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Office of Continuing Legal Education at the University of Kentucky College of Law

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**UK
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2nd Annual

**Computer &
Technology Law
Institute**

March 2000



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Institute**

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**Presented by the
OFFICE OF CONTINUING LEGAL EDUCATION
UNIVERSITY OF KENTUCKY COLLEGE OF LAW**

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**UPDATE ON UCITA, UETA AND
OTHER LEGISLATIVE DEVELOPMENTS**

*Carlyle C. Ring, Jr.
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Washington, D.C.*

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SECTION A



**UPDATE ON UCITA, UETA
AND OTHER LEGISLATIVE DEVELOPMENTS**

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SECTION A

UPDATE ON UCITA, UETA AND OTHER LEGISLATIVE DEVELOPMENTS

Carlyle C. Ring, Jr.
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Washington, DC

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University of Kentucky, College of Law
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THE NEED FOR UNIFORMITY

Information technology accounts for more than one-third of the nation's economic growth and is the most rapidly expanding component of the U.S. economy. According to the U.S. Department of Commerce,¹ by 2006, almost half of the U.S. Workforce will be employed by industries that are either major producers of intensive users of information technology products and services. These employees average \$53,000 annual compensation compared to \$30,000 for all employees of private employers. Until now, however, there has been no law providing clear, consistent and uniform rules governing the intangibles of transactions involving computer information.

Few question the need for uniform rules. Everyone who has actively studied the issue concludes that uniform rules are required. Those uniform rules can either be achieved by Uniform State Laws where contract law has traditionally resided or by federal preemption. Congress has a number of bills now before it that would preempt parts of state contract law. Most states also are seeing more ad hoc bills on e-commerce.

In the early 90's a federal task force on Intellectual Property in the National Information Infrastructure (NII) concluded:

“[the] challenge for commercial law...is to adapt to the reality of the NII by providing clear guidance as to the rights and responsibilities of those using the NII. Without certainty in electronic contracting, the NII will not fulfill its commercial potential.”

The White House issued a paper on July 1, 1997 that found: “Many businesses and consumers are still wary of conducting extensive business over the Internet because of a lack of a predictable legal environment governing transactions.”²

The report notes the work of the Conference and states:

“The administration supports the prompt consideration of these [uniform state law] proposals, and the adoption of uniform legislation by all states.”³

¹ U.S. Department of Commerce, “The Emerging Digital Economy II” (issued June 1999).

² A framework for Global Electronic Commerce, <http://iitf.nist.gov/eleccomm/ecommm.htm>, at page 2.

The Conference Communiqué for Global Business Dialogue on Electronic Commerce (GBDe)⁴ states:

“We came together today for this inaugural conference of the GBDe in order to express our collective sense of urgency with respect to addressing electronic commerce issues by businesses and public authorities worldwide... It is the consensus position of the GBDe that inconsistent local, national and international patchwork regulation and inflexible regulatory constraints will deprive consumers of the economic benefits of an innovative electronic marketplace and would lead to significant uncertainty to consumers. Governments, administrations, parliaments and international organizations around the world are beginning to question the applicability of traditional, national legislative approaches to this new medium, which is uniquely swift and borderless. They are challenging us to develop effective self-regulatory and market-driven mechanisms that are not limited to national border, to address critical policy issues... We have drawn up proposals and criteria that will create a practical and flexible – where needed – legal and effective market-driven framework that promotes an open and frictionless global marketplace. Existing barriers must be overcome. In that process, we give precedence to effective self-regulation and technological solutions, where possible. In special cases, where regulation may be considered essential, any intervention of public authorities should be narrowly tailored, internationally-oriented, transparent and aiming a level playing field.”⁵

Hal Burman, Office of Legal Adviser, Department of State, at an American Law Institute meeting, emphasized the great importance of a consistent U.S. legal framework in order to succeed in international negotiations:

“Our ability to extend and protect United States interests in a globalized economy – and electronic commerce is the epitome of that globalized economy – depends entirely on our ability to proceed from a basis of some commonality in state law. If there is any substantial delay [in completing UCITA] that will impair our effort..., other countries...are going to take the lead.” (transcript, pp.145-6)

The need for uniformity is illustrated by the following common event: a business person is flying somewhere over the United States using his or her laptop computer, connecting with a database. The exact location of the airplane is unknown, as is the location of the servers, or the holder of the database. A license is proposed. The business person accesses the database which may be copyrighted. Among the many questions are: Is the holder of the database the owner or authorized by the owner to transfer the database? Has

³ *id* at page 5.

⁴ An international meeting of 70 CEO's or Board members, 110 government officials and representatives of international multilateral organizations. Principal presenters and participants included Mozelle Thompson, FTC; Sanford Lituach, The Walt Disney Co.; Richard Brown, EDS; Steve Case, AOL; Louis Gerstner, IBM; David House, Nortel; Lew Platt, Hewlett Packard; and Bert Roberts, MCIWorld Com.

⁵ Conference Communiqué dated September 13, 1999.
<http://www.gbde.org/conference/recommendations.html>.

a valid license been agree to? What are the terms of the license? What warranties arise? What are the applicable standards of performance? Who are the parties to the contract (license)? Have the identities of the parties been adequately established? What law applies? What states have jurisdiction in the event of a dispute? If the database holder is without authority, is the business person an infringer of the copyright?

Under current laws, these and many other questions are not answered clearly, consistently and uniformly. Thus, there might be a valid and enforceable contract (license) or terms of a contract in one state but not another. The chaos in a national and international Internet is self-evident and wholly unacceptable.

The void can be filled either by Uniform State Laws with its integration into existing state contract law or Congress can impose uniform rules but likely without adequate provision to coordinate with, and integrate into, existing state contract law.

AD HOC STATE DIGITAL SIGNATURES ACTS

States have been enacting digital signature acts of various types and forms to facilitate e-commerce in their states. Presently, 47 states have done so.⁶

But individual and disparate rules by each state, that are not uniform, do not serve the needs of interstate and global commerce nor facilitate the realization of the full potential of the Information Age.

FEDERAL LEGISLATION

Congress has taken an active interest in facilitating interstate e-commerce by federal preemption of ad hoc state statutes.

On the House side, H.R. 1714 was approved with Congressman Tom Bliley as the Patron. And on the Senate side, S.761 was passed with Senator Abraham as the patron. The first is entitled "Electronic Signatures in Global and National Commerce Act" and the second "Millennium Digital Commerce Act."

Both bills would preempt state law for interstate e-commerce. Both would exclude some transactions such as those under the revised UCC articles, family law, wills and trusts, governmental transactions, health care decisions, court orders, etc. Much of the present definitions and language of these bills follow UETA. Both would substantially lift the preemption if a state enacts UETA.

These bills are presently in Conference. There is a significant likelihood that Congress will enact some kind of preemptive bill this year. A good comparison of the two bills is available at the NJ Law Revision Commission website.⁷

⁶ See www.mbc.com for listings of the various state enactments.

⁷ <http://www.lawrev.state.nj.us/fedbill.htm>.

NCCUSL E-COMMERCE UNIFORM ACTS

Over the last two decades, NCCUSL has been actively engaged in developing appropriate uniform e-commerce rules for particular substantive transactions:

- (a) UCC Article 4A for e-commerce funds transfers (wholesale wire transfers) was promulgated in 1989 and now is enacted in all 50 states as well as being incorporated into CHIPS (Clearing House International Payments System), Fedwire (Federal Reserve Board) and NACHA (National Automated Clearing House Association).
- (b) Revised UCC Articles 3 and 4 promulgated in 1990 in part to modernize check collections for electronic transactions (check truncation) which has been enacted in all but three states.
- (c) Revised UCC Article 8 promulgated in 1994 in part to modernize to accommodate indirect electronic holding of securities which is now enacted in 47 states.
- (d) Revised UCC Article 5 promulgated in 1995 in part to cover electronic Letters of Credit which has now been enacted in 43 states.
- (e) Revised UCC Article 9 promulgated in 1998 in part to accommodate electronic filings. It already has been enacted in six states with rapid consideration and enactment by many other states anticipated in 2000.

UETA and UCITA are further steps by NCCUSL in developing e-commerce rules appropriate for particular transactions.

UETA

The Uniform Electronic Transactions Act (UETA) was promulgated in 1999 by NCCUSL has a limited mission: to enable e-commerce in transactions outside of the Uniform Commercial Code and UCITA. It will apply to UCC Articles 2 and 2A (goods) until the project to update those Articles for e-commerce are completed and enacted by the various states. In short, UETA applies to non-UCC transactions.

UETA simply provides that an "electronic signature" and an "electronic record" are effective as signatures and as writings if the parties have so agreed. All substantive law concerning the transaction remains wholly in place. The objective of UETA is to make sure that transactions in the electronic marketplace are as enforceable as transactions memorialized on paper and with manual signature, without changing any of the substantive rules of law that apply. An electronic record of a transaction is the equivalent of a paper record and an electronic signature is given the same legal effect as a manual signature.

The basic provisions of UETA are:

- Section 7 simply states that “a record of signature may not be denied legal effect or enforceability solely because it is in electronic form.”
- Excluded from its scope are the revised UCC Articles, wills and trusts, and other laws a state wishes to exclude.
- All other substantive law rules (Section 103(d)) continue to apply including rules for posting, notice, disclosure and content rules (Section 8(c)).
- Electronic signatures and records only apply if the parties have agreed to transaction electronically (Section 5).
- “Transferable records” (notes and documents under UCC Articles 3 and 7) are accommodated to facilitate the current bundling of such documents for financing of such transactions. Section 16 gives legal certainty for such transactions.
- Sections 17, 18, and 19 provide authorization and procedures for electronic transactions with state agencies. The sections are in brackets to indicate that they are appropriate for states that have not otherwise made provisions to authorize their state agencies to facilitate the efficiencies of electronic transaction between parties and governmental agencies.

See the attached summary of UETA

UETA has been enacted already in two states: Pennsylvania and California. UETA has been introduced as a bill in 18 other states so far in 2000. It is anticipated it will be enacted in many of these 18 states, and others in which it may be introduced later this year.

UCITA

The Uniform Computer Information Transactions Act (UCITA) was promulgated by NCCUSL also in 1999, but not fully styled for introduction until December. UCITA covers:

- Software contracts and licenses
- On-line access to databases
- Contracts to distribute information over the Internet
- Contracts to create computer programs

UCITA has been introduced so far in five states: Hawaii, Illinois, Maryland, Oklahoma and Virginia. It is anticipated that bills will be introduced in additional states in 2000.

UCITA has been passed by both Houses in Virginia (House: 95-2; Senate: 39 – 0) The Governor has announced he will sign the UCITA bill.

In Maryland, the Speaker and President of the Senate are principal Patrons of the UCITA Bills and have placed it on the priority legislative agenda. The Bar Associations of

Delaware and Washington have approved favorable reports on UCITA endorsing its enactment.

A. WHY UCITA?

- **America is in the Information Age.** Information technology already accounts for more than one-third of the U.S. economy and is, by far, its most rapidly growing sector.
- **This new information-based economy will to reach its full potential without predictable rules of commercial law.** The Uniform Commercial Code, Article 2, governs commercial transactions in tangible goods, but there are no comparable uniform state rules today for computer information and Internet (e-commerce) contracting. This unfortunate state of affairs is an open invitation to confusion, controversy and litigation that will inevitably slow economic growth.
- **The Uniform Computer Information Transactions Act (UCITA) addresses this need.** It lays down clear, fair rules for electronic contracting that are a major improvement over the *status quo* for businesses, whether licensors/licensees or sellers/buyers, and for consumers.
- **UCITA is about jobs, wealth creation and global leadership.** It is not a set of academic answers to legal quibbles.
- **UCITA was produced in an open, thoughtful, even-handed process.** The National Conference of Commissioners on Uniform State Laws (NCCUSL) spent a decade studying and debating the issues, publishing drafts and receiving public comment before finally approving UCITA, by a vote of 43 states to six. The Commissioners are distinguished judges, law professors and practicing lawyers who are appointed by and answerable to their states' Governors and legislatures. Their conclusions deserve a strong presumption of fairness and correctness.
- **UCITA is a product of compromise that, like every compromise, fully satisfies no one, but, on balance, is very fair.** Some consumer representatives want more consumer protections; some vendors want fewer. Some corporate information technology managers criticize UCITA as unfairly restrictive while their own lawyers endorse it as far better than current law. NCCUSL thoughtfully balanced these and other competing interests and produced a Uniform Act that is fair to all. As UCITA moves to state legislatures, the same arguments *pro* and *con* that were made to NCCUSL will be made again. It is important to recognize that these arguments have already been heard with respect and addressed. The critical goal of uniformity would not be met if each of the 50 states attempted to develop a new consensus.

UCITA is a uniform law that is urgently needed if we are to keep this country's economic engine running. Its enactment by the states, as approved by NCCUSL, must be given high priority.

B. UCITA THEMES

- **Freedom of Contract**

UCITA, like the UCC, is premised on the parties having freedom of choice. The terms and effect of a contract are determined by agreement rather than by legislative fiat. The exercise of contract choice opens up full opportunities for innovation and growth. With certain limited exceptions the terms expressed by the parties in their agreement control. If their agreement is silent, then trade usage and the parties' course of dealing and performance are looked to, and only if the contract is both silent and trade usage and course of performance is unhelpful, do the "gap-filler" provisions of UCITA apply.

- **Information and First Amendment**

Rights in intellectual property are established by other law such as patent and copyright law. UCITA specifically provides that federal preemption applies (Section 105(a)). State intellectual property law supplements UCITA and is not displaced by UCITA (Section 114(a)). UCITA adopts a neutral position with respect to what, ultimately, are issues of federal and international information rights policy. However, UCITA provides a basis for case by case resolution of the myriad issues in Section 105(b).

- **Fundamental Public Policy Issues**

A principal concern of consumers and other users and developers of computer information has been that the contracts which provide for its use not contain provisions which violate fundamental public policies. The Drafting Committee did not want to depart from the longstanding policy that a statute premised on freedom of contract should not be a regulatory statute, and thus was reluctant to include in the statute a laundry list of impermissible terms. Instead, members of the Drafting Committee worked with members of the academic community for several months to craft a solution which would recognize the legal principle that certain terms of certain contracts may be unenforceable because they violate a fundamental public policy. That solution is now embodied in Section 105(b) and accompanying comments.

C. SCOPE

- **Limited to “Computer Information Transactions” (Section 103 (a))**

UCITA covers “computer information transactions”, i.e. “an agreement...to create, modify, transfer, or license computer information or informational rights in computer information (102(11)). UCITA applies to contracts to license or buy software, contracts to create computer programs, contracts for on-line access to databases and contracts to distribute information over the Internet. UCITA does not apply to goods such as television sets, stereo equipment, airplanes or traditional books and publications. Goods generally remain subject to UCC Article 2 or Article 2A.

- **Opting in and Opting Out (Section 104)**

Under common law, the right of parties to choose generally permits them to adopt the law they may wish to apply to their transaction. However, UCITA places some specific restrictions on opting in or out in order to safeguard the parties (Section 104).

- **Exclusions from UCITA**

UCITA does not affect transactions in the core businesses of other information industries (e.g. print, motion picture, broadcast, sound recordings) whose commercial practices in their traditional businesses differ from those in the computer software industry. UCITA expressly excludes:

- a. Financial services transactions;
- b. Motion pictures, broadcast and cable TV, other than mass-market transactions in computer information;
- c. Sound recordings, musical works, phonorecord or enhanced sound recording;
- d. Compulsory licenses (103(d)(3));
- e. Contracts of employment of an individual other than as an independent contractor and newsgathering persons (103(d)(4);
- f. A contract which does not require that the information be furnished as computer information or in which the form of the information as computer information is otherwise *de minimis* with respect to the primary subject matter of the transaction (103(d)(5));
- g. Newspapers, magazines, books, and other print forms by the definition of “computer information” except when transferred in electronic form (e.g. over Internet by license), and (Section 102(11));
- h. E-mail communications merely about the agreement

D. ASSENT: UCITA'S SAFEGUARDS AGAINST INADVERTANT ASSENT AND SAFE HARBORS FOR CONTRACT FORMATION

There are a number of concepts in UCITA that need to be read together to fully appreciate the safeguards incorporated to protect the parties from inadvertent contracts, particularly in e-commerce. Some of these protections do not exist in common law. These concepts include:

1. "Authenticate" (Section 102(6)) includes "signature" but also are "with the intent to sign a record, otherwise to execute or adopt an electronic symbol, sound or process referring to, attached to, included in, or logically associated or linked with, a record or term." There is no authentication without an intent for the authentication to be a signing;
2. Agreement by conduct: "intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term"; (see also Restatement, Contracts(Second))
 - there must be "intent" and also "reason to know to be proven from all the circumstances
 - the circumstances may include a "reconfirmation" as a safe harbor, i.e. an initial click on "I agree" followed by a second display asking whether the person really intends to agree and a second click in response thereto (Section 112(d)).
3. Opportunity to Review Before conduct can be assent above, there must be an opportunity to review the terms (Section 112(e)),
4. Later terms, after beginning performance or use, are adopted only "...if the parties had reason to know that their agreement would be represented...by a later record to be agreed on." (Section 209)
5. In a Mass-market License, the licensee is entitled to reject the contract with later terms for any reason and obtain not only a refund but incidental costs of return or destruction and reasonable and foreseeable costs of restoring the licensee's system (Section 210(b));
6. Pretransaction Disclosure (Section 211) provides a strong incentive for disclosure of all terms before the licensee must pay or gets delivery, and lastly

7. “Attribution” to the party to be bound is required. The efficacy of an attribution procedure is determined by the circumstances including any agreement of the parties (Section 213(c)). Commercial reasonableness of an attribution procedure is a factor in making that determination (Section 212).

In short, a party to be bound must have an opportunity to review the terms, then assent with an intent to authenticate or intent by conduct and with reason to know that the other party will infer assent; (or if the opportunity to assent is after performance or use, the party to be bound must have reason to know there are later terms and in a mass-market transaction the party can return the item with a cost-free refund), and lastly, the claimant has the burden of establishing attribution (Section 213(a)).

E. ELECTRONIC CONTRACT (SECTIONS 212-215)

- A record or authentication may not be denied legal effect, validity or enforceability solely on the ground that it is electronic (Section 107). A group of sections then set forth particular rules to be used when an electronic record or authentication is at issue.

F. WARRANTIES (PART 4)

UCITA provides the following basic warranties which will be familiar to practitioners in the field of licensing law: quiet enjoyment and non-infringement, merchantability of a computer program, information content and fitness for licensee’s purpose and system integration. It also clarifies what is an express warranty. It sets forth the manner in which implied warranties may be disclaimed. Implied warranties are not generally recognized and/or clear under common law. UCITA thus significantly extends warranties over those under current law.

- **Implied Warranty, Informational Content (Section 404)**

UCITA establishes a new implied warranty which focuses on the accuracy of data provided under a contract. The basic warranty states: “...a merchant that, in a special relationship of reliance with a licensee, collects, compiles, processes provides or transmits informational content warrants to its licensee that there is no inaccuracy in the informational content caused by the merchant’s failure to perform with reasonable care.” Note that this warranty does not guarantee that there will be no inaccuracies; rather it gives some protection by assuring that there will be no inaccuracies caused by a failure to use reasonable care.

- **Implied Warranty, Licensee’s Purpose; System Integration (Section 405)**

If licensor has reason to know of any particular purpose for which the

information is required and that the licensee is relying on the licensor for expertise, there is an implied warranty that the information will be fit for that purpose unless, from all the circumstances, it appears that licensor was to be paid for the amount of its time or effort regardless of the suitability of the information, in which case, the implied warranty is that there is no failure to achieve the licensee's particular purpose caused by the licensor's lack of reasonable care and workmanlike effort to achieve that purpose.

G. TRANSFER OF INTERESTS AND RIGHTS (PART 5)

- UCITA generally permits transfer of a contractual interest under a license. However, transfer may be prohibited under other law (e.g. copyright law), or may not be allowed if such a transfer would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.
- However, if the parties agree to a term prohibiting transfer, that term is enforceable. In a mass-market license it must also be conspicuous.

H. FINANCING ARRANGEMENTS (SECTIONS 507-511)

- UCITA establishes bridge rules for license financing transactions that are not governed by UCC Article 9. The rules are similar to those for "Finance Lease" under Article 2A.

I. REMEDIES: LIMITATIONS ON ELECTRONIC SELF-HELP (SECTION 816)

- Electronic self-help is prohibited (i) if its exercise will result in substantial harm to the public health and safety or grave harm to the public interest (ii) unless the license has a separately-assented-to term that allows a limited exercise of electronic self-help. Upon cancellation of a license, use of electronic means to exercise a licensor's right to repossession in **NOT** permitted except as provided in Section 816. (*Note: This is a change from current common law under which electronic self-help is more broadly permitted.*)
- These provisions, when taken together with the provisions of Section 815, are so restrictive that it is unlikely that any licensor will be able to effectively use electronic self-help except in the most egregious cases; e.g. where a licensee is improperly disclosing the licensor's confidential and proprietary information. Most licensors would not agree to negotiate such provisions into their standard form contracts; thus it is a major benefit for licensees that UCITA effectively excludes electronic self-help from standard form contracts.

J. CONSUMER PROTECTIONS ARE PRESERVED

While many of the transactions to be covered by UCITA are commercial between merchants, UCITA also extends consumer protections to UCITA transactions.

Section 105(c) explicitly provides:

“(c) Except as provided in Subsection (d), if this [Act] or a term of a contract under this [Act] conflicts with a consumer protection statute [or administrative rule], the consumer protection statute [or rule] governs.”

Subsection (d) sets forth rules that enable e-commerce by allowing an electronic record, authentication, and conspicuousness. The Official Comments clearly state that “timing, manner and content” of disclosures are unmodified by those e-commerce enabling rules. However, to the extent a state provides for a “writing” and does not wish an electronic message to be authorized, a legislative note instructs the state to except such statutory provisions.

UCITA: (1) retains existing consumer protections laws, (2) adopts consumer rules in Article 2, and (3) adds limited additional protections appropriate for issues associated with computer information transactions.

Many contract law rules in UCITA benefit consumers. The doctrines of unconscionability, good faith, and fundamental public policy provide important consumer protections. But these rules also affect more than consumer transactions and respond to commercial concerns as well. So do the rules in UCITA (like those in Article 2) that disclaimer of implied warranties in a record must be conspicuous, or the rule in UCITA that a contractual choice of forum is unenforceable if it is unreasonable and unjust, or the rule in UCITA that assent is not effective unless there was an opportunity to review terms prior to giving assent. All of these and other rules benefit consumers but are not typically denominated as “consumer protection” rules. They contribute to the fact that UCITA creates a world in which consumers are better off than under current law.

UCITA also includes rules focused solely on consumer contracts and rules focused on mass-market contracts, which include all consumer contracts.

Section 105(c) provides that, except for stated rules regarding electronic commerce, if there is a conflict between UCITA and a consumer protection statute, the consumer protection law governs. Consistent with this theme, UCITA enacts rules preserving existing consumer law even if that result would not necessarily occur under other state law, such as:

- Section 104: an agreement to opt into or out of UCITA cannot change a mandatory consumer protection law that would otherwise apply
- Section 109(a): an agreed choice of law cannot alter an otherwise applicable consumer protection rule that cannot be varied by agreement

UCITA retains consumer protection rules contained in UCC Article 2 including:

- Section 303: a contract term requiring that modifications of contract be in writing is not enforceable in a consumer contract unless the consumer manifests assent to the term
- Section 704: licensee has a right to refuse tender of a copy that does not perfectly conform to the contract
- Section 803: consequential damages for personal injury cannot be disclaimed for a computer program contained in consumer goods

UCITA establishes various consumer protection rules focused on computer information transactions that do not exist under current law. These include:

- Section 209: a license cannot alter terms expressly agreed between the parties and, if presented after delivery, licensee has cost-free right of return if it refuses terms
- Section 214 a consumer has a right to avoid an online contract if it acts promptly to avoid the effect of an electronic mistake
- Section 302: safe harbor rule for changing terms in a continuing contract requires that the licensee that is a consumer be given a right to terminate when change is made
- Section 409(b): a warranty to a consumer extends to all individual consumers in the family or household if use should have been expected by the licensor
- Section 805: the statute of limitations for consumers cannot be reduced by agreement
- Section 104: a term changing the application of UCITA to the transaction must be conspicuous in a mass market transaction
- Section 503: a term that prohibits transfer of a contract right must be conspicuous for a mass market transaction.

APPENDIX A

**FACT SHEET ON
UNIFORM ELECTRONIC TRANSACTIONS ACT
(UETA)**

A Few Facts About
UNIFORM ELECTRONIC TRANSACTIONS ACT

PURPOSE: The Uniform Electronic Transactions Act is designed to support the use of electronic commerce. The primary objective of this act is to establish the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures, removing barriers to electronic commerce.

ORIGIN: Completed by the Uniform Law Commissioners in 1999.

STATE ADOPTIONS:

California
Pennsylvania

2000 INTRODUCTIONS:

Alabama	Minnesota
Arizona	Nebraska
Colorado	Ohio
Hawaii	Oklahoma
Idaho	Rhode Island
Indiana	Utah
Kansas	Vermont
Kentucky	Virginia
Maryland	West Virginia

For any further information regarding the Uniform Electronic Transactions Act, please contact John McCabe or Katie Robinson at 312-915-0195.

(2/15/00)

APPENDIX B

**SUMMARY OF
UNIFORM ELECTRONIC TRANSACTIONS ACT
(UETA)**

UNIFORM ELECTRONIC TRANSACTIONS ACT

- A Summary -

The Uniform Law Commissioners promulgated the Uniform Electronic Transactions Act (UETA) in 1999. It is the first comprehensive effort to prepare state law for the electronic commerce era. Many states have already adopted legislation pertaining to such matters as digital signatures, but UETA represents the first national effort at providing some uniform rules to govern transactions in electronic commerce that should serve in every state. Although related to the Uniform Commercial Code, the rules of UETA are primarily for "electronic records and electronic signatures relating to a transaction" that is not subject to any article of the Uniform Commercial Code, except for Articles 2 and 2A. A "transaction" means an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs. Much is excluded in this definition, including required notices, disclosures or communications by courts and governmental agencies.

UETA applies only to transactions in which each party has agreed by some means to conduct them by electronically. Agreement is essential. Nobody is forced to conduct to electronic transactions. Parties to electronic transactions come under UETA, but they may also opt out. They may vary, waive or disclaim most of the provisions of UETA by agreement, even if it is agreed that business will be transacted by electronic means. The rules in UETA are almost all default rules that apply only in the event the terms of an agreement do not govern.

Electronic commerce means, of course, persons doing business with other persons with computers and telephone or television cable lines. The Internet is the great marketplace for these kinds of transactions; a marketplace developing almost daily in 1999 (and presumably into the foreseeable future). The outlines and boundaries for this marketplace are still unknown and developments are not predictable. It is not possible to predict with any certainty how new law should develop to serve that marketplace or any other electronic marketplace that might develop in the future.

However, a few things are known about the existing electronic marketplace and there are some assumptions about the law that governs transactions within it that can be made with reasonable certainty in 1999, and that will continue to be reasonably certain into the future. Electronic transactions are conducted by communicating digitized information from one person to another. That digitized information can be communicated and stored without the use of paper, and the basic language of electronic transactions is fully and inherently paperless. In fact, relying on paper for the memorialization of transactions and upon manual signatures for verifying them are most likely to impede electronic transactions, adding to their costs. And there is no benefit to any party to an electronic transaction, with very few exceptions, in requiring that they be memorialized on paper with signatures that are manual. The need to expand requirements in the law for writings and manual signatures so that electronic records and electronic signatures will satisfy those requirements, is the one thing that is reasonably certain with respect to electronic transactions.

UETA does not attempt to create a whole new system of legal rules for the electronic marketplace. The objective of UETA is to make sure that transactions in the electronic marketplace are as enforceable as transactions memorialized on paper and with manual signatures, but without changing any of the substantive rules of law that apply. This is a very limited objective--that an electronic record of a transaction is the equivalent of a paper record, and that an electronic signature will be given the same legal effect, whatever that might be, as a manual signature. The basic rules in UETA serve this single purpose.

The basic rules are in Section 7 of UETA. The most fundamental rule in Section 7 provides that a "record or signature may not be denied legal effect or enforceability solely because it is in electronic form." The second most fundamental rule says that "a contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation." The third most

fundamental rule states that any law that requires a writing will be satisfied by an electronic record. And the fourth basic rule provides that any signature requirement in the law will be met if there is an electronic signature.

Almost all of the other rules in UETA serve the fundamental principles set out in Section 7, and tend to answer basic legal questions about the use of electronic records and signatures. Thus, Section 15 determines when information is legally sent or delivered in electronic form. It establishes when electronic delivery occurs--when an electronic record capable of retention by the recipient is legally sent and received. The traditional and statutory rules that govern mail delivery of the paper memorializing a transaction can't be applied to electronic transactions. Electronic rules have to be devised., and UETA provides the rule.

Another rule that supports the general validity of electronic records and signatures in transactions is the rule on attribution in Section 9. Electronic transactions are mostly faceless transactions between strangers. UETA states that a signature is attributable to a person if it is an act of that person, and that act may be shown in any manner. If a security procedure is used, its efficacy in establishing the attribution may be shown. In the faceless environment of electronic transactions, the obvious difficulties of identification and attribution must be overcome. UETA, Section 9 gives guidance in that endeavor.

Much has been much written about digital signatures in electronic commerce. What is a digital signature? It is really a method of encryption that utilizes specific technology. In the faceless environment of the electronic marketplace and particularly the Internet, such technologies are highly useful.

It is not wholly certain what the legal impact of these technologies should be. For that reason UETA may not be characterized as a digital signature statute. It does facilitate the use of digital signatures and other security procedures in rules such as the one in Section 9 on attribution. Section 10 provides some rules on errors and changes in messages. It favors the party who conforms to the security procedure used in the specific transaction against the party who does not, in the event there is a dispute over the content of the message.

But nothing in UETA requires the use of a digital signature or any security procedure. It is technologically neutral. Persons can use the most up-to-date digital signature technology, or less sophisticated security procedures such as passwords or pin numbers. Whatever parties to transactions use for attribution or assuring message integrity may be offered in evidence if there is a dispute.

UETA is procedural, not substantive. It does not require anybody to use electronic transactions or to rely upon electronic records and signatures. It does not prohibit paper records and manual signatures. Basic rules of law, like the general and statutory law of contracts, continue to apply as they have always applied.

There are three provisions in UETA that need special attention, and that are not directly in support of the basic rules in Section 7. First, UETA excludes transactions subject to the Uniform Commercial Code, except for those under Articles 2 and 2A, the Uniform Computer Information Transactions Act, laws governing estates and trusts, and any other specific laws that a state wants to exempt from the rules applied in UETA. Some writing and signature requirements in state law do not impact the enforceability of transactions, and have objectives that should not be affected by adoption of a statute like UETA. The limitation of UETA to agreed electronic transactions will eliminate any conflict with other writing requirements for the most part. However, there is some room for jurisdiction-specific tailoring of UETA permitted in each state, to assure no conflict. Exclusions should be carefully and conservatively selected. Most law relating to contracts and transactions between persons will serve the public better if electronic records and signatures are recognized.

Second, UETA provides for "transferable records" in Section 16. Notes under Article 3 and

documents under Article 7 of the Uniform Commercial Code are "transferable records" when in electronic form. Notes and documents are negotiable instruments. The quality of negotiation relies upon the note or document as the single, unique token of the obligations and rights embodied in the note or document. Maintaining that quality as a unique token for electronic records is the subject of Section 16. A transferable record exists when there is a single authoritative copy of that record existing and unalterable in the "control" of a person. A person in "control" is a "holder" for the purposes of transferring or negotiating that record under the Uniform Commercial Code. Section 16 is essentially a supplement to the Uniform Commercial Code, until its relevant articles can be fully amended or revised to accommodate electronic instruments.

Third, UETA clearly validates contracts formed by electronic agents. Electronic agents are computer programs that are implemented by their principals to do business in electronic form. They operate automatically, without immediate human supervision, though they are certainly not autonomous agents. They are a kind of tool that parties use to communicate. Section 14 provides that a person may form a contract by using an electronic agent. That means that the principal, which is the person or entity which provides the program to do business, is bound by the contract that its agent makes.

When somebody buys something on the Internet, therefore, that person will be assured that the agreement is valid, even though the transaction is conducted automatically by a computer that solicits orders and payment information. Did anyone really think that every order on the Internet involves a direct communication with a human being?

Three sections of UETA deal with electronic records that state governmental agencies create and retain. Section 17 allows a state to designate one agency or officer as the authority on creation and retention of governmental records. Section 18 allows a state to designate which agency or officer regulates the communication of electronic records and use of electronic signatures between agencies and other persons. Section 19 allows a state to designate an agency or officer to set standards that promote consistency and interoperability between state agencies with respect to the use of electronic records and signatures. All three sections are optional sections, there for the state that needs them, but not mandatory for all states in order to implement uniformity. These are very important provisions, however, because they provide a state with some root law for organizing the electronic business of the state. They should be given very serious consideration in every state.

It is not possible to cover every aspect of UETA in a short summary. This summary highlights some important aspects. The adoption of these rules will be a boon to electronic commerce. They will not artificially skew any market or make any substantive law relating to contracts any different from that governing transactions memorialized on paper. Every state should adopt them as quickly as possible.

Founded in 1892, the National Conference of Commissioners on Uniform State Laws is a confederation of state commissioners on uniform laws. Its membership comprises more than 300 attorneys, judges, and law professors, who are appointed by each of the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, to draft uniform and model state laws and work toward their enactment.

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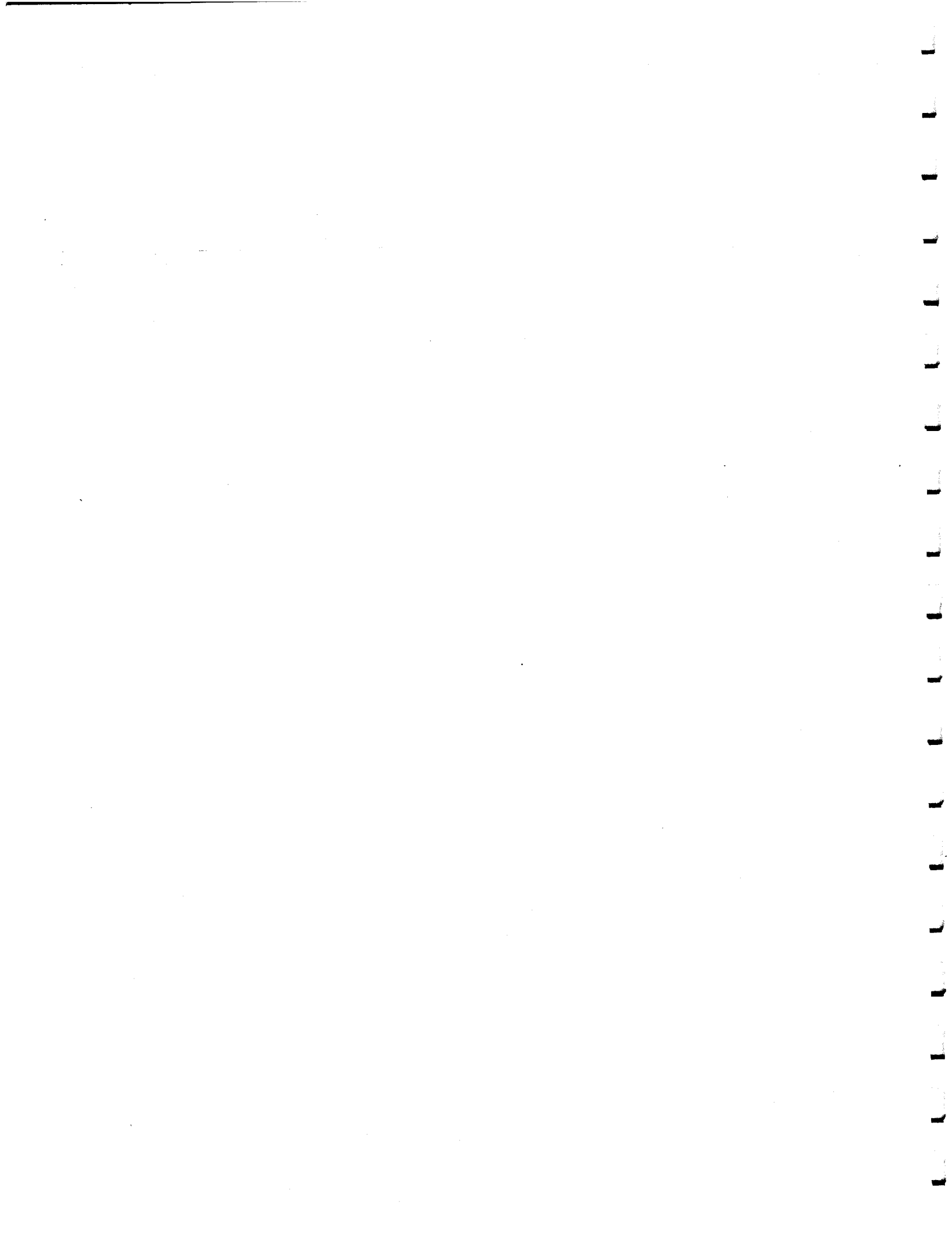
COMMON MISTAKES IN INTERNET CONTRACTS

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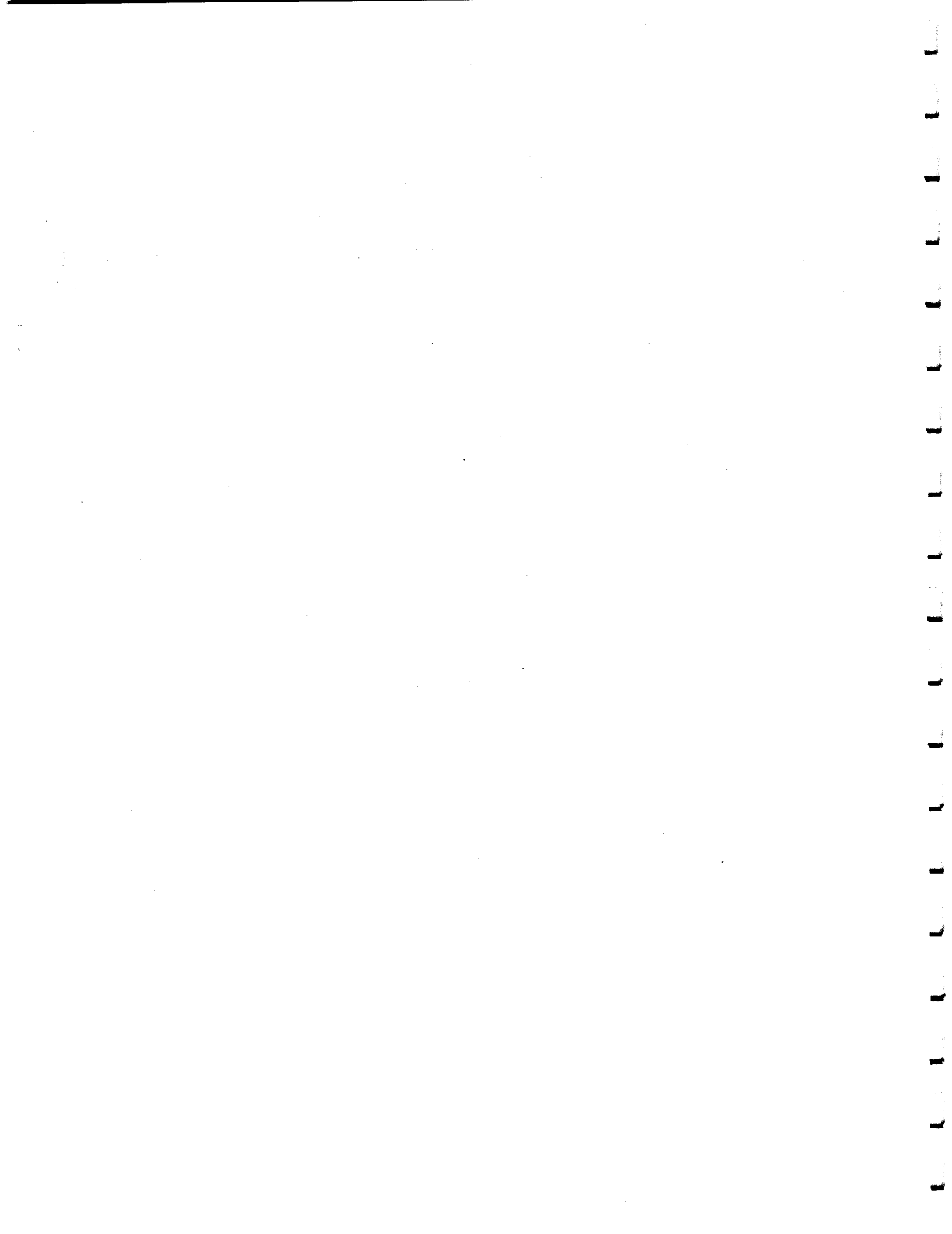
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COMMON MISTAKES IN INTERNET CONTRACTS

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This paper discusses contract laws and legislative proposals that will affect contracts for access to web sites and the licensing or sale of computer information. Specifically, the paper focuses on the Computer Information Transactions Act (UCITA), the use of contracts in the information economy, and foreign approaches to electronic commerce. The oral presentation will focus on samples of common mistakes made in Internet contracting. Because mistakes often occur from lack of knowledge of consumer laws, a brief list of federal consumer statutes is included at the end of this paper.

