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Law Makes Gradual Gains to Adapt to E-Commerce

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TRADITIONAL LAW has often proved to be inadequate in dealing with e-commerce legal issues. As a result, many new federal and state statutes have been passed in the last several years in an attempt to provide an appropriate road map to resolving these issues. One of these new laws, the Digital Millennium Copyright Act has already been found to be lacking in certain Internet copyright issues. This article will discuss the application of various legal issues in e-commerce, including copyright and trademark infringement, defamation, the formation of an e-contract, jurisdiction, advertising on the Internet and taxes.

One theme that resonates through e-commerce legal issues is that the government has tried to keep interference with the Internet at a minimum. As will be seen, the theories of free enterprise versus a "free Internet" have clashed.

E-commerce on the Internet will often involve global business. Who will set the rules for global business? One may engage in international e-commerce without even knowing it, i.e. by buying something on-line without realizing that the seller is in Germany. Global disputes will probably have to be resolved on-line.

In terms of basic terminology, most people know that "B to C" means business to consumer and "B to B" means business to business. Until their demise in the new millennium, we were bombarded with TV ads dealing with "B to C"; however, do you know that most of the money made on-line is "B to B?" In fact, in recent years "B to B" has been more than 10 times larger then B to C.

Internet legal issues are extremely current and constantly changing. It has been said that 32 minutes is one year in Internet time and thus, by the time you finish reading this article, many legal problems may have been dealt with in new and novel ways.

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Copyright Infringement

What is copyright infringement? Copyright is defined as:

> A property right in an original work of authorship (i.e. literary, musical, artistic, photographic or film work) fixed in any tangible medium of expression, giving the holder the exclusive right to reproduce, adapt, distribute, perform and display the work.[1]

To determine whether there has been an infringement of a copyright, one must first look to traditional copyright law. There are three types of infringement:

• Direct infringement, violating someone's copyright;

• Contributory infringement, knowledge of and contributing to the infringement. For example, a flea market owner with knowledge that people leasing space in the flea market are selling T-shirts in violation of someone's copyright.

• Vicarious liability; one can be held liable if he has a right to supervise the infringer and receives a financial benefit from the infringer. In such case, knowledge of the actual infringement is not required. Under traditional law, Internet Service Providers (ISPs) — outside companies providing the server and Internet connection for a Web site — would be extremely vulnerable to vicarious liability.

As a result, in the fall of 1998, Congress passed the Digital Millennium Copyright Act (DMCA). The DMCA offers broad protections for ISPs that unknowingly transport, cache or store copyrighted materials provided they take the required action discussed below. "Caching" is the practice of temporarily storing popular Internet material locally, in an ISP's server, so that the ISP's users can access that material more readily.

DMCA provides the following "safe harbors:"

Transmission. An ISP is not liable for transporting infringing material as long as it did not:

- initiate the transmission or routing,
- select the recipients of the material, or
- modify the materials.

Caching. An ISP is not liable for infringing material made available on-line by someone else as long as it does not modify the materials.

Storage. An ISP is not liable for storing infringing material as long as it:

- does not have actual knowledge that the material infringes a copyright, and
- is not aware of facts or circumstances from which the infringing activity is apparent.

To be eligible for the "safe harbors" an ISP must:

- designate an agent to receive notices of claimed infringement;
- post that designation on-line; and
- file the designation with the U.S. Copyright Office.

To seek the removal or blocking of infringing material on-line, one must send a Notice of Claimed Infringement containing the following information:

- the physical or electronic signature of the person authorized to act on behalf of the copyright owner;
- the identity of the copyrighted work;
- the identity of the infringing material to be blocked or removed by the ISP and sufficient information to locate the alleged infringing material;
- reasonably sufficient information to permit the ISP to contact the complaining party, i.e. the complaining party's physical or e-mail address;

• a statement of the complaining party's good faith belief that the use of the material is not authorized; and

• a statement that the information in the notice is accurate and under penalty of perjury that the complaining party is authorized to act on behalf of the copyright owner.

