprehensive contractual law of intellectual property. The

---

methodology suggested is first to identify the underlying policies of intellectual property law and contract. Particular intellectual property or contractual rules may then be better understood in terms of the overall theoretical framework which supports the statutory or common law implementation of those rules. Where those rules seemingly collide, a compromise may be appropriate to effect the goals of both sets of laws. If that compromise is not feasible then at least the issue has been sharpened in such a manner that policymakers may make reasoned choices about what goals should be given precedence. This method of decisionmaking is preferable to ad hoc judicial review which may serve neither to enhance the intellectual property system nor to further the goal of coherent contract law.