I. REASONS FOR CONTRACTING -- NEW AND OLD. While use of standard form contracts are necessary to mass distribution of many products and typify modern commerce, such contracts are particularly important in the online and computer information industries. For online and information products, the purpose and reasons for contracts, standard form or otherwise, at least include a desire by the information provider (a) to define the product offered and (b) to control liability.¹

A. DEFINING THE PRODUCT. One of the purposes of information contracts is to define the information product. Assume a wire service assembles an internet data base of news stories for use by reporters and writers at a price that justifies assembly and maintenance of the data base. The same data base could be offered to consumers, but the price they would be willing to pay for their non-commercial uses would not support the product. The solution? A license at a commercial price to commercial users, and a license at a lower price to consumer users. The data base is exactly the same under each license -- thus it is the license, i.e., the contract, that defines the product (product #1 is access to a data base for commercial purposes; product #2 is access to a data base for consumer purposes only). Put another way:

Consider the following contract term:

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

There is no doubt that the contract term defines and describes the product being transferred. While the tangible subject matter of the contract is most likely to involve delivery of a copy of the motion picture "James Bond 1998", the product is not the copy, but the rights granted in use of the content contained on the copy. If that point is not clear, compare the value of the contract term stated above to the value of the product in a contract in which the contract term provides the transferee with "exclusive rights throughout the United States" to publicly perform or display "James Bond 1998." Yet, both contracts are satisfied by delivery of the same copy of the motion picture. The contract, not merely the copy, is the product.²

This fact distinguishes information products from goods: a car is a Chevy or a Ford-- one doesn't need to read a contract to determine what the essential product is. Information products are not self-defining: typically one needs to read the license to determine what the product is.

If the product is a copyrightable work, the provider is faced with a threshold question: if it distributes the product so as to invoke the copyright first sale doctrine, it will lose the right to control further distribution. Thus a copyright owner who sells a copy only for use in North America may be faced with the argument that because the copy was sold, no restrictions on distribution apply and that copy may be redistributed in South America or elsewhere. The

answer to this problem cannot be that a copyright owner can only sell copies, i.e., can only offer one product. Contracts always have been and will continue to be the answer:

If the proprietor of an information asset is not permitted to contractually distinguish what rights it grants or withholds, that proprietor has only one asset available for transfer and with respect to which it can contract only one time. That rule obviously does not exist in modern law and is not consistent with basic property or contract law. The ability to contractually define and isolate what rights are and are not transferred is critical to commercialization of informational assets.

Id.

This dilemma of how to create commercially viable products for both providers and customers, is common throughout the information industries, including the software industry. The software industry solved the dilemma with licenses, i.e., contracts:

Copyright law forbids copying a literary work without permission, except for "fair use," which permits limited copying, as for example, copying limited portions of a book as part of a book review. Because software must be copied in order to be useful (computers copy software in order to use it), permission to copy must be granted in order to commercialize literary works in the form of software. In some cases, e.g. commercial software code libraries, meaningful commercialization requires that the literary work be copied many times.

Early developers who wished to commercialize their software were, therefore, faced with the challenge of making it possible to permit people to use the software without requiring the developer to give up his copyrights. Developers (whether they undertook to publish and distribute their own software or arranged to have a publisher distribute it for a royalty or on some other basis) were aware that copying software is inexpensive and easy. Reprinting an entire book may well cost more than purchasing a second copy from the author or publisher. Not so software. Making a copy takes little time, and is substantially less trouble and less costly than licensing another copy. Mass market license agreements advise the licensee of the circumstances under which copying is unauthorized, and therefore "unfair" because unauthorized copying violates the licensee's obligations to the licensor.

Developers were also aware (if only after talking with their lawyers) that if they did not make some effort to limit copying, their software might become "public domain." If this occurred, commercial potential would be destroyed.

Developers wanted to be able to provide their creations to a mass market. To do so, developers had to enable their customers to use the applications the developers created, while assuring the developers' ability to obtain income from their creative efforts. In other words, the developers' challenge was to find a way to facilitate intended use of software applications without sacrificing the possibility of commercial gain. The solution which the industry devised was licensing. The use of a contract between developer (whether directly, or through a publisher who would undertake to distribute the software for the developer) made it possible to tailor arrangements to particular applications, and to make changes quickly - an important element in the rapidly developing world of technology.

In essence, licenses tell customers what developers consider "fair use" of their "literary" creations. . . .

Harris, Michalyn, *Is Article 2B Really Anti-Competitive?*, 3 *Cyberspace Lawyer* No. 8, 16 at 18 (Glasser LegalWorks, 1998) (citations omitted), author's copy available at <http://www.winpro.com/articles/anti-competitive.htm>.

Licensing is not limited to product delivered in a box. Use of many web sites and the information available at or through those sites is also the subject of contract between the site and the customer. As explained by another commentator:

Without an effective contracting method to license software and electronic information to the mass market, the value and choice of products would have been diminished significantly, and some companies would have had no viable products at all. Organizations as diverse as Consumers Union, Consumer Net, University of California at Berkeley, Dartmouth College, Massachusetts Institute of Technology, Texas Classroom Teachers Association, Public Broadcast Service, Free Software Foundation, Robert Woods Johnson Foundation, Partnership For Food Safety Education, National Pediatric and Family HIV Resource Center, National Institute of Health Library, National Kidney Foundation. . . and Catholic Online Webmail employ standard form contracts to provide software and information to the mass market.

Critics of mass market licensing try to paint a picture of software or information licensing amounting to nothing more than a collection of "me too" forms in which licenses simply mirror a copyright first sale. Nothing could be further from the truth. Today's mass market licensing is characterized by contract variety and a variety of license terms. It is common for mass market license to provide users with more rights than the user would have acquired had the user simply bought a copy of the software, including reproduction, derivative works, and distribution rights. As new products have arisen, such as multimedia software, client-server products, and web site "products," contract variety and customer choice have also flourished via mass market licensing.

See Gomulkiewicz, Robert, *The License Is The Product: Comments On The Promise of Proposed Article 2B (or Something Like It) For Software And Information Licensing*, 13 Berkeley Technology Journal 891 (1998)(citations omitted). See also, Gomulkiewicz and Williamson, *A Brief Defense of Mass Market Software License Agreements*, 22 Rutgers Computer & Tech. L.J. 335 (1996).

Are these contracts valid or must every provision of a copy of information be a "first sale." The answer is "yes," they are valid (assuming compliance is had with contract and other applicable law) and "no," courts have not forced all distribution structures into a "first sale" mode. See e.g., Nimmer, Raymond T., *Breaking Barriers; The Relation Between Contract And Intellectual Property Law*, 13 Berkeley Tech. L.J. 827 (1998). The Federal Circuit Court of Appeals recently held that a license of a copy of software did not give the licensee ownership of the copy,³ i.e., a transfer is not a sale if the license terms are not consistent with rights after a sale. See also, *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

B. CONTROLLING LIABILITY. As to a second reason for contracts, the desire to control liability, licenses allow parties to allocate risks and comply with applicable contract laws. For example, some laws require certain contract terms to be set forth in a "writing," or to be expressly agreed or specially disclosed -- under Article 2 of the Uniform Commercial Code, a disclaimer of an implied warranty of fitness for a particular purpose must be in a writing, and incidental and consequential damages are available to a buyer unless a contract provides otherwise. Contracts are used by the information industries in the same way they are used by other industries: to control liability or allocate risks such as by disclaiming warranties, excluding certain damages, and/or limiting remedies.

Of course, one must consult applicable contract law in order to know one's liability and to draft an enforceable contract to control it, and that law may vary with the product in question. An example of variances in law is provided by comparing existing and proposed laws regarding the implied warranty of non-infringement.

(i) **Common Law.** There is no implied warranty of non-infringement in the common law. There are common law duties of reasonable care and workmanlike effort in service contracts, but those duties tend to inform the service, not any product that flows from the service. There are also torts, such as negligent misrepresentation, that can apply to one who negligently supplies inaccurate information when the requisite duty exists and reliance is foreseeable. See e.g., *Rosenstein v. Standard & Poort's Corp.*, 636 N.E.2d 665 (1993)(cause of action for negligent misrepresentation established where company that was official source for calculating index values owed duty as matter of law to trader to use due care in calculating the values which it knew were going to be used for contract settlements; but exculpatory clause in contract was enforceable, so no liability found). The ability to disclaim these duties, and the language necessary to do it, is not uniform and is governed by the common law. Article 2 is also used, by analogy, by some courts.

(ii) **Article 2.** Article 2 of the Uniform Commercial Code applies to sales of goods, e.g., to the sale of a car with patented windshield wipers. Article 2-312 inserts into every contract for the sale of a good, a statutory warranty against infringement, which warranty may be disclaimed completely. But the warranty may not be disclaimed as part of a disclaimer of implied warranties. See Official Comment No. 4 to Article 2-312. The language necessary to disclaim it also does not mirror the language necessary to disclaim an implied warranty. See Article 2-312((2) (the warranty will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have).

(iii) **Uniform Computer Information Transactions Act.** UCITA, the new uniform act for computer information transactions, was drafted to adapt laws written for goods to the unique attributes of computer information (see below). Section 401 of UCITA follows existing Article 2 with respect to the non-infringement warranty, but it adds more protection for licensees who provide specifications than does existing or proposed Article 2. As in Article 2, the UCITA warranty can be disclaimed but not as part of a disclaimer of implied warranties.

Subsections (i) through (iii) above are intended to illustrate differences in underlying contract laws that affect the liability of contracting parties and the varying rules for controlling that liability. Many lawyers, particularly intellectual property lawyers, will be tempted to view only subsection (i) as relevant to their practice, i.e, they believe that only the common law applies.

That may be a dangerous assumption. As information and other intellectual property is distributed increasingly like a commodity, online or offline, courts will struggle to find uniform

law. The software industry long believed that it was governed by the common law and not Article 2, but courts forced to deal with cases concerning software, particularly boxed software distributed in the mass market, started to grab for the Article 2 lifeline because it afforded the only uniform body of codified law even if that law was not written with information in mind. UCITA will solve that problem as to matters within its scope.

II. THE UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT.

The high technology and information industries are fueling the U.S. economy,⁴ yet no uniform body of contract law exists for computer information. The only uniform body of contract law in the U.S. is U.C.C. Article 2, which was written for goods. The need for a comprehensive body of laws contemplating information instead of goods has been explained in other contexts:

Applying the present libel laws to cyberspace or computer networks entails rewriting statutes that were written to manage physical, printed objects, not computer networks or services. . . A uniform system . . . is needed to cope with the impact of the information age. It is the responsibility of the legislature to manage this technology and to change or amend the statutes as needed.⁵

The need to rewrite law to reflect new economies is an old problem evidenced throughout the history of sales law. Karl Llewellyn, the author of Article 2, described the need to “unhorse” a sales law that was based on economies existing before the mercantile or industrial ages, i.e., the need to divorce sales law from laws written for economies contemplating real estate, horses and haystacks. *See generally*, Llewellyn, Karl, *The First Struggle To Unhorse Sales*, 52 Harvard Law Review 873 and 875 (1939). In describing the early efforts to “unhorse” sales law from analytical tools deriving from the “village smith,” Llewellyn noted that thinking in terms of “land-law” developed in judges a rigid attitude towards words with a tremendous power of carry-over into non-land transactions, and that approaching a commercial (sales) document with the eyes of a land conveyancer could lead to “pretty awful results.” *Id.*

He also believed that all sales law could not be lumped into a single class and that sales of mercantile goods needed to be thought of and treated differently from sales of farms, sales made at farms (instead of in distant markets) and horses:

If the wares are there, the descriptive words may be but a means of *identifying* which bales or barrels are under discussion, but such influence as the horse has is toward making words have legal force: ‘sound and kind’ in a bill of sale for a horse means ‘warranted so.’ The first move toward a law of pure commerce in wares is thus interestingly *away from* giving meaning to such words; for wool is not to be expected to have hidden vicious tendencies to kick. The type of “description” of ware which is to be relied on is a description of species, which, if it proves not to fit the barrel or the bale, unidentifies what has been apparently identified as the subject of the deal.⁶

The same subtleties can arise with respect to the differences between information and goods. A reason Llewellyn believed mercantile sales should not be thrown into a “single intellectual bin with cases of other and different pattern,” is the same reason that licenses of information should not be thrown into the single intellectual bin for sales of goods.⁷

And thus the need and rationale for the Uniform Computer Information Transactions Act, a uniform act adopted by the National Conference of Uniform Law Commissioners in July,

1999.⁸ UCITA creates a different and explained intellectual bin for cases of other or different patterns than sales of goods, to wit, licensing of computer information.

III. UCITA PHILOSOPHY – Commercial Contract Code. Grant Gilmore defined commercial legislation as "legislation which is designed to clarify the law about business transactions rather than to change the habits of the business community," and noted that the principal objects of the draftsmen of commercial legislation "are to be accurate and not to be original."⁹ UCITA largely takes the same approach by seeking to clarify or resolve existing confusion and to establish "default" or "fallback" rules that will apply *if parties do not otherwise contract*. As in the UCC, some of the default rules cannot be changed by contract but most of them can.

UCITA retains consumer protections found under existing commercial contract law, preserves substantive consumer protections found under consumer protection laws, and adds new consumer protections, but it does this in the context of a traditional commercial contract code. Like existing Article 2, its primary purpose is to codify and facilitate commerce. This focus has engendered much criticism from lobbyists for some consumers who desired to use UCITA as a vehicle to promulgate a uniform consumer code. However, that is not and has never been the purpose of commercial contract law and ignores the numerous consumer protections laws that exist under state and federal laws that are not disturbed by UCITA.¹⁰

Theoretically it would be advisable to aggregate all of the 50-state and federal consumer statutes and insert their common denominator into both UCITA and UCC Article 2 so that uniform statutes would result and it would no longer be necessary to ascertain and comply with the varying consumer laws of each state. However, as a political matter, that is not possible. Lobbyists for some consumers in both the UCITA drafting project and a project to revise Article 2, routinely requested additional consumer protections in the both statutes but never suggested or agreed that the new, uniform protections would replace existing state consumer protections laws. Thus, conversion of UCITA or Article 2 into a uniform consumer code would have resulted in the loss of commercial contract codes without achieving any uniformity with respect to consumer laws --- all varying state and federal laws would have continued additionally to exist. Given the need for and history of commercial contract codes, such a loss cannot be justified.

With respect to default rules generally, theoretically they are supposed to reflect existing law or industry practice, so parties who intentionally or unintentionally become subject to them largely should not be surprised by their terms. That is often true in UCITA. For example, the rights in information transferred by a contract are limited to the rights existing at the time of the transfer, not later developed rights or improvements (i.e., there is no inherent right to updates).

However, in other cases the default rules do not reflect industry practices. There are several reasons for this. Sometimes the default rules are used to reflect a policy choice regarding which party should start with an advantage, rather than an industry practice. Parties who do not contract around the default rules will be bound by that choice. For example, although the software industry routinely excludes consequential damages, the default rule in UCITA for computer programs, as in existing law common law, makes consequential damages available to an aggrieved party. Thus the licensee retains its current advantage notwithstanding contrary

industry practice. Another reason that the default rules might not reflect industry practices is that the information industries are converging. Thus there are no common industry practices in some cases because each industry has its own practice, at least as to its own products. As to converged products, no one knows the law. UCITA resolves that by creating common default rules, even if they may or may not reflect a particular industry's practice.

Last, the very nature of UCITA's subject matter requires it to create law in new areas. For example, a government White Paper notes that the NII "will not be used to its fullest commercial potential if providers and consumers cannot be confident that their electronic agreements are valid and enforceable." See Bruce A. Lehman, Intellectual Property and the National Information Infrastructure, *The Report of the Working Group on Intellectual Property Rights* at 54. UCITA contains electronic contracting provisions that help address these questions.

The resolution of currently debated issues may be viewed as reflecting or not reflecting industry practice, or as ordinary or not, depending upon one's viewpoint. For example, opponents of "shrinkwrap" licenses who side with courts that have not enforced such licenses,¹¹ may argue that the "mass market license" provisions are not routine because they enforce shrinkwrap licenses under restricted conditions. However, given the validation of shrinkwrap licenses under existing law by a majority of courts,¹² proponents of shrinkwrap licenses would argue that UCITA's provisions are not routine because they invalidate shrinkwrap licenses unless statutory restrictions not found in existing law on any majority or uniform basis, are met. They would also note that UCITA accords some consumer protections to businesses and thus ignores the existing, clear dividing line established by most other law.

Many of the most commonly asked questions about UCITA are addressed in a paper supplied by NCCUSL. A copy is available at <http://www.nccusl.org/pressrel/UCITAQA.HTM>.

IV. FOREIGN APPROACHES TO ELECTRONIC COMMERCE. The European Union is moving quickly to construct a coherent internal framework for electronic commerce by the Year 2000:

The Commission's 1997 Communication on electronic commerce set a clear objective of creating a European coherent legal framework by the year 2000. This proposal meets that objective. It builds upon and completes a number of other initiatives [Note 2] that, together, will eliminate the remaining legal obstacles [to the provision of on-line services and electronic commerce], while ensuring that general interest objectives are met, particularly the achievement of a high level of consumer protection. This proposal will reinforce the position of the Community in the international discussions on the legal aspects of electronic commerce which are currently underway in a number of international fora (WTO, WIPO, UNCITRAL, OECD). The Community will thus secure a major role in international negotiations and significantly contribute to the establishment of a global policy for electronic commerce.

[Note 2 reads as follows:] Amongst the most recent are the directives on the "regulatory transparency mechanism", the protection of personal data, the protection of consumers in respect of contracts negotiated at a distance; and the proposals on the legal protection of conditional access services, electronic signatures, copyright and related rights and electronic money.

Proposal for A European parliament And Council Directive on Certain legal Aspects Of Electronic commerce In The Internal Market, at 3 (11/18/98) (unofficial English translation of provisional final version; citations omitted except as noted). The European Union recognizes

that the costs of current legal uncertainty regarding electronic commerce are real,¹³ and that the existence of a legal structure is *itself* a valuable asset:

Electronic commerce provides the Community with a unique opportunity to create economic growth, a competitive European industry and new jobs. The legal framework of the internal market and the euro are key tools for exploiting this opportunity.

... the Union must act in order to establish within Europe a genuine single market for electronic commerce. This single market must ensure that European businesses and citizens are able to receive and supply information society services throughout the Community, irrespective of frontiers. *Indeed, the legal framework of the internal market forms a major asset for electronic commerce, and electronic commerce forms a major asset for the internal market* . . .¹⁴

But for UCITA, the U.S. is far behind. One need only consider the impact that the EU Directive on data protection¹⁵ has had on U.S. businesses to understand that foreign law will fill any vacuum created by the inability of U.S. states (or the U.S.) to act, and that such foreign law may or may not reflect or respect U.S. values and laws.

To illustrate. Online sales are not yet heavily regulated in the U.S. The FTC has regulated "telemarketing sales" by requiring compliance with its Telemarketing Sales Rule. That rule, however, does not apply to sales conducted solely online. When initially proposed, the rule was interpreted to apply to online sales because the definition of telemarketing contained the term "telephonic mediums." *See*, 60 FR 30411 (1995). On the basis of comments received regarding the proposed rule, however, the final rule was revised to limit its application to telephone calls only. 60 FR 30411 (1995) ("[T]he Commission acknowledges that it does not have the necessary information available to it to support the coverage of on-line services under the rule⁴⁴." Footnote 44: "Such media remain subject to the Commission's jurisdiction under the FTC Act. 15 U.S.C. 41 *et seq.* *See, e.g., FTC v. Corzine, dba Chase Consulting*, No. CIV-S-94-1146-DFL JFM [E.D. Cal Dec. 1994]."

Now consider the European Council in its Directive On the Protection of Consumers In Respect of Distance Contracts ("ECD"). Directive 97/7/EC (May 20, 1997). The directive has recently been amended, but this author has not yet been able to obtain a copy of the amendments; accordingly, this discussion is based on the 1997 version of the directive. The directive grants broad protection to "consumers" involved in "distance contracts" by "means of communication at a distance." Consumers are defined as any natural person acting for purposes outside his trade, business or profession. "Distance Contracts" cover, with certain exceptions, contracts regarding goods or services between a supplier and a consumer under an organized distance sales scheme, where the supplier makes exclusive use of "means of communication at a distance" up through the point of contracting. This latter term includes any means used to conclude a contract between the supplier and consumer that does not involve in-person contact, including mail, fax, telephone, radio, television, videotex (*microcomputer* and television screen) with *keyboard*, and *email*.

In direct contradiction of the instantaneous nature of electronic commerce and the interactive nature of some sites, consumers have seven working days to withdraw at will and without penalty from any distance contract. A full refund is due, although direct return charges can be imposed. Importantly, "unsealed audio or video recordings, records or computer

software, CD-ROMs or CD-Is" and "books taken out of their original wrapping" are *not* covered by the withdrawal and refund right. This exception reflects a recognition by the European Union of the difference between the excepted products (such as software) and ordinary goods (toaster, clothes, cars and other items sold online): the withdrawal/refund right carries a risk for the excepted products of copying or use before exercise of the withdrawal right. For goods, the EU approach is like the FTC or state consumer protection "door-to-door" sales rules that allow a 3-day rescission right, but *only* with respect to door-to-door sales where the physical presence of the sales person can be coercive. Such coercion does not exist for online sales: the consumer need simply click to another site if it wants to abandon a sale.

The point of the illustration is not to determine which approach is best, but to illustrate that, by default, the EU will set the rules for electronic commerce if the U.S. states do not set a U.S. policy. The EU expressly recognizes that its ability to formulate rules "will reinforce the position of the Community in the international discussions on the legal aspects of electronic commerce which are currently underway in a number of international fora."

UCITA can serve the same function for U.S. states. It reflects traditional U.S. legal principles as found in existing Article 2 and the common law, and goes on to adapt them to computer information and electronic commerce. While no group may believe that it perfectly meets their desires, the larger question is whether the EU rules perfectly do so? For those who prefer the traditional principles of U.S. commerce, the answer should be no and action should be taken to adopt UCITA.

V. SELECTED U.S. CONSUMER LAWS. The following is a very brief, and necessarily misleading, summary of some the major federal consumer laws that could affect web sites, directly or by analogy. Many states have parallel, slightly different, or additional consumer statutes that may or may not be preempted by the federal statutes.

All of the Federal Reserve Board regulations are the subject of proposed amendments that would enable and restrict the use of electronic means to comply with the regulations. See e.g., 64 F.R. 49722 (September 14, 1999).

FTC Telemarketing Sales Rule (16 CFR § 310). This rule should not apply to web site, but the FTC is creeping towards applying aspects of it. As to why it should not apply, see above discussion and 60 FR 30411 (1995) ("[T]he Commission acknowledges that it does not have the necessary information available to it to support the coverage of on-line services under the rule⁴⁴." Footnote 44: "Such media remain subject to the Commission's jurisdiction under the FTC Act. 15 U.S.C. 41 *et seq.* See, e.g., *FTC v. Corzine, dba Chase Consulting*, No. CIV-S-94-1146-DFL JFM [E.D. Cal Dec. 1994]"). However, the FTC has suggested interpreting this rule as possibly applicable in several situations. See e.g., 63 F.R. 24996 (May 6, 1998)(FTC Interpretation of Rules and Guides to Electronic Media; Request for Comment. See e.g., discussion of e-mail solicitations).

FTC Mail/Telephone Order Rule (16 CFR §435). This is the rule that governs the date by which products ordered by phone or mail must be shipped and what happens if there is a delay.

Fair Credit Reporting Act, 15 USC § 1681. The federal Fair Credit Reporting Act primarily applies to persons who report credit information. Typically such persons are credit bureaus, but any business that reports information about a consumer's credit record needs to do so in a manner that prevents it from becoming a "consumer reporting agency" subject to the act (such can include businesses or affiliates who share information). The act also applies to users of credit reports. Purposes for obtaining credit reports are restricted and statutory disclosures are required if actions are based on a report. See 15 USC § 1681h. Odd situations can invoke this act (e.g., credit card "swipe" structures).

Fair Debt Collection Practices Act, 15 USC § 1601. This act governs debt collectors who collect consumer debts owed to third parties. The act limits communications, prohibits numerous forms of actions viewed as deception or harassment, and requires debt collectors to disclose certain information about the debts being collected as well as about debtors' rights to dispute and obtain verification of the debt. A debt collector is any person in any business whose principal purpose is debt collection and who regularly collects or attempts to collect debts owed another.

FTC Credit Practices Rule, 16 CFR Part 44. The FTC Credit Practices Rule prohibits sellers and lenders from engaging in certain consumer credit practices deemed to be unfair acts or practices. The rule prohibits inclusion of certain provisions in a consumer loan or sales contract, such as a confession of judgment, and requires a specified notice to be given to credit cosigners.

FTC Rule: Preservation of Consumer Claims And Defenses, 16 CFR § 433. This is the "holder in due course" rule. It essentially allows a consumer to assert defenses against a holder-in-due-course of a consumer credit contract and requires the contract to contain a notice of the rule.

FRB Regulation B, 12 CFR Part 202. Regulation B implements the federal Equal Credit Opportunity Act. Federal law prohibits discrimination with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract), the fact that all or part of the applicant's income derives from any public assistance program or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or state law. 12 CFR § 202.2(z). State laws can add additional prohibited bases such as creed and the presence of any sensory, mental or physical handicap. Local laws can also apply (e.g., municipal codes might prohibit credit discrimination on the basis of parental status and political ideology etc.).

Regulation B is *not* just a consumer statute. It also applies to business credit in varying degrees.

The Act applies to "creditors," which term includes any person who, in the ordinary course of business, regularly participates in the decision whether to extend credit (which is any right to defer the repayment of debt). 12 CFR and 1 CFR § 202.2(1) and Supp. I at § 202.2(j)#1. Under Regulation Z and with respect to credit secured by a dwelling, "regularly" is defined

numerically. 12 CFR § 226.2(17) Note 3. "Regularly" is not defined in Regulation B, but the regulation is intended to cover a broader range of credit transactions than Regulation Z.

In addition to prohibiting discrimination, Regulation B requires delivery of a notice of credit approval or rejection and a statement of reasons for any rejection, restricts the circumstances in which the signature of both spouses can be required on a debt, and contains significant record keeping requirements.

FRB Regulation E, Electronic Fund Transfers. An electronic fund transfer (EFT) is any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, that is initiated through an electronic terminal, telephone or computer or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account. "Financial institution" is not limited to banks and other insured depository institutions, but includes any person who, directly or indirectly, holds an account belonging to a consumer (15 USC § 1693b(8)) and any person who issues an access device and agrees with a consumer to provide EFT services. 12 CFR § 205.2(i). An "account" is not limited to checking and savings accounts, but includes other consumer asset accounts held by a financial institution. 12 CFR § 205.2(b). "Consumer asset account" is not defined but in recent years, the FRB has flirted with defining it very broadly in a manner that would cover smart cards. An "access device" means any combination of a card, code or other means of access to a consumer's account that may be used by the consumer to initiate an EFT. 12 CFR § 205.2(a)(1). All debit card transactions are EFTs.

Under Regulation E, access devices may only be issued upon request, specified and extensive disclosures must be given to the consumer, and transfers must be billed and documented, and errors must be resolved, in a specified fashion. Persons such as retailers who issue debit cards are governed by a complicated division of obligations between the retailer (the "service provider") and the financial institution holding the consumer's account. Regulation E imposes a limit on the liability of consumers for unauthorized EFTs, and compulsory use of EFTs is prohibited.

FRB Regulation Z, 12 CFR Part 226. Regulation Z supplements Title I of the Consumer Credit Protection Act, 15 USC 1601, and implements the Truth In Lending Act. It applies to any person who is a "creditor," which is defined to include a corporation who regularly extends consumer credit that is subject to a finance charge (term includes an interest charge) or is payable by written agreement in more than four installments and to whom the obligation is initially payable. "Regularly" means extending consumer credit in the preceding calendar year more than 25 times (or more than 5 times if the credit is secured by a dwelling). See 12 CFR § 226.2(17) and Note 3. Regulation Z requires, among other things, that *extensive* disclosures be made before the first extension of credit, that complying periodic statements be delivered for open-end credit, and that certain procedures be followed to resolve billing errors or certain other complaints. Most of the credit card provisions of Regulation Z also apply to *business* credit, not just consumer credit. The regulation also limits a cardholder's liability for unauthorized uses of credit cards. Credit advertising restrictions are also imposed. The FTC is authorized to take regulatory action for noncompliance and class action and other damages are also available.

FRB Regulation M, Consumer Leasing, 12 CFR Part 213. This regulation requires lessors to provide consumers with uniform costs and other disclosures about consumer lease transactions. Many states have similar statutes. The National Conference of Commissioners on Uniform State Laws is working on a state law uniform act. The federal regulation generally applies to consumer leases of personal property in which the contractual obligation does not exceed \$25,000 and has a term of more than four months. An automobile lease is the most common type of consumer lease covered by the act.

Usury. Usury statutes restrict the amount of interest and similar charges that may be charged on a loan or other extension of credit. Penalties for violation are severe and breach is usually also a violation of Consumer Protection Acts. Usury statutes exist at the state level and also, for federally chartered institutions such as national banks or federal thrifts, at the federal level. There are several federal doctrines, such as the "Most Favored Lender Doctrine," that make state usury statutes applicable to programs offered insured financial institutions. Usury statutes apply to almost all creditors. Accordingly, any company, whether or not a financial institution, needs to be aware of usury statutes if the company extends credit and contracts for interest. The company needs to comply with the usury statute or locate an exemption from it. Usury protections typically are considered to be a fundamental policy of the state and contrary choice of law clauses sometimes are not enforceable (the Comptroller of the Currency would say the opposite, however).

¹ See e.g., Nimmer, Raymond T., *Breaking Barriers; The Relation Between Contract And Intellectual Property Law*, 13 Berkeley Tech. L.J. 827, 836 (1998) (information contracts typically deal with at least 3 issues: product issues (defining the subject matter), liability issues (defining the allocation of risk), and performance issues (defining how the transaction will be performed)).

² *Id. supra* at 842.

³ *DSC Communications v. Pulse Communications*, -- F.3d -- (Fed. Cr. 1999) (the case involved a standard form software license used in the telecommunications industry). See also *MAI Systems Cor. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); *Expeditors int'l of Wash., Inc. v. Direct Line Cargo Mgmt Servs., Inc.*, 995 F. Supp. 468 (D. N.J. 1998) (licensee not an owner).

⁴ The U.S. high-tech industry represented a project 6.2% of the U.S. gross domestic product in 1996, up from 5.4% in 1990. The automotive manufacturing and services percentage is 4.3; the high-tech industry (which was conservatively defined only to include high-tech manufacturing, communications services and software and computer-related services, and to exclude the biotechnology industry and the wholesale and retail trade of high-tech goods), is slightly behind the private health services industry at 6.5%. The high-tech industry also creates millions of new jobs which, because they tend to require workers with more education and technical abilities, pay 73% more than the average private sector wage in the U.S. Additionally, the high-tech industry is the single largest exporter in the U.S. See American Electronics Association and Nasdaq, *Cybernation, The Importance of the high-Technology Industry to the American Economy* (1997), "Key Findings" (copy available from AEA at 1-800-284-4232).

⁵ *It's In The Cards inc. v. Fuschetto*, 535 N.W.2d 11 at 14-15 (1995).

⁶ *Id.* at 887. The point here would appear to be that horses could not be characterized by species because of their inherent individual differences. It appears that they traditionally did not carry any implied warranties either because they were viewed as "detachable agrarian chattel," "articles of natural growth" distinguishable from wares, or simply as horses and not wares. Llewellyn, Karl, *Across Sales On Horseback*, 52 *Harvard Law Review* 737, 740, 741 (1939).

⁷ *Llewellyn, Id.* Note 23 at 874 (as between the law of real estate conveyancing and the law of mercantile sales, the latter should be channeled under circumstances which permit them to be perceived as mercantile cases, which permit them to remain unconfused in their impact because they are not thrown into a single intellectual bin).

⁸ Examples of other uniform acts drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) include (but are not limited to) the Uniform Trade Secrets Act and the Uniform Limited Partnership Act. The purpose of NCCUSL is to promote uniformity in state law on all subjects where uniformity is desirable and practicable. To accomplish this, the commissioners participate in drafting acts and endeavor to secure their consideration by state legislatures. *National Conference Of Commissioners on Uniform State Laws*, 1995-96 Reference Book at 3. NCCUSL is composed of approximately four commissioners from each state, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Commissioners are appointed by state governors and tend to be law school professors, legislators, practicing lawyers, and state code revisers. *Id.* Commissioners are appointed to drafting committees and a "reporter" is chosen to draft each proposed act. The Reporter for UCITA was Dean Raymond T. Nimmer, Leonard Childs Professor of Law, University of Houston.

⁹ Gilmore, Grant, *On The Difficulties Of Codifying Commercial Law*, 57 *The Yale Law Journal* 1341 (1948).

¹⁰ For a discussion of the treatment of consumers in the U.C.C. or Article 2B, see Miller, Fred H., *Consumers And The Code: The Search For The Proper Formula*, 75 *WA Univ. L. Quart.* 187 (1997); Dively, Mary Jo Howard and Cohn, Donald, *Treatment of Consumer under Proposed U.C.C. Article 2B Licenses*, 16 *J. Marshall J. Computer & Info. L.* 315 (1997), corrected version available from www.2Bguide.com; cf. Hillebrand, Gail, *The Uniform Commercial Code Drafting Process: Will Articles 2, 2B and 9 Be Fair to Consumers?*, 75 *Wash. U.L.Q.* 69 (1997). For a debate regarding requests made by a representative of some consumers, see Hillebrand, Gail and Towle, Holly, 32 *UCC Bulletin* 1-8 (September, 1997, Part One); and 33 *UCC Bulletin* 1-8 (October, 1997, Part Two).

¹¹ See, e.g., *Wyse Technology v. Step-Saver* (court used § 2-207 to hold that a shrink wrap license in software packages delivered after a prior telephone contract did not become part of the sale contract).

¹² See e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Hill vs. Gateway 2000 Inc.*, 105 F.3d 1147 (7th Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 NYS2d 569 (NY AD 1998); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 1999 WL 39017 (Wash.App. 1999); *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F.Supp. 759 (D. Ariz. 1993) (enforceable where no prior firm agreement because terms conditional, but not effective where prior telephone agreement); and *Caspi v. The Microsoft Network, L.L.C. et. al.*, Superior Court of New Jersey Appellate Division, A-2182-97T5 (approved for publication 7/2/99) (choice of forum clause in online contract which consumer could review entire contract and click "I Agree" or "I disagree" enforceable). For decisions not within the information industries but which also validate that contract terms not seen at the time of contracting can be enforceable, see e.g., *Carnival Cruise Lines, Inc.*, 499 U.S. 585 (1991). For cases enforcing terms of a shrinkwrap without delving into arcane enforceability questions, see *Green Book Int'l Corp. v. Inunity Corp.*, 2 F. Supp. 112 (D. Mass. 1998). See also *Micro Star v. Formgen, Inc.*, 942 F. Supp. 1312, aff'd 154 F.3d 1107 (9th Cir. 1998) (lower court enforced license buried in code; appellate court did not review this issue, concluding that either the license barred the conduct or there was no license to prevent claim of infringement). Compare, e.g., *Vault Corp. v. Quaid Software*, 655 F.Supp. 750, aff'd 847 F.2d 255 (5th Cir. 1988) (lower court held contract was invalid contract of adhesion, appellate court did not review this issue).

¹³ The European Union reports:

The current legal framework gives rise to significant costs for operators wishing to develop their activities across borders. The results of a survey undertaken within the "*Commercial Communications*" newsletter demonstrate the significance and specific nature of these costs.

The significance of legal costs: 64% of respondents undertook a legal analysis of the regulatory situation and notably regarding the cross-border situation. Of the 36% who did not, 43% had not yet done so because they were still in pilot phases and 30% because they could not afford to undertake such an evaluation.

Estimated legal costs to launch an Information Society service vary enormously. Several examples demonstrate how they often amount to considerable sums: one operator responded that he is using 3-4 days of external legal advice per month, another uses 50 hours per month of both internal and external legal advice (amounting to approximately 70,000 DM per year), another used fifty days of both in-house and external legal advice to launch a new service and an SME indicated that it had to employ a lawyer on a full-time basis. One of the key operators in the electronic commerce market noted that he has to rely on 8 in house lawyers dedicating 45 hours per week and 18 outside legal advisers who on average supply 175 hours of advice per week. For the UK market alone, this operator estimated that a review of the regulatory framework for his information society service cost him 60,000 ECU.

The specificity of the legal costs associated with electronic commerce. Of those who have undertaken a legal analysis, no less than 40% believe that the legal uncertainty that characterized electronic commerce was greater than for other lines of business. The cross-border dimension of the activity also distinguishes it since 64% evaluated legal aspects other than those in their own country and 57% believed it was essential to evaluate how the activity would be treated in other Member States. Moreover, of those who did not make a legal assessment, only 26% denied that there was a risk and 30% would have done so if they had had the resources to.

Id. at 8 (emphasis added).

¹⁴ *Id.* at Note 14, *supra* at 6 (emphasis added).

¹⁵ See the Directive Concerning the Protection of Individuals in Relation to the Processing of Personal Data. This directive establishes strict rules on the collection and transfer of data about individuals, and creates individual rights to obtain information in the files collected about them. It also restricts transfers of data from the EU to jurisdictions without "adequate provisions for the protection of personal information."

**THE INTERNET CONTRACT:
MISTAKES & WAR STORIES**

• **PRESENTATION POWER-POINT SLIDES** •

*Timothy E. Nielander
Preston Gates & Ellis LLP
Seattle, Washington*

The Internet Contract: Mistakes & War Stories

Overview

Classifying The Deal

Common Mistakes

Scenarios

Pulling together a Checklist

Preston Gates Ellis LLP

Classifying The Deal

Gimme that Web Language

Preston Gates Ellis LLP

Hybrid Activities

Access

License Transactions

Purchases

n **Goods**

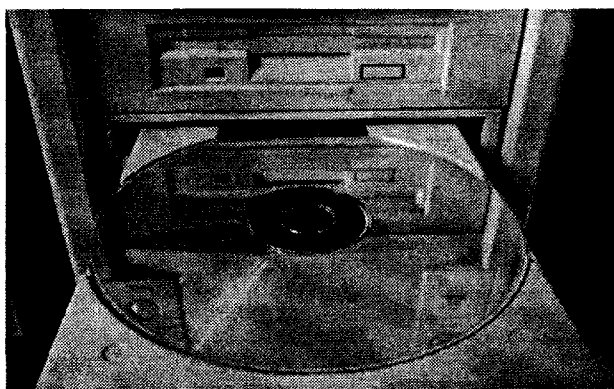
n **Services**

Preston Gates Ellis LLP

Common Mistakes

Preston Gates Ellis LLP

Contractless



Preston Gates Ellis LLP

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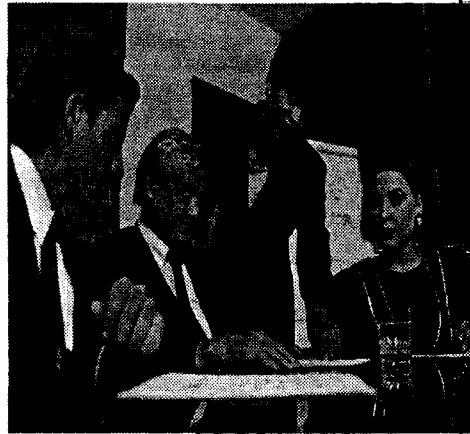
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Consider the Process

Consent
Attribution
Error Correction
Mag-Moss



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Legislative Initiatives

FTC Proposed Regulation

UCITA

UETA

EU Distance Directive

Preston Gates Ellis LLP

Consider Substance

Regulation

Geography

Goods/Services

Preston Gates Ellis LLP

The Amendment

Offline Relationship

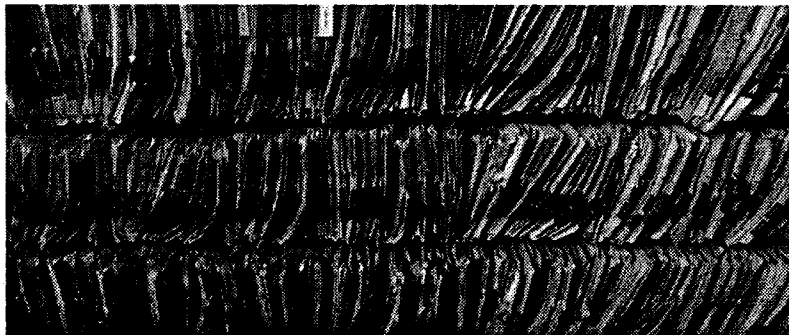
Online Agreement

n "Only in a signed writing"

Preston Gates Ellis LLP

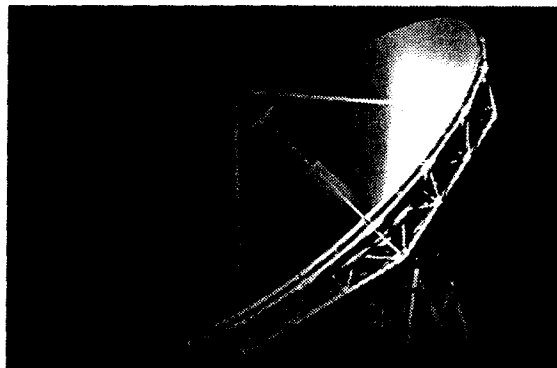
Record Retention

Whither the contract?