When the ISP receives such a notification, it must (a) act expeditiously to remove or block access to the allegedly infringing material and (b) take steps to notify the alleged infringer. If it does so, the DMCA exempts the ISP from liability. On the other hand, the ISP's failure to take down or block the infringing material will result in the loss of the ISP's statutory exemptions from liability.

After being notified by the ISP, the alleged infringer can give a "counter-notification" to the ISP that its removal or blocking of material is the result of a mistake or misidentification, i.e. that the material is not infringing. The ISP must then provide the copyright owner with the "counter-notification." If the copyright owner does not notify the ISP that it has started a lawsuit to restrain the alleged infringement within 10 to 14 business days after receiving the "counter-notification," then the ISP must replace or unblock the user's materials. Hence, the "counter-notice" forces an immediate lawsuit.

Be aware that the DMCA does not replace traditional copyright law. An ISP that does not qualify for the "safe harbors" can still seek to avoid liability under traditional copyright law.

The DMCA could not adequately resolve the Napster case. Napster is a Web site that allows access to other people's files to download music. The service is free, and by mid-2000, it was reported that Napster had 70 million users who were downloading 14,000 songs a minute. Napster was sued for copyright infringement by the five major record labels — Sony, AOL Time Warner, Universal, EMI and Bertelsmann.

Napster argued that it was entitled to the "safe harbors" specified in the DMCA. It stated that it was not liable for transmitting infringing material because it did not initiate the transmission or routing, did not select the recipients and did not modify the material. It said it should not be liable for caching infringing materials made available on-line by someone else since it does not modify the materials. Since Napster does not store any copies of songs, it should not be held liable for storage, even though it might have actual knowledge that the material is infringing copyrights and may be aware of facts and circumstances from which infringing activity is apparent.

Nevertheless, a federal judge in the Napster case issued a preliminary injunction pending trial, which enjoined Napster from permitting the exchange of copyrighted music owned by the five major record labels. In February 2001, the Ninth U.S. Circuit Court of Appeals upheld the preliminary injunction saying that Napster "knowingly encourages and assists" in the exchange of copyrighted music and that Napster "knew or had reason to know" of direct infringement and in fact, abetted the infringement, i.e. contributory infringement.

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The Court of Appeals found that the plaintiffs, in all likelihood, would prove Napster guilty of contributory infringement. The Ninth Circuit also stated that "preliminary injunction against Napster's participation in copyright infringement is not only warranted, but required." The Court of Appeals did not really discuss the DMCA's "safe harbors" to which Napster seemed to be entitled. The court implied that since Napster's Web site was designed to enable copyright infringement, it would not allow this to continue even if there might be some technical loopholes provided by the DMCA. At the present time, Napster has been shut down completely but hopes to reopen on a subscription fee basis. In the meantime, there are many other Web sites now providing free access to music. Most have no central directory, which makes it difficult to enforce copyright laws against these Web sites.

Trademarks

A trademark is defined as "[a] word, phrase, logo or other graphic symbol used by a manufacturer or seller to distinguish its product or products from those of others."[2] Its main purpose is to guarantee a product's genuineness.

To receive federal protection, a trademark must be: (a) distinctive rather than merely descriptive, (b) affixed to a product that is actually in the marketplace, and (c) registered in the U.S. Patent and Trademark Office.

With respect to trademark infringement, we must once again start with traditional law, which is similar to copyright law in that, there are the same three kinds of infringement: (a) direct infringement (b) contributory infringement and (c) vicarious liability. The DMCA does not apply to trademarks and, thus there are no safe harbors.

In determining whether there has been an infringement of a trademark, first the court will look at the "likelihood of confusion." The factors that a court will consider in determining the likelihood of confusion are (a) the strength of the mark, (b) the proximity of the goods (i.e. televisions versus apparel), and (c) "initial interest confusion." Initial interest confusion is created when you search on-line under a trademark and get referred to other sites. This can be an infringement.