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The Privacy "Policy"



Preston Gates Ellis LLP

Scenarios



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Electronic Contracting Dealing in a Global Market

Cultural Traditions & Contract Formation

- n Buttons
- n Signatures
- n Chops



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Consent Procedures

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Bienvenue
Welcome to
The Chicago Board of Trade
The World's Leading Futures
and Options Exchange
The World's Largest
Futures and Options
Trading Facility

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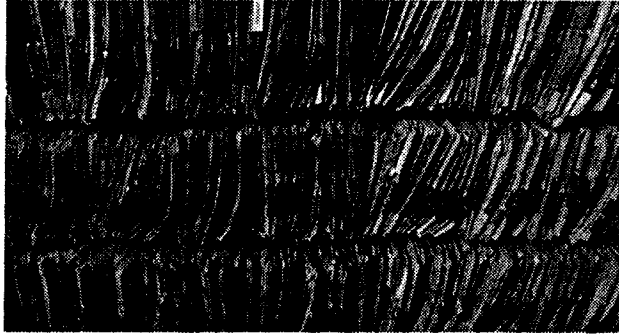
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Traditional UCC2 Sales

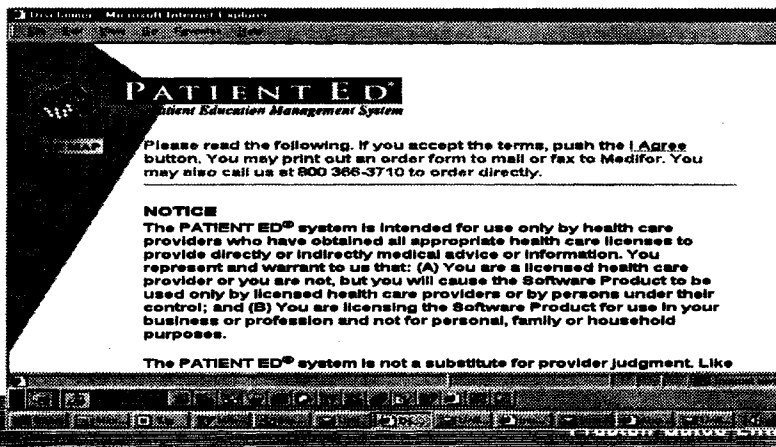
New Twist: Battle of Forms



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Provide Services

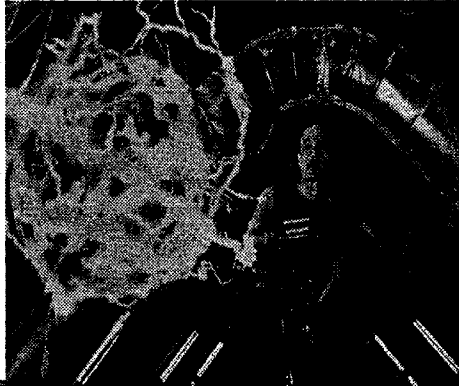
New Twist: Open World



License Agreements

New Twist: Technology

- n Scope
- n Efficiencies
- n Self Help



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Sticky Content

Good Housekeeping Seal

Information Provider's Liability



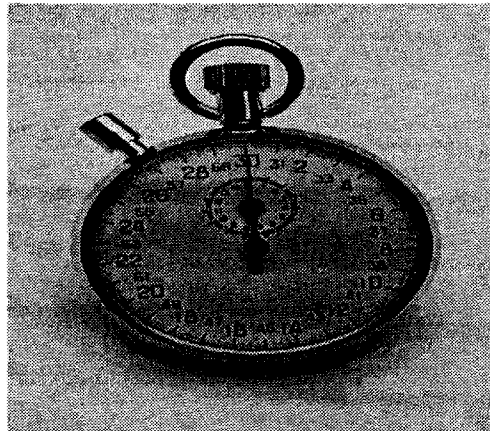
Checklist Process

- n Classify Activity
- n Analyze Consent Procedure
- n Analyze Substantive Law

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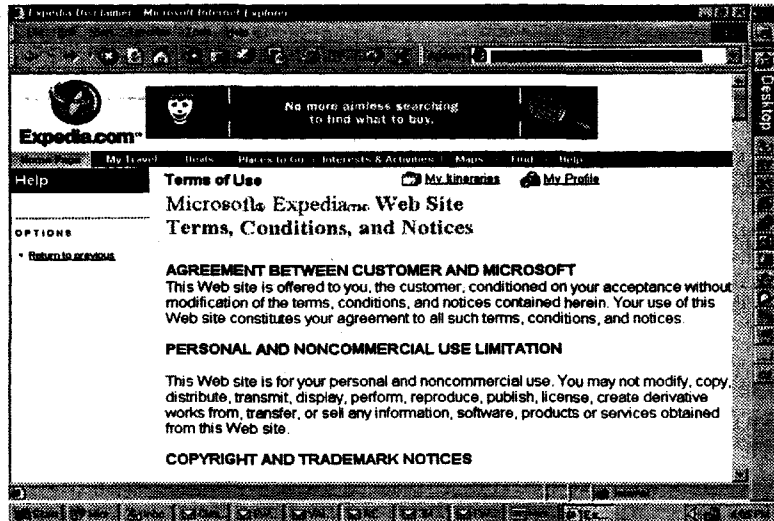
Coordinating with Other Actors

Marketing
Records
IT



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End Product



**BROADBAND ACCESS
TO THE INTERNET**

*John G. Hundley
High Speed Access Corp.
Louisville, Kentucky*

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SECTION C



Broadband Access to the Internet

**University of Kentucky
College of Law
2nd Annual Computer and
Technology Law Institute**

**John G. Hundley
High Speed Access Corp.**



Broadband Access to the Internet

◆ Issues to be covered

- **Internet-Network Architecture**
 - **how does broadband work?**
 - **choices of access**
 - **why it matters, and effect on client's business**
 - **Some Regulatory Issues**

◆ Issues not covered

- **Internet legislation and regulation per se**
- **Content**
- **Intellectual Property - copyright, trademark**
- **Privacy**
- **E-commerce/taxation/jurisdiction**

The Internet-What is it?

◆ Definition

- Generally thought of as a “packet-switched” copper/fiber, shared transport network that switches and transports bits of data from one location to another.
- Features:
 - “No guarantees” about order or timing of delivery, integrity of data (packet loss occurs), or security or privacy (absent additional hardware and software to secure your CPE). Quality of Service (QoS) standards are common in network agreements with major carriers.
 - Services originate at the edge of the network in Customer Premises Equipment (CPE). The Internet is simply a transport medium.
 - No bandwidth reservation or fixed routing.
 - Predominately a publishing medium for text and images, but voice and video streaming are rapidly evolving.

The Internet-What is it?

- **Data is digitized and organized into "cells" or "packets" of 8's or 0's with an identification header and information field, then routed via multiple paths through the network before reassembly and display.**
- **Differentiated from circuit-switched, point-to-point POTS.**
- **TCP/IP Protocols: most common is ATM - Asynchronous Transfer Mode - high speed data switching and transfer protocol. ATM is slowly displacing Frame Relay.**
- **Truly profound and unprecedented impact on Society**
- **For the first time in human history we have accessible, inexpensive, mass worldwide two-way interactive communication and information sharing capability on a real time basis. Change is coming MUCH FASTER than the industrial revolution. The Internet as most of us know it is only 6 years old.**

The Internet - History

- ◆ The Internet originated as a 1968 DOD communications initiative. The intent was to design a network capable of withstanding a nuclear attack.
- ◆ Computers should talk to one another across multipath network, and not be dependent on a central hub mainframe.
- ◆ Advanced Research Project Agency Network (ARPANET) went online in 1969 at four sites at University of California.
- ◆ Microprocessor invented in 1971
- ◆ Telenet - which allowed connection via remote (host) computers - arrived in 1972 along with other universities and military sites.

The Internet - History

- ◆ The "Internet" (f/k/a ARPANET) spanned the globe in 1975 - the same year the Altair 8800 (the first home PC) was introduced.
- ◆ Academic USENET newsgroup channels opened up in 1978
- ◆ CompuServe created in 1979.
- ◆ IBM PC introduced in 1981 with MS-DOS standard operating system
- ◆ In 1989, British researcher Tim Berners-Lee dreams up the World Wide Web (WWW) for the transfer of documents. WWW debuts in 1992.

The Internet - What is it?

- ◆ **By the Numbers**

- **Some 80-90 million U.S. users accessing 65 million computing devices are online today. FCC expect 1B users to be online worldwide this decade.**
- **90% of those devices are desktop/notebook PCs**
- **By 2007, there will be 221 million devices accessing the Net, but only 41% will be PCs. The balance will be other appliances, in-car devices, mobile phones/PDAs, etc.**
- **E-commerce: \$35B this year to \$300B in 2010 (?)**

The Internet-What is it?

- ◆ **Disintermediation Impacts of the Internet**
 - **Marketing, Sales, Advertising**
 - **Email**
 - **E-commerce**
 - **Financial Services**
 - **Video and Entertainment**
 - **Education**
 - **Politics**
 - **Information Publishing**
 - **the Killer App?**

The Internet—What is it?

- ◆ **High Speed or Broadband Access**
 - generally thought of bandwidth/data throughput equal or exceeding 128Kbps (remember ISDN?)
 - ◆ **Growth of High Speed Access**
 - approximately 2.0 million today (80% cable modem)
 - 3.3 million by December 31, 2000 (41% will have access to CM, only 21% will have access to DSL)
 - 16.6 million by December 31, 2004 (42% CM, other DSL/wireless)
- [Yankee Group, 1/28/00]

The Internet - Methods of Access

- ◆ **Dial-up Modems**

- **Standard point to point copper - 56Kbps bandwidth limitation**
- **Standard ISP offering**

The Internet - Methods of Access

◆ Advanced Digital Set-Top Box

> Souped-up cable TV converter box that supports:

- "Hundreds" of digital TV channels
- Internet web browsing via TV (not PC)
- Online Shopping
- EPG - electronic program guides
- Email
- "Local" content - weather, sports, community bulletin boards, etc.
- Video on Demand [impulse pay per view]
- Interactive TV advertising [Wink Communications, etc.]
- Interactive Gaming
- Digital video recording (limited) ["pause" a football game]
- Can be combined with NIC and C/DSL modem for PC
- Examples: Worldgate®, WebTV®

The Internet - Methods of Access

- ◆ **Cable Modem Access**
- ◆ **Characteristics of the Cable Plant**
 - **RF - Radio Frequency Spectrum**
 - **Architecture of the Cable Plant**
 - **DOCSIS**
 - **Data over Cable Service Interface Specifications**
 - **Developed by CableLabs, an industry consortium**

Cable Modem Broadband Access

◆ Advantages

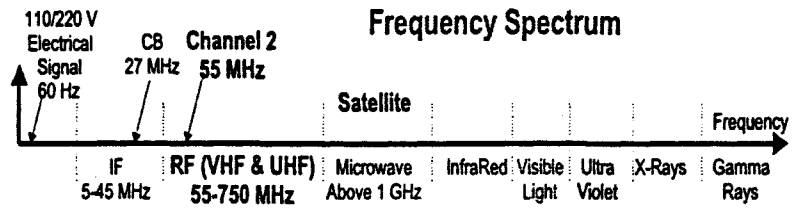
- 500 Kbps - 10Mbps downstream, 128Kbps up
- Bandwidth advantage over DSL
- Well-established cable networks

◆ Disadvantages

- Somewhat more susceptible to periodic contention-based slowdowns due to shared bandwidth
- Primarily for residential areas
- "always on" security risks
- 2-way service often requires expensive plant upgrade for cable operator

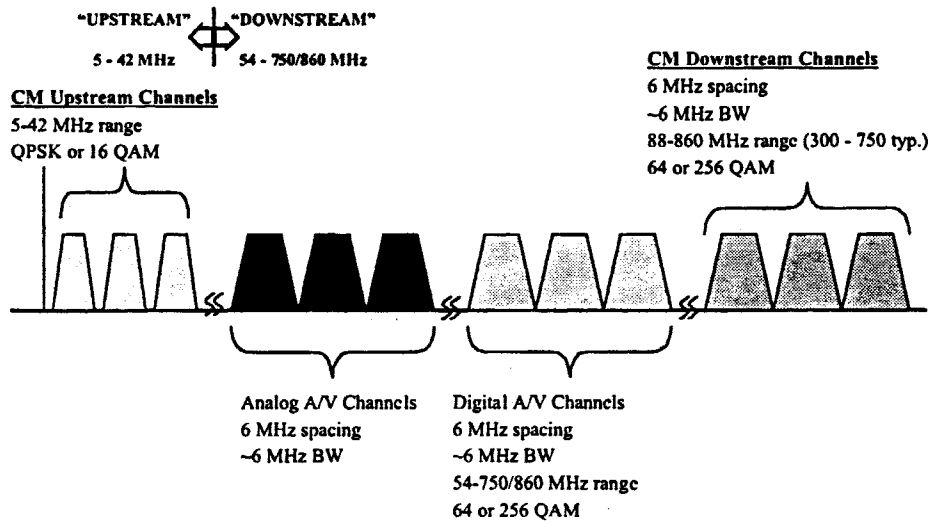
RF Spectrum

Part 1 - Cable
Technology



- ◆ **Radio Freq (RF)**
 - > Above Audio to InfraRed
- ◆ **Down Stream (DS)**
 - > Cable company to subscriber
 - > 55-750 MHz
- **Up Stream (US)**
 - Subscriber to Cable company
 - 5-42 MHz

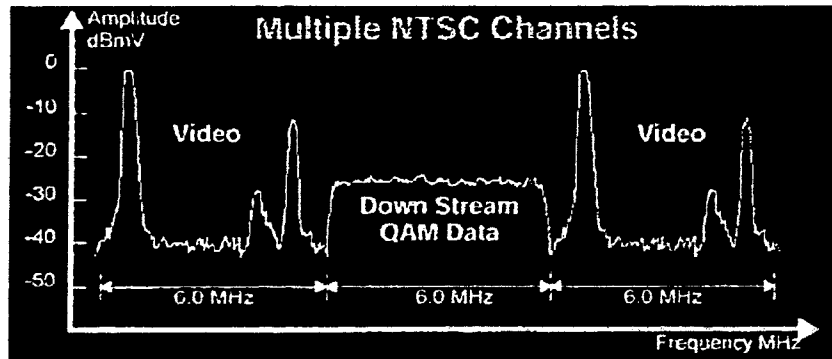
Typical Cable Frequency Plan



In the US direction, one or more channels of US bandwidth can be allocated anywhere in the 5 - 42 MHz range that does not interfere with other US signals that may be carried on the cable system, to transport DOCSIS CM bursts to the CMTS. A US channel's occupied bandwidth depends on how fast data is being sent on that channel (the "symbol rate.") This data rate parameter is one of the many US channel parameters that are configured into the CMTS, then continuously "advertised" by the CMTS to its CMs using the CMTS broadcast DS UCDs.

In the DS direction, a DOCSIS DS channel is 6 MHz wide. It can be placed in any 6 MHz slot in the DS spectrum, anywhere 88 to 860 MHz, which is in the cable systems DS bandpass and does not interfere with other DS cable system signals, in place of e.g. a standard 6 MHz bandwidth analog or digital TV signal that might otherwise be placed there. One common DS spectrum allocation places analog TV channels at the lowest DS frequencies, then digital TV channels, then one or more DOCSIS DS channels at the highest DS frequencies on the system.

Cable Signals



Typical spectrum appearance on a spectrum analyzer w/ 100kHz BW

The DOCSIS DS signal's appearance on a spectrum analyzer is quite different from an analog channel's spectrum. Here, a DOCSIS DS is between two analogs. Note how energy is distributed evenly across the DOCSIS channel, but has strong peaks at video, sound and color carrier frequencies of each analog channel.

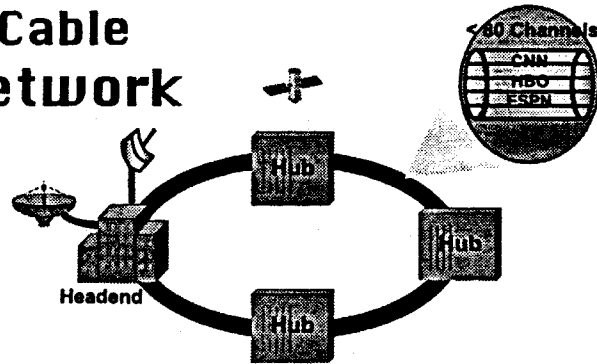
The amplitude (level) of an analog signal is defined as its peak visual carrier level...the top of the high analog peak in this picture.

The level of a digital signal is defined as the total energy in its whole 6 MHz bandwidth...a value not readily apparent in this picture. In this analyzer display, the CMTS DS signal is actually correctly adjusted to a DOCSIS-recommended 10 dB below the level to which an analog channel would be set on this channel. But the plateau of the digital signal currently "appears" another 18 dB lower on the screen. This is due to the $10 \log(6 \text{ MHz} / 100 \text{ kHz}) = 18 \text{ dB}$ additional correction factor associated with the analyzer's 100 kHz bandwidth setting.

A DOCSIS channel is typically referenced by the CENTER frequency of the 6 MHz channel occupies (i.e. 3 MHz above the lower band edge). Contrast this with the analog NTSC television signals, which are historically referenced by their visual carrier frequency, which is 1.25 MHz above their lower band edge.

HFC (Hybrid Fiber Coaxial) Technology

Cable Network



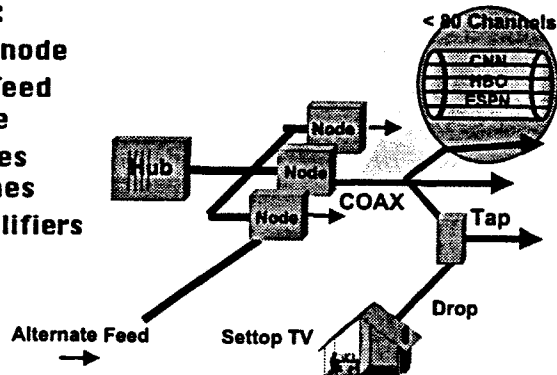
Reliability

- RING architecture
- Analog fiber RING for broadcast video
- Headend/hub to improve reliability
- SONET/SDH RING overlay for reliability of advanced services

HFC (Hybrid Fiber Coaxial) Technology Cable Network

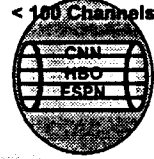
Reliability, Increased Access Bandwidth

- ◆ **Smaller, robust serving areas:**
 - HFC to the node
 - Alternate feed to the node
 - Target nodes of 500 homes
 - Fewer amplifiers

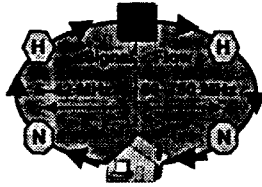


HFC (Hybrid Fiber Coaxial) Technology

Cable Network

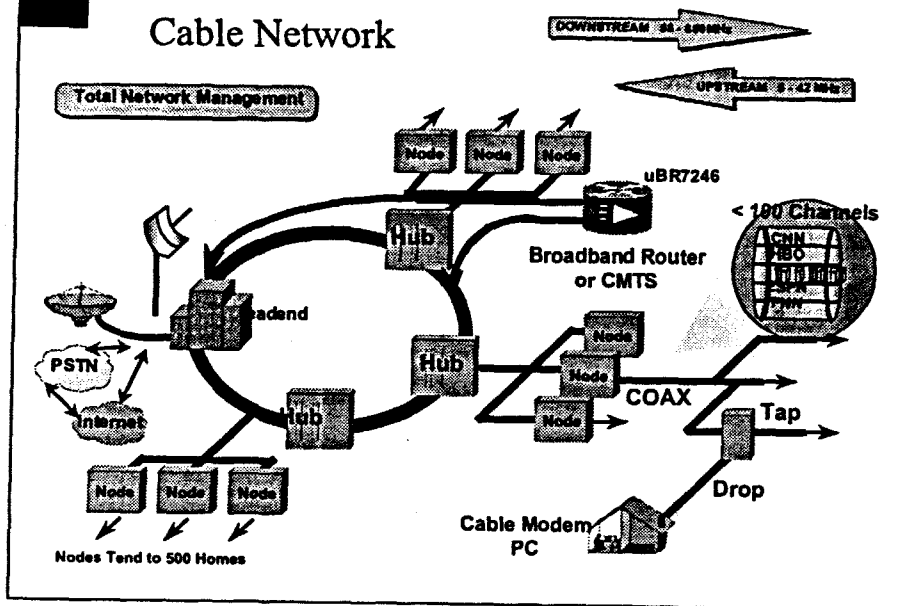


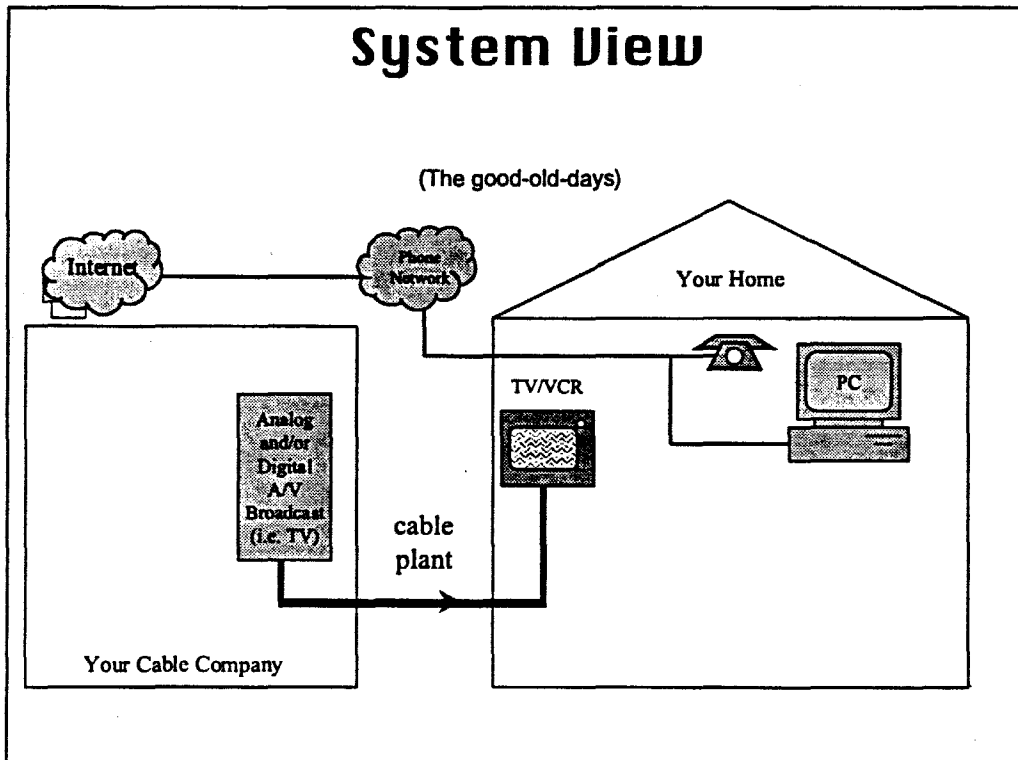
- ◆ **Increased bandwidth:**
 - > Downstream "rebuilds" to 750 MHz
 - > Wide band amplifiers etc...
- ◆ **Two way operation:**
 - > Upstream (5-42 MHz) "Provisioned" and "Operational"



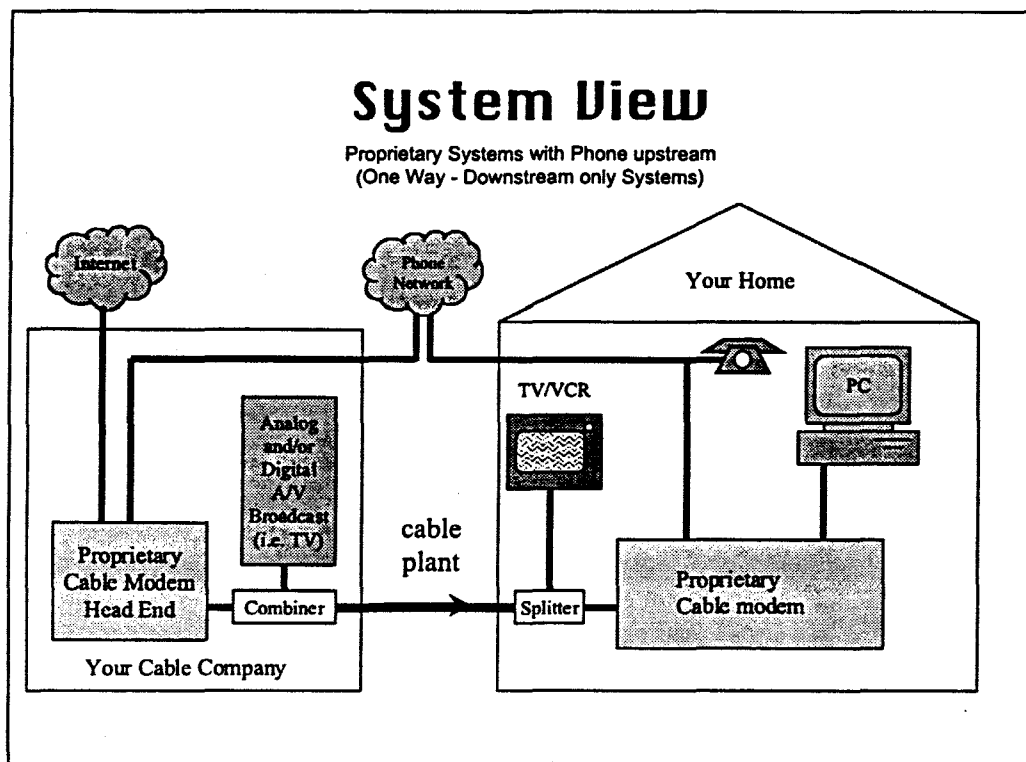
HFC (Hybrid Fiber Coaxial) Technology

Cable Network





In the "good old" days (before Cable Modems - CMs), CATV operators delivered TV signals ONE-way to consumer TV sets. In recent years that became supplemented with telephone companies providing connectivity for the consumer's internet access.

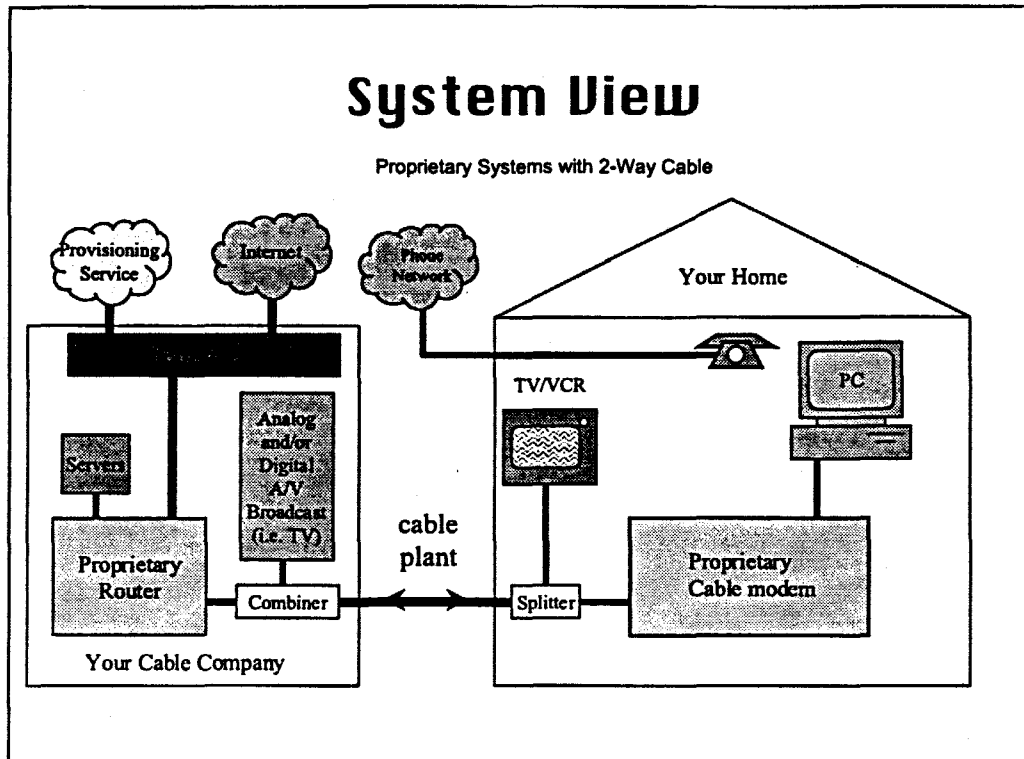


Then, to provide consumers with higher speed internet access, some manufacturers introduced “proprietary” CM solutions consisting of packaged combinations of their CMs with companion CM headend equipment. Both the CM and cable modem headend equipment were manufactured by the same vendor. Many such systems remain installed today.

These “proprietary” cable modem solutions provide no interoperability among different manufacturers’ CMs and cable modem headend components. In this scenario, it is impractical to sell these CMs in retail stores because consumers like can’t re-use them if they relocate their residence to another cable system.

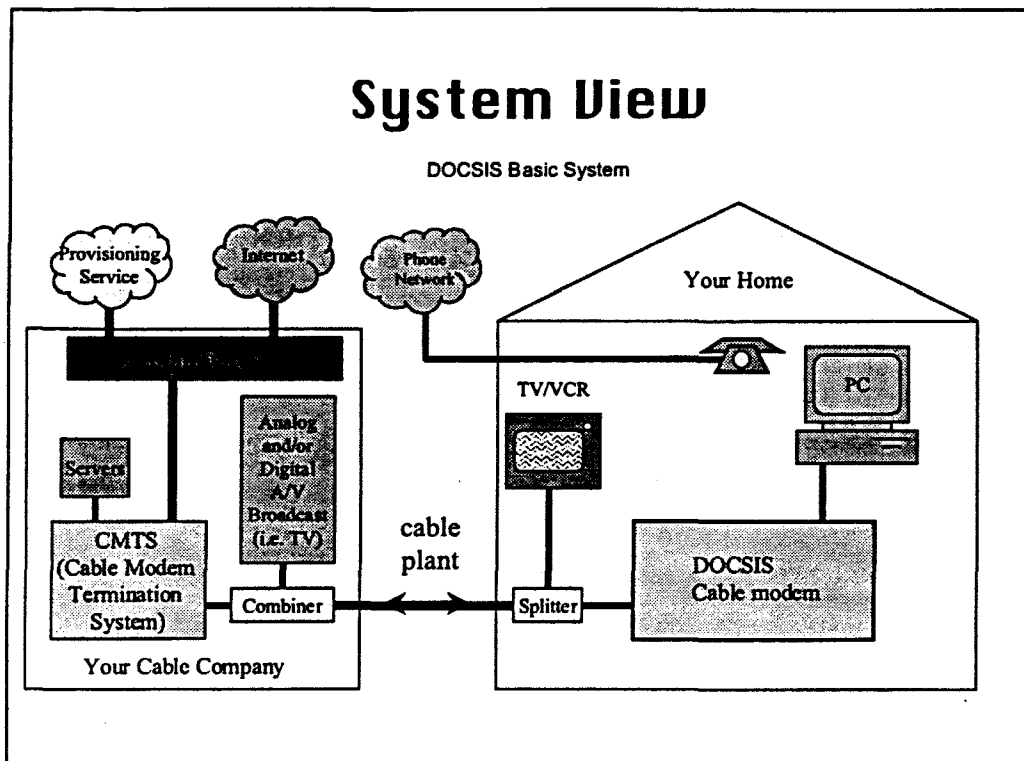
Nevertheless, the proprietary CM systems have, over the last few years, allowed the cable operator to become a conduit for providing internet services to consumers.

Many cable systems weren’t yet capable of upstream communications. For these “one-way” cable systems, hybrid proprietary CM solutions were created. These use CATV coax cable for DS communication, but telephone lines for US communication, to provide internet access services to homes and businesses.



The trend is toward two-way communication over the cable system, eliminating the need for the telephone return path. Two-way cable systems use the cable TV coax for both downstream (DS -- cable headend to CM) and upstream (US -- CM back to cable headend) data transport.

Some of the proprietary cable modem system solution were capable of working with these two-way cable systems.

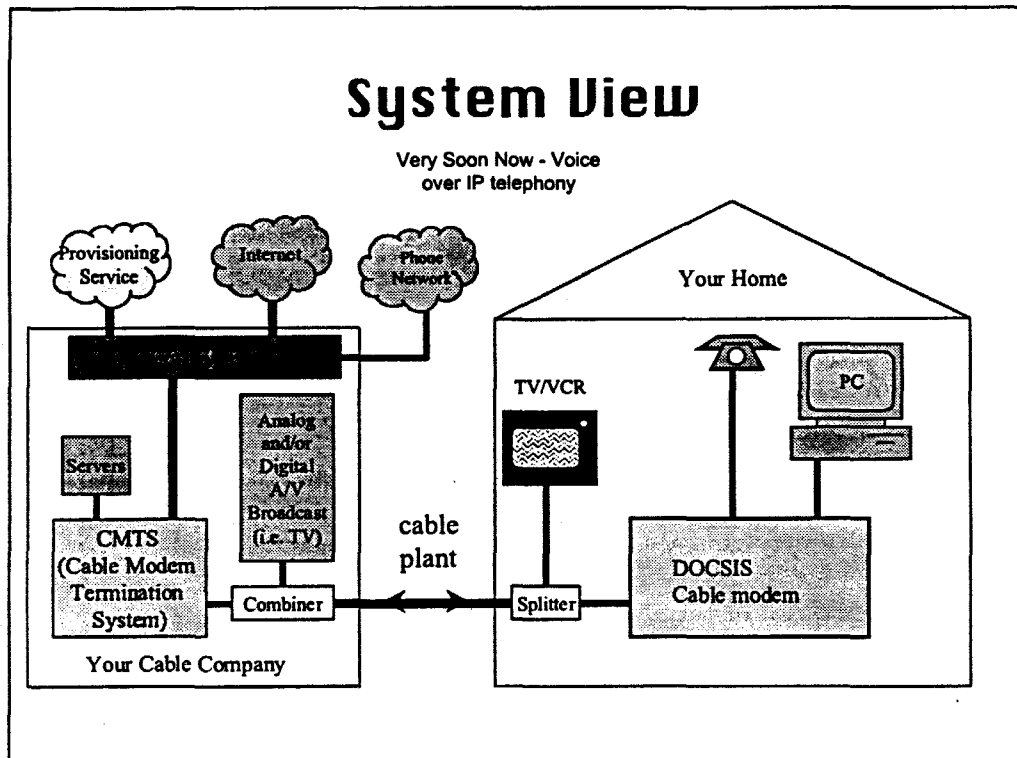


In an effort to establish a CM “standard”, and thereby make possible CM retail sales direct to consumer, CableLabs and the Multimedia Cable Network Systems (MCNS) consortium of cable operators created DOCSIS - Data Over Cable Service Interface Specifications.

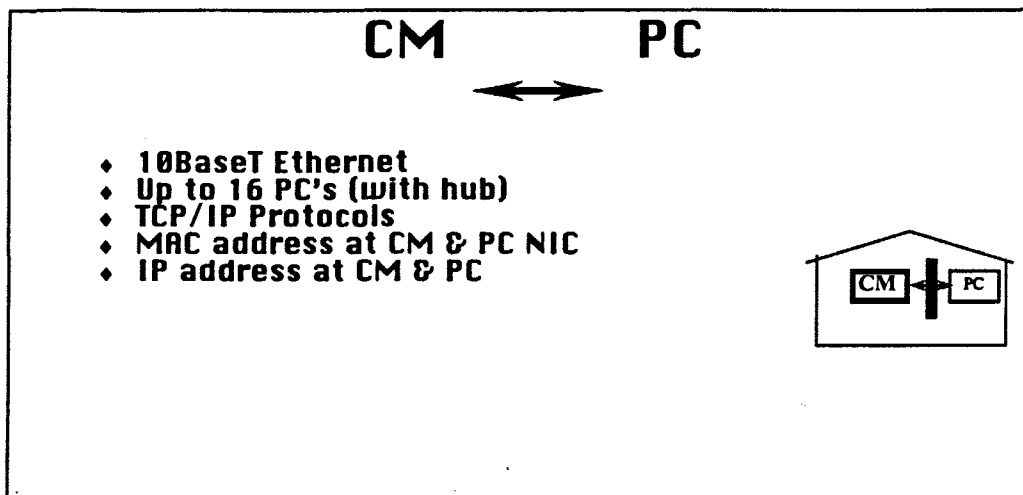
The first two CM models built to the first round of DOCSIS specifications (“DOCSIS 1.0”) became “CableLabs Certified” in March of 1999. The RCA DCM105 was one of those. The first CMTS (DOCSIS-compliant cable modem headend unit) became “CableLabs Qualified” soon thereafter.

The cable operator is now positioned to provide STANDARDIZED cable modem internet access nationwide, using CableLabs Certified DOCSIS CMs and CableLabs Certified DOCSIS CMTS’s.

In a CableLabs DOCSIS compliant cable modem system, any vendors’ CMTS is interoperable with any vendors’ CMs.



In the future, the DOCSIS standard may go on to provide the system communications “core” functions that enable economical and reliable telephone and other services to be provided over a cable TV system, in addition to internet delivery services to homes.



The PC's ethernet network interface card (NIC) connects to the CM via a standard (not crossover) 10BaseT ethernet cable at the CM's RJ-45 jack.

DOCSIS specifies a compliant CM must support at least one PC. The RCA DCM105 can support up to 16 simultaneously connected PCs, but DOCSIS also allows the maximum number that can actually operate in a specific DOCSIS cable system to be commanded to the CMs to a smaller number.

The PC, like the CM, uses TCP/IP data communications protocols. TCP/IP communication can take place between the CM or PC and any device on the Internet with which communication is authorized by the cable operator.

Once CM automatic startup is complete and the RCA DCM105 is on-line and operational, it behaves like a remotely-programmable packet filter. It is remotely programmable because it can be "talked to" by a remote device by via TCP/IP with an application level protocol such as Simple Network Management Protocol (SNMP). It is a packet filter because it filters data traffic going CMTS to PC and PC to CMTS: not all data that appears at the CM RF connector is passed to the PD, and not all data the appears at the CM ethernet connector is passed to the CMTS. Aside from this filtering, an operating CM is basically an RF - to - ethernet adapter between CMTS and PC.

Each CM has a unique MAC address that is printed on the back of the CM and hard-coded into it. The CM also must have an IP address to communicate over the Internet to support servers and other devices involved in its operation. It receives this IP address during the CM automatic startup process.

Similarly, each PC connected to the DCM105 CM has a unique MAC address hard-coded into it (on its ethernet NIC) and must have an IP address to communicate over the Internet. The PC may receive its IP address automatically during its startup, or the installer may directly enter a pre-assigned IP address, depending upon the cable system's practices.

The CM automatically "learns" the MAC addresses of the PCs connected to it, up to the maximum number allowed, by watching the addresses embedded in data sent to the CM by its PCs. When the CM reboots, it forgets the MAC addresses of all PCs it had learned, and must relearn them in subsequent activity.

DOCSIS also provides a mechanism whereby ALL a CM's ability to pass data can be disabled by a command to the CM. If this command is sent, the CM can still be "talked to" by authorized devices on the Internet, but communication to/from the PC is totally disabled.

DOCSIS

Data Over Cable Service Interface Specifications

- ◆ **Industry Standard**
- ◆ **Focus: Internet Over Cable TV Systems**
- ◆ **Family of Documents (www.cablemodem.com)**
- ◆ **Parallel CableLabs Efforts:**
 - **OpenCable**
 - **PacketCable**
- ◆ **Defines "Reference Architecture"**

DOCSIS is a very versatile CATV industry standard. It is evolving.

"DOCSIS 1.0" is effectively complete. Product is available and being installed in hundreds of CATV systems.

"DOCSIS 1.1" is on the horizon, and will add technology that makes possible Quality of Service (QoS) guarantees needed for newer services like DOCSIS-based telephony over cable. Another CableLabs effort -- PacketCable -- is merging its efforts with DOCSIS to realize this.

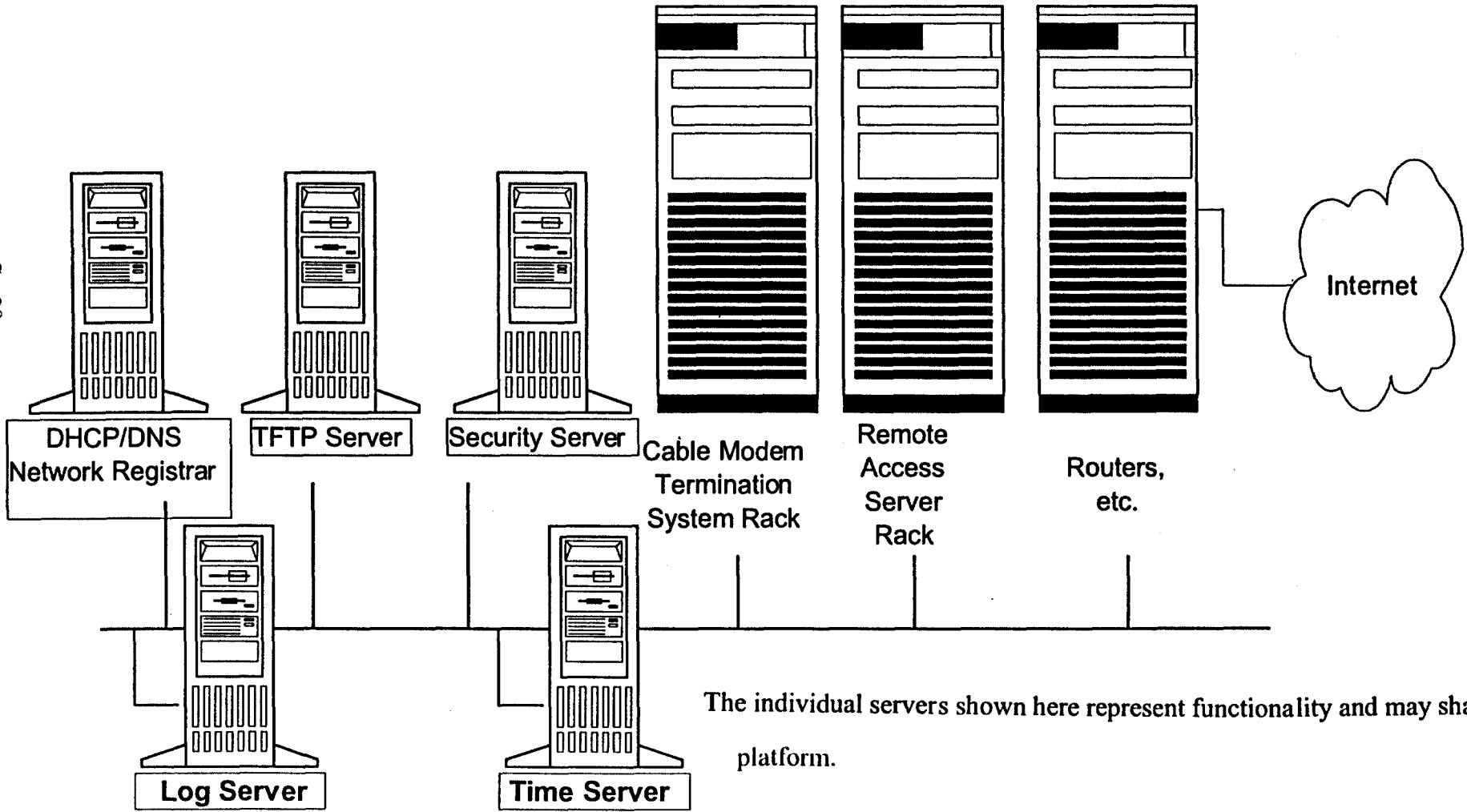
DOCSIS is really a family of documents. These are available from the public area of the CableLabs cable modem website at www.cablemodem.com.

DOCSIS defines a Reference Architecture for an overall data communication system optimized to connect consumer PCs to the internet using the DOCSIS CM and DOCSIS CMTS.

The CMTS and CM are now the industry standard fundamental building blocks for a cable operator to implement cable modem service.

DOCSIS Server types and Purpose

C-29

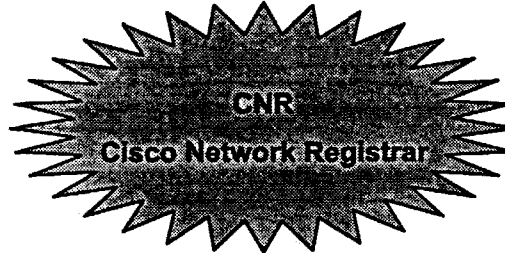


The individual servers shown here represent functionality and may share the same platform.

DOCSIS Requirements

Cisco Solution

- ◆ **DHCP (Dynamic Host Configuration Protocol):**
 - provides IP addresses for Modems and PC's
 - extended options and fields (Special DOCSIS feature)
- ◆ **TOD (Time Of Day)**
 - system time clock
- ◆ **TFTP (Trivial File Transfer Protocol)**
 - modem configuration files
 - modem configuration files (Special DOCSIS feature)
 - vendor & feature specific per user modifications by billing system



The Internet - Methods of Access

- ◆ **xDSL - Digital Subscriber Line**
- ◆ **Requires DSLAM (digital subscriber line access multiplexer) in the CO, or other feeder aggregation points**
- ◆ **Provides last mile capacity by upgrading copper phone line that runs to building.**
- ◆ **Digitized transmission signal expands available frequency.**
- ◆ **Variety of bit rates - ADSL, SDSL, HDSL, VDSL, etc.**
- ◆ **ADSL - Asymmetric DSL most common consumer application - allows for greater downstream than upstream.**
- ◆ **SDSL - Single Line DSL provides symmetric 2-way bit rates and is the most common commercial application**

Digital Subscriber Line (cont.)

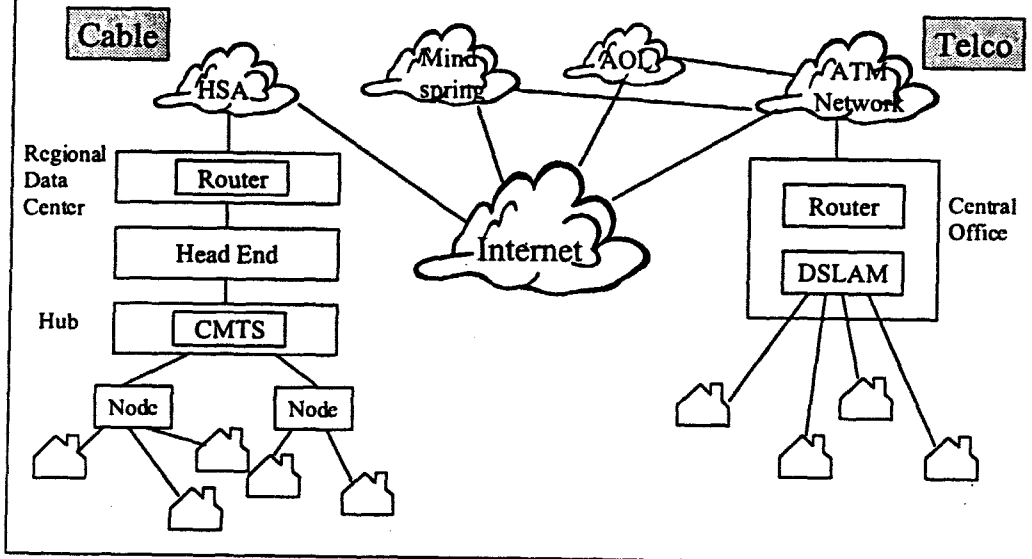
♦ Advantages

- » Voice operates at 30-3,400 Hz, or 2% of spectrum.
- » xDSL's broader range of frequencies permits 256K-8M MHz downstream, 64K-1M MHz upstream.
- » Uses existing copper
- » point-to-point functionality
- » Added Security - point to point DSL bypasses the telco's switch, converting the local loop into a private line.
- » No shared connections, somewhat more consistent speeds

♦ Disadvantages

- » Distance Limitations - 18,000 ft., or about 3.5 miles from CO, for ADSL
- » "Dirty Copper" - DLCs, or Digital Loop Carriers, must be bypassed.
- » Load Coils, Bridge Taps, crosstalk-bundling with T-1s, can degrade signal. Attenuation is the enemy.
- » Provisioning Difficulties
- » Like cable modems, "always on" can present security risks.
- » ADSL market potential includes 60-75% of 170M or so access lines.

Cable v. Telco



Comparison of Architectures

Types	Dedicated Access	Shared Medium Access
Examples	Traditional Telephone (Twisted Wire Pairs)	Broadband (2-way cable) Cellular Radio Two-way LMDS Two-Way Satellite
Arrangement	Group of Point-to-Point Connections (loops)	Bus (loopless)
Capacity	Guaranteed for each customer	Contention-based Dynamically shared

The Internet - Methods of Access

◆ DBS - Direct Broadcast Satellite

- **C and Ku bands deployed**
- **New Ka band and spot beam due 2001**
- **DirecPC, Isky, Teledesic, others**
- **Geostationary v. LEO-low earth orbit (Iridium)**
- **400Kbps - 2Mbps**
- **expect explosive growth of VSAT technology**

Direct Broadcast Satellite (cont.)

- ♦ **Advantages**
- ♦ **Wide geographic coverage**
- ♦ **One-way now, broad 2-way deployments 2004**
- ♦ **Disadvantages**
- ♦ **Not yet reliable, rain fade signal attenuation**
- ♦ **Inherent bandwidth limitations and High latency (signal delay)**
- ♦ **Expensive Transceiver/CPE**

The Internet - Methods of Access

- ◆ **LMDS - Local Multipoint Distribution Service (voice and data)**
 - **FCC licensed spectrum in the 28 GHz band and in the 38.6-40.0 GHz band, with 1.3 GHz bandwidth**
 - **Used in high density areas - 5 miles "line of sight" and "rain fade"**
 - **Expensive equipment**
- ◆ **MMDS - Multichannel Multipoint Distribution Service ("wireless cable" - video and data).**
 - **FCC licensed spectrum between 2.5 - 2.7 GHz**
 - **Lower frequency = lower susceptibility to weather and return path interference**
 - **Expensive head end and CPE**

Wireless

- ◆ **Microwave - Unlicensed**
 - various between 2.4-5.8 GHz
 - line of sight, 10 mile limit
 - 2.4 GHz band is "noisy" - microwave oven interference, etc.
- ◆ **Laser**
 - rooftop to rooftop up to 3 miles
 - fat 10 to 155 Mbps, but high fade margin, expensive
- ◆ **Mobile Wireless - PCS/Cellular Spectrum**
 - emerging Wireless Application Protocols - CDMA, TDMA, or GSM - for Personal Display Devices (PDA's), cell phones, etc.
 - relatively low bandwidth, expensive
 - expect Explosive Growth

The Internet -Methods of Access

- Bandwidth Equivalents (T-1 = 24 channels at 1.5 Mbps each)

	<u>T-1</u>	<u>DS-3</u>	<u>OC-3</u>	<u>OC-12</u>	<u>OC-48</u>	<u>OC-192</u>
T-1	1	28	84	336	1344	5376
DS-3		1	3	12	48	192
OC-3			1	4	16	64
OC-12				1	4	16
OC-48					1	4
OC-192						1

The Internet - Methods of Access

◆ Fiber

- > digitized signal carried as pulses (photons) of light of varying frequency (color).
- > very fast, wide bandwidth - 10Mbps (OC-192) and up
- > high quality, high security, too expensive for most applications
- > immune to electrical interference
- > wave division multiplexing extends life of "old" single mode fiber with OC-48 or lower capacity and 30 miles or less regeneration.
- > 1 strand of non-zero dispersion shifted fiber equivalent to eight (8) OC-192s of bandwidth, with 60 mile regeneration spacing.
- > "Next Gen" long-haul fiber getting all the press - 4 hops coast to coast (500 mile hops)
 - Otera announced 2,500 mile hop, 10 Gigabits/second, on 3/07/00.

The Internet Backbone

◆ Global Service Providers

- ATT, MCI/Worldcom-UUNet,

◆ New Network/Transport Providers

- Williams Telecomm, QWest, others

◆ Optical Switching

- challenge is to reduce the number of opto-electric conversions and regenerations - eliminate the electronic data router
- become as adept manipulating photons as electrons
- experts equate today's optical technology to the 1950's electronics industry prior to the invention of the integrated circuit

Convergence of Voice, Video and Data

- ◆ **Regulatory/Legacy Conflict**
 - **Buckets of Historical Regulation**
- ◆ **IP Telephony**
- ◆ **Destruction of Old Business Models**

Legal Issues affecting Broadband Access

- ◆ **Classification of Cable Modem Service**
- ◆ **Cable v. DSL**
- ◆ **FORCED, or OPEN ACCESS**
 - > **AT&T Corp. v. City of Portland, 43 F. Supp. 2d 1146 (USDC Or. June 3, 1999), on appeal to 9th Circuit**
 - > **What exactly does it mean?**
 - > **Where is the FCC?**
- ◆ **Some Legislative Issues**



**YEAR 2000:
THE AFTERMATH & LEGISLATIVE DEVELOPMENTS**

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SECTION D



YEAR 2000: THE AFTERMATH & LEGISLATIVE DEVELOPMENTS

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III. BUSINESS / LEGAL DISPUTES D-3

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THE Y2K ACT D-7**



YEAR 2000: THE AFTERMATH & LEGISLATIVE DEVELOPMENTS

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I. INTRODUCTION

When Haley's Comet was approaching the earth's atmosphere in the early part of the 20th century, many doomsayers predicted the end of the world. That natural phenomenon proved to be a miscalculation and passed without event.

In the late 1990s, the Y2K defect in computers became widely known and many doomsayers predicted a catastrophic impact on the world economy and the very survival of the species in view of the world's increasing reliance upon computers in this age.

As has been widely reported, the root of the Y2K problem was that programmers had utilized two digit encoding description and had not provided for the three digits that would be required upon the advent of the year 2000. Upon discovery of the situation, there was a widespread disparity between the extent of the problem with respect to mainframe computers, software, and embedded chips.

In or around 1998, the initial reports of Y2K computer failures pertained to inventory systems and scheduling systems, primarily in the medical field and in the transportation industry. With only two years to go before the critical date, the business world essentially was ignorant of the potential magnitude of the situation. At that time, industry analysts correctly forecasted that there would be global catastrophes unless the situation was promptly and adequately addressed.

During the ensuing 24 months, the private and public sectors responded in an astonishing way to address the situation. In the private sector, essentially every corporate business implemented Y2K assessment and remedial programs. These reactionary measures were embraced by the computer industry for two reasons. First, the computer industry, by its very nature, is on the cutting edge of technological developments and is analytical in nature. This problem-solving bent was suited well to address the Y2K issue. Secondly, the Y2K problem was a golden opportunity for the computer industry and software vendors to market upgrades to their existing systems and enjoy the profits derived therefrom.

Within that two-year span, massive effort was implemented to review nearly every business' computer systems to determine Y2K exposure. Hundreds upon thousands of computers were found to be defective, and it was widely believed that there would be an onslaught of litigation.

The rapid pace in technological developments resulted in widespread business solution approaches to the situation - rather than fighting the matters in the courts. The software vendors and computer manufacturers frequently would simply discount their services and products in return for the opportunity to upgrade computer systems and cure Y2K defects.

The result of the Y2K "panic" is that nearly every business in the United States has in some way or another upgraded or modernized their computer systems, which are integral to nearly every facet of today's business world. It is anticipated that productivity has been advanced by nearly a decade as a result of this phenomenon.

II. THE Y2K ACT

Sixteen or more states enacted specialized Y2K legislation to address the anticipated onslaught of litigation. Similarly, the United States Congress passed the Y2K Act in order to provide a cooling off period for Y2K disputes to avoid what was viewed as a possible unmanageable disruption of the court system.

In the end, a few hundred Y2K related lawsuits have been filed throughout the country. However, the vast majority of the disputes have been resolved by computer upgrade or fixes.

Those lawsuits which were instituted are subject to the federal Y2K Act, which contains the following provisions:

- ▶ Lender's may not foreclose on residential mortgages where the failure to pay is related to a Y2K glitch.
- ▶ Plaintiffs are severely curtailed in their ability to obtain punitive damages, unless they can prove by clear and convincing evidence intentional wrongful conduct, and the net worth of the defendant has threshold limits which could range from \$250,000 to \$500,000. In addition, plaintiffs cannot obtain punitive damages from a governmental entity.
- ▶ The most significant portion of the statute is the pre-litigation notice, which provides that when damages are sought in litigation (as opposed to purely injunctive relief) the claimant must send notice via certified mail to the designated agents of the defendant. The notice must give specified and detailed information about the material defect, a cause to harm, the loss actually suffered, what remedy that it sought, the basis for the remedy, and who may negotiate a resolution of the dispute with the defendant.
- ▶ The defendant has thirty days to respond and advise how it intends to remedy the loss, and as to whether it is willing to participate in arbitration or mediation outside the court system. The parties have sixty days to do so unless the parties agree to a longer time period.

- ▶ The plaintiff may file suit only if the defendant fails to respond in thirty days, or if the plaintiff is seeking purely injunctive relief.
- ▶ There are heightened pleading requirements in which all complaints must set forth, in particularity, the specific information about the nature and the amount of each element of damage claimed, giving the factual basis for those damages claimed, and specific information about how the defects manifested themselves, and how the factual defects are material to the plaintiff's business.
- ▶ The plaintiff has a duty to mitigate the damages it seeks by heeding the defendant's Y2K readiness disclosure, or other disclosures which the plaintiff reasonably should have known about, unless the plaintiff was intentionally defrauded by the defendant.
- ▶ There are contractual damage limitations in accordance with the terms of the contracts between the parties.
- ▶ In tort actions under the Y2K Act, a plaintiff cannot recover damages for economic loss (such as loss of profits), business interruption (unless the damages are provided for in the contract), or unless the Y2K failure caused damage to tangible personal property or real property.
- ▶ There are severe restrictions on the bringing of class actions under for Y2K defects, which prevent the filing of numerous low-damage class actions in the federal courts.
- ▶ The government's ability to impose civil penalties on small businesses in situations such as banking or security systems or public health, safety environmental situations in which the problem was caused by Y2K failures, may be suspended for a time period.

There are a number of Y2K cases being actively litigated in the court systems today pursuant to the guidelines. However, nothing of the magnitude as originally anticipated by many analysts. In January of 2000, the United States Government declared that its Y2K compliance efforts were successful and it reported that no catastrophe had occurred.

III. BUSINESS / LEGAL DISPUTES

The recent widespread software upgrades and purchase of new systems - which are a result of the old systems being non-Y2K compliant - have given rise to numerous business and legal disputes. Those disputes involve numerous issues which are not specifically Y2K related. Such issues relate to matters that arise in:

- ▶ general software disputes;
- ▶ remediation of various computer bugs;
- ▶ allocation of royalties;
- ▶ ownership of codes and software products;
- ▶ choice of law and choice of venue issues;
- ▶ noncompete and nondisclosure issues;
- ▶ injunctive remedies;
- ▶ measure of damages;
- ▶ representations and warranties;
- ▶ company and individual liabilities; and
- ▶ marketing and licensing arrangements

APPENDIX

THE Y2K ACT

TITLE 15 U.S.C.
CHAPTER 92
SECTIONS 6601-6617

**TITLE 15 USC
CHAPTER 92
Sections 6601-6617
Y2K ACT**

6601. Findings and purposes

(a) Findings

The Congress finds the following:

(1)(A) Many information technology systems, devices, and programs are not capable of recognizing certain dates in 1999 and after December 31, 1999, and will read dates in the year 2000 and thereafter as if those dates represent the year 1900 or thereafter or will fail to process dates after December 31, 1999.

(B) If not corrected, the problem described in subparagraph (A) and resulting failures could incapacitate systems that are essential to the functioning of markets, commerce, consumer products, utilities, Government, and safety and defense systems, in the United States and throughout the world.

(2) It is in the national interest that producers and users of technology products concentrate their attention and resources in the time remaining before January 1, 2000, on assessing, fixing, testing, and developing contingency plans to address any and all outstanding year 2000 computer date- change problems, so as to minimize possible disruptions associated with computer failures.

(3)(A) Because year 2000 computer date-change problems may affect virtually all businesses and other users of technology products to some degree, there is a substantial likelihood that actual or potential year 2000 failures will prompt a significant volume of litigation, much of it insubstantial.

(B) The litigation described in subparagraph (A) would have a range of undesirable effects, including the following:

(i) It would threaten to waste technical and financial resources that are better devoted to curing year 2000 computer date-change problems and ensuring that systems remain or become operational.

(ii) It could threaten the network of valued and trusted business and customer relationships that are important to the effective functioning of the national economy.

(iii) It would strain the Nation's legal system, causing particular problems for the small businesses and individuals who already find that system inaccessible because of its complexity and expense.

(iv) The delays, expense, uncertainties, loss of control, adverse publicity, and animosities that frequently accompany litigation of business disputes could exacerbate the difficulties associated with the date change and work against the successful resolution of those difficulties.

(4) It is appropriate for the Congress to enact legislation to assure that the year 2000 problems described in this section do not unnecessarily disrupt interstate commerce or create unnecessary caseloads in Federal courts and to provide initiatives to help businesses prepare and be in a position to withstand the potentially devastating economic impact of such problems.

(5) Resorting to the legal system for resolution of year 2000 problems described in this section is not feasible for many businesses and individuals who already find the legal system inaccessible, particularly small businesses and individuals who already find the legal system inaccessible, because of its complexity and expense.

(6) Concern about the potential for liability--in particular, concern about the substantial litigation expense associated with defending against even the most insubstantial lawsuits--is prompting many persons and businesses with technical expertise to avoid projects aimed at curing year 2000 computer date- change problems.

(7) A proliferation of frivolous lawsuits relating to year 2000 computer date-change problems by opportunistic parties may further limit access to courts by straining the resources of the legal system and depriving deserving parties of their legitimate rights to relief.

(8) Congress encourages businesses to approach their disputes relating to year 2000 computer date-change problems responsibly, and to avoid unnecessary, time-consuming, and costly litigation about Y2K failures, particularly those that are not material. Congress supports good faith negotiations between parties when there is such a dispute, and, if necessary, urges the parties to enter into voluntary, nonbinding mediation rather than litigation.

(b) Purposes

Based upon the power of the Congress under Article I, Section 8, Clause 3 of the Constitution of the United States, the purposes of this chapter are--

- (1) to establish uniform legal standards that give all businesses and users of technology products reasonable incentives to solve year 2000 computer date- change problems before they develop;
- (2) to encourage continued remediation and testing efforts to solve such problems by providers, suppliers, customers, and other contracting partners;
- (3) to encourage private and public parties alike to resolve disputes relating to year 2000 computer date-change problems by alternative dispute mechanisms in order to avoid costly and time-consuming litigation, to initiate those mechanisms as early as possible, and to encourage the prompt identification and correction of such problems; and
- (4) to lessen the burdens on interstate commerce by discouraging insubstantial lawsuits while preserving the ability of individuals and businesses that have suffered real injury to obtain complete relief.

6602. Definitions

In this chapter:

(1) Y2K action

The term "Y2K action"--

(A) means a civil action commenced in any Federal or State court, or an agency board of contract appeal proceeding, in which the plaintiff's alleged harm or injury arises from or is related to an actual or potential Y2K failure, or a claim or defense arises from or is related to an actual or potential Y2K failure;

(B) includes a civil action commenced in any Federal or State court by a government entity when acting in a commercial or contracting capacity; but

(C) does not include an action brought by a government entity acting in a regulatory, supervisory, or enforcement capacity.

(2) Y2K failure

The term "Y2K failure" means failure by any device or system (including any computer system and any microchip or integrated circuit embedded in another device or product), or any software, firmware, or other set or collection of processing instructions to process, to calculate, to compare, to sequence, to display, to store, to transmit, or to receive year-2000 date-related data, including failures--

(A) to deal with or account for transitions or comparisons from, into, and between the years 1999 and 2000 accurately;

(B) to recognize or accurately to process any specific date in 1999, 2000, or 2001; or

(C) accurately to account for the year 2000's status as a leap year, including recognition and processing of the correct date on February 29, 2000.

(3) Government entity

The term "government entity" means an agency, instrumentality, or other entity of Federal, State, or local government (including multijurisdictional agencies, instrumentalities, and entities).

(4) Material defect

The term "material defect" means a defect in any item, whether tangible or intangible, or in the provision of a service, that substantially prevents the item or service from operating or functioning as designed or according to its specifications. The term "material defect" does not include a defect that--

(A) has an insignificant or de minimis effect on the operation or functioning of an item or computer program;

(B) affects only a component of an item or program that, as a whole, substantially operates or functions as

designed; or

(C) has an insignificant or de minimis effect on the efficacy of the service provided.

(5) Personal injury

The term "personal injury" means physical injury to a natural person, including--

(A) death as a result of a physical injury; and

(B) mental suffering, emotional distress, or similar injuries suffered by that person in connection with a physical injury.

(6) State

The term "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Northern Mariana Islands, the United States Virgin Islands, Guam, American Samoa, and any other territory or possession of the United States, and any political subdivision thereof.

(7) Contract

The term "contract" means a contract, tariff, license, or warranty.

(8) Alternative dispute resolution

The term "alternative dispute resolution" means any process or proceeding, other than adjudication by a court or in an administrative proceeding, to assist in the resolution of issues in controversy, through processes such as early neutral evaluation, mediation, minitrial, and arbitration.

6603. Application of chapter

(a) General rule

This chapter applies to any Y2K action brought after January 1, 1999, for a Y2K failure occurring before January 1, 2003, or for a potential Y2K failure that could occur or has allegedly caused harm or injury before January 1, 2003, including any appeal, remand, stay, or other judicial, administrative, or alternative dispute resolution proceeding in such an action.

(b) No new cause of action created

Nothing in this chapter creates a new cause of action, and, except as otherwise explicitly provided in this chapter, nothing in this chapter expands any liability otherwise imposed or limits any defense otherwise available under Federal or State law.

(c) Claims for personal injury or wrongful death excluded

This chapter does not apply to a claim for personal injury or for wrongful death.

(d) Warranty and contract preservation

(1) In general

Subject to paragraph (2), in any Y2K action any written contractual term, including a limitation or an exclusion of liability, or a disclaimer of warranty, shall be strictly enforced unless the enforcement of that term would manifestly and directly contravene applicable State law embodied in any statute in effect on January 1, 1999, specifically addressing that term.

(2) Interpretation of contract

In any Y2K action in which a contract to which paragraph (1) applies is silent as to a particular issue, the interpretation of the contract as to that issue shall be determined by applicable law in effect at the time the contract was executed.

(3) Unconscionability

Nothing in paragraph (1) shall prevent enforcement of State law doctrines of unconscionability, including adhesion, recognized as of January 1, 1999, in controlling judicial precedent by the courts of the State whose law applies to the Y2K action.

(e) Preemption of State law

This chapter supersedes State law to the extent that it establishes a rule of law applicable to a Y2K action that is inconsistent with State law, but nothing in this chapter implicates, alters, or diminishes the ability of a State to defend itself against any claim on the basis of sovereign immunity.

(f) Application with year 2000 information and readiness disclosure act

Nothing in this chapter supersedes any provision of the Year 2000 Information and Readiness Disclosure Act.

(g) Application to actions brought by a government entity

(1) In general

To the extent provided in this subsection, this chapter shall apply to an action brought by a government entity described in section 6602(1)(C) of this title.

(2) Definitions

In this subsection:

(A) Defendant

(i) In general

The term "defendant" includes a State or local government.

(ii) State

The term "State" means each of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

(iii) Local government

The term "local government" means--

- (I) any county, city, town, township, parish, village, or other general purpose political subdivision of a State; and
- (II) any combination of political subdivisions described in subclause (I) recognized by the Secretary of Housing and Urban Development.

(B) Y2K upset

The term "Y2K upset"--

(i) means an exceptional temporary noncompliance with applicable federally enforceable measurement, monitoring, or reporting requirements directly related to a Y2K failure that are beyond the reasonable control of the defendant charged with compliance; and

(ii) does not include--

(I) noncompliance with applicable federally enforceable measurement, monitoring, or reporting requirements that constitutes or would create an imminent threat to public health, safety, or the environment;

(II) noncompliance with applicable federally enforceable measurement, monitoring, or reporting requirements that provide for the safety and soundness of the banking or monetary system, or for the integrity of the national securities markets, including the protection of depositors and investors;

(III) noncompliance with applicable federally enforceable measurement, monitoring, or reporting requirements to the extent caused by operational error or negligence;

(IV) lack of reasonable preventative maintenance;

(V) lack of preparedness for a Y2K failure; or

(VI) noncompliance with the underlying federally enforceable requirements to which the applicable federally enforceable measurement, monitoring, or reporting requirement relates.

(3) Conditions necessary for a demonstration of a Y2K upset

A defendant who wishes to establish the affirmative defense of Y2K upset shall demonstrate, through properly signed, contemporaneous operating logs, or other relevant evidence that--

(A) the defendant previously made a reasonable good faith effort to anticipate, prevent, and effectively remediate a potential Y2K failure;

(B) a Y2K upset occurred as a result of a Y2K failure or other emergency directly related to a Y2K failure;

(C) noncompliance with the applicable federally enforceable measurement, monitoring, or reporting requirement was unavoidable in the face of an emergency directly related to a Y2K failure and was necessary to prevent the disruption of critical functions or services that could result in harm to life or property;

(D) upon identification of noncompliance the defendant invoking the defense began immediate actions to correct any violation of federally enforceable measurement, monitoring, or reporting requirements; and

(E) the defendant submitted notice to the appropriate Federal regulatory authority of a Y2K upset within 72 hours from the time that the defendant became aware of the upset.

(4) Grant of a Y2K upset defense

Subject to the other provisions of this subsection, the Y2K upset defense shall be a complete defense to the imposition of a penalty in any action brought as a result of noncompliance with federally enforceable measurement, monitoring, or reporting requirements for any defendant who establishes by a preponderance of the evidence that the conditions set forth in paragraph (3) are met.

(5) Length of Y2K upset

The maximum allowable length of the Y2K upset shall be not more than 15 days beginning on the date of the upset unless specific relief by the appropriate regulatory authority is granted.

(6) Fraudulent invocation of Y2K upset defense

Fraudulent use of the Y2K upset defense provided for in this subsection shall be subject to the sanctions provided in section 1001 of Title 18.

(7) Expiration of defense

The Y2K upset defense may not be asserted for a Y2K upset occurring after June 30, 2000.

(8) Preservation of authority

Nothing in this subsection shall affect the authority of a government entity to seek injunctive relief or require a defendant to correct a violation of a federally enforceable measurement, monitoring, or reporting requirement.

(h) Consumer protection from Y2K failures

(1) In general

No person who transacts business on matters directly or indirectly affecting residential mortgages shall cause or permit a foreclosure on any such mortgage against a consumer as a result of an actual Y2K failure that results in an inability to accurately or timely process any mortgage payment transaction.

(2) Notice

A consumer who is affected by an inability described in paragraph (1) shall notify the servicer for the mortgage, in writing and within 7 business days from the time that the consumer becomes aware of the Y2K failure and the consumer's inability to accurately or timely fulfill his or her obligation to pay, of such failure and inability and shall provide to the servicer any available documentation with respect to the failure.

(3) Actions may resume after grace period

Notwithstanding paragraph (1), an action prohibited under paragraph (1) may be resumed, if the consumer's mortgage obligation has not been paid and the servicer of the mortgage has not expressly and in writing granted the consumer an extension of time during which to pay the consumer's mortgage obligation, but only after the later of--

(A) four weeks after January 1, 2000; or

(B) four weeks after notification is made as required under paragraph (2), except that any notification made on or after March 15, 2000, shall not be effective for purposes of this subsection.

(4) Applicability

This subsection does not apply to transactions upon which a default has occurred before December 15, 1999, or with respect to which an imminent default was foreseeable before December 15, 1999.

(5) Enforcement of obligations merely tolled

This subsection delays but does not prevent the enforcement of financial obligations, and does not otherwise affect or extinguish the obligation to pay.

(6) Definition

In this subsection--

(A) The term "consumer" means a natural person.

(B) The term "residential mortgage" has the meaning given the term "federally related mortgage loan" under section 3 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2602).

(C) The term "servicer" means the person, including any successor, responsible for receiving any scheduled periodic payments from a consumer pursuant to the terms of a residential mortgage, including amounts for any escrow account, and for making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage. Such term includes the person, including any successor, who makes or holds a loan if such person also services the loan.

(i) Applicability to securities litigation

In any Y2K action in which the underlying claim arises under the securities laws (as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), the provisions of this chapter, other than section 6612(b) of this title, shall not apply.

6604. Punitive damages limitations

(a) In general

In any Y2K action in which punitive damages are permitted by applicable law, the defendant shall not be liable for punitive damages unless the plaintiff proves by clear and convincing evidence that the applicable standard for awarding damages has been met.

(b) Caps on punitive damages

(1) In general

Subject to the evidentiary standard established by subsection (a), punitive damages permitted under applicable law against a defendant described in paragraph (2) in a Y2K action may not exceed the lesser of--

- (A) three times the amount awarded for compensatory damages; or
- (B) \$250,000.

(2) Defendant described

A defendant described in this paragraph is a defendant--

- (A) who--
 - (i) is sued in his or her capacity as an individual; and
 - (ii) whose net worth does not exceed \$500,000; or
- (B) that is an unincorporated business, a partnership, corporation, association, or organization, with fewer than 50 full-time employees.

(3) No cap if injury specifically intended

Paragraph (1) does not apply if the plaintiff establishes by clear and convincing evidence that the defendant acted with specific intent to injure the plaintiff.

(c) Government entities

Punitive damages in a Y2K action may not be awarded against a government entity.

6605. Proportionate liability

(a) In general

Except in a Y2K action that is a contract action, and except as provided in subsections (b) through (g), a person against whom a final judgment is entered in a Y2K action shall be liable solely for the portion of the judgment that corresponds to the relative and proportionate responsibility of that person. In determining the percentage of responsibility of any defendant, the trier of fact shall determine that percentage as a percentage of the total fault of all persons, including the plaintiff, who caused or contributed to the total loss incurred by the plaintiff.

(b) Proportionate liability

(1) Determination of responsibility

In any Y2K action that is not a contract action, the court shall instruct the jury to answer special interrogatories, or, if there is no jury, the court shall make findings with respect to each defendant, including defendants who have entered into settlements with the plaintiff or plaintiffs, concerning--

(A) the percentage of responsibility, if any, of each defendant, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff; and

(B) if alleged by the plaintiff, whether the defendant (other than a defendant who has entered into a settlement agreement with the plaintiff)--

- (i) acted with specific intent to injure the plaintiff; or
- (ii) knowingly committed fraud.

(2) Contents of special interrogatories or findings

The responses to interrogatories or findings under paragraph (1) shall specify the total amount of damages that the plaintiff is entitled to recover and the percentage of responsibility of each defendant found to have caused or contributed to the loss incurred by the plaintiff.

(3) Factors for consideration

In determining the percentage of responsibility under this subsection, the trier of fact shall consider--

(A) the nature of the conduct of each person found to have caused or contributed to the loss incurred by the plaintiff; and

(B) the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff.

(c) Joint liability for specific intent or fraud

(1) In general

Notwithstanding subsection (a), the liability of a defendant in a Y2K action that is not a contract action is joint and several if the trier of fact specifically determines that the defendant--

- (A) acted with specific intent to injure the plaintiff; or
- (B) knowingly committed fraud.

(2) Fraud; recklessness--

(A) Knowing commission of fraud described

For purposes of subsection (b)(1)(B)(ii) and paragraph (1)(B) of this subsection, a defendant knowingly committed fraud if the defendant--

- (i) made an untrue statement of a material fact, with actual knowledge that the statement was false;
- (ii) omitted a fact necessary to make the statement not be misleading, with actual knowledge that, as a result of the omission, the statement was false; and
- (iii) knew that the plaintiff was reasonably likely to rely on the false statement.

(B) Recklessness

For purposes of subsection (b)(1)(B) and paragraph (1) of this subsection, reckless conduct by the defendant does not constitute either a specific intent to injure, or the knowing commission of fraud, by the defendant.

(3) Right to contribution not affected

Nothing in this section affects the right, under any other law, of a defendant to contribution with respect to another defendant found under subsection (b)(1)(B), or determined under paragraph (1)(B) of this subsection, to have acted with specific intent to injure the plaintiff or to have knowingly committed fraud.

(d) Special rules

(1) Uncollectible share

(A) In general

Notwithstanding subsection (a), if, upon motion made not later than 6 months after a final judgment is entered in any Y2K action that is not a contract action, the court determines that all or part of the share of the judgment against a defendant for compensatory damages is not collectible against that defendant, then each other defendant in the action is liable for the uncollectible share as follows:

(i) Percentage of net worth

The other defendants are jointly and severally liable for the uncollectible share if the plaintiff establishes that--
(I) the plaintiff is an individual whose recoverable damages under the final judgment are equal to more than 10 percent of the net worth of the plaintiff; and
(II) the net worth of the plaintiff is less than \$200,000.

(ii) Other plaintiffs

For a plaintiff not described in clause (i), each of the other defendants is liable for the uncollectible share in proportion to the percentage of responsibility of that defendant.

(iii) For a plaintiff not described in clause (i), in addition to the share identified in clause (ii), the defendant is liable for an additional portion of the uncollectible share in an amount equal to 50 percent of the amount determined under clause (ii) if the plaintiff demonstrates by a preponderance of the evidence that the defendant acted with reckless disregard for the likelihood that its acts would cause injury of the sort suffered by the plaintiff.

(B) Overall limit

The total payments required under subparagraph (A) from all defendants may not exceed the amount of the uncollectible share.

(C) Subject to contribution

A defendant against whom judgment is not collectible is subject to contribution and to any continuing liability to the plaintiff on the judgment.

(D) Suits by consumers

(i) Notwithstanding subparagraph (A), the other defendants are jointly and severally liable for the uncollectible share if--

- (I) the plaintiff is a consumer whose suit alleges or arises out of a defect in a consumer product; and
- (II) the plaintiff is suing as an individual and not as part of a class action.

(ii) In this subparagraph:

(I) The term "class action" means--

(aa) a single lawsuit in which: (1) damages are sought on behalf of more than 10 persons or prospective class members; or (2) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated; or

(bb) any group of lawsuits filed in or pending in the same court in which: (1) damages are sought on behalf of more than 10 persons; and (2) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

(II) The term "consumer" means an individual who acquires a consumer product for purposes other than resale.

(III) The term "consumer product" means any personal property or service which is normally used for personal, family, or household purposes.

(2) Special right of contribution

To the extent that a defendant is required to make an additional payment under paragraph (1), that defendant may recover contribution--

- (A) from the defendant originally liable to make the payment;
- (B) from any other defendant that is jointly and severally liable;
- (C) from any other defendant held proportionately liable who is liable to make the same payment and has paid less than that other defendant's proportionate share of that payment; or
- (D) from any other person responsible for the conduct giving rise to the payment that would have been liable to make the same payment.

(3) Nondisclosure to jury

The standard for allocation of damages under subsection (a) and subsection (b)(1), and the procedure for reallocation of uncollectible shares under paragraph (1) of this subsection, shall not be disclosed to members of the jury.

(e) Settlement discharge

(1) In general

A defendant who settles a Y2K action that is not a contract action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons. Upon entry of the settlement by the court, the court shall enter an order constituting the final discharge of all obligations to the plaintiff of the settling defendant arising out of the action. The order shall bar all future claims for contribution arising out of the action--

- (A) by any person against the settling defendant; and
- (B) by the settling defendant against any person other than a person whose liability has been extinguished by the settlement of the settling defendant.

(2) Reduction

If a defendant enters into a settlement with the plaintiff before the final verdict or judgment, the verdict or judgment shall be reduced by the greater of--

- (A) an amount that corresponds to the percentage of responsibility of that defendant; or
- (B) the amount paid to the plaintiff by that defendant.

(f) General right of contribution

(1) In general

A defendant who is jointly and severally liable for damages in any Y2K action that is not a contract action may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages. A claim for contribution shall be determined based on the percentage of responsibility of the claimant and of each person against whom a claim for contribution is made.

(2) Statute of limitations for contribution

An action for contribution in connection with a Y2K action that is not a contract action shall be brought not later than 6 months after the entry of a final, nonappealable judgment in the Y2K action, except that an action for contribution brought by a defendant who was required to make an additional payment under subsection (d)(1) may be brought not later than 6 months after the date on which such payment was made.

(g) More protective State law not preempted

Nothing in this section preempts or supersedes any provision of State law that--

- (1) limits the liability of a defendant in a Y2K action to a lesser amount than the amount determined under this section; or
- (2) otherwise affords a greater degree of protection from joint or several liability than is afforded by this section.

6606. Prelitigation notice

(a) In general

Before commencing a Y2K action, except an action that seeks only injunctive relief, a prospective plaintiff in a Y2K action shall send a written notice by certified mail (with either return receipt requested or other means of verification that the notice was sent) to each prospective defendant in that action. The notice shall provide specific and detailed information about--

- (1) the manifestations of any material defect alleged to have caused harm or loss;
- (2) the harm or loss allegedly suffered by the prospective plaintiff;
- (3) how the prospective plaintiff would like the prospective defendant to remedy the problem;
- (4) the basis upon which the prospective plaintiff seeks that remedy; and
- (5) the name, title, address, and telephone number of any individual who has authority to negotiate a resolution of the dispute on behalf of the prospective plaintiff.

(b) Person to whom notice to be sent

The notice required by subsection (a) shall be sent--

- (1) to the registered agent of the prospective defendant for service of legal process;
- (2) if the prospective defendant does not have a registered agent, then to the chief executive officer if the prospective defendant is a corporation, to the managing partner if the prospective defendant is a partnership, to the proprietor if the prospective defendant is a sole proprietorship, or to a similarly-situated person if the prospective defendant is any other enterprise; or
- (3) if the prospective defendant has designated a person to receive prelitigation notices on a Year 2000 Internet Website (as defined in section 3(7) of the Year 2000 Information and Readiness Disclosure Act), to the designated person, if the prospective plaintiff has reasonable access to the Internet.

(c) Response to notice

(1) In general

Within 30 days after receipt of the notice specified in subsection (a), each prospective defendant shall send by certified mail with return receipt requested to each prospective plaintiff a written statement acknowledging receipt of the notice, and describing the actions it has taken or will take to address the problem identified by the prospective plaintiff.

(2) Willingness to engage in ADR

The written statement shall state whether the prospective defendant is willing to engage in alternative dispute resolution.

(3) Inadmissibility

A written statement required by this subsection is not admissible in evidence, under Rule 408 of the Federal Rules of Evidence or any analogous rule of evidence in any State, in any proceeding to prove liability for, or the invalidity of, a claim or its amount, or otherwise as evidence of conduct or statements made in compromise negotiations.

(4) Presumptive time of receipt

For purposes of paragraph (1), a notice under subsection (a) is presumed to be received 7 days after it was sent.

(5) Priority

A prospective defendant receiving more than one notice under this section may give priority to notices with respect to a product or service that involves a health or safety related Y2K failure.

(d) Failure to respond

If a prospective defendant--

(1) fails to respond to a notice provided pursuant to subsection (a) within the 30 days specified in subsection (c)(1); or

(2) does not describe the action, if any, the prospective defendant has taken, or will take, to address the problem identified by the prospective plaintiff, the prospective plaintiff may immediately commence a legal action against that prospective defendant

(e) Remediation period

(1) In general

If the prospective defendant responds and proposes remedial action it will take, or offers to engage in alternative dispute resolution, then the prospective plaintiff shall allow the prospective defendant an additional 60 days from the end of the 30-day notice period to complete the proposed remedial action or alternative dispute resolution before commencing a legal action against that prospective defendant.

(2) Extension by agreement

The prospective plaintiff and prospective defendant may change the length of the 60-day remediation period by written agreement.

(3) Multiple extensions not allowed

Except as provided in paragraph (2), a defendant in a Y2K action is entitled to no more than one 30-day period and one 60-day remediation period under paragraph (1).

(4) Statutes of limitation, etc., tolled

Any applicable statute of limitations or doctrine of laches in a Y2K action to which paragraph (1) applies shall be tolled during the notice and remediation period under that paragraph.

(f) Failure to provide notice

If a defendant determines that a plaintiff has filed a Y2K action without providing the notice specified in subsection (a) or without awaiting the expiration of the appropriate waiting period specified in subsection (c), the defendant may treat the plaintiff's complaint as such a notice by so informing the court and the plaintiff in its initial response to the plaintiff. If any defendant elects to treat the complaint as such a notice--

(1) the court shall stay all discovery and all other proceedings in the action for the appropriate period after filing of the complaint; and

(2) the time for filing answers and all other pleadings shall be tolled during the appropriate period.

(g) Effect of contractual or statutory waiting periods

In cases in which a contract, or a statute enacted before January 1, 1999, requires notice of nonperformance and provides for a period of delay prior to the initiation of suit for breach or repudiation of contract, the period of delay provided by contract or the statute is controlling over the waiting period specified in subsections (c) and (d).

(h) State law controls alternative methods

Nothing in this section supersedes or otherwise preempts any State law or rule of civil procedure with respect to the use of alternative dispute resolution for Y2K actions.