Courts also look to whether the allegedly infringing item is creating "dilution" of famous marks. In considering "dilution," courts look at "blurring" and "tarnishment." "Blurring" is another party's use of similar trademarks, which causes their identification with your goods to become "blurred" (for example, "Cadillac" used to sell lawn mowers). "Tarnishment" is associating a famous mark with goods of a lesser quality or offensive material (for example, the Candyland game was used on a pornographic Web site).

Domain names merely identify one's address on the Internet. Enterprising individuals ("cybersquatters") bought up domain names and tried to sell them to trademark owners. Some examples

of domain names are MTV.com, McDonalds.com, abc.com and NYYankees.com. Suits by the trademark owners led to conflicting decisions as some cybersquatters claimed they were not using the name in the marketplace, which as aforesaid is a requirement to receive federal protection.

The International Corporation for Assigned Names and Numbers (ICANN) was created by the U.S. Department of Commerce to privatize the management of the domain name system. Network Solutions, Inc. (NSI) is the primary registrar of domain names in the United States. NSI's dispute resolution policy was not very effective against cybersquatters and accordingly, ICANN began selecting other companies to act as domain name registrars.

Since neither ICANN, NSI or the courts were able to solve the problem of cybersquatting, it was necessary for Congress to pass federal legislation. In November 1999, Congress passed the Anti-Cybersquatting Consumer Protection Act, whose purpose is to prohibit the buying up of domain names. To maintain a cause of action under the act, one must show a bad faith intent to profit, i.e. that the party registered the domain name to cause "confusion" or to "dilute" the value of the trademark. In considering the bad faith issue, courts are to consider the following items:

- Did the defendant try to sell the name to the trademark owner?
- Did the defendant register a number of domain names that are confusingly similar?
- Is it a famous trademark?
- Have the defendants used the domain name in connection with bona fide commercial transactions?
- Did the defendants intend to divert consumers from the trademark owner?

The act also protects famous individuals whose names have been registered as domain names. Under this statute one can be awarded monetary damages as well as injunctive relief. If the registered owner of a domain name cannot be located, you can proceed with an action against the domain name, and have the domain name transferred to you.

To avoid domain name disputes, companies should register their trademarks as domain names and should do so globally. Remember ".com" covers the United States only.

Defamation

Defamation is "[t]he act of harming the reputation of another by making a false statement to a third party."[3]

In the case of *Stratton Oakmont, Inc. v. Prodigy Services Co.*, 23 Media L. Rep. (BNA) 1794 (Sup. Ct, N.Y. 1995), the plaintiff sued Prodigy for allegedly defamatory statements posted by an unidentified individual on Prodigy's "Money Talk" computer bulletin board. Under traditional law, a publisher (i.e. The New York Times) can be held liable but not the distributor (i.e. the newsstand). Since Prodigy "monitored" the content of the bulletin board, the court found that it was a publisher and held it liable. This led to another federal statute. Not wanting to restrict e-commerce, Congress passed the Telecommunications Act of 1996 (a/k/a Communications Decency Act) which superseded the *Prodigy* case by making it clear that an ISP is not a publisher.

In several cases since the passage of the Communications Decency Act, AOL, which was sued for things said in "chat rooms," was found not to be a publisher and, therefore, not liable. In one case, a notice appeared on AOL's bulletin board that the plaintiff (Zeran) was selling T-shirts with offensive logos regarding the Oklahoma City bombings. Although this was not true, the notice gave Zeran's name and telephone number. Zeran asked AOL to remove the notice from its bulletin board, and it did. However, a similar message was posted on AOL's bulletin board multiple times thereafter. Still the Fourth Circuit Court of Appeals held that AOL had no liability. See *Zeran v. America Online, Incorporated*, 129 F.3d 327 (4th Cir. 1997).

With respect to defamation, Congress decided that in Internet communications, it would not only keep government interference at a minimum, but it made a policy decision to punish defamatory on-line speech only through the originating party.

Formation of A Contract

E-contracts have been around since the 1960s. They were created using Electronic Data Information (EDI) rather than the internet. EDI is a closed system, i.e. computer to computer. For years Ford Motor Company has used EDI with its suppliers.

What are some of the legal issues with respect to e-contracts?