(i) Provisional remedies unaffected

Nothing in this section interferes with the right of a litigant to provisional remedies otherwise available under Rule 65 of the Federal Rules of Civil Procedure or any State rule of civil procedure providing extraordinary or provisional remedies in any civil action in which the underlying complaint seeks both injunctive and monetary relief.

(j) Special rule for class actions

For the purpose of applying this section to a Y2K action that is maintained as a class action in Federal or State court, the requirements of the preceding subsections of this section apply only to named plaintiffs in the class action.

6607. Pleading requirements

(a) Application with Rules of Civil Procedure

This section applies exclusively to Y2K actions and, except to the extent that this section requires additional information to be contained in or attached to pleadings, nothing in this section is intended to amend or otherwise supersede applicable rules of Federal or State civil procedure.

(b) Nature and amount of damages

In all Y2K actions in which damages are requested, there shall be filed with the complaint a statement of specific information as to the nature and amount of each element of damages and the factual basis for the damages calculation.

(c) Material defects

In any Y2K action in which the plaintiff alleges that there is a material defect in a product or service, there shall be filed with the complaint a statement of specific information regarding the manifestations of the material defects and the facts supporting a conclusion that the defects are material.

(d) Required state of mind

In any Y2K action in which a claim is asserted on which the plaintiff may prevail only on proof that the defendant acted with a particular state of mind, there shall be filed with the complaint, with respect to each element of that claim, a statement of the facts giving rise to a strong inference that the defendant acted with the required state of mind.

6608. Duty to mitigate

(a) In general

Damages awarded in any Y2K action shall exclude compensation for damages the plaintiff could reasonably have avoided in light of any disclosure or other information of which the plaintiff was, or reasonably should have been, aware, including information made available by the defendant to purchasers or users of the defendant's product or services concerning means of remedying or avoiding the Y2K failure involved in the action.

(b) Preservation of existing law

The duty imposed by this section is in addition to any duty to mitigate imposed by State law.

(c) Exception for intentional fraud

Subsection (a) does not apply to damages suffered by reason of the plaintiff's justifiable reliance upon an affirmative material misrepresentation by the defendant, made by the defendant with actual knowledge of its falsity, concerning the potential for Y2K failure of the device or system used or sold by the defendant that experienced the Y2K failure alleged to have caused the plaintiff's harm.

6609. Application of existing impossibility or commercial impracticability doctrines

In any Y2K action for breach or repudiation of contract, the applicability of the doctrines of impossibility and commercial impracticability shall be determined by the law in existence on January 1, 1999. Nothing in this chapter shall be construed as limiting or impairing a party's right to assert defenses based upon such doctrines.

6610. Damages limitation by contract

In any Y2K action for breach or repudiation of contract, no party may claim, or be awarded, any category of damages unless such damages are allowed--

- (1) by the express terms of the contract; or
- (2) if the contract is silent on such damages, by operation of State law at the time the contract was effective or by operation of Federal law.

6611. Damages in tort claims

(a) In general

A party to a Y2K action making a tort claim, other than a claim of intentional tort arising independent of a contract, may not recover damages for economic loss unless--

- (1) the recovery of such losses is provided for in a contract to which the party seeking to recover such losses is a party; or
- (2) such losses result directly from damage to tangible personal or real property caused by the Y2K failure involved in the action (other than damage to property that is the subject of the contract between the parties to the Y2K action or, in the event there is no contract between the parties, other than damage caused only to the property that experienced the Y2K failure), and such damages are permitted under applicable Federal or State law.

(b) Economic loss

For purposes of this section only, and except as otherwise specifically provided in a valid and enforceable written contract between the plaintiff and the defendant in a Y2K action, the term "economic loss" means amounts awarded

to compensate an injured party for any loss, and includes amounts awarded for damages such as--

- (1) lost profits or sales;
- (2) business interruption;
- (3) losses indirectly suffered as a result of the defendant's wrongful act or omission;
- (4) losses that arise because of the claims of third parties;
- (5) losses that must be pled as special damages; and
- (6) consequential damages (as defined in the Uniform Commercial Code or analogous State commercial law).

(c) Certain other actions

A person liable for damages, whether by settlement or judgment, in a civil action to which this chapter does not apply because of section 6603(c) of this title whose liability, in whole or in part, is the result of a Y2K failure may, notwithstanding any other provision of this chapter, pursue any remedy otherwise available under Federal or State law against the person responsible for that Y2K failure to the extent of recovering the amount of those damages.

6612. State of mind; bystander liability; control

(a) Defendant's state of mind

In a Y2K action other than a claim for breach or repudiation of contract, and in which the defendant's actual or constructive awareness of an actual or potential Y2K failure is an element of the claim, the defendant is not liable unless the plaintiff establishes that element of the claim by the standard of evidence under applicable State law in effect on the day before January 1, 1999.

(b) Limitation on bystander liability for Y2K failures

(1) In general

With respect to any Y2K action for money damages in which--

(A) the defendant is not the manufacturer, seller, or distributor of a product, or the provider of a service, that suffers or causes the Y2K failure at issue;

(B) the plaintiff is not in substantial privity with the defendant; and

(C) the defendant's actual or constructive awareness of an actual or potential Y2K failure is an element of the claim under applicable law, the defendant shall not be liable unless the plaintiff, in addition to establishing all other requisite elements of the claim, proves, by the standard of evidence under applicable State law in effect on the day before January 1, 1999, that the defendant actually knew, or recklessly disregarded a known and substantial risk, that such failure would occur.

(2) Substantial privity

For purposes of paragraph (1)(B), a plaintiff and a defendant are in substantial privity when, in a Y2K action arising out of the performance of professional services, the plaintiff and the defendant either have contractual relations with one another or the plaintiff is a person who, prior to the defendant's performance of such services, was specifically identified to and acknowledged by the defendant as a person for whose special benefit the services were being performed.

(3) Certain claims excluded

For purposes of paragraph (1)(C), claims in which the defendant's actual or constructive awareness of an actual or potential Y2K failure is an element of the claim under applicable law do not include claims for negligence but do include claims such as fraud, constructive fraud, breach of fiduciary duty, negligent misrepresentation, and interference with contract or economic advantage.

(c) Control not determinative of liability

The fact that a Y2K failure occurred in an entity, facility, system, product, or component that was sold, leased, rented, or otherwise within the control of the party against whom a claim is asserted in a Y2K action shall not constitute the sole basis for recovery of damages in that action. A claim in a Y2K action for breach or repudiation of contract for such a failure is governed by the terms of the contract.

(d) Protections of the Year 2000 Information and Readiness Disclosure Act apply

The protections for the exchanges of information provided by section 4 of the Year 2000 Information and Readiness Disclosure Act (Public Law 105-271) shall apply to any Y2K action.

6613. Appointment of special masters or magistrate judges for Y2K actions

Any district court of the United States in which a Y2K action is pending may appoint a special master or a magistrate judge to hear the matter and to make findings of fact and conclusions of law in accordance with Rule 53 of the Federal Rules of Civil Procedure.

6614. Y2K actions as class actions

(a) Material defect requirement

A Y2K action involving a claim that a product or service is defective may be maintained as a class action in Federal or State court as to that claim only if--

- (1) it satisfies all other prerequisites established by applicable Federal or State law, including applicable rules of civil procedure; and
- (2) the court finds that the defect in a product or service as alleged would be a material defect for the majority of the members of the class.

(b) Notification

In any Y2K action that is maintained as a class action, the court, in addition to any other notice required by applicable Federal or State law, shall direct notice of the action to each member of the class, which shall include--

- (1) a concise and clear description of the nature of the action;
- (2) the jurisdiction where the case is pending; and
- (3) the fee arrangements with class counsel, including the hourly fee being charged, or, if it is a contingency fee, the percentage of the final award which will be paid, including an estimate of the total amount that would be paid if the requested damages were to be granted.

(c) Forum for Y2K class actions

(1) Jurisdiction

Except as provided in paragraph (2), the district courts of the United States shall have original jurisdiction of any Y2K action that is brought as a class action.

(2) Exceptions

The district courts of the United States shall not have original jurisdiction over a Y2K action brought as a class action if--

- (A)(i) a substantial majority of the members of the proposed plaintiff class are citizens of a single State;
- (ii) the primary defendants are citizens of that State; and

- (iii) the claims asserted will be governed primarily by the laws of that State;
- (B) the primary defendants are States, State officials, or other governmental entities against whom the district courts of the United States may be foreclosed from ordering relief;
- (C) the plaintiff class does not seek an award of punitive damages, and the amount in controversy is less than the sum of \$10,000,000 (exclusive of interest and costs), computed on the basis of all claims to be determined in the action; or
- (D) there are less than 100 members of the proposed plaintiff class.

A party urging that any exception described in subparagraph (A), (B), (C), or (D) applies to an action shall bear the full burden of demonstrating the applicability of the exception

(3) Procedure if requirements not met

(A) Dismissal or remand

A United States district court shall dismiss, or, if after removal, strike the class allegations and remand, any Y2K action brought or removed under this subsection as a class action if--

- (i) the action is subject to the jurisdiction of the court solely under this subsection; and
- (ii) the court determines the action may not proceed as a class action based on a failure to satisfy the conditions of Rule 23 of the Federal Rules of Civil Procedure.

(B) Amendment; removal

Nothing in paragraph (A) shall prohibit plaintiffs from filing an amended class action in Federal or State court. A defendant shall have the right to remove such an amended class action to a United States district court under this subsection.

(C) Period of limitations tolled

Upon dismissal or remand, the period of limitations for any claim that was asserted in an action on behalf of any named or unnamed member of any proposed class shall be deemed tolled to the full extent provided under Federal law.

(D) Dismissal without prejudice

The dismissal of a Y2K action under subparagraph (A) shall be without prejudice.

(d) Effect on Rules of Civil Procedure

Except as otherwise provided in this section, nothing in this section supersedes any rule of Federal or State civil procedure applicable to class actions.

6615. Applicability of State law

Nothing in this chapter shall be construed to affect the applicability of any State law that provides stricter limits on damages and liabilities, affording greater protection to defendants in Y2K actions, than are provided in this chapter.

6616. Admissible evidence ultimate issue in State courts

Any party to a Y2K action in a State court in a State that has not adopted a rule of evidence substantially similar to Rule 704 of the Federal Rules of Evidence may introduce in such action evidence that would be admissible if Rule 704 applied in that jurisdiction.

6617. Suspension of penalties for certain year 2000 failures by small business concerns

(a) Definitions. In this section –

(1) the term “agency” means any executive agency, as defined in section 105 of title 5, United States Code, that has the authority to impose civil penalties on small business concerns;

(2) the term “first-time violation” means a violation by a small business concern of a federally enforceable rule or regulation (other than a Federal rule or regulation that relates to the safety and soundness of the banking or monetary system or for the integrity of the National Securities markets, including protection of depositors and investors) caused by a Y2K failure if that Federal rule or regulation had not been violated by that small business concern within the preceding 3 years; and

(3) the term “small business concern” has the same meaning as a defendant described in section 5(b)(2)(B) [15 USCS Section 6604(b)(2)(B)].

(b) Establishment of liaisons. Not later than 30 days after the date of the enactment of this Act [enacted July 20, 1999], each agency shall –

(1) establish a point of contact within the agency to act as a liaison between the agency and small business concerns with respect to problems arising out of Y2K failures and compliance with Federal rules or regulations; and

(2) publish the name and phone number of the point of contact for the agency in the Federal Register.

(c) General rule. Subject to subsections (d) and (e), no agency shall impose any civil money penalty on a small business concern for a first-time violation.

(d) Standards for waiver. An agency shall provide a waiver of civil money penalties for a first-time violation, provided that a small business concern demonstrates, and the agency determines, that –

(1) the small business concern previously made a reasonable good faith effort to anticipate, prevent, and effectively remediate a potential Y2K failure;

(2) a first-time violation occurred as a result of the Y2K failure of the small business concern or other entity, which significantly affected the small business concern’s ability to comply with a Federal rule or regulation;

(3) the first-time violation was unavoidable in the face of a Y2K failure or occurred as a result of efforts to prevent the disruption of critical functions or services that could result in harm to life or property;

(4) upon identification of a first-time violation, the small business concern initiated reasonable and prompt measures to correct the violation; and

(5) the small business concern submitted notice to the appropriate agency of the first-time violation within a reasonable time not to exceed 5 business days from the time that the small business concern became aware that the first-time violation had occurred.

(e) Exceptions. An agency may impose civil money penalties authorized under Federal law on a small business concern for a first-time violation if–

(1) the small business concern’s failure to comply with Federal rules or regulations resulted in actual harm, or constitutes or creates an imminent threat to public health, safety, or the environment; or

(2) the small business concern fails to correct the violation not later than 1 month after initial notification to the agency.

(f) Expiration. This section shall not apply to first-time violations caused by a Y2K failure occurring after December 31, 2000.

INTERNET BUSINESS MODELS

Matthew M. Clark
Senior Counsel- Transactions & E-Commerce
G.E. Appliances
Louisville, Kentucky

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SECTION E





GE Appliances

***E-Commerce Business Models:
The GE Experience***

Matthew M. Clark
Senior Counsel, Transactions/E-Commerce

Computers and Technology Law Institute
University of Kentucky
College of Law
March 17-18, 2000





GE Overview

“This company, like every company in the world today, is in the midst of the biggest, most transformational revolution in the past century, brought on by the internet.”

“It will change everything for us, in our dealings with each other, our suppliers, and above all our **customers.**”

- *Jack Welch, 1999*



Recent E-Commerce Events & Players

GE's E-Commerce Ramp

Audit Staff

- Deploy teams to high priority businesses to help carry out S-1 actions

Global BMC

- Assist in customer & benchmarking interviews
- Validate opportunities & threats in concert with businesses & Corporate Internet Initiatives Team

Corporate Internet Initiatives Team (CIG, CR&D, Corp Mktg)

- Share internal & external best practices (EC strategy, organization)
- Identify greatest threats & greatest opportunities, including cross-business ones
- Establish common standards (infrastructure, applications, security)
- Help businesses prepare for S-1's

Existing Business EC Teams (Mktg, IT, BD)

- Continue CWC development (push from Level 1 to Level 4)
- Evaluate broader internet opportunities & threats
- Define action plans & implement

Major Events

Jan 1999

JFW challenges every business on EC at Boca

Jul 1999

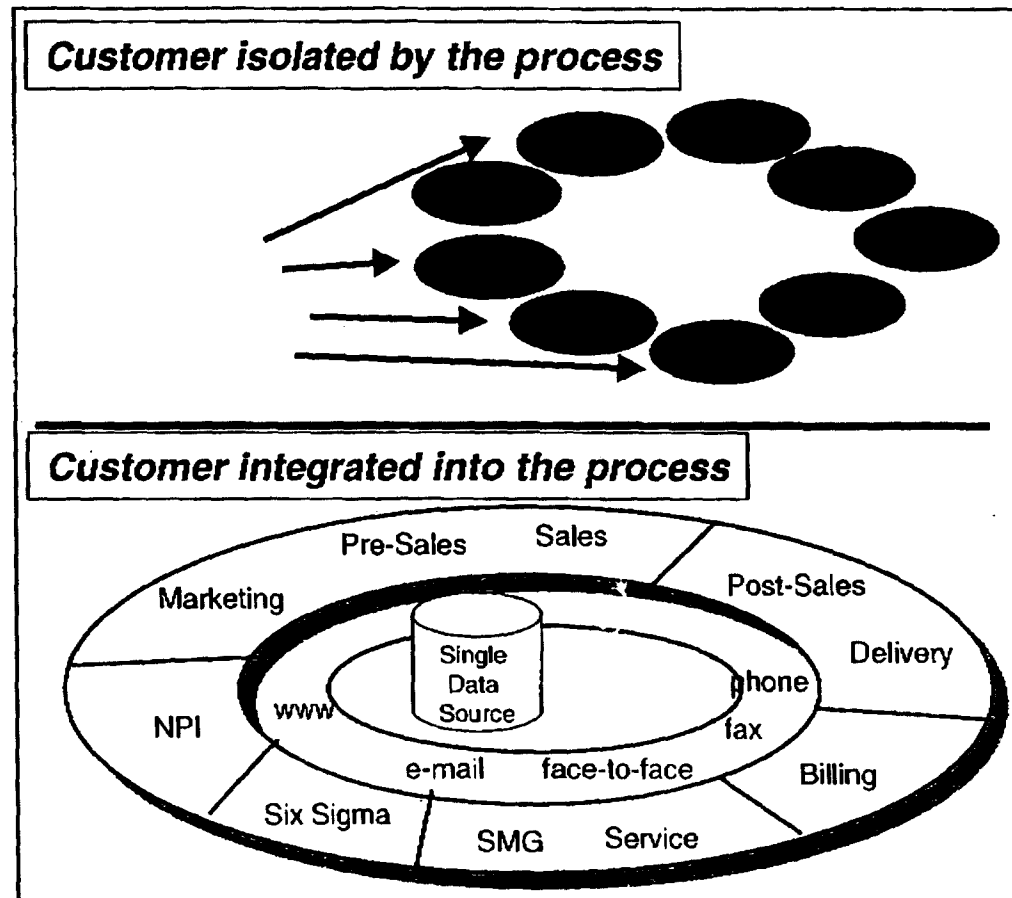
S-1 Reviews (EC major issue)



Definition - 360° View

A **360° View** of the Customer is a collection of processes and technology that ...

- Collects key information about customers
- Centralizes information - enabling the "Single Face of GEA"
- Enables personalization
- Focuses on the relationship



Taken from Customers.com - Patricia Seybold

You should not have to understand our organization to do business with us



EC Playing Field



EXAMPLES

Level 4

Differentiable
Services
("Sticky")

- Personalization (e.g., account history, pricing, open orders)
- Customized Interface
- Remote Monitoring & Diagnostics (online VMI)
- Customers Dashboards

Level 3

Complex
Transactions &
Services

- Product/Service Configurators
- Real-Time Collaborative Design
- Interactive/Smart Troubleshooting
- Online Interactive Training Materials

Level 2

Simple
Transactions &
Services

- Detailed Product Information (e.g., specifications, pricing, availability)
- Online Order Track and Pay
- Simple Troubleshooting (static guides)

Level 1

Brochureware

- Company Information
- Basic Product Information
- Annual Report



E-Commerce Metrics

Customer Metrics

Return on Relationship: This is defined as the actual return on investment from a particular business relationship, where a relationship is defined as all transactions conducted by an individual online customer.

Repeat Customer: How many customers conduct online transactions more than once. This measures the penetration within an account.

Abandonment Rate: How many customers being a transaction and then abandon it. This will demonstrate potential problem spots with our system or potential customer hesitation points.

Conversion Rates (Surfer-to-Shopper-to-Buyer): This measurement will show how successful we are in capturing online business.

Online Customer Base: How many customers have registered with the site?

Financial

Revenue: How much Revenue has been generated online?

Average Order Revenue: How much is the average order?

Cost Savings: How much savings can be directly attributed to online information or services?



E-Commerce Metrics

Web Metrics

Search Engine Rank: Where does our site rank when searching select search engines with pertinent keywords?

Unique Visitors/Month: How many visitors come to our site each month?

Clickstreams: What are the most popular paths through the site?

Most/Least Popular Content: What pages on the site are most visited? Least visited?

Links-IN: How many other sites are linking to our site?

Performance Metrics

Load Time: How long does it take for our homepage to load?

Transaction Times: How long do select transactions take?

System Errors: How often do our servers create an error that a customer views?

Customer Satisfaction: This is a qualitative measurement that can be made using customer surveys.



Beating Aggregators



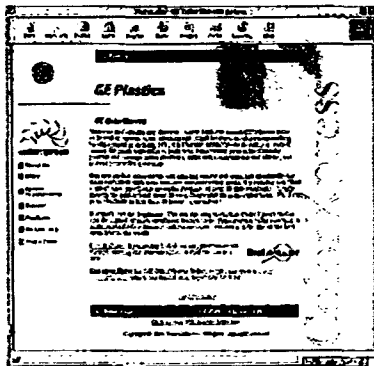
Industry Firsts

- "On-Line" Color Matching
- E-Commerce functionality
 - "Micro-Lots"
- "Xpress" Services @ Premium Prices

E - 8

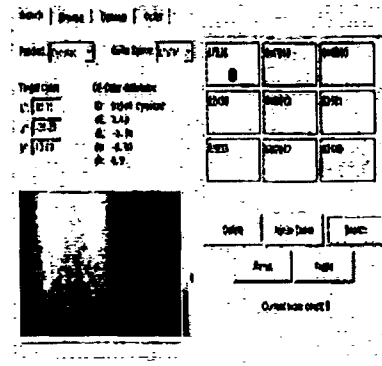
Internet Color Matching

ColorXpress Website



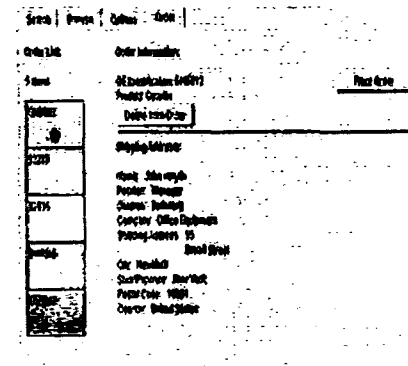
Step 1

Color Matching Process



Step 2

Order Entry Process



Step 3

Raising The Bar & Changing The Game on The Competition



Polymerland - Microsoft Internet Explorer provided by GE Corporate

File Edit View Go Favorites Help

Address <http://www.polymerland.com/>

Links [Quality Coach login](#) [eureka](#) [GE Home Page](#) [GE Corporate](#) [GE external](#) [msnbc cover](#) [GESPI - SSDW](#) [Fidelity Inv](#)



Polymerland

Welcome

What's New

Customer Info

[SHIPMENT TRACKER](#)
[ORDER INQUIRY/ENTRY](#)
[MATERIAL SELECTOR](#)

Products & Services

Technical Assistance

Feedback

Search

Site Map



and is a productive resource available to

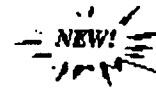
Polymerland[®]

Welcome to Polymerland. *The only resin source you will ever need.*

Service innovation has made Polymerland the global leader in thermoplastic resin distribution featuring quality products from the leading suppliers of engineering resins, commodities, custom compounds, and specialty compounds.



Customer Shipment Tracking!



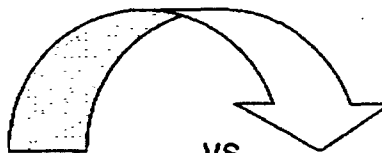
Order Inquiry/Entry Quick Login:



Our site was last updated February 22, 1999. For details on what has changed, check out the What's New section!



What worked vs. What didn't



- | | | |
|--------------------------------------|-----|------------------------------------|
| ■ Moving quickly | vs. | ■ Waiting for perfection |
| ■ Training your people | vs. | ■ Not selling the value |
| ■ Show the value to your customers | vs. | ■ Not telling anyone |
| ■ Reward your Commercial team | vs. | ■ Not engaging the entire business |
| ■ Deliver true value | vs. | ■ Delivering "Brochureware" |
| ■ Ask your customer's what they want | vs. | ■ Thinking you already know |

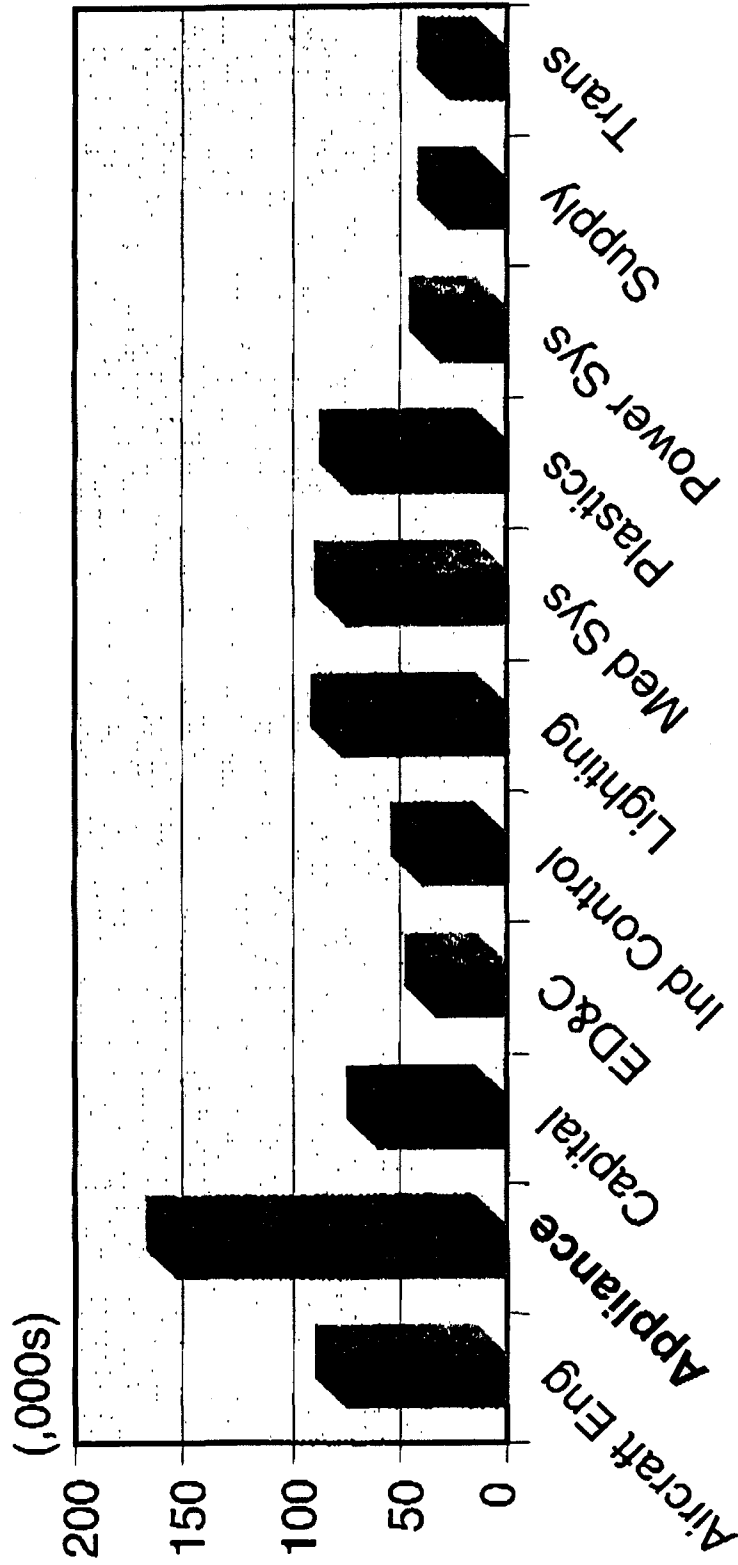
E - 10

Summary of Results

- 2 - 3 million dollars a week
- Decrease of 1000 calls per week
- Customer satisfaction/loyalty
- Business excitement!
- Business growth

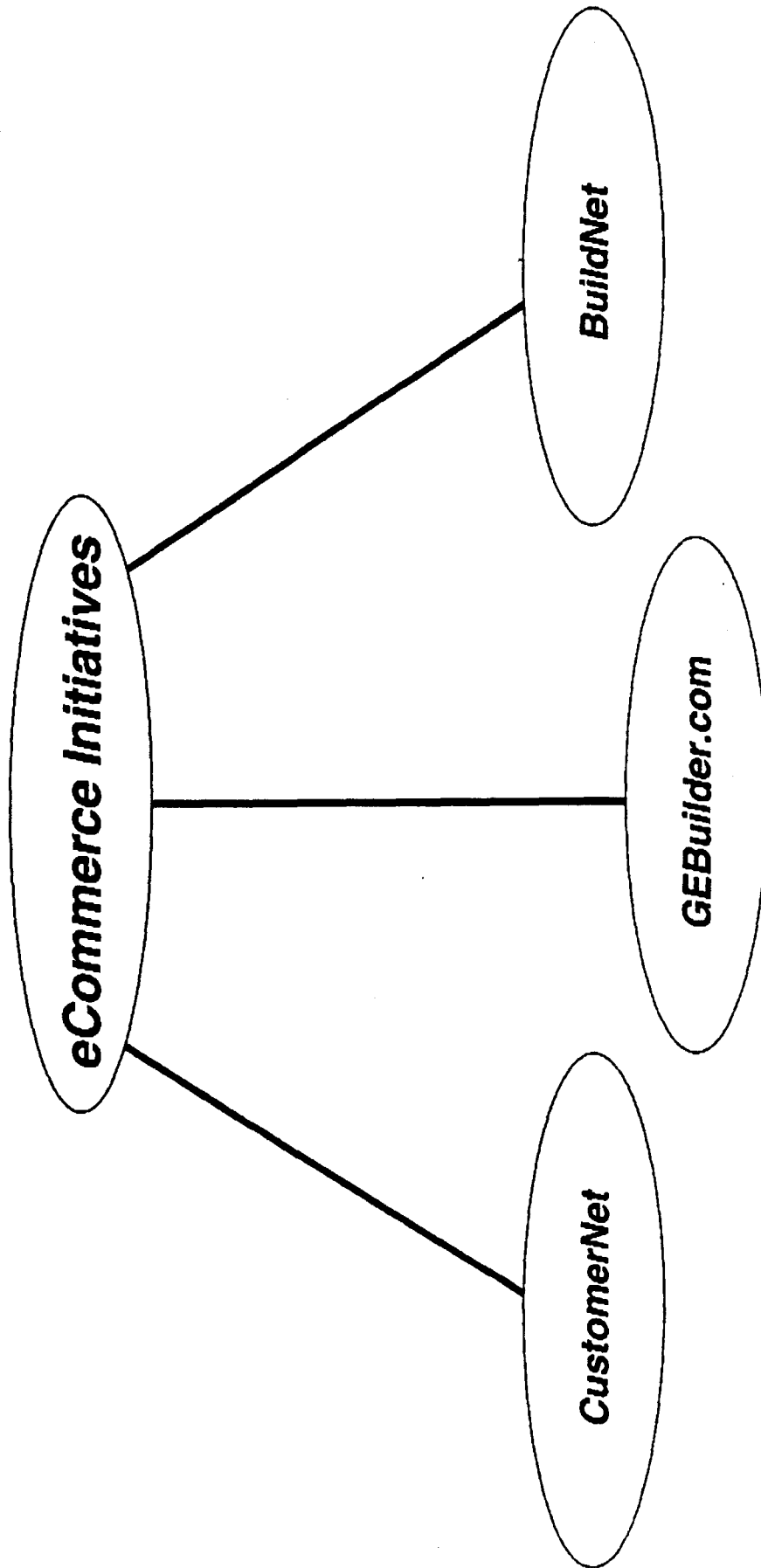


www.ge.com





GE Appliances





Draft - Proprietary & Confidential

(5/8/99)

GEA - Customer Web Center

CustomerNet



- Introduced in 1996 with 6 customers ... over 1800+ active today
- Average 1000+ orders per week
- \$500MM GSB in 1998
- Current Capability
 - Ordering, availability, pricing, front room tools, check invoicing, etc.

Ahead of competition ... plan to stay there



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GEA Customer Web Center

CustomerNet



CustomerNet

[Logoff](#) [Home](#)

[Help for this page](#)



Welcome to GEA's CustomerNet

26-D2861 : Kelley Appliances

MAP Schedule updated to include MAP Bulletin 99-2 issued on 04/06/99 NEW!

You have new Price Hot Sheets issued on 02/19/99 NEW!

You have Backorders Available

News about AVB

Superseded/Obsolete Inventory List

Monthly Customer Survey

Showcase Closeout Specials

General

- [Availability/Price](#)
- [Purchase History](#)
- [Co-op Adv Status](#)
- [Price Hot Sheets](#)
- [Special Programs](#)

Start Order

- [Top30 Form](#)
- [Blank Form](#)
- [Customized Form](#)
- [Form with notes](#)

Order Review

- [View/Print Orders](#)
- [Edit Orders](#)

Invoice Lookup/ Proof of Delivery

- [All Invoices](#)
- [Known Invoice #](#)
- [Known P.O. #](#)
- [Known MS #](#)

If this is your first visit to our *CustomerNet* site, please go to [CustomerNet Features](#) for an overview on using the GEA *CustomerNet*. If you have not been on *CustomerNet* for a while, you may see a special NEW! prompt on the home page. Click this prompt to read about changes and enhancements since your last visit.

The categorized and scrollable menu at left is your key to moving anywhere in the *CustomerNet* site quickly and easily. Move your pointer to the menu at left and click your left mouse button to display that site



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GEA Customer Web Center

CustomerNet



Smith's CustomerNet - Home Microsoft Internet Explorer

File Edit View Go Favorites Help

Back Forward Stop Refresh Home Search Favorites History Channels Fullscreen Mail Print

Address N:\uhls\custnet\smilhs.htm

Welcome to... my Page Specials Product

GE Appliances **Smith's**
Welcome back Brian!

Growth Planning

- Account Targets
- Floor Planning Tools
- Pricing Programs
- Store Merchandising
- Promotion Planning
- Product Accessories
- Extended Service Plans

Get Personalized
Click here to "personalize" your experience at GEA CustomerNet. The next time you enter, your favorite choices and items will be ready for you to access!

After-Sale Service Support

- Service Protection Plus
 - Contract Submission
 - Contract Management
- Parts and Service
 - Parts Ordering and Tracking
 - Service Scheduling and Status

In-Store Services

- Quick Spec Design Center
- Custom Brochure
- Sales Training
- Store Merchandising
- POS.com

Back Room Order Service

- Order
- Shipment Tracking
- Inventory Management.com

Reporting

- My GE Six Sigma Dashboard
- My GE Operational Measurements
 - Mix
 - Turns
- S/C Penetration
 - V%

Done Local intranet zone

- Direction we need to go ...
- Easy to find information
- Integrated, easy access ...
 - myPage (personalized)
 - Specials
 - Products, Parts, Services
- Phase 1 planned for 3Q99



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GEA Customer Web Center

Builder.com



GE Appliances



YOUR KITCHEN YOUR CHOICE

Welcome Home to Style and Innovation

GE and your builder invite you to visit our virtual appliance showroom--a place where you can:

- Get an inside look at the latest appliance styles, convenience features and GE innovations.
- Make your GE appliance selections now!
- Visit the Interactive Design Center.

Inside you'll find all the information you need to design your

- New tool to enhance builder appliance sales
- Educate new home buyer on what's new in appliances
- Allows home buyer to pre-select their specific appliance upgrades & options
- Decorating tips for the entire house

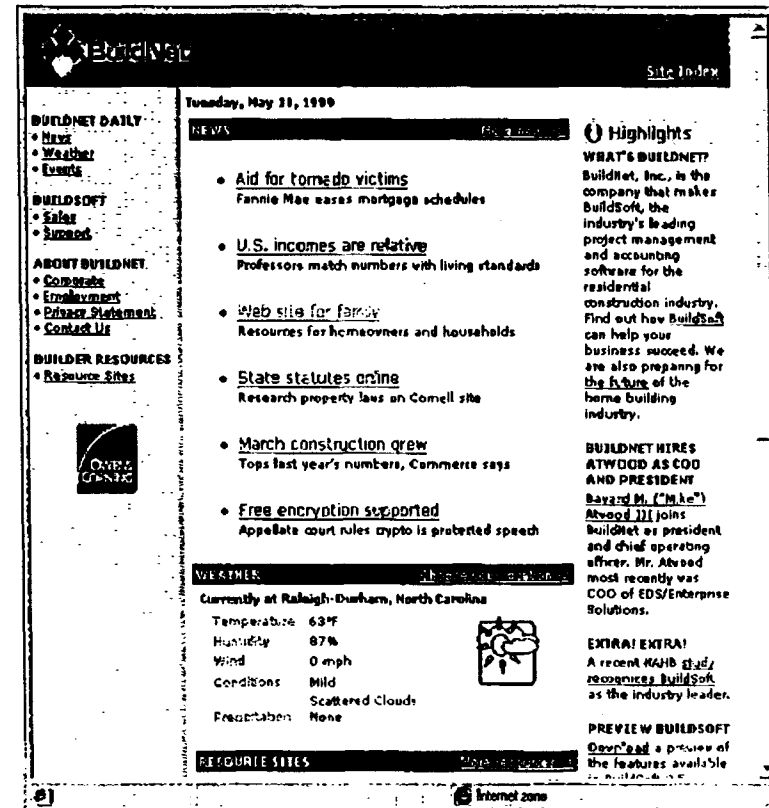
Late August 1999 Rollout



Move from 2% of builders' world to integrated business partner ...

- Complete tool for the builder -- planning, accounting, and project management
- eCommerce connection to suppliers & distributors - from purchasing through delivery logistics
- Creates efficiencies throughout the supply chain

E - 17



Create industry standard eCommerce tool



- Internet world is a reality ... Business-to-Business eCommerce will lead
- Foremost priority for GE
- Several GEA initiatives launched and in development
- Current partners are key to internet success





- Target the right customer
- Own the customer's total experience
- Streamline business processes that impact the customer
- Provide a 360° view of the customer relationship
- Let customers help themselves
- Help customers do their jobs
- Deliver personalized service

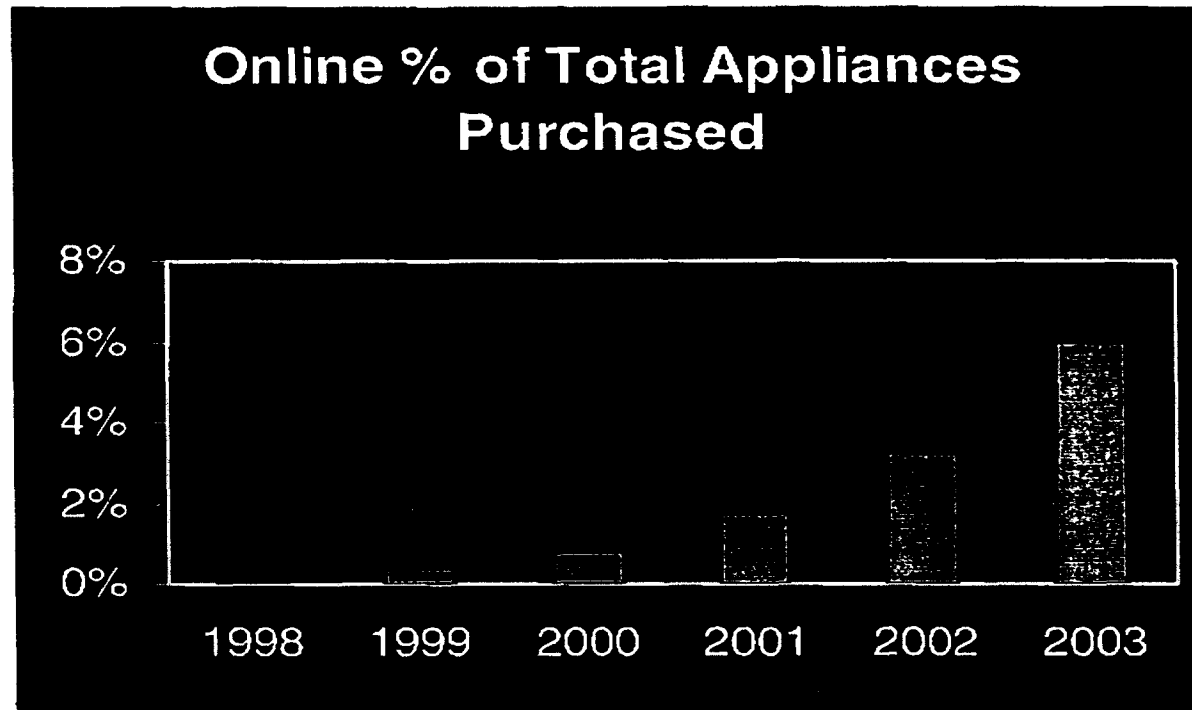


- Do not waste our time
- Remember who we are
- Make it easy for us to order
- Make sure your service delights us
- Customize your products and services for me





Internet penetration and access continues to grow ...



... but online transactions will be relatively small.

- Forrester Research

Current Distribution critical to success



	<u>Web Presence</u>	<u>Web Presentation</u>	<u>Mention Appliances</u>	<u>Selling Anything</u>
--	---------------------	-------------------------	---------------------------	-------------------------

Nationals

▪ Sears	<input checked="" type="checkbox"/>	Offers appliances, parts & contract	<input checked="" type="checkbox"/>	Yes
---------	-------------------------------------	-------------------------------------	-------------------------------------	-----

▪ Home Depot	<input checked="" type="checkbox"/>	Company Info	<input checked="" type="checkbox"/>	No
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Aggregators

▪ Value America	<input checked="" type="checkbox"/>	Offers all, under major appl.	<input checked="" type="checkbox"/>	Yes
-----------------	-------------------------------------	-------------------------------	-------------------------------------	-----

▪ Appliance order.com	<input checked="" type="checkbox"/>	Offers all major appliances	<input checked="" type="checkbox"/>	Yes
-----------------------	-------------------------------------	-----------------------------	-------------------------------------	-----

▪ CompareNet	<input checked="" type="checkbox"/>	Offers comparisons of major appliances with links to purchase	<input checked="" type="checkbox"/>	No
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Builders

▪ Zaring Homes	<input checked="" type="checkbox"/>	Offers home models, loan info, & community info		No
----------------	-------------------------------------	---	--	----

▪ CENTEX Homes	<input checked="" type="checkbox"/>	Offers building and related financial services		No
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Retail

HPS



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GEA - Customer Web Center

Nationals



- Selling On-line
- Appliance repair
- Weekly specials
- Parts, accessories

E - 23

SEARS Find It Customer Service Store Locator Products & Services About Sears Home

APPLIANCES ONLINE



Appliances
Shop the largest selection of appliances on the web

PartsDirect
Over 4 million parts online

Craftsman Tools
Over 3500 tools online with projects & tips

Weekly Specials in Our Store
Blues Clues™ Togo pasta kit Sears HomeCentral

Home Find It Customer Service Store Locator Products & Services About Sears
Appliances Tools Parts Home Service Lawn & Garden Fashion Don't Miss

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Please view our [privacy policy](#) and [terms and conditions](#).

SEARS product listing | about ordering | shipping cost | post orders | knowledge center |

contact us
[Call, visit or e-mail](#)

Sears Appliances
The largest appliance site online!

Shop Online

- ▶ **Shop Smart**
Use side-by-side comparisons.
- ▶ **We Make It Easy!**
Everything you need to know about ordering with us online - all in one place.
- ▶ **Knowledge Center**
Get advice, answers to common questions, terms and appliance basics.




Appliance Repair
Sears HomeCentral™ trained technicians can service all of your appliances.

Parts
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Montgomery Ward
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- What features would you like?
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Dishwashers

Brand

Physical Features

Color

Control Type

Basic Features

- Standard Cycles
- Upper Rack Adjustable
- China/Crystal
- Hi-Temp Wash Option
- Indicator Lights
- Stemware Holder

Special Features

- Low Energy
- Noise Reduction
- Heavy Duty Food Disposer

by selecting
features

EC MODELS THAT WORK... AND THAT DON'T WORK

WORK	DON'T WORK	JURY STILL OUT
<p>-Bricks' N Click (BN.com; GAP; Sears)</p>	<p>-Buttons & Banners</p>	<p>-Subscription fees (may work now for AOL but will they hold up?)</p>
<p>-Target Marketing via Internet to selected interest groups.</p>	<p>-SPAM- unsolicited poorly targeted email</p>	<p>-Wizards</p>
<p>-Auctions/reverse Auctions (Priceline, e-bay; GE-Bid)</p>	<p>-Copy Cats-No brand awareness</p>	<p>-Big N Bulky.com (Appliances, furniture, cars, large CE)</p>
<p>Brand, Brand, Brand (Sony, Disney, CNBC)</p>	<p>-ANY poorly executed offering (Toys R Us) -poor delivery -poor quality -poor security</p>	<p>-Grocery, Delivery (Webvan)</p>
<p>-Meeting unmet needs ...effectively (Drugstore.com, ImproveNet, B&N-out-of-print search; Realtor.com)</p>		<p>-“Communities” iVillage for Women</p>
<p>-Streamlining life's "necessities" (Service.com, Housestore.com)</p>		<p>-Amazon.com. High traffic w/ thin margins Critical path not clear</p>

E-COMMERCE BUSINESS MODELS

	Brochure Ware	Hosting	Wizards	Transactional			Communities	Data Wiring and Use
				1-2-1	Aggregator	Auction		
Explanation/Attributes	Explanatory material on line; like brochures in stores, but better	Explanatory <i>plus</i> --refers users to fulfillment sources	Interactive sites or capabilities--teaching, directing, providing a "better way"	On-line sale of products/ services w/great margins)	Pulls together a variety of offerings in a product/ service area or for a user group	Enables user to bid online for products or services	Assembles a variety of contents and lines for groups of users	Collects and organizes data for internal and/or external use Data Types: demographic, psychographic, financial
B2B	Public company sites	GEA.com	GE's Polymerland	GE's Customer-Net	Buildet	GE's e-Bid		Everyone
B2C	<ul style="list-style-type: none"> • Public company sites (Coke, Raytheon) • Institutions • "Dinosaurs" (Haverhill) 	ImproveNet Realtor.com Xoom.com	GE's Mixing Spoon Ask Jeeves GE Svc.Net How2.com MapQuest	Amazon Webvan Sears	Brandwise ValueAmerica CompareNet	E-Bay Priceline	<ul style="list-style-type: none"> • iVillage • AOL • MSNBC 	DoubleClick
Revenue Model <i>Note: Equity growth potential for all</i>	<ul style="list-style-type: none"> • Cost Center • Indirect sales lift • Brand awareness 	<ul style="list-style-type: none"> • Indirect sales lift • Brand awareness 	<ul style="list-style-type: none"> • Advertising • Eyeball traffic for later sale or alliance • Generates great data 	<ul style="list-style-type: none"> -OM -Conversion/trans. Fee -Data generator 	<ul style="list-style-type: none"> -Trans. fee -Advertising -Software sales -Sub fee 	<ul style="list-style-type: none"> -Trans. fee -Advertising. 	<ul style="list-style-type: none"> • Subscription fee • Advertising • Eyeball traffic • Possible trans. fee • Data generator 	<ul style="list-style-type: none"> • Rent or sell • Swaps • e-Marketing (Spam, profiling) • Strategic planning

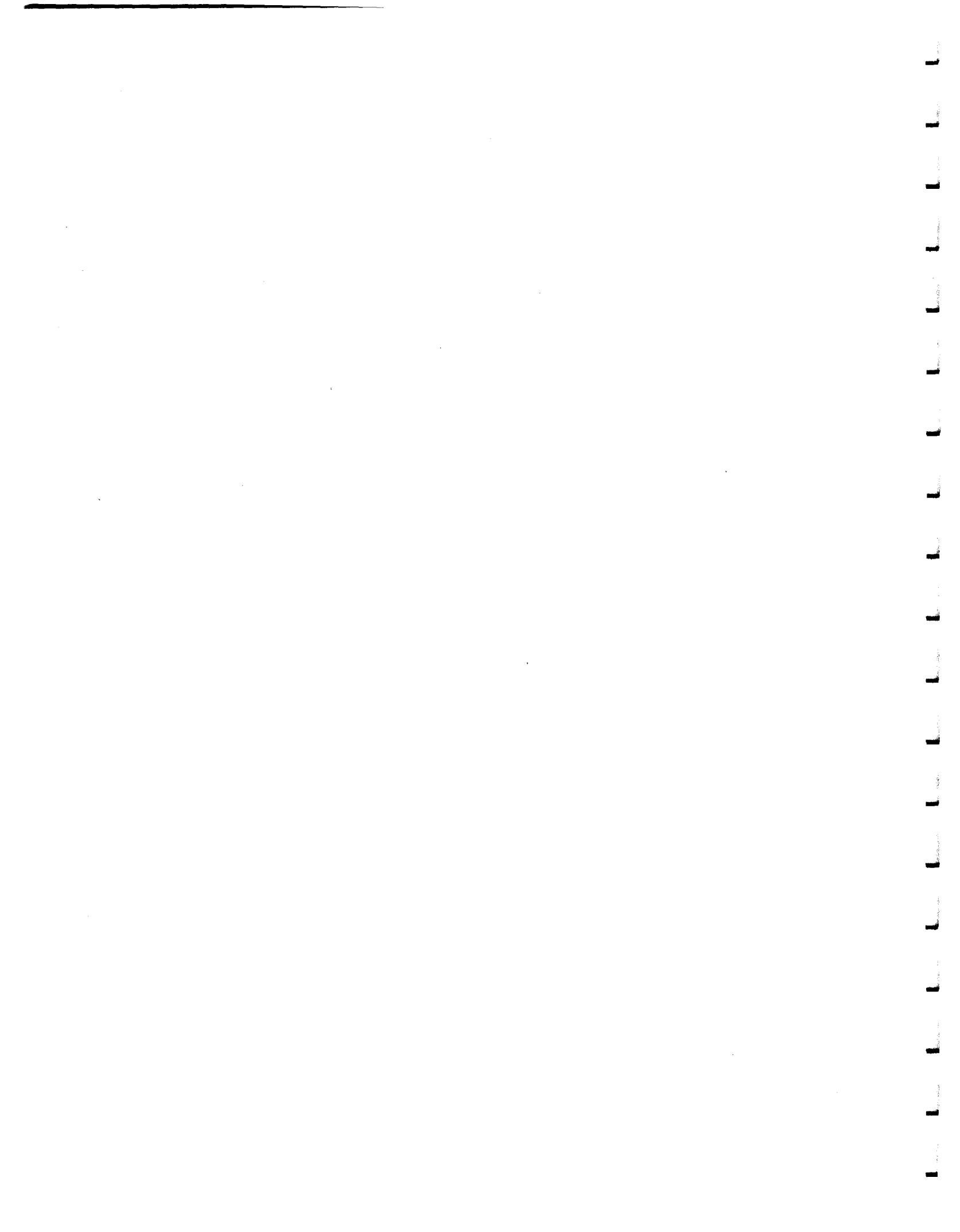
**INTERNET USER AGREEMENTS &
OTHER CONTRACTUAL ISSUES
RELATING TO THE INTERNET**

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SECTION F



**INTERNET USER AGREEMENTS &
OTHER CONTRACTUAL ISSUES RELATING TO THE INTERNET**

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**INTERNET USER AGREEMENTS AND OTHER
CONTRACTUAL ISSUES RELATING TO THE INTERNET**

I. INTRODUCTION

The 1990's saw a logarithmic explosion of the number of people and businesses using the Internet and particularly the World Wide Web. Accurately assessing the number of people with Internet access is difficult. Published estimates indicate that the actual number of people with Internet access went from four million in 1994 to 112 million in 1998. The number will double to 200 million by the end of 2000. By comparison it took more than fifty years for normal telephone access to achieve the level of saturation the Internet has achieved in less than a decade.

This tremendous rise in usage has created a commensurate growth in the number of companies that commercially provide Internet access. These companies range from giants such as America Online, with a nationwide system of access, to local Internet service providers (ISP's) that might only serve a single locality. The ISP may just provide access, or it may provide a full range of services, including e-mail, web page hosting and design, and providing of on-line content. The ISP may provide service to consumers with a computer at home for family use, or to businesses that have hundreds of users and a need for continuous high speed access.

The agreement between the ISP and the Internet user must clearly define this relationship. For a consumer seeking only limited access for personal use through a telephone modem, there may in fact be no negotiation of the agreement, as the consumer typically accepts the standard "form" agreement. For businesses seeking a broader range of services, there will be issues on the table for discussion. In either case, the parties should understand what the issues are and what the contract says.

II. MEANS OF ACCESSING THE INTERNET

Internet Access Providers (IAPs)

An IAP is a company focused on providing access via servers directly connected to the Internet. IAPs typically provide no on-line content or resources, and merely act as a gateway. Examples are NetCom., PSINet and Sprintlink.

Internet Service Providers (ISPs)

ISP's offer the gateway typical of an IAP, but offer other services such as web site hosting, web site design, e-mail and domain name registration. Access is typically provided by leased telecommunication lines. The difference between IAPs and ISPs has become somewhat blurred and it is not uncommon to see the terms used interchangeably.

On-Line Service Providers (OSPs)

OSPs provide the client with technologies, including software, that enable the client to use the Internet and typically provide content and other resources. Examples are American Online, CompuServe and Prodigy. Again, there is some blurring of the distinctions between categories as ISP's will typically have a web page with some level of content.

III. TYPES OF ACCESS

Modem Access

A telephone modem with speeds in the 28 kbps to 56 kbps is the typical low end linking method to connect to an ISP/IAP. The problem is the inherent limitation of the modem which impacts on response time and the ability to download materials.

Gateways and Designated Lines

Gateways are devices which relay information between networks using routers connected to the Internet. Gateways use either a Point to Point Protocol (PPP) or Service Line Internet Protocol (SLIP). Dedicated links allow a computer network to access the Internet via a telephone line used solely for that purpose.

ISDN

Integrated Services Digital Network (ISDN) provides a high speed transmission across a switched network and eliminates the conversion of the signal to an analog signal as with a modem.

T1

T1 lines are dedicated point to point connections running from the user's site to the communications center of the ISP. Access is approximately 100 times faster than a 14.4 kbps modem and significantly faster than an ISDN line. T1 lines can be divided into as many as 24 channels, each of which is four times faster than a 14.4. kbps modem.

Cable Modems

Cable modems permit wider bandwidth access by use of a hybrid coaxial/fiber optic cable construction, with access typically through a cable TV Network.

ADSL

Asymmetric Digital Subscriber Line (ADSL) offers wide-band connection over standard phone lines. Speed is comparable to T1 lines on uploads but is markedly slower on downloads.

Wireless Access

Wireless access is accomplished either by satellite delivery or use of a wireless phone network.

Free Access

This is a variation of consumer oriented modem access that provides access in return for either (or both) the ability to market the user's demographic information or for the providing of advertising to the user. This would only be viable for personal or small business use.

IV. IMPORTANT CONTRACT PROVISIONS

A. Intended Use of Service.

Contracts should specify whether this is a consumer-oriented agreement for a single user and his family or alternatively is a commercial or business user that will be accessing Internet services for multiple users and multiple locations through its own server. A typical consumer user provision will include the following:

User acknowledges that the services are intended for personal use only. In order to keep phone lines available for other users who are actively using their accounts, provider has a 20 minute idle timeout policy. Further, provider may logout any user who has been on line for more than four (4) hours continuously, even with activity. User agrees not to utilize any software device or other automatic methods to allow the account to stay logged on while not in active use.

For a consumer-oriented account the provider may also restrict the size of e-mail contained in a mailbox at any one time, the use of simultaneous log ons at multiple locations, and the use of multiple log ons from one location through a router. Obviously, this type of provision would not appear in an agreement for business usage.

B. Restricted Activities.

As part of the terms and conditions of use, the service provider will often set out in detail prohibited activities. These would include some or all of the following:

1. Interference with the use of the Internet by other authorized users;
2. Sending of e-mail using a log on name other than that assigned by the service provider;
3. Publishing, posting or distributing defamatory, infringing or obscene material;
4. Making fraudulent offers;
5. Hacking;
6. Sending of unsolicited bulk e-mail;
7. Attempting to intercept e-mail;
8. Sending files containing software or other protected intellectual property unless the user owns or controls the rights thereto;
9. Mail bombing or news bombing. Mail bombing is the sending of 10 or more similar messages to the same e-mail address. News bombing constitutes sending more than 10 MB of data to a news group.
10. Planting viruses or other corrupted data files;
11. Violating export laws or other software technical information export controls;
12. Installation of auto responders, cancel boxes or other automated routines that generate excessive amounts of traffic;
13. Disruption of discussion groups;
14. Engaging in commercial e-mail activities;
15. General prohibitions against engaging in activities that violate United States and international laws, rules or regulations.

C. Indemnification Agreements.

The service provider should require indemnification from the user for damages or claims arising out of the user's Internet activities. A typical provision would include:

User agrees to indemnify the writer, its affiliates and assigns from and against any and all liabilities, expenses (including reasonable attorney fees) and damages arising out of claims based upon user's use (or the use by one who gains access to the services through user's account) of services, including any claim of libel, defamation, violation of right to privacy or publicity, loss of service by the subscribers or infringement of any intellectual property or other proprietary rights.

Note: An indemnification agreement is only as good as the financial solvency of the indemnifier. The provider will wish to take other affirmative steps to insulate itself from liability to third parties as a result of user's activities.

D. Limitations on Liability.

Service provider should include a broadly worded disclaimer of liability. This should limit special or consequential damages and disclaim all warranties except those specifically provided.

E. ECPA Notice.

The Electronic Communications Privacy Act (18 U.S.C. §2510 et seq.) requires notice if the electronic mail and other communications systems provided do not offer the same level of privacy as is afforded to regular mail by the United States Postal Service. This requirement is independent of other privacy policies. The service provider will typically give this notice.

F. Choice of Law.

The agreement should set out what jurisdiction's laws cover the interpretation of the contract and where the disputes will be resolved. A typical provision would be:

Terms and conditions of this agreement are governed by the laws of the Commonwealth of Kentucky without regard to its conflict law. User hereby consents to the exclusive jurisdiction of any of the courts located in Fayette County, Kentucky for all disputes arising out of or relating to the use of the services. User specifically consents to the exercise of this personal jurisdiction in these courts and waives the rights to removal or consent to removal.

G. Software Sub-Licenses.

The Internet service provider will provide to the user software to facilitate utilization of service. This may include a browser software such as Netscape Communicator® or Internet Explorer®, along with other dial up networking software to allow connection to be established. As part of the user agreement, the terms and conditions of this sub-license should be set out in detail. For business uses, the user will wish to see the license as part of its due diligence. If any warranty is provided for this software, that warranty should designate who the responsible party is, whether it is the ISP or the author of the software. If a technical service representative is available, the hours of availability should be addressed.

H. Termination Rights.

The contract should set out in detail the provisions for either party to terminate the agreement, the reasons for such termination and post-termination rights.

I. Other Policies and Amending the Agreement.

The basic agreement should contain a provision incorporating by reference other policies which may be periodically posted by the ISP. Typically these policies shall be accepted by the user and the non-accepting user shall have the right to terminate the arrangement. The types of policies which might be posted by a service provider would be electronic mail use policies and privacy policies. A typical provision would state:

Provider may revise and/or modify this agreement and any posted policies at any time or in any manner. Any revision and/or modification will be effective thirty (30) days after provider posts notice to members on its web site (<http://www.PROVIDER.net>) and/or on its members pages or by e-mail or in various publications and mailings to its members.

J. Alternative Dispute Resolution.

As stated above, the agreement should contain a jurisdictional choice and venue selection clause. A service provider may wish to consider reference to alternative dispute methods such as arbitration or mediation. Binding arbitration is increasingly attractive as a method to avoid exposure to class action lawsuits. Most alternative dispute resolution forums do not provide a mechanism for class actions suits.

V. ENFORCEABILITY OF CLICK WRAP AGREEMENTS.

Of significant concern in drafting an Internet user agreement is the proper mechanism to insure that its provisions will be enforceable. As this is a computer agreement and will be "signed" on-line, the provider needs some degree of certainty as to whether its "click wrap agreement" will be enforceable. At least three decisions have indicated that a click wrap agreement will be enforced. These include Hotmail Corp. v. Van\$ Money Pie, Inc., 47 U.S.P.Q. 2d 1020 (N.D. Ca. 1998). In that case the judge granted the plaintiff's request for a preliminary injunction against a user that had violated the plaintiff's terms of service agreement and a click wrap agreement. In Storm Impact, Inc. v. Software of the Month Club, 13 F.Supp. 2d 782 (N.D. Ill. 1998) the court held that the express provisions of rights contained in the terms of the service agreement displayed on the screen were valid and enforceable. Finally, in America On-Line, Inc., v. LCGM, Inc., 46 F.Supp.2d 444 (E.D. Va. 1998) a Virginia court ruled in favor of the America On-Line, finding that the defendant had breached the terms of the service agreement with AOL.

The enactment of statutes such as the Uniform Electronic Transaction Act (UETA) and the Uniform Computer Information Transactions Act (UCITA), along with other digital signature laws enhance the continued viability of the "shrink wrap" or "click wrap" concept.

As a drafter, a "shrink wrap" or "click wrap" agreement should contain the following elements:

1. The license should give the user notice at the time that the transaction is subject to such an agreement;
2. The notice should be clearly visible;
3. The detailed license terms must be disclosed to the user prior to or shortly after the start of the service;
4. The user should be offered a refund if he decides to reject the terms;
5. The user's acceptance of the terms should involve a specific action such as clicking a box or typing "yes" before submitting to continue the transaction;
6. If the agreement includes terms which are uncommon in industry, or are likely to cause surprise, such terms should be highlighted.

VI. OTHER DRAFTING CONSIDERATIONS

Depending on the nature of the service provided, other considerations may come into play in the development of the Internet user agreement. The service provider may provide a minimum level of web hosting for the users. If so, the terms and conditions of this web page hosting should be delineated along with any design functions or responsibilities. If the service provider assists the user in creating a web page, there needs to be clearly expressed delineation of who will own the resulting intellectual property and who will be responsible for content issues.

The service provider is in a position to gather a great deal of information concerning the user. The service provider should set out its policies with respect to the use of, or a potential transfer of this information. Whatever policy the ISP has with respect to use of information, the ISP should allow the user some degree over that use. This can be accomplished with either an "opt-in" or "opt-out" approach. The distinction is whether the user has to take an affirmative action to protect his privacy ("opt-out") or an affirmative action to allow utilization of information about him and his account ("opt-in").

VII. LEGAL ISSUES FOR SERVICE PROVIDERS - CONTRIBUTORY AND VICARIOUS LIABILITY

The Internet is a medium which allows for easy posting and transfer of copyrighted material or material containing trademarks or other intellectual property. Such transfer, however, may infringe the rights of the intellectual property owner. As the actual infringer may be hard to track down and without the deep pockets of the ISP, the ISP is often the target of any action by the proprietary rights owner. This is done through theories of either direct, contributory, or vicarious liability. In Marobie-FL, Inc. v. National Assoc. of Fire Equipment Distributors, 983 F.Supp. 1167 (N.D. Ill. 1997), the plaintiff sought damages on a direct liability theory against the ISP because the material was stored on the ISP's hard drive. The Court found that the defendant was similar to the owner of a copy machine and that the defendant only provided the means to copy and did not itself perform any of the infringing activities, therefore it was not directly liable for the infringement of the copyrighted work. Under a theory of contributory infringement, it is necessary to establish whether the access provider should have known that the user was infringing the plaintiff's copyrights

after having received notice from the plaintiffs. See Religious Technology Center v. NetCom On-Line Communications Services, Inc., 907 F.Supp. 1361 (N.D. Calif. 1995). In that case the court held that the plaintiffs had raised a genuine issue of fact as to whether the access provider should have known that the infringement was occurring after having received notice from the plaintiffs.

Vicarious liability requires that the service provider has the right and ability to controlling infringer's act and receives a direct financial benefit from the infringement. Unlike contributory infringement, knowledge of infringing nature of activity is not an element necessary to prove vicarious liability. Software trade groups such as the Software Publishers Associations have provided guidelines for ISP's to keep them on the side of the angels with respect to infringement. These codes are often criticized as being too expansive in defining the potential liability of an ISP.

To some extent the issues of contributory and vicarious liability for on-line service providers have been resolved by recent revisions to the Copyright Act. See 17 U.S.C. §512.¹

These provisions provide a safe harbor for ISP's if the following conditions are met:

1. The ISP has no actual knowledge of the infringement;
2. The ISP is not aware of facts or circumstances that would make the infringement apparent;
3. The ISP receives no financial benefit from the infringement; and
4. The ISP responds expeditiously upon necessary notice.

¹Due to a drafting error there are two provisions in Title 17 of the United States labeled §512. Reference here is to the second §512.

VIII. PRIVACY CONSIDERATIONS

The use of the Internet raises substantial issues of personal privacy. These have been addressed in passing above and are impacted by the Electronic Communications Privacy Act ("ECPA") and the Children's Online Privacy Protection Act ("COPPA") (15 U.S.C. §6501 et seq). Additionally, the industry has attempted some degree of self-regulation with respect to personal privacy and selling personal privacy information. Certain sites such as the BBB Online (www.BBBonline.org) or TrustE (www.truste.org) provide certification of a site's particular privacy practices and sample or model policy. For an on-line service provider, the privacy issue is both a legal issue and a marketing issue as Internet users become more concerned with their personal privacy.

APPENDIX

Sample Internet Service Provider Agreement

**DISCLAIMER: THIS IS A SAMPLE
FORM AGREEMENT FOR DISCUSSION
PURPOSES AND IS NOT INTENDED
AS A DEFINITIVE FORM**

SAMPLE: INTERNET SERVICE PROVIDER AGREEMENT

THIS INTERNET SERVICE PROVIDER AGREEMENT (the "Agreement") is entered into as of _____, 1999, by and between LOCAL COMPANY, INC., a Kentucky corporation ("Company"), and _____ ("Client").

WHEREAS, Client desires to obtain Internet access through Company's network established by Company with BIG PHONE COMPANY;

NOW, THEREFORE, the parties agree as follows:

1. Services and Responsibilities of Company. Company agrees to provide the "Services" described on Exhibit A.

2. Term of Agreement. The Agreement shall commence on the date of installation and continue in effect for a period of ____ () years unless terminated sooner as provided herein. At the end of the term the Agreement shall automatically renew for an additional period of ____ () years.

3. Compensation. For Company's provision of the services set forth herein, Client promises to pay to Company the monthly fees ("Fees") as set forth on Exhibit A attached hereto. The monthly fees shall be due and payable on or before the ____ day of each month following the month during which the services were provided. All payments not made to Company by such date shall thereafter bear interest at ____% per month. After the initial term of this Agreement, Company may adjust the rates and charges upon sixty (60) days notice to Client. Client agrees to pay Company its then prevailing rates for time and materials for service provided by Company (or third party) to identify or correct any failure caused by facilities or equipment not furnished by Company or to repair damage or interruption caused by equipment.

4. Use of Services. Client agrees to maintain access to service as confidential and privileged information, and to use the services in accordance with all applicable laws and regulations. Client agrees that he will not use the services to publish, post, distribute or disseminate another person's proprietary information, including trademarks or copyrighted information without the express authorization of the rights holder.

5. Warranty. Company will endeavor to provide the Service on a 24-hour-a-day, 7-day-per-week basis. Company does not warrant that the Service will be provided without interruption. In the case of a service interruption caused by Company, Company shall refund to Client in the form of a credit Company's service charge for the period during which the service was interrupted if credit is granted by Company's upstream provider of service. Such credit will not be given for Service

interruption caused by Client, or by activities or facilities furnished by Client or third parties, or by any occurrence beyond the control of Company. Company MAKES THIS WARRANTY IN LIEU OF ALL OTHER WARRANTIES, EXPRESSED OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

6. Limitation of Liability. With respect to claims arising out of provision of the service set out in this Agreement, Company's liability, whether in contract, tort or otherwise, shall be limited to direct damages which shall not exceed the total charges to Client for the services for the initial term of this Agreement. In the case of service interruption, Company's liability shall be limited to a prorated credit for the charges applicable for the period of interruption. Under no circumstances shall Company be liable for incidental, consequential or special damages, notwithstanding their foreseeability or disclosure by Client to Company, including, but not limited to, damages arising from delay, loss of data, profits, or goodwill. Company shall bear no liability for use of equipment or services provided under the Agreement in connection with life support systems or devices. Company may from time-to-time provide advice, make recommendations or supply other analysis related to the system, equipment and services described in this Agreement, and while Company shall use reasonable efforts in this regard, Client acknowledges and agrees that this limitation of liability shall apply to provision of such advice, recommendations and analysis.

7. Responsibility for Telecommunications Charges. The Service is intended to be connected to the public switched telephone network. Client is solely responsible for selection, implementation and maintenance of security features for defense against unauthorized long distance calling. Client is solely responsible for payment of long distance, toll and other telecommunications charges and any other charges incurred through use of the Service.

8. Hazardous Substances. Except as disclosed to and acknowledged in writing by Company, Client certifies that it is not aware of the presence of any asbestos or other hazardous substance (as defined by any federal, state or local law or regulation) at any location where Company is to perform services under this Agreement. If during such performance Company employees or agents encounter any such substance, Client agrees to take all necessary steps, at its own expense, to remove or contain the asbestos or other hazardous substance and to test the premises to ensure that exposure does not exceed the least exposure limit for the protection of workers. Company may suspend performance under this Agreement until the removal or containment has been completed and approved by the appropriate governmental agency and Company. Performance obligations under this Agreement shall be extended for the delay caused by said cleanup or removal. Client's failure to remove or contain hazardous substances shall entitle Company to terminate this Agreement without further liability. If Company so terminates, Client shall pay Company the fees due under this Agreement for the balance of what would have been due for the remaining term of the Agreement.

9. Compliance With Law. The specifications and requirements of the Service, its price and installation are based on compliance with applicable laws, regulations and ordinances in effect

on the date the price is quoted to Client. Client agrees to pay any additional costs incurred by Company after the date of this Agreement resulting from changes in laws.

10. Delayed Performance. If performance under this Agreement is interfered with by acts of God, war, riot, embargo, acts of the Government in its sovereign capacity, labor difficulties, unavailability of equipment or parts from vendors, changes requested by Client, or any other circumstances beyond the reasonable control and without the fault of the party affected, such party, upon giving prompt notice to the other party, shall be excused from such performance on a day-to-day basis to the extent of such interference (and the other party shall likewise be excused from its performance), provided that the party so affected shall use reasonable efforts to remove such causes of nonperformance and both parties shall proceed whenever such causes are removed or cease.

11. Default. If either party fails to perform any material obligation under this Agreement or violates any material term or condition of this Agreement, and such failure or violation is not cured within five (5) days following receipt of a default notice from the other party, then the other party shall have the right to terminate this Agreement upon written notice to the defaulting party.

12. Insolvency. Either party may terminate this Agreement by notice, in writing, if the other party admits insolvency, makes an assignment for the benefit of creditors, or has a trustee or receiver appointed over all or any substantial part of its assets.

13. Authorization and Enforceability. The execution, delivery and performance of this Agreement by Client has been duly authorized by Client and, if a corporation, its directors and officers, and this Agreement has been duly executed and delivered by Client and is enforceable in accordance with its terms.

14. Indemnification and Limitation of Liability. Client shall indemnify and hold Company and its employees and agents harmless from and against any claims, demands, costs, loss, damage, liability, obligations, fines, penalties or expense, including without limitation reasonable attorneys' fees, in connection with or arising out of the Services performed for Client by Company pursuant to and within the scope of this Agreement, and such indemnification shall include without limitation, claims of third parties for copyright or trademark infringement or for violations of any federal, state or local laws, rules or regulations governing or affecting the Services. The provisions of this Section shall apply if loss or damage, irrespective of cause or origin, results directly or indirectly to persons or property, from performance or non-performance of the Services, or from negligence, active or otherwise, by Company, its agents, servants, assigns or employees. The obligations of Client under this Section shall survive the termination of this Agreement.

15. Miscellaneous.

a. Notices. Any and all notices, demands or other communications given by any of the parties hereunder shall be in writing and shall be validly given or made if given by personal delivery, facsimile, or if deposited in the United States mail, certified or registered, postage prepaid,

return receipt requested. If such notice, demand or other communication be given by personal delivery or facsimile, service shall be conclusively deemed made at the time of such personal service or facsimile transmission if received. Any notice, demand or other communication given by mail shall conclusively be deemed given seventy-two (72) hours following its deposit in the United States mail addressed to the party to whom such notice, demand or other communication is to be given as hereinafter set forth:

To Company: LOCAL COMPANY, INC. To Client: _____

b. Relationship of Parties. Nothing contained in this Agreement shall be deemed or construed to create a partnership, fiduciary relationship, joint tenancy, joint venture or co-ownership by or between the parties herein.

c. Time of the Essence. Time shall be of the essence in the performance of all of the obligations of the parties under this Agreement.

d. Successors and Assigns. All of the terms and provisions contained herein shall inure to the benefit of and shall be binding upon the parties hereto and their respective heirs, executors, administrators, personal representatives, successors and assigns.

e. Applicable Law and Severability. This Agreement shall, in all respects, be governed by the laws of the State of Kentucky.

16. ECPA Notice. In accordance with the Electronic Communication Privacy Act, Company hereby provides notice that use of electronic mail pursuant to this Agreement is not as secure as the use of the United States Postal Service, First Class Mail.

17. Venue. The parties agree that venue for any claim, action, suit or proceeding arising under pursuant to this Agreement shall be with the United States District Court for the Eastern District of Kentucky or the Fayette County, Kentucky Circuit or District Courts. The parties submit to jurisdiction before these courts and agree that service of process may be obtained pursuant to the provisions of the Kentucky long-arm statute.

18. Attorney's Fees. In the event an action is brought to enforce or interpret this Agreement, the prevailing party shall be entitled to recover its reasonable attorneys' fees and expenses incurred in connection with the action.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the day and year first above written.

COMPANY: LOCAL COMPANY, INC.

CLIENT: _____

By: _____

By: _____

Title: _____

Title: _____

Phone: _____

Phone: _____

EXHIBIT A

Services Provided:

Charge To Client:

BUSINESS METHOD PATENTS

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SECTION G

BUSINESS METHOD PATENTS

- **What Is A Patentable Business Method?**
- **Effective Prosecution Of A Business Method Patent**

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BUSINESS METHOD PATENTS:
•What Is A Patentable Business Method
•Effective Prosecution Of A Business Method Patent

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1. What is a Patentable Business Method

Amazon, the on-line bookstore, recently obtained a patent for linking web pages. This announcement on *Bloomberg News*, February 28, triggered a point and a half jump in Amazon's stock price. [See Endnote]. Such e-commerce patents have been incubating in the patent office and are now beginning to emerge in record numbers. Nearly 1400 e-commerce patents issued in the **first half** of 1999. This compares to 648 that issued for **all** of 1997. The Patent Office has hired 500 new examiners for its Internet and Software Section to handle the backlog. The ticking sound you hear may be a patent "time bomb" set to go off in the market which is vital to your commercial enterprise.

Is the U.S. patent system sanctioning an unprecedented expansion in conceptual ownership? Many would agree that it is. If you believe that there has been a paradigm shift in knowledge based commerce, you should expect the patent system to respond to this challenge by protecting the new knowledge based developments. This may require strategic defensive planning to protect your investment. Get your computer engineers to begin "thinking" patent protection as soon as they come up with a workable solution to a software problem. Then become a user of your own business method. Don't just patent it. If it's the lifeblood of your commercial enterprise, put it into practice...at Internet speed. Offense, it is said, is often the best defense. That is true here. Think defensively, if you do, you will at least have a defense to a patent infringement suit. Under a recent amendment to the patent law, a prior user, his customers, or a successor in the business, may continue using a patented business method by others if it was in use more than a year before the filing date of the patent (Intellectual Property and Communications Reform Act of 1999, PL 106-113, 11/29,99). Also, the recent amendments alleviate the "time bomb" effect. Patent applications will be laid open to public inspection within 18 months after the filing date. The problem of an application pending in secret for many years in the Patent Office and then "exploding" in the market just as the investments of others are beginning to bear fruit will be curtailed. This coupled with the "prior user" defense should alleviate many of the perceived problems created by this paradigm shift in the patent law toward the granting of patents on knowledge based inventions, so called business method patents.

So, how do you recognize a potential business method worth patenting? Is it a mere algorithm? Can an abstract idea, an algebraic formula with no concrete, and practical application become a business method patent? The questions suggest the answer.

The Patent Act harkens back to the Constitution.¹ The core principle, whether a process is tangible or intangible, is whether it produces a tangible, useful result. Useful has a special meaning. The intellectual activity can't end in an abstraction. An algorithm expressed as a thought process is not useful. Until it has been reduced to practice in the solution of a real world problem, it remains an unpatentable expression. Let's examine the holding in *State Street Bank*² to see how the law applies to an accounting program for a financial institution.

¹ Article 1, Section 8, 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. (Emphasis added).

²State Street Bank and Trust Co. v. Signature Financial Group, Inc. 149 F.3d 1368, 1375, (Fed. Cir. 1998) 47 US PQ2d 1596, 1604

1.1 The Holding in State Street Bank

The Court of Appeals for the Federal Circuit (CAFC) didn't exist when the 1952 Act came into effect, but its predecessor, the Customs Court of Patent Appeals (CCPA) had allowed electronic patents in computer technology. The computer's brain, its CPU, had to do something useful and concrete in the external world. The computer as a "machine" was statutory subject matter under Section 101. The case law had not reached the question of whether software alone was statutory subject matter. It was protected under the copyright law. So the Patent Office took a narrow view of software being statutory subject matter guided by the CCPA. Section 101 spells out what subject matter may be patented³. Business method patents were barred, until the CAFC provided a clarification in *State Street*.

Signature Financial obtained U.S. Patent 5,193,056 in March 1993. State Street and Signature were competitors in offering mutual fund partnerships. State Street brought a declaratory judgment action against Signature in 1996 alleging that the patent was invalid for failing to claim statutory subject matter under Section 101. State Street had entered into an oral license agreement with Signature which left State Street free to challenge Signature's patent. A written license agreement would typically bar such a challenge. State Street alleged that the patent was drawn to nonstatutory subject matter by attempting to claim an unpatentable mathematic algorithm. The Patent Office had allowed the claims "disguised" as a machine. It looked like a hardware patent carrying out a useful external result, namely data processing of share price information in mutual fund partnerships. The Massachusetts District Court found the core issue on the motion for summary judgment by State Street to be as follows:

³ 35 USC 101 is broad and general in nature, "Any ...process, machine, manufacture, or composition of matter, or any....improvement thereof..." may be patented. And Section 100 (b) further expands "process" to include "art or method, and... a new use of a known process, machine, manufacture, composition of matter, or material." If the claims of the patent pursuant to Section 112, second paragraph, fall into any one of the named categories, the invention is allowed to proceed through the further analysis required for patentability under Section 102 novelty. Even though the claims may pass muster under Section 102, they still have to be "nonobvious" under Section 103 to become a patent.

“Whether computer software that essentially performs mathematical accounting functions and is configured to run on a general purpose... computer is patentable under Section 101....”

The Court noted that this question had vexed theorist and practitioners since computers had entered the marketplace some thirty years ago.⁴ The case reached the CAFC⁵ in 1998. In an opinion by Judge Rich, it reversed the lower Court’s holding on non statutory subject matter for a business method:

“Today, we hold that the transformation of data, representing discreet dollar amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces a ‘useful, concrete and tangible result’—a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.”⁶

The CAFC recognized that the judicial exception which had been engrafted upon Section 101 as the Business Method exception was dead, and dispatched it with a succinct sentence:

“We take this opportunity to lay this ill-conceived exception to rest.”⁷

While this decision seemingly opens the floodgates for patenting mere mathematical algorithms as methods of doing business, the Court made it abundantly clear that by merely lowering the first hurdle, statutory subject matter under Section 101, it was not lowering the successive hurdles required to be cleared before an invention would be considered patentable. It would still have to pass the second, third, and fourth hurdles to patentability, namely that the

⁴ John A. Burtis *Towards A Rational Jurisprudence of Computer-Related Patentability in Light of In Alappat*. 79 Minn. L. Rev. 1129 (1995) “It is into this judicial quagmire that the court must dive.” CCH 1996 ¶ 47450, p. 68,729.

⁵ 47 USPQ 2d 1596 (Fed Cir 1998)

⁶ Id 1601

⁷ Id 1602

claims omit no element required for a complete and workable disclosure under Section 112⁸ that it be novel under Section 102, and not obvious under Section 103. This last hurdle [Section 103] tripped up AT & T in the most recent business method case to reach the CAFC.

1.2 The Holding in AT&T Corporation v Excel Communications Inc.⁹

The claims of the AT&T patent were pure method of doing business claims denied protection under Section 101 by the District Court as not directed to statutory subject matter. It was clear from the written description of the '184 patent that AT&T was claiming a process that "applies Boolean algebra to [subscribers and call recipients], (PICs) to determine the value of the PIC indicator, and applies that value through switching and recording mechanisms to create a signal useful for billing purposes."¹⁰

After reversing the lower Court's holding of nonstatutory subject matter, on remand, the District Court¹¹ looked at a similar billing exchange for telephone subscribers within a local Family Network offered by MCI to its subscribers. The AT & T method claims were found to be infringed by Excel's national billing network. However, the claims would also "read on" MCI's local Family Network. It was in public use more than a year before the filing of the AT & T patent. As such it was a bar to claims held invalid for obviousness under Section 103.

⁸ The "omitted element" prong of Section 112's written description requirement is interpreted to prevent the inventor from broadening a claim by omitting an element previously indicated as an essential element. See, e.g. DeWitt, Does supreme Court Precedent Sink Submarine Patents? 38 IDEA 601 (1998).

⁹ 172 F.3d 1352, [1353-54], 50 USPQ 2d 1447 (Fed Cir 1999)

¹⁰ ID at 1358

¹¹ 52 US PQ 2d1865

2. Effective Prosecution of a Business Method Patent

It may come as no surprise that the most recent Edition of the Patent Examining Guidelines eliminates the paragraph, which read:

“Though seemingly within the category of process or method, a method of doing business can be rejected as not being within the statutory classes, see *Hotel Security Checking v Lorraine Company* 160 F. 467(2nd Cir. 1908) and *In Wait*, 24 USPQ 88, 22 CCPA 822 (1932, 1934).”

Rather the newer Edition of the manual now reads:

“Office personnel have had difficulty in properly treating claims directed to methods of doing business. Claims should not be categorized as methods of doing business. Instead, such claims should be treated like any other process claims.”

In *State Street*, the CAFC endorsed this change:

“We agree that this is precisely the manner in which this type of claim should be treated.”

Business method patents are to be treated no differently than any other process patents if the claims are directed to “a useful, concrete, and tangible result.” In the case of Signature’s patent, it was a final share of price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities.

Although these were “machine” claims, they were in “means plus function” form, expressed as a series of steps on a flow chart¹² similar in result to the AT &T method

¹²Section 112, ¶ 6 “An element in a claim...may be expressed as a means or step [flow chart] for performing a specified function...and ...construed to cover the corresponding structure, material, or acts described in the specification and equivalents thereof.” Figure 1 of the ‘056 patent in *State Street* is illustrative of a flow chart type of disclosure necessary to support a “means plus function” claim in a business method patent.

claims which read, in part, as follows:

Claim 1. "A method for use in a telecommunications systems ... comprising the steps of: generating a message record for an interchange call between an originating subscriber, and including in said message record, a primary interchange carrier (PIC) indicator having a value which is a function of whether or not the interchange carrier associated with the terminating subscriber is a predetermined one of said interexchange carriers."

Although these claims successfully cleared the "hurdles" of Sections 101 (statutory subject matter), 112 (distinctly claiming the subject matter), 102 (novelty), on remand, the District Court found the claims invalid for obviousness under Section 103 as a matter of law.

3. Conclusion

We come back to the question of whether the patent system is challenging the legitimacy of our knowledge based economy by issuing proprietary exclusionary rights to those who seek to patent business methods and whether this reflects an unhealthy paradigm shift in the patent law? Judging from the U. S. economic surge compared to the rest of the world one might say that the incentive to protect knowledge based inventions was stimulating growth and attracting capital formation and investment. Amazon's stock price jumped on the announcement by *Bloomberg News* it was obtaining a web patent. The signs appear favorable for those who seek patent protection for business method inventions.

ENDNOTE

Chairman of Amazon Urges Reduction of Patent Terms, New York Times, By Matt Richtig, March 11, 2000: This title was followed by a sub-caption, "Bezos Suggests 3 to 5 years, Instead of 20". Tim O'Reilly, CEO of O'Reilly & Associates, publisher of computer books, who advocates open sourcing, or free access to computer source code and software, wrote to Mr. Bezos complaining about Amazon's business method patents. In response, Mr. Bezos posted a letter on Amazon's web page suggesting shorter terms, and implying that Amazon would not vigorously enforce its own "One Click" and "Web Linking" patents. This is being discounted as a public relations stunt. Amazon may have an "image" problem after its One Click patent suit precluded barnesandnoble.com from using single mouse click ordering (since avoided by two clicks). Patent terms can be "dedicated" to the public at any time by the owner. Also, technology often becomes obsolete in other fields, besides software. When it does, the solution is not to change the term of all patents, simply let the market "obsolete" the patent. The owner can merely let it lapse by skipping the maintenance fee when due at the fourth, eighth or twelfth years after issue.