- Are electronic signatures valid and binding?
- Does an e-contract satisfy the statute of frauds?
- How do you enforce e-contracts?

Many states have now enacted the Uniform Electronics Transaction Act (UETA).[4] UETA, which is a procedural statute, is presently pending in several other states.[5] It covers electronic records and electronic signatures that relate to a "transaction." The term "transaction" is limited to business, commercial and governmental affairs. It applies to consumers, but not contracts between individuals.

The statute provides that a contract may not be denied legal effect solely because electronic records were used in its formation. An electronic record will satisfy the legal requirement of a writing, i.e. the statute of frauds. The statute also recognizes the validity of an electronic signature, which is defined as any identifying word, symbol or process attached "with an intent to sign." Documents can be notarized with an electronic signature.

Under the terms of UETA, a contract can be formed by the interaction of electronic agents, even though no individual is aware of the contract. How is this possible? A computer, programmed to order goods upon receipt of inventory information, can issue a purchase order, which includes an electronic signature. The other party's computer can be programmed to automatically accept the order. Are we getting close to "The Terminator"?

A new federal statute, which recognizes electronic signatures, entitled the Electronic Signatures in Global and National Commerce Act (E-SIGN), was recently passed and became effective Oct. 1, 2000.

Two states have also passed a substantive statute called the Uniform Computer Information Transaction Act (UCITA). Although it was approved in July 1999 by the National Commission on Uniform State Laws, to date it has only been adopted in Maryland and Virginia. It is pending in several other states.[6]

When is a contract a contract? E-mails

can be intercepted and changed during transmission. You could instruct your broker to sell 1,000 shares of ABC, Inc., and he could receive an e-mail, which tells him to buy 1,000 shares of ABC, Inc. Who is responsible? UCITA tries to establish rules of attribution. For instance, if the parties agree to use a reasonable security procedure, a message sent according to that procedure is attributable to the sender, unless the sender proves the message did not originate from a source that it controls. Under UCITA, an e-contract is formed when an e-mail acceptance reaches the other party's system, even if it is not opened. One should review UCITA for more detailed attribution rules dealing with issues such as encryption.

Jurisdiction

With e-commerce, laws based on geographic boundaries are no longer applicable. Internet companies are trying to figure out whose laws are binding upon them. With jurisdictional issues, once again one must start with traditional law. First determine whether the defendant's contacts with the state satisfy the state's long arm statute.

Long arm statutes require "minimum contacts" in order for a state to exercise personal jurisdiction over non-residents. Then the court must determine whether the exercise of jurisdiction satisfies the notions of "fair play and substantial justice." To do so, the court should determine whether the exercise of jurisdiction satisfies the "due process" clause of the U.S. Constitution and whether the defendant could reasonably anticipate being hauled into a state court because of his contacts with that state.

In e-commerce there are typically three types of jurisdictional cases: pornography, gambling and intellectual property disputes (copyright disputes and trademark versus domain names).

To date, there is no definitive answer on e-commerce jurisdiction. Personal jurisdiction has been found to be proper for a defendant who clearly does business over the Internet with people or corporations in the state. If the user in the forum state exchanges information through defendant's Web site, jurisdiction is determined by examining the commercial nature of the exchange and the level of interactivity. See *Inset Sys. v. Intstruction Set, Inc.* 937 F. Supp. 161 (D. Conn. 1996).

On the other hand, courts have held that the posting of information or advertisements on a Web site, which is accessible both within and outside the forum state, is insufficient to subject one to personal jurisdiction in the forum state. The mere establishment of a Web site is not enough to confer personal jurisdiction in another state. See *Bensusan Restaurant Corp. v. King*, 937 F.Supp. 295 (S.D.N.Y. 1996), aff'd. 126 F.3d 25 (2d Cir. 1997).

By the same token, passive advertising on a Web site, i.e. where actual orders were not taken over the Internet, does not subject one to personal jurisdiction. Courts analogize advertisements on a Web site to advertisements in a national publication which have been held to be an insufficient basis for the exercise of personal jurisdiction. See *Hearst Corp. v. Goldberger*, No. 96 Civ. 3620, 1997 U.S. Dist. LEXIS 2065 (S.D.N.Y. Feb. 26, 1997) and *David Mink v. AAAA Development, LLC*, 190 F.3d 333 (5th Cir. 1999). Other courts have found personal jurisdiction to exist based on Internet advertising where the advertising is directed to people in the state and where residents of the state subscribe to the services or purchase the products. See *Zippo Manufacturing Co. v. Zippo Dot Com, Inc.*, 952 F.Supp. 1119 (W.D. Pa. 1997).

In the case of *U.S. v. Thomas*, 74 F.3d 701 (6th Cir. 1996), cert. denied 519 U.S. 820 (1996), a couple in California with an adult oriented bulletin board was charged and convicted in Tennessee of the interstate transportation of obscene materials. The U.S. Court of Appeals for the Sixth Circuit held that jurisdiction was proper in Tennessee since a Tennessee resident signed up for the services and downloaded the materials. The court also determined that the materials were pornographic under Tennessee community standards, even though they would probably not be pornographic under California law.

In order to protect itself, a company should disclose the nature of its Web site and disclaim liability. It should also eliminate troublesome jurisdictions ("screening") and "target" its site for jurisdictions with favorable laws.

Advertising

Again we must first look to traditional advertising regulations. The Federal Trade Commission (FTC) prohibits misleading claims for food, drugs and cosmetic products. All advertising claims must be substantiated, i.e. you must have a reasonable basis for all claims. This includes both an express or direct claim and an implied claim, i.e. where you give the public a "net impression." In fact, a claim, which is literally true, may be actionable if the "net impression" is misleading or deceptive.

A number of factors go into determining how much substantiation is required including, without limitation, the following:

- Is the claim a priority claim? That is, is the advertisement saying that there is "none better?" Or, is it superiority claim, i.e. saying that your product is better than all others? Obviously, a superiority claim requires a higher degree of substantiation than a priority claim.
- What are the benefits if the claim is true and the consequences if it is false, i.e. will it create a health hazard?
- What is the ease and cost in developing substantiation?
- What is the type of product? A health product will require a higher degree of substantiation.
- What is the level of substantiation that experts in the field agree is reasonable?
- Who is responsible for substantiation? All of the following have been held liable for false product claims: advertisers, advertising agencies, where they actively participate in the creation of the advertisement especially in a case of "net impression," retailers, cataloguers, infomercial producers and home shopping channels.

On the other hand, the traditional media, i.e. television, newspapers and magazines have not been held liable for false claims. The FTC has encouraged the media to have in-house screening procedures.

The liability of Web site owners for the contents of advertisements placed on their site is also unsettled. A Web site owner should have legal disclaimers on its site and if it has internal screening procedures, it should be in a better position with the FTC.

The FTC Rules and Regulations apply

to e-commerce. When using the word "free," all of the terms, conditions and obligations must appear in close conjunction with the word "free." For example, "buy one get one free."

Disclaimers must be clear, prominent and in close proximity to the claims they modify. According to the FTC, the disclaimer must be "unavoidable" to the consumer. Disclaimers, which are essential to the truth of the message, must be on the same page. For example, an advertisement offering a free phone, only if you sign up for three years of service. You can use a link for disclaimers that merely modify or expand the message; however, the link must say click for the terms and conditions.

E-commerce sites must comply with FTC Mail and Telephone Order Sales Rules as follows:

- Shipment within 30 days or within the time specified in the advertisement.
- A "reasonable basis" to believe the product can be shipped within the time specified.

A First Delay Notice is okay unless the consumer cancels. The notice must include a revised shipping date (no more than an additional 30 days) and an option to cancel and a means for the consumer to cancel at no expense.

If there is a Second Delay Notice, the order will be cancelled unless the consumer responds not to cancel. It must also have a revised shipping date and a means for the consumer to respond at no expense.

Regulated products or services may pose certain risks on-line. For instance, alcohol and tobacco products should not be capable of being purchased on-line by children. To run auctions on the Internet one must be aware that various states regulate auctioneers and may require licenses.