TABLE OF AUTHORITIES

U.S. CONSTITUTION

Article 1, Section 8	G-2
<i>(footnote 1)</i>	

STATUTORY AUTHORITY

The Intellectual Property and Communications Reform Act PL 106 - 113, November 29, 1999	G-1
Title 35 U.S.C., Sections 100, 101, 102, 103 and 112	G-3
<i>(footnote 3)</i>	
Title 35 U.S.C., Section 112	G-5, G-6
<i>(footnotes 8 and 12)</i>	

CASE LAW

<u>State Street Bank and Trust v. Signature Financial Group, Inc.</u> , 149 F.3d 1368, 1375 (Fed. Cir. 1998)	G-2
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ARTICLES

<i>Towards a Rational Jurisprudence of Computer-Related Patentability in Light of In Alappat</i> , 79 Minn. L.Rev. 1129 (1995), John A. Burtis	G-4
<i>(footnote 4)</i>	
<i>Does Supreme Court Precedent Sink Submarine Patents?</i> , 38 IDEA 601 (1998), DeWitt	G-5
<i>(footnote 8)</i>	
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<i>(Endnote)</i>	

APPENDIX

State Street Bank & Trust v. Signature Financial Group, Inc., 149 F.3d 1368 (Fed.Cir. 1998)

AT & T Corporation v. Excel Communications, Inc., 172 F.3d 1352 (Fed.Cir. 1999)

149 F.3d 1368
47 U.S.P.Q.2d 1596
(Cite as: 149 F.3d 1368)

STATE STREET BANK & TRUST CO., Plaintiff-Appellee,
v.
SIGNATURE FINANCIAL GROUP, INC. Defendant-Appellant.

No. 96-1327.

United States Court of Appeals,
Federal Circuit.

July 23, 1998.

Bank brought action against assignee of patent for computerized accounting system used to manage mutual fund investment structure, seeking declaratory judgment that patent was invalid and unenforceable. The United States District Court for the District of Massachusetts, Patti B. Saris, J., 927 F.Supp. 502, granted summary judgment for bank, and assignee appealed. The Court of Appeals, Rich, Circuit Judge, held that: (1) patent was directed to machine, not process; (2) invention was not unpatentable under mathematical algorithm exception to patentability; and (3) there is no "business method" exception to patentability.

Reversed and remanded.

[1] FEDERAL COURTS ↻766
170Bk766

On appeal, Court of Appeals is not bound to give deference to the district court's grant of summary judgment, but must make an independent determination that the standards for summary judgment have been met.

[2] PATENTS ↻324.5
291k324.5

Court of Appeals reviews patent claim construction de novo including any allegedly fact-based questions relating to claim construction.

[3] PATENTS ↻324.5
291k324.5

Court of Appeals reviews statutory construction de novo.

[4] PATENTS ↻101(8)
291k101(8)

"Machine" claims having means-plus-function clauses may only be reasonably viewed as process claims if there is no supporting structure in the written description that corresponds to the claimed "means" elements.

[5] PATENTS ↻101(11)
291k101(11)

Patent claiming data processing system for managing a financial services configuration of a portfolio established as a partnership, which machine was made up of, at the very least, specific structures disclosed in written description and corresponding to means-plus-function elements recited in claim, was directed to machine, not process. 35 U.S.C.A. § 101.

[6] PATENTS ↻3
291k3

It is improper to read limitations into statute generally setting forth patentable subject matter where the legislative history indicates that Congress clearly did not intend such limitations. 35 U.S.C.A. § 101.

[7] PATENTS ↻6

291k6

Unpatentable mathematical algorithms are identifiable by showing they are merely abstract ideas constituting disembodied concepts or truths that are not "useful"; to be patentable an algorithm must be applied in a "useful" way. 35 U.S.C.A. § 101.

[8] PATENTS ↻6

291k6

Transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical calculations into a final share price, for purpose of managing mutual fund investment structure, was practical application of a mathematical algorithm, formula, or calculation, because it produced useful, concrete and tangible result, and claimed machine thus was not unpatentable under mathematical algorithm exception to patentability. 35 U.S.C.A. § 101.

[9] PATENTS ↻6

291k6

Dispositive inquiry in determining patentability of invention notwithstanding its inclusion of mathematical algorithm is whether the claim as a whole is directed to statutory subject matter; it is irrelevant that a claim may contain, as part of the whole, subject matter which would not be patentable by itself, and claim drawn to subject matter otherwise statutory does not become nonstatutory simply because it uses a mathematical formula, computer program or digital computer. 35 U.S.C.A. § 101.

[10] PATENTS ↻101(1)

291k101(1)

The question of whether a patent claim encompasses statutory subject matter should not focus on which of the four categories of subject matter a claim is directed to, namely, process, machine, manufacture, or composition of matter, but rather on the essential characteristics of the subject matter, in particular, its practical utility. 35 U.S.C.A. § 101.

[11] PATENTS ↻7.14

291k7.14

Business methods are subject to same legal requirements for patentability as applied to any other process or method, and thus there is no "business method" exception to patentability. 35 U.S.C.A. § 101.

*1369 William L. Patton, Ropes & Gray, Boston, Massachusetts, argued for plaintiff-appellee. With him on the brief were James L. Sigel and James S. DeGraw. Also on the brief was Maurice E. Gauthier, Samuels, Gauthier, Stevens & Reppert.

Steven L. Friedman, Dilworth, Paxson, Kalish & Kauffman LLP, Philadelphia, Pennsylvania, argued for defendant-appellant. With him on the brief were Steven J. Henry, Wolf, Greenfield & Sacks, P.C., Boston, Massachusetts; and Philip G. Koenig, Pittas //Koenig, Winchester, Massachusetts.

William T. Ellis, Foley & Lardner, Washington, D.C., for amicus curiae Information Technology Industry Council. With him on the brief were Harold C. Wegner, Richard L. *1370 Schwaab, and Mary Michelle Kile. Of counsel was John F. Cooney, Venable, Baetjer, Howard & Civiletti, LLP.

Robert C. Scheinfeld, Baker & Botts, L.L.P., New York, New York, for amicus curiae Mastercard International Service. With him on the brief was Lawrence T. Kass. Of counsel on the brief for amicus curiae VISA International Service Association were Laurie S. Hane, Donald S. Chisum, and Alan L. Durham, Morrison & Foerster LLP, Palo Alto, California.

Before RICH, PLAGER, and BRYSON, Circuit Judges.

RICH, Circuit Judge.

Signature Financial Group, Inc. (Signature) appeals from the decision of the United States District Court for the

District of Massachusetts granting a motion for summary judgment in favor of State Street Bank & Trust Co. (State Street), finding U.S. Patent No. 5,193,056 (the '056 patent) invalid on the ground that the claimed subject matter is not encompassed by 35 U.S.C. § 101 (1994). See *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 927 F.Supp. 502, 38 USPQ2d 1530 (D.Mass.1996). We reverse and remand because we conclude that the patent claims are directed to statutory subject matter.

BACKGROUND

Signature is the assignee of the '056 patent which is entitled "Data Processing System for Hub and Spoke Financial Services Configuration." The '056 patent issued to Signature on 9 March 1993, naming R. Todd Boes as the inventor. The '056 patent is generally directed to a data processing system (the system) for implementing an investment structure which was developed for use in Signature's business as an administrator and accounting agent for mutual funds. In essence, the system, identified by the proprietary name Hub and Spoke (R), facilitates a structure whereby mutual funds (Spokes) pool their assets in an investment portfolio (Hub) organized as a partnership. This investment configuration provides the administrator of a mutual fund with the advantageous combination of economies of scale in administering investments coupled with the tax advantages of a partnership.

State Street and Signature are both in the business of acting as custodians and accounting agents for multi-tiered partnership fund financial services. State Street negotiated with Signature for a license to use its patented data processing system described and claimed in the '056 patent. When negotiations broke down, State Street brought a declaratory judgment action asserting invalidity, unenforceability, and noninfringement in Massachusetts district court, and then filed a motion for partial summary judgment of patent invalidity for failure to claim statutory subject matter under § 101. The motion was granted and this appeal followed.

DISCUSSION

[1][2][3] On appeal, we are not bound to give deference to the district court's grant of summary judgment, but must make an independent determination that the standards for summary judgment have been met. *Vas-Cath, Inc. v. Mahurkar*, 935 F.2d 1555, 1560, 19 USPQ2d 1111, 1114 (Fed.Cir.1991). Summary judgment is properly granted where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). The substantive issue at hand, whether the '056 patent is invalid for failure to claim statutory subject matter under § 101, is a matter of both claim construction and statutory construction. "[W]e review claim construction de novo including any allegedly fact-based questions relating to claim construction." *Cybor Corp. v. FAS Techs.*, 138 F.3d 1448, 1451, 46 USPQ2d 1169, 1174 (Fed.Cir.1998) (in banc). We also review statutory construction de novo. See *Romero v. United States*, 38 F.3d 1204, 1207 (Fed.Cir.1994). We hold that declaratory judgment plaintiff State Street was not entitled to the grant of summary judgment of invalidity of the '056 patent under § 101 as a matter of law, because the patent claims are directed to statutory subject matter.

The following facts pertinent to the statutory subject matter issue are either undisputed or represent the version alleged by the nonmovant. See *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). The patented invention relates generally to a system that allows an administrator to monitor and record the financial information flow and make all calculations necessary for maintaining a partner fund financial services configuration. As previously mentioned, a partner fund financial services configuration essentially allows several mutual funds, or "Spokes," to pool their investment funds into a single portfolio, or "Hub," allowing for consolidation of, inter alia, the costs of administering the fund combined with the tax advantages of a partnership. In particular, this system provides means for a daily allocation of assets for two or more Spokes that are invested in the same Hub. The system determines the percentage share that each Spoke maintains in the Hub, while taking into consideration daily changes both in the value of the Hub's investment securities and in the concomitant amount of each Spoke's assets.

In determining daily changes, the system also allows for the allocation among the Spokes of the Hub's daily income, expenses, and net realized and unrealized gain or loss, calculating each day's total investments based on the concept of a book capital account. This enables the determination of a true asset value of each Spoke and accurate calculation of allocation ratios between or among the Spokes. The system additionally tracks all the relevant data determined on a daily basis for the Hub and each Spoke, so that aggregate year end income, expenses, and capital gain or loss can be

determined for accounting and for tax purposes for the Hub and, as a result, for each publicly traded Spoke.

It is essential that these calculations are quickly and accurately performed. In large part this is required because each Spoke sells shares to the public and the price of those shares is substantially based on the Spoke's percentage interest in the portfolio. In some instances, a mutual fund administrator is required to calculate the value of the shares to the nearest penny within as little as an hour and a half after the market closes. Given the complexity of the calculations, a computer or equivalent device is a virtual necessity to perform the task.

The '056 patent application was filed 11 March 1991. It initially contained six "machine" claims, which incorporated means-plus-function clauses, and six method claims. According to Signature, during prosecution the examiner contemplated a § 101 rejection for failure to claim statutory subject matter. However, upon cancellation of the six method claims, the examiner issued a notice of allowance for the remaining present six claims on appeal. Only claim 1 is an independent claim.

[4] The district court began its analysis by construing the claims to be directed to a process, with each "means" clause merely representing a step in that process. However, "machine" claims having "means" clauses may only be reasonably viewed as process claims if there is no supporting structure in the written description that corresponds to the claimed "means" elements. See *In re Alappat*, 33 F.3d 1526, 1540-41, 31 USPQ2d 1545, 1554 (Fed.Cir.1994) (in banc). This is not the case now before us.

[5] When independent claim 1 is properly construed in accordance with § 112, ¶ 6, it is directed to a machine, as demonstrated below, where representative claim 1 is set forth, the subject matter in brackets stating the structure the written description discloses as corresponding to the respective "means" recited in the claims.

1. A data processing system for managing a financial services configuration of a portfolio established as a partnership, each partner being one of a plurality of funds, comprising:

- (a) computer processor means [a personal computer including a CPU] for processing data;
- (b) storage means [a data disk] for storing data on a storage medium;
- (c) first means [an arithmetic logic circuit configured to prepare the data disk to magnetically store selected data] for initializing the storage medium;
- (d) second means [an arithmetic logic circuit configured to retrieve information from a specific file, calculate incremental increases or decreases based on specific input, allocate the results on a percentage basis, and store the output in a *1372 separate file] for processing data regarding assets in the portfolio and each of the funds from a previous day and data regarding increases or decreases in each of the funds, [sic, funds'] assets and for allocating the percentage share that each fund holds in the portfolio;
- (e) third means [an arithmetic logic circuit configured to retrieve information from a specific file, calculate incremental increases and decreases based on specific input, allocate the results on a percentage basis and store the output in a separate file] for processing data regarding daily incremental income, expenses, and net realized gain or loss for the portfolio and for allocating such data among each fund;
- (f) fourth means [an arithmetic logic circuit configured to retrieve information from a specific file, calculate incremental increases and decreases based on specific input, allocate the results on a percentage basis and store the output in a separate file] for processing data regarding daily net unrealized gain or loss for the portfolio and for allocating such data among each fund; and
- (g) fifth means [an arithmetic logic circuit configured to retrieve information from specific files, calculate that information on an aggregate basis and store the output in a separate file] for processing data regarding aggregate year-end income, expenses, and capital gain or loss for the portfolio and each of the funds.

Each claim component, recited as a "means" plus its function, is to be read, of course, pursuant to § 112, ¶ 6, as inclusive of the "equivalents" of the structures disclosed in the written description portion of the specification. Thus, claim 1, properly construed, claims a machine, namely, a data processing system for managing a financial services configuration of a portfolio established as a partnership, which machine is made up of, at the very least, the specific structures disclosed in the written description and corresponding to the means-plus-function elements (a)-(g) recited in the claim. A "machine" is proper statutory subject matter under § 101. We note that, for the purposes of a § 101 analysis, it is of little relevance whether claim 1 is directed to a "machine" or a "process," as long as it falls within at least one of the four enumerated categories of patentable subject matter, "machine" and "process" being such

categories.

This does not end our analysis, however, because the court concluded that the claimed subject matter fell into one of two alternative judicially- created exceptions to statutory subject matter. [FN1] The court refers to the first exception as the "mathematical algorithm" exception and the second exception as the "business method" exception. Section 101 reads:

FN1. Indeed, although we do not make this determination here, the judicially created exceptions, i.e., abstract ideas, laws of nature, etc., should be applicable to all categories of statutory subject matter, as our own precedent suggests. See *Alappat*, 33 F.3d at 1542, 31 USPQ2d at 1556; see also *In re Johnston*, 502 F.2d 765, 183 USPQ 172 (CCPA 1974) (Rich, J., dissenting).

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.

The plain and unambiguous meaning of § 101 is that any invention falling within one of the four stated categories of statutory subject matter may be patented, provided it meets the other requirements for patentability set forth in Title 35, i.e., those found in §§ 102, 103, and 112, ¶ 2. [FN2]

FN2. As explained in *In re Bergy*, 596 F.2d 952, 960, 201 USPQ 352, 360 (CCPA 1979) (emphases and footnote omitted): The first door which must be opened on the difficult path to patentability is § 101 The person approaching that door is an inventor, whether his invention is patentable or not Being an inventor or having an invention, however, is no guarantee of opening even the first door. What kind of an invention or discovery is it? In dealing with the question of kind, as distinguished from the qualitative conditions which make the invention patentable, § 101 is broad and general; its language is: "any * * * process, machine, manufacture, or composition of matter, or any * * * improvement thereof." Section 100(b) further expands "process" to include "art or method, and * * * a new use of a known process, machine, manufacture, composition of matter, or material." If the invention, as the inventor defines it in his claims (pursuant to § 112, second paragraph), falls into any one of the named categories, he is allowed to pass through to the second door, which is § 102; "novelty and loss of right to patent" is the sign on it. Notwithstanding the words "new and useful" in § 101, the invention is not examined under that statute for novelty because that is not the statutory scheme of things or the long-established administrative practice.

*1373 [6] The repetitive use of the expansive term "any" in § 101 shows Congress's intent not to place any restrictions on the subject matter for which a patent may be obtained beyond those specifically recited in § 101. Indeed, the Supreme Court has acknowledged that Congress intended § 101 to extend to "anything under the sun that is made by man." *Diamond v. Chakrabarty*, 447 U.S. 303, 309, 100 S.Ct. 2204, 65 L.Ed.2d 144 (1980); see also *Diamond v. Diehr*, 450 U.S. 175, 182, 101 S.Ct. 1048, 67 L.Ed.2d 155 (1981). [FN3] Thus, it is improper to read limitations into § 101 on the subject matter that may be patented where the legislative history indicates that Congress clearly did not intend such limitations. See *Chakrabarty*, 447 U.S. at 308, 100 S.Ct. 2204 ("We have also cautioned that courts 'should not read into the patent laws limitations and conditions which the legislature has not expressed.' " (citations omitted)).

FN3. The Committee Reports accompanying the 1952 Act inform us that Congress intended statutory subject matter to "include anything under the sun that is made by man." S.Rep. No. 82-1979 at 5 (1952); H.R.Rep. No. 82-1923 at 6 (1952).

The "Mathematical Algorithm" Exception

The Supreme Court has identified three categories of subject matter that are unpatentable, namely "laws of nature, natural phenomena, and abstract ideas." *Diehr*, 450 U.S. at 185, 101 S.Ct. 1048. Of particular relevance to this case, the Court has held that mathematical algorithms are not patentable subject matter to the extent that they are merely abstract ideas. See *Diehr*, 450 U.S. 175, 101 S.Ct. 1048, *passim*; *Parker v. Flook*, 437 U.S. 584, 98 S.Ct. 2522, 57 L.Ed.2d 451 (1978); *Gottschalk v. Benson*, 409 U.S. 63, 93 S.Ct. 253, 34 L.Ed.2d 273 (1972). In *Diehr*, the Court explained that certain types of mathematical subject matter, standing alone, represent nothing more than abstract ideas until reduced to some type of practical application, i.e., "a useful, concrete and tangible result." *Alappat*, 33 F.3d at 1544, 31 USPQ2d at 1557. [FN4]

FN4. This has come to be known as the mathematical algorithm exception. This designation has led to some confusion,

especially given the Freeman-Walter-Abele analysis. By keeping in mind that the mathematical algorithm is unpatentable only to the extent that it represents an abstract idea, this confusion may be ameliorated.

[7] Unpatentable mathematical algorithms are identifiable by showing they are merely abstract ideas constituting disembodied concepts or truths that are not "useful." From a practical standpoint, this means that to be patentable an algorithm must be applied in a "useful" way. In *Alappat*, we held that data, transformed by a machine through a series of mathematical calculations to produce a smooth waveform display on a rasterizer monitor, constituted a practical application of an abstract idea (a mathematical algorithm, formula, or calculation), because it produced "a useful, concrete and tangible result"--the smooth waveform.

Similarly, in *Arrhythmia Research Technology Inc. v. Corazonix Corp.*, 958 F.2d 1053, 22 USPQ2d 1033 (Fed.Cir.1992), we held that the transformation of electrocardiograph signals from a patient's heartbeat by a machine through a series of mathematical calculations constituted a practical application of an abstract idea (a mathematical algorithm, formula, or calculation), because it corresponded to a useful, concrete or tangible thing--the condition of a patient's heart.

[8] Today, we hold that the transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces "a useful, concrete and tangible result"--a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.

The district court erred by applying the Freeman-Walter-Abele test to determine whether the claimed subject matter was an unpatentable abstract idea. The Freeman-Walter-Abele test was designed by the Court *1374 of Customs and Patent Appeals, and subsequently adopted by this court, to extract and identify unpatentable mathematical algorithms in the aftermath of *Benson and Flook*. See *In re Freeman*, 573 F.2d 1237, 197 USPQ 464 (CCPA 1978) as modified by *In re Walter*, 618 F.2d 758, 205 USPQ 397 (CCPA 1980). The test has been thus articulated:

First, the claim is analyzed to determine whether a mathematical algorithm is directly or indirectly recited. Next, if a mathematical algorithm is found, the claim as a whole is further analyzed to determine whether the algorithm is "applied in any manner to physical elements or process steps," and, if it is, it "passes muster under § 101."

In re Pardo, 684 F.2d 912, 915, 214 USPQ 673, 675-76 (CCPA 1982) (citing *In re Abele*, 684 F.2d 902, 214 USPQ 682 (CCPA 1982)). [FN5]

FN5. The test has been the source of much confusion. In *In re Abele*, 684 F.2d 902, 214 USPQ 682 (CCPA 1982), the CCPA upheld claims applying "a mathematical formula within the context of a process which encompasses significantly more than the algorithm alone." *Id.* at 909. Thus, the CCPA apparently inserted an additional consideration--the significance of additions to the algorithm. The CCPA appeared to abandon the application of the test in *In re Taner*, 681 F.2d 787, 214 USPQ 678 (CCPA 1982), only to subsequently "clarify" that the Freeman-Walter-Abele test was simply not the exclusive test for detecting unpatentable subject matter. *In re Meyer*, 688 F.2d 789, 796, 215 USPQ 193, 199 (CCPA 1982).

[9] After *Diehr* and *Chakrabarty*, the Freeman-Walter-Abele test has little, if any, applicability to determining the presence of statutory subject matter. As we pointed out in *Alappat*, 33 F.3d at 1543, 31 USPQ2d at 1557, application of the test could be misleading, because a process, machine, manufacture, or composition of matter employing a law of nature, natural phenomenon, or abstract idea is patentable subject matter even though a law of nature, natural phenomenon, or abstract idea would not, by itself, be entitled to such protection. [FN6] The test determines the presence of, for example, an algorithm. Under *Benson*, this may have been a sufficient indicium of nonstatutory subject matter. However, after *Diehr* and *Alappat*, the mere fact that a claimed invention involves inputting numbers, calculating numbers, outputting numbers, and storing numbers, in and of itself, would not render it nonstatutory subject matter, unless, of course, its operation does not produce a "useful, concrete and tangible result." *Alappat*, 33 F.3d at 1544, 31 USPQ2d at 1557. [FN7] After all, as we have repeatedly stated,

FN6. See e.g. *Parker v. Flook*, 437 U.S. 584, 590, 98 S.Ct. 2522, 57 L.Ed.2d 451 (1978) ("[A] process is not unpatentable simply because it contains a law of nature or a mathematical algorithm."); *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127, 130, 68 S.Ct. 440, 92 L.Ed. 588 (1948) ("He who discovers a hitherto unknown phenomenon of nature has no claim

to a monopoly of it which the law recognizes. If there is to be invention from such a discovery, it must come from the application of the law to a new and useful end."); *Mackay Radio & Tel. Co. v. Radio Corp. of Am.*, 306 U.S. 86, 94, 59 S.Ct. 427, 83 L.Ed. 506 (1939) ("While a scientific truth, or the mathematical expression of it, is not a patentable invention, a novel and useful structure created with the aid of knowledge of scientific truth may be.").

[W]hen a claim containing a mathematical formula implements or applies that formula in a structure or process which, when considered as a whole, is performing a function which the patent laws were designed to protect (e.g., transforming or reducing an article to a different state or thing), then the claim satisfies the requirements of § 101.

Diehr, 450 U.S. at 192, 101 S.Ct. 1048; see also *In re Iwahashi*, 888 F.2d 1370, 1375, 12 USPQ2d 1908, 1911 (Fed.Cir.1989); *Taner*, 681 F.2d at 789, 214 USPQ at 680. The dispositive inquiry is whether the claim as a whole is directed to statutory subject matter. It is irrelevant that a claim may contain, as part of the whole, subject matter which would not be patentable by itself. "A claim drawn to subject matter otherwise statutory does not become nonstatutory simply because it uses a mathematical formula, computer program or digital computer." *Diehr*, 450 U.S. at 187, 101 S.Ct. 1048.

FN7. As the Supreme Court expressly stated in *Diehr*, its own holdings in *Benson and Flook* "stand for no more than these long-established principles" that abstract ideas and natural phenomena are not patentable. *Diehr*, 450 U.S. at 185, 101 S.Ct. 1048 (citing *Chakrabarty*, 447 U.S. at 309, 100 S.Ct. 2204 and *Funk Bros.*, 333 U.S. at 130, 68 S.Ct. 440.).

every step-by-step process, be it electronic or chemical or mechanical, involves an algorithm in the broad sense of the term. Since § 101 expressly includes processes as a category of inventions which may be patented and § 100(b) further defines the word "process" as meaning "process, art or *1375 method, and includes a new use of a known process, machine, manufacture, composition of matter, or material," it follows that it is no ground for holding a claim is directed to nonstatutory subject matter to say it includes or is directed to an algorithm. This is why the proscription against patenting has been limited to mathematical algorithms....

In re Iwahashi, 888 F.2d 1370, 1374, 12 USPQ2d 1908, 1911 (Fed.Cir.1989) (emphasis in the original). [FN8]

FN8. In *In re Pardo*, 684 F.2d 912 (CCPA 1982), the CCPA narrowly limited "mathematical algorithm" to the execution of formulas with given data. In the same year, in *In re Meyer*, 688 F.2d 789, 215 USPQ 193 (CCPA 1982), the CCPA interpreted the same term to include any mental process that can be represented by a mathematical algorithm. This is also the position taken by the PTO in its Examination Guidelines, 61 Fed.Reg. 7478, 7483 (1996).

[10] The question of whether a claim encompasses statutory subject matter should not focus on which of the four categories of subject matter a claim is directed to [FN9]--process, machine, manufacture, or composition of matter--but rather on the essential characteristics of the subject matter, in particular, its practical utility. Section 101 specifies that statutory subject matter must also satisfy the other "conditions and requirements" of Title 35, including novelty, nonobviousness, and adequacy of disclosure and notice. See *In re Warmerdam*, 33 F.3d 1354, 1359, 31 USPQ2d 1754, 1757-58 (Fed.Cir.1994). For purpose of our analysis, as noted above, claim 1 is directed to a machine programmed with the Hub and Spoke software and admittedly produces a "useful, concrete, and tangible result." *Alappat*, 33 F.3d at 1544, 31 USPQ2d at 1557. This renders it statutory subject matter, even if the useful result is expressed in numbers, such as price, profit, percentage, cost, or loss.

FN9. Of course, the subject matter must fall into at least one category of statutory subject matter.

The Business Method Exception

[11] As an alternative ground for invalidating the '056 patent under § 101, the court relied on the judicially-created, so-called "business method" exception to statutory subject matter. We take this opportunity to lay this ill-conceived exception to rest. Since its inception, the "business method" exception has merely represented the application of some general, but no longer applicable legal principle, perhaps arising out of the "requirement for invention"--which was eliminated by § 103. Since the 1952 Patent Act, business methods have been, and should have been, subject to the same legal requirements for patentability as applied to any other process or method. [FN10]

FN10. As Judge Newman has previously stated,

[The business method exception] is ... an unwarranted encumbrance to the definition of statutory subject matter in section 101, that [should] be discarded as error-prone, redundant, and obsolete. It merits retirement from the glossary of section 101.... All

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(Cite as: 149 F.3d 1368, *1375)

of the "doing business" cases could have been decided using the clearer concepts of Title 35. Patentability does not turn on whether the claimed method does "business" instead of something else, but on whether the method, viewed as a whole, meets the requirements of patentability as set forth in Sections 102, 103, and 112 of the Patent Act.

In re Schrader, 22 F.3d 290, 298, 30 USPQ2d 1455, 1462 (Fed.Cir.1994) (Newman, J., dissenting).

The business method exception has never been invoked by this court, or the CCPA, to deem an invention unpatentable. [FN11] Application of this particular exception has always been preceded by a ruling based on some clearer concept of Title 35 or, more commonly, application of the abstract idea exception based on finding a mathematical algorithm. Illustrative is the CCPA's analysis in *In re Howard*, 55 C.C.P.A. 1121, 394 F.2d 869, 157 USPQ 615 (CCPA 1968), wherein the court affirmed the Board of Appeals' rejection of the claims for lack of novelty and found it unnecessary to reach the Board's section 101 ground that a method of doing business is "inherently unpatentable." *Id.* at 872, 55 C.C.P.A. 1121, 394 F.2d 869, 157 USPQ at 617. [FN12]

FN11. See Rinaldo Del Gallo, III, *Are "Methods of Doing Business" Finally out of Business as a Statutory Rejection?*, 38 IDEA 403, 435 (1998).

FN12. See also *Dann v. Johnston*, 425 U.S. 219, 96 S.Ct. 1393, 47 L.Ed.2d 692 (1976) (the Supreme Court declined to discuss the section 101 argument concerning the computerized financial record-keeping system, in view of the Court's holding of patent invalidity under section 103); *In re Chatfield*, 545 F.2d 152, 157, 191 USPQ 730, 735 (CCPA 1976); *Ex parte Murray*, 9 USPQ2d 1819, 1820 (Bd.Pat.App & Interf. 1988) ("[T]he claimed accounting method [requires] no more than the entering, sorting, debiting and totaling of expenditures as necessary preliminary steps to issuing an expense analysis statement") states grounds of obviousness or lack of novelty, not of non-statutory subject matter.

*1376 Similarly, *In re Schrader*, 22 F.3d 290, 30 USPQ2d 1455 (Fed.Cir.1994), while making reference to the business method exception, turned on the fact that the claims implicitly recited an abstract idea in the form of a mathematical algorithm and there was no "transformation or conversion of subject matter representative of or constituting physical activity or objects." 22 F.3d at 294, 30 USPQ2d at 1459 (emphasis omitted). [FN13]

FN13. Any historical distinctions between a method of "doing" business and the means of carrying it out blur in the complexity of modern business systems. See *Paine, Webber, Jackson & Curtis v. Merrill Lynch*, 564 F.Supp. 1358, 218 USPQ 212 (D.Del.1983), (holding a computerized system of cash management was held to be statutory subject matter.)

State Street argues that we acknowledged the validity of the business method exception in *Alappat* when we discussed *Maucorps* and *Meyer*:

Maucorps dealt with a business methodology for deciding how salesmen should best handle respective customers and *Meyer* involved a "system" for aiding a neurologist in diagnosing patients. Clearly, neither of the alleged "inventions" in those cases falls within any § 101 category.

Alappat, 33 F.3d at 1541, 31 USPQ2d at 1555. However, closer scrutiny of these cases reveals that the claimed inventions in both *Maucorps* and *Meyer* were rejected as abstract ideas under the mathematical algorithm exception, not the business method exception. See *In re Maucorps*, 609 F.2d 481, 484, 203 USPQ 812, 816 (CCPA 1979); *In re Meyer*, 688 F.2d 789, 796, 215 USPQ 193, 199 (CCPA 1982). [FN14]

FN14. Moreover, these cases were subject to the Benson era Freeman-Walter-Abele test--in other words, analysis as it existed before *Diehr* and *Alappat*.

Even the case frequently cited as establishing the business method exception to statutory subject matter, *Hotel Security Checking Co. v. Lorraine Co.*, 160 F. 467 (2d Cir.1908), did not rely on the exception to strike the patent. [FN15] In that case, the patent was found invalid for lack of novelty and "invention," not because it was improper subject matter for a patent. The court stated "the fundamental principle of the system is as old as the art of bookkeeping, i.e., charging the goods of the employer to the agent who takes them." *Id.* at 469. "If at the time of [the patent] application, there had been no system of bookkeeping of any kind in restaurants, we would be confronted with the question whether a new and useful system of cash registering and account checking is such an art as is patentable under the statute." *Id.* at 472.

FN15. See also *Loew's Drive-in Theatres v. Park-in Theatres*, 174 F.2d 547, 552 (1st Cir.1949) (holding that the means for carrying out the system of transacting business lacked "an exercise of the faculty of invention"); *In re Patton*, 29 C.C.P.A. 982, 127 F.2d 324, 327-28 (CCPA 1942) (finding claims invalid as failing to define patentable subject matter over the references of record.); *Berardini v. Tocci*, 190 F. 329, 332 (C.C.S.D.N.Y.1911); *In re Wait*, 22 C.C.P.A. 822, 73 F.2d 982, 983 (CCPA 1934) ("[S]urely these are, and always have been, essential steps in all dealings of this nature, and even conceding, without holding, that some methods of doing business might present patentable novelty, we think such novelty is lacking here."); *In re Howard*, 55 C.C.P.A. 1121, 394 F.2d 869, 157 USPQ 615, 617 (CCPA 1968) ("[W]e therefore affirm the decision of the Board of Appeals on the ground that the claims do not define a novel process [so we find it] unnecessary to consider the issue of whether a method of doing business is inherently unpatentable."). Although a clearer statement was made in *In re Patton*, 29 C.C.P.A. 982, 127 F.2d 324, 327, 53 USPQ 376, 379 (CCPA 1942) that a system for transacting business, separate from the means for carrying out the system, is not patentable subject matter, the jurisprudence does not require the creation of a distinct business class of unpatentable subject matter.

This case is no exception. The district court announced the precepts of the business method exception as set forth in several treatises, but noted as its primary reason for finding the patent invalid under the business method exception as follows:

If Signature's invention were patentable, any financial institution desirous of implementing a multi-tiered funding complex modelled (sic) on a Hub and Spoke configuration would be required to seek Signature's permission before embarking on *1377 such a project. This is so because the '056 Patent is claimed [sic] sufficiently broadly to foreclose virtually any computer- implemented accounting method necessary to manage this type of financial structure.

927 F.Supp. 502, 516, 38 USPQ2d 1530, 1542 (emphasis added). Whether the patent's claims are too broad to be patentable is not to be judged under § 101, but rather under §§ 102, 103 and 112. Assuming the above statement to be correct, it has nothing to do with whether what is claimed is statutory subject matter.

In view of this background, it comes as no surprise that in the most recent edition of the Manual of Patent Examining Procedures (MPEP) (1996), a paragraph of § 706.03(a) was deleted. In past editions it read:

Though seemingly within the category of process or method, a method of doing business can be rejected as not being within the statutory classes. See *Hotel Security Checking Co. v. Lorraine Co.*, 160 F. 467 (2nd Cir.1908) and *In re Wait*, 24 USPQ 88, 22 C.C.P.A. 822, 73 F.2d 982 (1934).

MPEP § 706.03(a) (1994). This acknowledgment is buttressed by the U.S. Patent and Trademark 1996 Examination Guidelines for Computer Related Inventions which now read:

Office personnel have had difficulty in properly treating claims directed to methods of doing business. Claims should not be categorized as methods of doing business. Instead such claims should be treated like any other process claims. Examination Guidelines, 61 Fed.Reg. 7478, 7479 (1996). We agree that this is precisely the manner in which this type of claim should be treated. Whether the claims are directed to subject matter within § 101 should not turn on whether the claimed subject matter does "business" instead of something else.

CONCLUSION

The appealed decision is reversed and the case is remanded to the district court for further proceedings consistent with this opinion.

REVERSED and REMANDED.

END OF DOCUMENT

172 F.3d 1352
50 U.S.P.Q.2d 1447
(Cite as: 172 F.3d 1352)

AT&T CORP., Plaintiff-Appellant,
v.
EXCEL COMMUNICATIONS, INC., Excel Communications Marketing, Inc., and Excel
Telecommunications, Inc., Defendants-Appellees.

No. 98-1338.

United States Court of Appeals,
Federal Circuit.

April 14, 1999.

Holder of patent relating to method of indicating telephone call recipient's primary interexchange carrier (PIC) as data field in standard message record brought infringement action against competitor. The United States District Court for the District of Delaware, Sue L. Robinson, J., 1998 WL 175878, granted summary judgment for competitor, and patent holder appealed. The Court of Appeals, Plager, Circuit Judge, held that patent's method claims were within scope of patentable subject matter.

Reversed and remanded.

[1] PATENTS ↻ 314(5)

291k314(5)

Whether asserted patent claims are invalid for failure to claim statutory subject matter is a question of law which Court of Appeals reviews without deference. 35 U.S.C.A. § 101.

[2] FEDERAL COURTS ↻ 754.1

170Bk754.1

In matters of statutory interpretation, it is appellate court's responsibility independently to determine what the law is.

[3] PATENTS ↻ 7.14

291k7.14

Patent claim reciting method of indicating telephone call recipient's primary interexchange carrier (PIC) as data field in standard message record was "process" claim, under patent statute's definition of patentable subject matter. 35 U.S.C.A. § 101.

See publication Words and Phrases for other judicial constructions and definitions.

[4] PATENTS ↻ 6

291k6

A mathematical formula alone, sometimes referred to as a mathematical algorithm, viewed in the abstract, is considered unpatentable subject matter. 35 U.S.C.A. § 101.

[5] PATENTS ↻ 6

291k6

Because patent statute includes processes as a category of patentable subject matter, the judicially-defined proscription against patenting of a mathematical algorithm, to the extent such a proscription exists, is narrowly limited to mathematical algorithms in the abstract. 35 U.S.C.A. § 101.

[6] PATENTS ↻ 5

291k5

Whether stated implicitly or explicitly, scope of patent statute's definition of patentable subject matter is the same regardless of the form, machine, or process in which a particular claim is drafted. 35 U.S.C.A. § 101.

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[7] PATENTS ↪ 7.14

291k7.14

Patent claiming process for indicating telephone call recipient's primary interexchange carrier (PIC) as data field in standard message record, which employed subscribers' and call recipients' PICs as data, applied Boolean algebra to those data to determine value of PIC indicator, and applied that value through switching and recording mechanisms to create signal useful for billing purposes, was within scope of patentable subject matter, as process applied Boolean principle to produce useful, concrete, tangible result without preempting other uses of the mathematical principle. 35 U.S.C.A. § 101.

[8] PATENTS ↪ 6

291k6

Patent claims containing mathematical algorithms need not involve physical transformation or conversion of subject matter from one state into another to be deemed patentable subject matter. 35 U.S.C.A. § 101.

PATENTS ↪ 328(2)

291k328(2)

5,333,184. Cited.

*1353 Constantine L. Trela, Jr., Sidley & Austin, of Chicago, Illinois, argued for plaintiff-appellant. With him on the brief was Joseph S. Miller. Of counsel on the brief were Albert E. Fey, Thomas L. Secrest, and Steven C. Cherney, Fish & Neave, of New York, New York; and Laura A. Kaster and Christopher P. Godziela, AT&T Corp., of Liberty Corner, New Jersey.

Donald R. Dunner, Finnegan, Henderson, Farabow, Garrett & Dunner, L.L.P., of Washington, DC, argued for defendants-appellees. With him on the brief were J. Michael Jakes and Howard A. Kwon. Of counsel on the brief were Mike McKool, Jr., Eric W. Buether, and Monte M. Bond, McKool Smith, P.C., of Dallas, Texas.

Before PLAGER, CLEVINGER, and RADER, Circuit Judges.

PLAGER, Circuit Judge.

This case asks us once again to examine the scope of section 1 of the Patent Act, 35 U.S.C. § 101 (1994). The United States District Court for the District of Delaware granted summary judgment to Excel Communications, Inc., Excel Communications Marketing, Inc., and Excel Telecommunications, Inc. (collectively "Excel"), holding U.S. Patent No. 5,333,184 (the '184 patent) invalid under § 101 for failure to claim statutory subject matter. See *AT&T Corp. v. Excel Communications, Inc.*, No. CIV.A.96-434-SLR, 1998 WL 175878, at *7 (D.Del. Mar. 27, 1998). AT&T Corp. ("AT&T"), owner of the '184 patent, appeals. Because we find that the claimed subject matter is properly within the statutory scope of § 101, we reverse the district court's judgment of invalidity on this ground and remand the case for further proceedings.

BACKGROUND**A.**

The '184 patent, entitled "Call Message Recording for Telephone Systems," issued on July 26, 1994. It describes a message record for long-distance telephone calls that is enhanced by adding a primary interexchange carrier ("PIC") indicator. The addition of the indicator aids long-distance carriers in providing differential billing treatment for subscribers, depending upon whether a subscriber calls someone with the same or a different long-distance carrier.

The invention claimed in the '184 patent is designed to operate in a telecommunications system with multiple long-distance service providers. The system contains local exchange carriers ("LECs") and long-distance service (interexchange) carriers ("IXCs"). The LECs provide local telephone service and access to IXCs. Each customer has an LEC for local service and selects an IXC, such as AT & T or Excel, to be its primary long-distance service (interexchange) carrier or PIC. IXCs may own their own facilities, as does AT&T. Others, like Excel, called "resellers" or "resale carriers," contract with facility-owners to route their subscribers' calls through the facility- owners' switches and transmission lines. Some IXCs, including MCI and U.S. Sprint, have a mix of their own lines and leased lines.

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(Cite as: 172 F.3d 1352, *1353)

*1354 The system thus involves a three-step process when a caller makes a direct-dialed (1+) long-distance telephone call: (1) after the call is transmitted over the LEC's network to a switch, and the LEC identifies the caller's PIC, the LEC automatically routes the call to the facilities used by the caller's PIC; (2) the PIC's facilities carry the call to the LEC serving the call recipient; and (3) the call recipient's LEC delivers the call over its local network to the recipient's telephone.

When a caller makes a direct-dialed long-distance telephone call, a switch (which may be a switch in the interexchange network) monitors and records data related to the call, generating an "automatic message account" ("AMA") message record. This contemporaneous message record contains fields of information such as the originating and terminating telephone numbers, and the length of time of the call. These message records are then transmitted from the switch to a message accumulation system for processing and billing.

Because the message records are stored in electronic format, they can be transmitted from one computer system to another and reformatted to ease processing of the information. Thus the carrier's AMA message subsequently is translated into the industry-standard "exchange message interface," forwarded to a rating system, and ultimately forwarded to a billing system in which the data resides until processed to generate, typically, "hard copy" bills which are mailed to subscribers.

B.

The invention of the '184 patent calls for the addition of a data field into a standard message record to indicate whether a call involves a particular PIC (the "PIC indicator"). This PIC indicator can exist in several forms, such as a code which identifies the call recipient's PIC, a flag which shows that the recipient's PIC is or is not a particular IXC, or a flag that identifies the recipient's and the caller's PICs as the same IXC. The PIC indicator therefore enables IXCs to provide differential billing for calls on the basis of the identified PIC.