One must also bear in mind that when it is advertising on the Internet that this is a worldwide publication. Are your trademark or copyright licenses cleared for worldwide usage? To obtain worldwide licenses might be too costly so many companies are obtaining trademark or copyright licenses for use in the United States and on the Internet.

One must also be concerned with whether the advertisement complies with laws in all jurisdictions. Of course, it will be too costly to check the laws of all jurisdictions worldwide, but one should check with foreign counsel if it is a regulated type of product and your company has assets in that country.

Taxation

Once again, let's look at the traditional requirements for a state to tax a transaction. In order to satisfy the "due process" clause of the U.S. Constitution, there must be "minimum contacts" with the forum state. To satisfy the Commerce Clause, there must be a "substantial nexus" with the forum state. With respect to sales tax, one must answer the question, where is the sale taking place? Most sales tax laws only tax the sale of tangible personal property. What if you download music or buy software from Microsoft on-line? Some states now tax electronically delivered information but others do not. New York has changed its sales and use tax laws so that even software is considered tangible personal property subject to tax.

Pursuant to the Commerce Clause, each state may tax for its share of the transaction. With approximately 6,000 state and local jurisdictions imposing sales taxes, what rate do you charge and what jurisdiction would you pay for sales over the Internet? If you have a Web site, some states take the position that you are directing the activity to their state and thus, have satisfied the "minimum contacts" requirement of the "due process clause." But, what about the Commerce Clause? You may not have a "sufficient nexus" with the state.

Some entities have set up separate subsidiaries to transact e-commerce, for example, BarnesandNoble.com. However, if BarnesandNoble.com is found to be the "alter ego" of Barnes and Noble, which has stores in most states, it may be subject to sales and use taxes in those states.

Pursuant to Public Law 86-272, if orders are solicited by a person or his representative in a state but are sent outside the state for approval and are shipped from outside the state, then they are not taxable by that state. This is the law that governs catalog sales and will probably be applicable to most e-commerce transactions.

The Internet Tax Freedom Act, which was passed on Oct. 21, 1998, does not create a "tax free zone" on the Internet, as most people believe. This law merely created a moratorium from Oct. 1, 1998, through Oct. 20, 2001, for new state and local taxes on Internet access.[7] This moratorium does not apply to taxes "generally imposed and actually enforced" prior to Oct. 1, 1998. Accordingly, a transaction that was previously subject to tax is still subject to tax even if it is an Internet transaction. Most Internet companies, not being able to figure out whose tax laws apply to their transactions, conveniently interpreted the Internet Tax Freedom Act to mean that internet transactions are free from taxation.

Conclusion

E-commerce raises some interesting legal issues, which in many cases traditional law has not been able to deal with effectively. This has led to a series of federal and state statutes designed for these Internet issues. However, even these statutes have sometimes proved ineffective with respect to some e-commerce issues. Remember 32 minutes is one year in Internet time, so by the time new laws are passed, new e-commerce problems develop. It may take a long time, but it is probably necessary to design a worldwide commercial system for e-commerce.

(1) Black's Law Dictionary 337 (7th ed. 1999).

(2) Black's, supra note 1, at 1500.

(3) Black's, supra note 1, at 427.

(4) As of July 5, 2001, UETA has been adopted in Alabama, Arizona, Arkansas, California, Delaware, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia and Wyoming.

(5) It has been introduced and its enactment is pending in Colorado, Connecticut, District of Columbia, Illinois, Massachusetts, Missouri, Vermont and Wisconsin.

(6) UCITA is presently pending in the following states: Arizona, Delaware, District of Columbia, Hawaii, Iowa, Illinois, Maine, New Hampshire, New Jersey, Oregon, Texas and Washington.

(7) Presently pending in Congress is an act entitled the Internet Tax Moratorium and Equity Act, which if passed will extend the moratorium created by the Internet Tax Freedom Act from Oct. 20, 2001 until Dec. 31, 2005. H.R. 1410, 107th Cong. §3 (2001).

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