The application that issued as the '184 patent was filed in 1992. The U.S. Patent and Trademark Office ("PTO") initially rejected, for reasons unrelated to § 101, all forty-one of the originally filed claims. Following amendment, the claims were issued in 1994 in their present form. The '184 patent contains six independent claims, five method claims and one apparatus claim, and additional dependent claims. The PTO granted the '184 patent without questioning whether the claims were directed to statutory subject matter under § 101.

AT&T in 1996 asserted ten of the method claims against Excel in this infringement suit. The independent claims at issue (claims 1, 12, 18, and 40) include the step of "generating a message record for an interexchange call between an originating subscriber and a terminating subscriber," and the step of adding a PIC indicator to the message record. Independent claim 1, for example, adds a PIC indicator whose value depends upon the call recipient's PIC:

A method for use in a telecommunications system in which interexchange calls initiated by each subscriber are automatically routed over the facilities of a particular one of a plurality of interexchange carriers associated with that subscriber, said method comprising the steps of:

generating a message record for an interexchange call between an originating subscriber and a terminating subscriber, and

including, in said message record, a primary interexchange carrier (PIC) indicator having a value which is a function of whether or not the interexchange carrier associated with said terminating subscriber is a predetermined one of said interexchange carriers.

(Emphasis added.) Independent claims 12 and 40 add a PIC indicator that shows if a *1355 recipient's PIC is the same as the IXC over which that particular call is being made. Independent claim 18 adds a PIC indicator designed to show if the caller and the recipient subscribe to the same IXC. The dependent claims at issue add the steps of accessing an IXC's subscriber database (claims 4, 13, and 19) and billing individual calls as a function of the value of the PIC indicator (claims 6, 15, and 21).

The district court concluded that the method claims of the '184 patent implicitly recite a mathematical algorithm. See AT&T, 1998 WL 175878, at * 6. The court was of the view that the only physical step in the claims involves data-gathering for the algorithm. See *id.* Though the court recognized that the claims require the use of switches and

computers, it nevertheless concluded that use of such facilities to perform a non-substantive change in the data's format could not serve to convert non-patentable subject matter into patentable subject matter. See *id.* at *6-7. Thus the trial court, on summary judgment, held all of the method claims at issue invalid for failure to qualify as statutory subject matter. See *id.* at *7.

DISCUSSION

A.

Summary judgment is appropriate if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. See Fed.R.Civ.P. 56(c). We review without deference a trial court's grant of summary judgment, with all justifiable factual inferences drawn in favor of the party opposing the motion. See *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

[1][2] The issue on appeal, whether the asserted claims of the '84 patent are invalid for failure to claim statutory subject matter under 35 U.S.C. § 101, is a question of law which we review without deference. See *Arrhythmia Research Technology v. Corazonix Corp.*, 958 F.2d 1053, 1055-56, 22 USPQ2d 1033, 1035 (Fed.Cir.1992). In matters of statutory interpretation, it is this court's responsibility independently to determine what the law is. See *Hodges v. Secretary of the Dep't of Health & Human Servs.*, 9 F.3d 958, 960 (Fed.Cir.1993).

B.

Our analysis of whether a claim is directed to statutory subject matter begins with the language of 35 U.S.C. § 101, which reads:

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.

The Supreme Court has construed § 101 broadly, noting that Congress intended statutory subject matter to "include anything under the sun that is made by man." See *Diamond v. Chakrabarty*, 447 U.S. 303, 309, 100 S.Ct. 2204, 65 L.Ed.2d 144 (1980) (quoting S.Rep. No. 82-1979, at 5 (1952); H.R.Rep. No. 82-1923, at 6 (1952)); see also *Diamond v. Diehr*, 450 U.S. 175, 182, 101 S.Ct. 1048, 67 L.Ed.2d 155 (1981). Despite this seemingly limitless expanse, the Court has specifically identified three categories of unpatentable subject matter: "laws of nature, natural phenomena, and abstract ideas." See *Diehr*, 450 U.S. at 185, 101 S.Ct. 1048.

[3] In this case, the method claims at issue fall within the "process" [FN1] category of the four enumerated categories of patentable subject matter in § 101. The district court held that the claims at issue, though otherwise within the terms of § 101, implicitly recite a mathematical algorithm, see *AT&T*, 1998 WL 175878, at *6, and thus fall within the judicially created *1356 "mathematical algorithm" exception to statutory subject matter.

FN1. "Process" is defined in 35 U.S.C. § 100(b) to encompass: "[a] process, art or method, and includes a new use of a known process, machine, manufacture, composition of matter, or material."

[4] A mathematical formula alone, sometimes referred to as a mathematical algorithm, viewed in the abstract, is considered unpatentable subject matter. See *Diamond v. Diehr*, 450 U.S. 175, 101 S.Ct. 1048, 67 L.Ed.2d 155 (1981); *Parker v. Flook*, 437 U.S. 584, 98 S.Ct. 2522, 57 L.Ed.2d 451 (1978); *Gottschalk v. Benson*, 409 U.S. 63, 93 S.Ct. 253, 34 L.Ed.2d 273 (1972). Courts have used the terms "mathematical algorithm," "mathematical formula," and "mathematical equation," to describe types of nonstatutory mathematical subject matter without explaining whether the terms are interchangeable or different. Even assuming the words connote the same concept, there is considerable question as to exactly what the concept encompasses. See, e.g., *Diehr*, 450 U.S. at 186 n. 9, 101 S.Ct. 1048 ("The term 'algorithm' is subject to a variety of definitions ... [Petitioner's] definition is significantly broader than the definition this Court employed in *Benson* and *Flook*."); accord *In re Schrader*, 22 F.3d 290, 293 n. 5, 30 USPQ2d 1455, 1457 n. 5 (Fed.Cir.1994).

[5] This court recently pointed out that any step-by-step process, be it electronic, chemical, or mechanical, involves an

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"algorithm" in the broad sense of the term. See *State Street Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368, 1374-75, 47 USPQ2d 1596, 1602 (Fed.Cir.1998), cert. denied, --- U.S. ---, 119 S.Ct. 851, 142 L.Ed.2d 704 (1999). Because § 101 includes processes as a category of patentable subject matter, the judicially-defined proscription against patenting of a "mathematical algorithm," to the extent such a proscription still exists, is narrowly limited to mathematical algorithms in the abstract. See *id.*; see also *Benson*, 409 U.S. at 65, 93 S.Ct. 253 (describing a mathematical algorithm as a "procedure for solving a given type of mathematical problem").

Since the process of manipulation of numbers is a fundamental part of computer technology, we have had to reexamine the rules that govern the patentability of such technology. The sea-changes in both law and technology stand as a testament to the ability of law to adapt to new and innovative concepts, while remaining true to basic principles. In an earlier era, the PTO published guidelines essentially rejecting the notion that computer programs were patentable. [FN2] As the technology progressed, our predecessor court disagreed, and, overturning some of the earlier limiting principles regarding § 101, announced more expansive principles formulated with computer technology in mind. [FN3] In our recent decision in *State Street*, this court discarded the so-called "business method" exception and reassessed the "mathematical algorithm" exception, see 149 F.3d at 1373-77, 47 USPQ2d at 1600-04, both judicially-created "exceptions" to the statutory categories of § 101. As this brief review suggests, this court (and its predecessor) has struggled to make our understanding of the scope of § 101 responsive to the needs of the modern world.

FN2. See, e.g., 33 Fed.Reg. 15581, 15609-10 (1968).

FN3. See *In re Tarczy-Hornoch*, 55 C.C.P.A. 1441, 397 F.2d 856, 158 USPQ 141 (CCPA 1968) (overruling the "function of a machine" doctrine); see also *In re Bernhart*, 57 C.C.P.A. 737, 417 F.2d 1395, 163 USPQ 611 (CCPA 1969) (discussing patentability of a programmed computer); *In re Musgrave*, 57 C.C.P.A. 1352, 431 F.2d 882, 167 USPQ 280 (CCPA 1970) (analyzing process claims encompassing computer programs). For a more detailed review of this history, with extensive citation to the secondary literature, see Justice Stevens's dissent in *Diehr*, 450 U.S. at 193, 101 S.Ct. 1048.

The Supreme Court has supported and enhanced this effort. In *Diehr*, the Court expressly limited its two earlier decisions in *Flook* and *Benson* by emphasizing that these cases did no more than confirm the "long-established principle" that laws of nature, natural phenomena, and abstract ideas are excluded from patent protection. 450 U.S. at 185, 101 S.Ct. 1048. The *Diehr* *1357 Court explicitly distinguished *Diehr*'s process by pointing out that "the respondents here do not seek to patent a mathematical formula. Instead, they seek patent protection for a process of curing synthetic rubber." *Id.* at 187, 101 S.Ct. 1048. The Court then explained that although the process used a well-known mathematical equation, the applicants did not "pre-empt the use of that equation." *Id.* Thus, even though a mathematical algorithm is not patentable in isolation, a process that applies an equation to a new and useful end "is at the very least not barred at the threshold by § 101." *Id.* at 188, 101 S.Ct. 1048. In this regard, it is particularly worthy of note that the argument for the opposite result, that "the term 'algorithm' ... is synonymous with the term 'computer program,'" *id.* at 219, 101 S.Ct. 1048 (Stevens, J., dissenting), and thus computer-based programs as a general proposition should not be patentable, was made forcefully in dissent by Justice Stevens; his view, however, was rejected by the *Diehr* majority.

As previously noted, we most recently addressed the "mathematical algorithm" exception in *State Street*. See 149 F.3d at 1373-75, 47 USPQ2d at 1600-02. In *State Street*, this court, following the Supreme Court's guidance in *Diehr*, concluded that "[u]npatentable mathematical algorithms are identifiable by showing they are merely abstract ideas constituting disembodied concepts or truths that are not 'useful.' ... [T]o be patentable an algorithm must be applied in a 'useful' way." *Id.* at 1373, 47 USPQ2d at 1601. In that case, the claimed data processing system for implementing a financial management structure satisfied the § 101 inquiry because it constituted a "practical application of a mathematical algorithm, ... [by] produc[ing] a useful, concrete and tangible result." *Id.* at 1373, 47 USPQ2d at 1601.

The *State Street* formulation, that a mathematical algorithm may be an integral part of patentable subject matter such as a machine or process if the claimed invention as a whole is applied in a "useful" manner, follows the approach taken by this court en banc in *In re Alappat*, 33 F.3d 1526, 31 USPQ2d 1545 (Fed.Cir.1994). In *Alappat*, we set out our understanding of the Supreme Court's limitations on the patentability of mathematical subject matter and concluded that:

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[The Court] never intended to create an overly broad, fourth category of [mathematical] subject matter excluded from § 101. Rather, at the core of the Court's analysis ... lies an attempt by the Court to explain a rather straightforward concept, namely, that certain types of mathematical subject matter, standing alone, represent nothing more than abstract ideas until reduced to some type of practical application, and thus that subject matter is not, in and of itself, entitled to patent protection.

Id. at 1543, 31 USPQ2d at 1556-57 (emphasis added). Thus, the Alappat inquiry simply requires an examination of the contested claims to see if the claimed subject matter as a whole is a disembodied mathematical concept representing nothing more than a "law of nature" or an "abstract idea," or if the mathematical concept has been reduced to some practical application rendering it "useful." Id. at 1544, 31 USPQ2d at 1557. In Alappat, we held that more than an abstract idea was claimed because the claimed invention as a whole was directed toward forming a specific machine that produced the useful, concrete, and tangible result of a smooth waveform display. See id. at 1544, 31 USPQ2d at 1557.

[6] In both Alappat and State Street, the claim was for a machine that achieved certain results. In the case before us, because Excel does not own or operate the facilities over which its calls are placed, AT&T did not charge Excel with infringement of its apparatus claims, but limited its infringement charge to the specified method or process claims. Whether stated implicitly or explicitly, we consider the scope of § 101 to be the same regardless of the form--machine or process--in which a particular claim is drafted. See, e.g., In *1358 re Alappat, 33 F.3d at 1581, 31 USPQ2d at 1589 (Rader, J., concurring) ("Judge Rich, with whom I fully concur, reads Alappat's application as claiming a machine. In fact, whether the invention is a process or a machine is irrelevant. The language of the Patent Act itself, as well as Supreme Court rulings, clarifies that Alappat's invention fits comfortably within 35 U.S.C. § 101 whether viewed as a process or a machine."); State Street, 149 F.3d at 1372, 47 USPQ2d at 1600 ("[F]or the purposes of a § 101 analysis, it is of little relevance whether claim 1 is directed to a 'machine' or a 'process,'...."). Furthermore, the Supreme Court's decisions in Diehr, Benson, and Flook, all of which involved method (i.e., process) claims, have provided and supported the principles which we apply to both machine--and process-type claims. Thus, we are comfortable in applying our reasoning in Alappat and State Street to the method claims at issue in this case.

C.

[7] In light of this review of the current understanding of the "mathematical algorithm" exception, we turn now to the arguments of the parties in support of and in opposition to the trial court's judgment. We note that, at the time the trial court made its decision, that court did not have the benefit of this court's explication in State Street of the mathematical algorithm issue.

As previously explained, AT&T's claimed process employs subscribers' and call recipients' PICs as data, applies Boolean algebra to those data to determine the value of the PIC indicator, and applies that value through switching and recording mechanisms to create a signal useful for billing purposes. In State Street, we held that the processing system there was patentable subject matter because the system takes data representing discrete dollar amounts through a series of mathematical calculations to determine a final share price--a useful, concrete, and tangible result. See 149 F.3d at 1373, 47 USPQ2d at 1601.

In this case, Excel argues, correctly, that the PIC indicator value is derived using a simple mathematical principle (p and q). But that is not determinative because AT&T does not claim the Boolean principle as such or attempt to forestall its use in any other application. It is clear from the written description of the '184 patent that AT&T is only claiming a process that uses the Boolean principle in order to determine the value of the PIC indicator. The PIC indicator represents information about the call recipient's PIC, a useful, non-abstract result that facilitates differential billing of long- distance calls made by an IXC's subscriber. Because the claimed process applies the Boolean principle to produce a useful, concrete, tangible result without pre-empting other uses of the mathematical principle, on its face the claimed process comfortably falls within the scope of § 101. See Arrhythmia Research Technology, Inc. v. Corazonix Corp., 958 F.2d 1053, 1060, 22 USPQ2d 1033, 1039 (Fed.Cir.1992) ("That the product is numerical is not a criterion of whether the claim is directed to statutory subject matter.").

[8] Excel argues that method claims containing mathematical algorithms are patentable subject matter only if there is a

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"physical transformation" or conversion of subject matter from one state into another. The physical transformation language appears in *Diehr*, see 450 U.S. at 184, 101 S.Ct. 1048 ("That respondents' claims involve the transformation of an article, in this case raw, uncured synthetic rubber, into a different state or thing cannot be disputed."), and has been echoed by this court in *Schrader*, 22 F.3d at 294, 30 USPQ2d at 1458 ("Therefore, we do not find in the claim any kind of data transformation.").

The notion of "physical transformation" can be misunderstood. In the first place, it is not an invariable requirement, but merely one example of how a mathematical algorithm may bring about a useful application. As the Supreme Court itself noted, "*1359 when [a claimed invention] is performing a function which the patent laws were designed to protect (e.g., transforming or reducing an article to a different state or thing), then the claim satisfies the requirements of § 101." *Diehr*, 450 U.S. at 192, 101 S.Ct. 1048 (emphasis added). The "e.g." signal denotes an example, not an exclusive requirement.

This understanding of transformation is consistent with our earlier decision in *Arrhythmia*, 958 F.2d 1053, 22 USPQ2d 1033 (Fed.Cir.1992). *Arrhythmia*'s process claims included various mathematical formulae to analyze electrocardiograph signals to determine a specified heart activity. See *id.* at 1059, 22 USPQ2d at 1037-38. The *Arrhythmia* court reasoned that the method claims qualified as statutory subject matter by noting that the steps transformed physical, electrical signals from one form into another form--a number representing a signal related to the patient's heart activity, a non- abstract output. See *id.*, 958 F.2d at 1059, 22 USPQ2d at 1038. The finding that the claimed process "transformed" data from one "form" to another simply confirmed that *Arrhythmia*'s method claims satisfied § 101 because the mathematical algorithm included within the process was applied to produce a number which had specific meaning--a useful, concrete, tangible result--not a mathematical abstraction. See *id.* at 1060, 22 USPQ2d at 1039.

Excel also contends that because the process claims at issue lack physical limitations set forth in the patent, the claims are not patentable subject matter. This argument reflects a misunderstanding of our case law. The cases cited by Excel for this proposition involved machine claims written in means- plus-function language. See, e.g., *State Street*, 149 F.3d at 1371, 47 USPQ2d at 1599; *Alappat*, 33 F.3d at 1541, 31 USPQ2d at 1554-55. Apparatus claims written in this manner require supporting structure in the written description that corresponds to the claimed "means" elements. See 35 U.S.C. § 112, para. 6 (1994). Since the claims at issue in this case are directed to a process in the first instance, a structural inquiry is unnecessary.

The argument that physical limitations are necessary may also stem from the second part of the Freeman-Walter-Abele test, [FN4] an earlier test which has been used to identify claims thought to involve unpatentable mathematical algorithms. That second part was said to inquire "whether the claim is directed to a mathematical algorithm that is not applied to or limited by physical elements." *Arrhythmia*, 958 F.2d at 1058, 22 USPQ2d at 1037. Although our en banc *Alappat* decision called this test "not an improper analysis," we then pointed out that "the ultimate issue always has been whether the claim as a whole is drawn to statutory subject matter." 33 F.3d at 1543 n. 21, 31 USPQ2d at 1557 n. 21. Furthermore, our recent *State Street* decision questioned the continuing viability of the Freeman-Walter- Abele test, noting that, "[a]fter *Diehr* and *Chakrabarty*, the Freeman-Walter-Abele test has little, if any, applicability to determining the presence of statutory subject matter." 149 F.3d at 1374, 47 USPQ2d at 1601. Whatever may be left of the earlier test, if anything, this type of physical limitations analysis seems of little value because "after *Diehr* and *Alappat*, the mere fact that a claimed invention involves inputting numbers, calculating numbers, outputting numbers, and storing numbers, in and of itself, would not render it nonstatutory subject matter, unless, of course, its operation does not produce a 'useful, concrete and tangible result.'" *Id.* at 1374, 47 USPQ2d at 1602 (quoting *Alappat*, 33 F.3d at 1544, 31 USPQ2d at 1557).

FN4. See *In re Freeman*, 573 F.2d 1237, 197 USPQ 464 (CCPA 1978), as modified by *In re Walter*, 618 F.2d 758, 205 USPQ 397 (CCPA 1980), and *In re Abele*, 648 F.2d 902, 214 USPQ 682 (CCPA 1982).

Because we focus on the inquiry deemed "the ultimate issue" by *Alappat*, rather than on the physical limitations inquiry of *1360 the Freeman-Walter-Abele test, we find the cases cited by Excel in support of its position to be inapposite. For example, in *In re Grams*, the court applied the Freeman-Walter-Abele test and concluded that the only

physical step in the claimed process involved data-gathering for the algorithm; thus, the claims were held to be directed to unpatentable subject matter. See 888 F.2d 835, 839, 12 USPQ2d 1824, 1829 (Fed.Cir.1989). In contrast, our inquiry here focuses on whether the mathematical algorithm is applied in a practical manner to produce a useful result. In *re Grams* is unhelpful because the panel in that case did not ascertain if the end result of the claimed process was useful, concrete, and tangible.

Similarly, the court in *In re Schrader* relied upon the Freeman- Walter-Abele test for its analysis of the method claim involved. The court found neither a physical transformation nor any physical step in the claimed process aside from the entering of data into a record. See 22 F.3d at 294, 30 USPQ2d at 1458. The Schrader court likened the data-recording step to that of data-gathering and held that the claim was properly rejected as failing to define patentable subject matter. See *id.* at 294, 296, 30 USPQ2d at 1458-59. The focus of the court in Schrader was not on whether the mathematical algorithm was applied in a practical manner since it ended its inquiry before looking to see if a useful, concrete, tangible result ensued. Thus, in light of our recent understanding of the issue, the Schrader court's analysis is as unhelpful as that of *In re Grams*.

Finally, the decision in *In re Warmerdam*, 33 F.3d 1354, 31 USPQ2d 1754 (Fed.Cir.1994) is not to the contrary. There the court recognized the difficulty in knowing exactly what a mathematical algorithm is, "which makes rather dicey the determination of whether the claim as a whole is no more than that." *Id.* at 1359, 31 USPQ2d at 1758. Warmerdam's claims 1-4 encompassed a method for controlling the motion of objects and machines to avoid collision with other moving or fixed objects by generating bubble hierarchies through the use of a particular mathematical procedure. See *id.* at 1356, 31 USPQ2d at 1755-56. The court found that the claimed process did nothing more than manipulate basic mathematical constructs and concluded that "taking several abstract ideas and manipulating them together adds nothing to the basic equation"; hence, the court held that the claims were properly rejected under § 101. *Id.* at 1360, 31 USPQ2d at 1759. Whether one agrees with the court's conclusion on the facts, the holding of the case is a straightforward application of the basic principle that mere laws of nature, natural phenomena, and abstract ideas are not within the categories of inventions or discoveries that may be patented under § 101.

D.

In his dissent in *Diehr*, Justice Stevens noted two concerns regarding the § 101 issue, and to which, in his view, federal judges have a duty to respond:

First, the cases considering the patentability of program-related inventions do not establish rules that enable a conscientious patent lawyer to determine with a fair degree of accuracy which, if any, program-related inventions will be patentable. Second, the inclusion of the ambiguous concept of an "algorithm" within the "law of nature" category of unpatentable subject matter has given rise to the concern that almost any process might be so described and therefore held unpatentable.

Diehr, 450 U.S. at 219, 101 S.Ct. 1048 (Stevens, J., dissenting).

Despite the almost twenty years since Justice Stevens wrote, these concerns remain important. His solution was to declare all computer-based programming unpatentable. That has not been the course the law has taken. Rather, it is now clear that computer-based programming constitutes patentable subject matter so long as the basic requirements of § 101 are met. Justice Stevens's concerns can be addressed within that framework.

***1361** His first concern, that the rules are not sufficiently clear to enable reasonable prediction of outcomes, should be less of a concern today in light of the refocusing of the § 101 issue that *Alappat* and *State Street* have provided. His second concern, that the ambiguous concept of "algorithm" could be used to make any process unpatentable, can be laid to rest once the focus is understood to be not on whether there is a mathematical algorithm at work, but on whether the algorithm-containing invention, as a whole, produces a tangible, useful, result.

In light of the above, and consistent with the clearer understanding that our more recent cases have provided, we conclude that the district court did not apply the proper analysis to the method claims at issue. Furthermore, had the court applied the proper analysis to the stated claims, the court would have concluded that all the claims asserted fall comfortably within the broad scope of patentable subject matter under § 101. Accordingly, we hold as a matter of law

that Excel was not entitled to the grant of summary judgment of invalidity of the '184 patent under § 101.

Since the case must be returned to the trial court for further proceedings, and to avoid any possible misunderstandings as to the scope of our decision, we note that the ultimate validity of these claims depends upon their satisfying the other requirements for patentability such as those set forth in 35 U.S.C. §§ 102, 103, and 112. Thus, on remand, those questions, as well as any others the parties may properly raise, remain for disposition.

CONCLUSION

The district court's summary judgment of invalidity is reversed, and the case is remanded for further proceedings consistent with this opinion.

REVERSED & REMANDED.

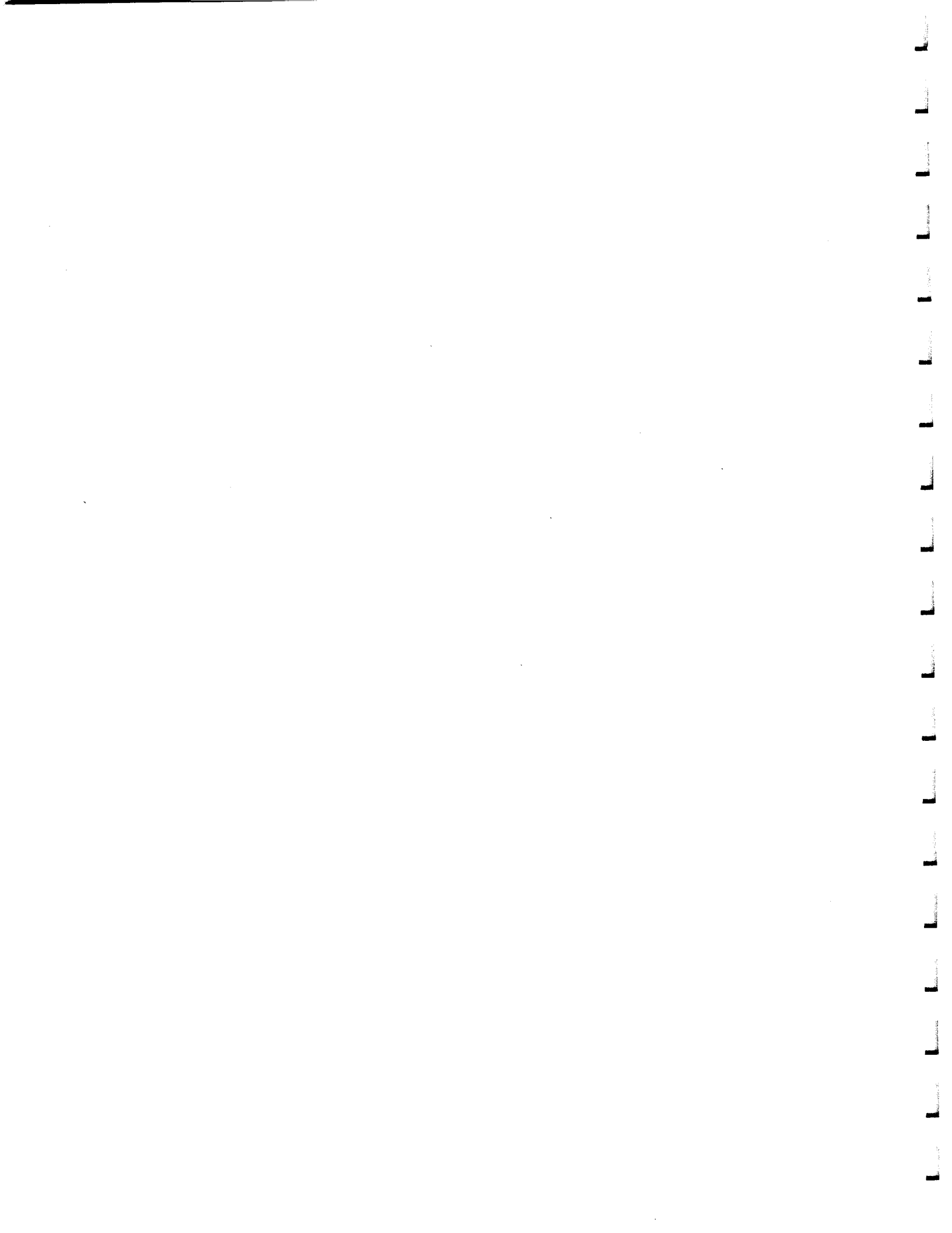
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BUSINESS METHOD PATENTS

A Litigation Perspective

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BUSINESS METHOD PATENTS:

A Litigation Perspective

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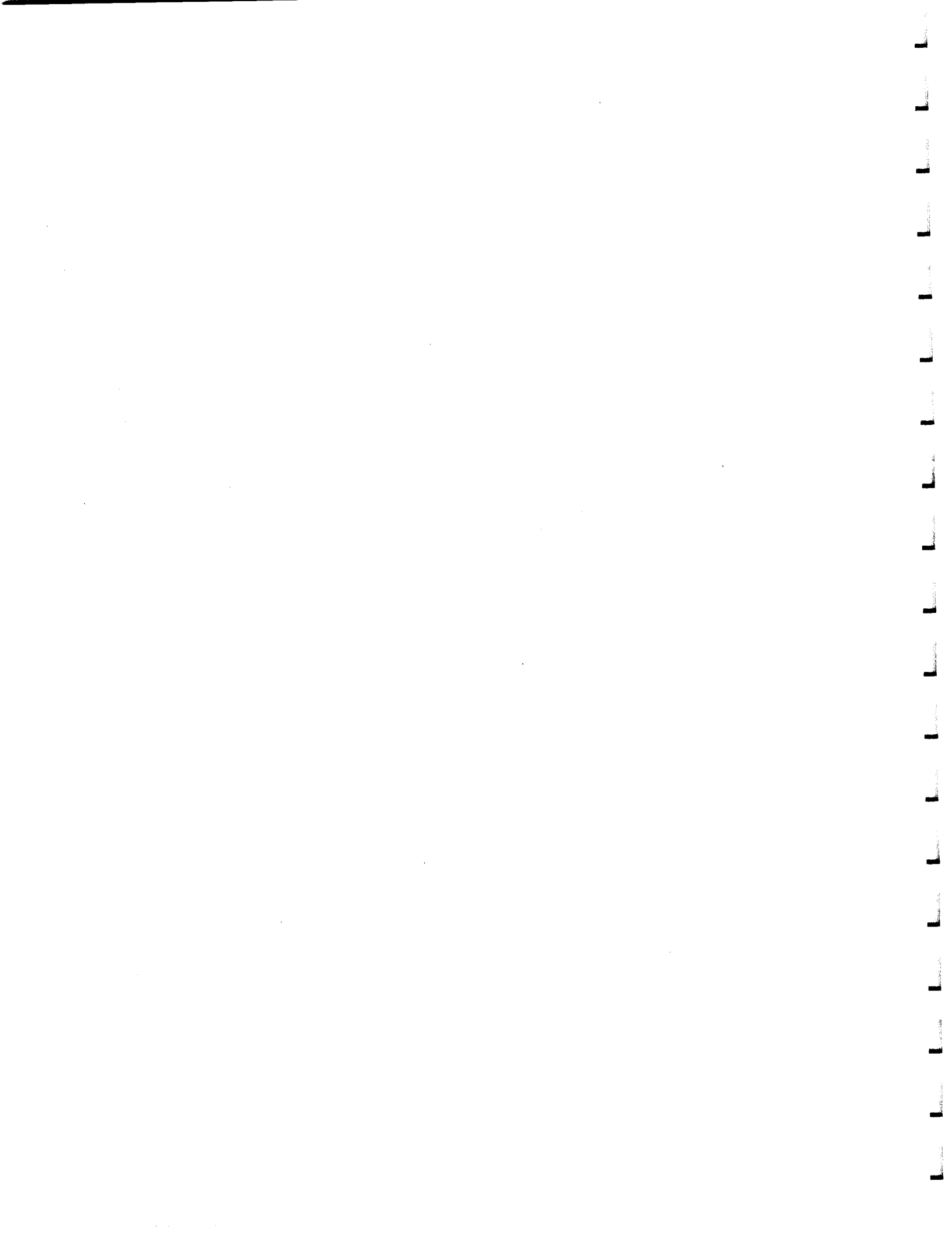
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I. Introduction.

Until lately, litigation over business method patents has been virtually unknown. Inventors have been reluctant to seek -- and the Patent & Trademark Office has been reluctant to grant -- patents for methods of doing business. That reluctance has been due in part to the vaguely held "business method" exception to what kinds of inventions constitute patentable subject matter under Section 101 of the Patent Act. In addition, prior to the recent advent of the Internet and e-commerce, "novel" and "non-obvious" business methods were somewhat hard to come by.

Two circumstances over the last several years, however, have conspired to change all of that. First, the United States Court of Appeals for the Federal Circuit, which has jurisdiction over all patent appeals, formally laid to rest the "ill-conceived" business method exception in its 1998 decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*¹ Second, the Internet Age for business arrived, and scores of novel business methods began springing up all over the place. As a result, Internet entrepreneurs began filing business method patent applications at a prodigious rate, and the Patent and Trademark Office began granting patents based on those applications. Now, it is quite clear to all concerned that novel business methods, and particularly novel *Internet* business methods, are "inventions" for which patent protection should be sought and vigorously enforced. As the *State Street* court noted in its opinion, patentable subject matter under section 101 extends to "anything under the sun that is made by man."²

¹149 F.3d 1368 (Fed. Cir. 1998), *cert. denied*, 119 S.Ct. 851 (1999).

²*Id.* at 1373 (quoting *Diamond v. Chakrabarty*, 447 U.S. 303, 309, 65 L. Ed. 2d 144, 100 S. Ct. 2204 (1980)).

Because business over the Internet began to take off in the mid- to late-1990's, that is when many Internet businesses — such as Amazon.com and Priceline.com — began filing patents applications on their new ways to do business over the Internet. With the several-year examination period that is typical for all patent applications, those early Internet patent applications have only recently begun to issue. Combined with the fact that patent applications are kept confidential by the Patent and Trademark Office during the examination period, that fact has resulted in several companies doing business on the Internet suddenly being hit with infringement actions during the past year. For instance, Barnesandnoble.com has been sued by its online bookseller rival Amazon.com for infringement of Amazon's patent on "one-click ordering" over the Internet. Likewise, Microsoft has been made the target of an infringement action by Priceline.com, which claims that Microsoft's Expedia travel site infringes Priceline's "reverse auction" patent. Finally, in what may be the most interesting situation of them all, online advertiser L90, Inc., was served with a potentially devastating patent infringement lawsuit by its competitor, DoubleClick, Inc., just before it was planning to go public. In short, the beginnings of what may turn out to be a flood of litigation between Internet competitors has now begun.

II. *Priceline.com, Inc. v. Microsoft Corp., et al.*

U.S. District Court for the District of Connecticut (New Haven)

Filed October 13, 1999

Case No. 99-CV-1991

A. PARTIES.

Plaintiff: Priceline.com Inc.

Defendants: Microsoft Corp.
Expedia, Inc.

B. ATTORNEYS.

Plaintiff: Cummings & Lockwood
Cravath, Swaine & Moore

Defendants: Pennie & Edmonds
Day, Berry & Howard

C. PATENT.

Patent No.: 5,794,207

Application Date: September 4, 1996

Issue date: August 11, 1998

Abstract:

The present invention is a method and apparatus for effectuating bilateral buyer-driven commerce. The present invention allows prospective buyers of goods and services to communicate a binding purchase offer globally to potential sellers, for sellers conveniently to search for relevant buyer purchase offers, and for sellers potentially to bind a buyer to a contract based on the buyer's purchase offer. In a preferred embodiment, the apparatus of the present invention includes a controller which receives binding purchase offers from prospective buyers. The controller makes purchase offers available globally to potential sellers. Potential sellers then have the option to accept a purchase offer and thus bind the corresponding buyer to a contract. The method and apparatus of the present invention have applications on

the Internet as well as conventional communications systems such as voice telephony.

Claims:

1. A method for using a computer to facilitate a transaction between a buyer and at least one of sellers, comprising:

inputting into the computer a conditional purchase offer which includes an offer price;

inputting into the computer a payment identifier specifying a credit card account, the payment identifier being associated with the conditional purchase offer;

outputting the conditional purchase offer to the plurality of sellers after receiving the payment identifier;

inputting into the computer an acceptance from a seller, the acceptance being responsive to the conditional purchase offer; and

providing a payment to the seller by using the payment identifier.

2. The method of claim 1, in which the step of inputting into the computer an acceptance comprises:

inputting into the computer an acceptance from each member of a set of sellers, the set of sellers comprising at least one seller, each acceptance being responsive to the conditional purchase offer;

and further comprising:

selecting one received acceptance, thereby determining a selected seller of the set of sellers;

and in which the step of providing a payment comprises:

providing a payment to the selected seller by using the payment identifier.

3. The method of claim 2, in which the step of selecting one received acceptance comprises:

determining a first received acceptance, thereby determining a first seller of the set of sellers;

and in which the step of providing a payment comprises:

providing a payment to the first seller by using the payment identifier.

4. The method of claim 1, further comprising:

determining if a predetermined amount is available in the credit card account.

5. The method of claim 1, in which the step of providing a payment comprises: transferring payment from the buyer to the selected seller.

6. The method of claim 1, in which the step of providing a payment comprises: transmitting the payment identifier to the selected seller.

7. The method of claim 1, further comprising:
outputting to the buyer a request for an authorization to use the payment identifier to provide payment if an acceptance is received; and
inputting into the computer the authorization from the buyer in response to the request.

8. The method of claim 1, in which the step of inputting into the computer an acceptance comprises:
inputting into the computer an acceptance from each of a set of sellers.

9. The method of claim 1 in which the conditional purchase offer includes an expiration date and is non-revocable prior to the expiration date.

10. The method of claim 1, further comprising:
determining an active period during which the conditional purchase offer is active;
and in which the step of inputting into the computer an acceptance is performed during the active period.

11. The method of claim 1, further comprising:
inputting into the computer a revocation of the conditional purchase offer after the step of receiving an acceptance; and in which the step of providing a payment comprises:
providing a payment of a predetermined amount to the seller.

12. An apparatus for facilitating a transaction between a buyer and at least one of a plurality of sellers, comprising:
a storage device; and
a processor connected to the storage device,
the storage device storing
a program for controlling the processor; and
the processor operative with the program to receive a conditional purchase offer which includes an offer price;
receive a payment identifier specifying a credit card account, the payment identifier being associated with the conditional purchase offer;
make the conditional purchase offer available to the plurality of sellers after receiving the payment identifier;
receive an acceptance from a seller, the acceptance being responsive to the conditional purchase offer; and
provide payment to the seller by using the payment identifier.

13. The apparatus of claim 12, in which the processor is further operative with the program to:
receive an acceptance from each member of a set of sellers, the set of sellers

comprising at least one seller, each acceptance being responsive to the conditional purchase offer;
select one received acceptance, thereby determining a selected seller of the set of sellers; and
provide a payment to the selected seller by using the payment identifier.

14. The apparatus of claim 13, in which the processor is further operative with the program to:
determine a first acceptance received, thereby determining a first seller of the set of sellers; and
provide a payment to the first seller by using the payment identifier.

15. The apparatus of claim 12, in which the processor is further operative with the program to:
determine if a predetermined amount is available in the credit card account.

16. The apparatus of claim 21, in which the processor is further operative with the program to:
transfer payment from the buyer to the seller.

17. The apparatus of claim 12, in which the processor is further operative with the program to:
transmit the payment identifier to the seller.

18. The apparatus of claim 12, in which the processor is further operative with the program to:
output to the buyer a request for an authorization to use the payment identifier to provide payment if an acceptance is received; and
receive the authorization from the buyer in response to the request.

19. The apparatus of claim 12, in which the processor is further operative with the program to:
receive an acceptance from each of a set of sellers.

20. The apparatus of claim 12, in which the conditional purchase offer includes an expiration date and is non-revocable prior to the expiration date.

21. The apparatus of claim 12, in which the processor is further operative with the program to:
determine an active period during which the conditional purchase offer is active; and
receive an acceptance during the active period.

22. The apparatus of claim 12, in which the processor is further operative with the program to:
receive a revocation of the conditional purchase offer after receiving an acceptance;
and
provide a payment of a predetermined amount to the seller.

23. A method for using a computer to facilitate a transaction between a buyer and at least one of a plurality of sellers, comprising:
inputting into the computer a conditional purchase offer which includes an offer price;
inputting into the computer a payment identifier specifying a financial account, the payment identifier being associated with the conditional purchase offer;
outputting to the buyer a request for authorization to use the payment identifier to provide a payment if an acceptance is received;
inputting into the computer authorization from the buyer in response to the request;
outputting the conditional purchase offer to the plurality of sellers after receiving the payment identifier;
inputting into the computer an acceptance from a seller, the acceptance being responsive to the conditional purchase offer; and
providing the payment to the seller by using the payment identifier.

24. The method of claim 23, in which the step of inputting into the computer an acceptance comprises:
inputting into the computer an acceptance from each member of a set of sellers, the set of sellers comprising at least one seller, each acceptance being responsive to the conditional purchase offer;
and further comprising;
selecting one received acceptance, thereby determining a selected seller of the set of sellers;
and in which the step of providing a payment comprises:
providing a payment to the selected seller by using the payment identifier.

25. The method of claim 24, in which the step of selecting an acceptance received comprises:
determining a first acceptance received, thereby determining a first seller of the at least one seller;
and in which the step of providing a payment comprises:
providing a payment to the first seller by using the payment identifier.

26. The method of claim 23, in which the financial account is a credit card account.

27. The method of claim 26, further comprising:
determining if a predetermined amount is available in the credit card account.

28. The method of claim 23, farther comprising:
transferring payment from the buyer to the seller.

29. The method of claim 23 in which the step of providing a payment comprises:
transmitting the payment identifier to the seller.

30. The method of claim 23, in which the step of inputting into the computer an
acceptance comprises:
inputting into the computer an acceptance from each of a set of sellers.

31. The method of claim 23, in which the conditional purchase offer includes an
expiration date and is non-revocable prior to the expiration date.

32. The method of claim 23, further comprising:
determining an active period during which the conditional purchase offer is active;
and in which the step of inputting into the computer an acceptance is performed
during the active period.

33. The method of claim 23, further comprising:
inputting into the computer a revocation of the conditional purchase offer after the
step of receiving an acceptance; and in which the step of providing a payment
comprises:
providing a payment of a predetermined amount to the seller.

34. An apparatus for facilitating a transaction between a buyer and at least one of a
plurality of sellers, comprising:
a storage device; and
a processor connected to the storage device,
the storage device storing
a program for controlling the processor; and
the processor operative with the program to
receive a conditional purchase offer which includes an offer price;
receive a payment identifier specifying a financial account, the payment identifier
being associated with the conditional purchase offer;
output to the buyer a request for an authorization to use the payment identifier to
provide a payment if an acceptance is received;
receive the authorization from the buyer in response to the request;
transmit the conditional purchase offer to the plurality of sellers after receiving the
payment identifier;
receive an acceptance from a seller, the acceptance being responsive to the

transmitted conditional purchase offer; and
provide the payment to the seller by using the payment identifier.

35. The apparatus of claim 34, in which the processor is further operative with the program to:

receive an acceptance from each member of a set of sellers, the set of sellers comprising at least one seller, each acceptance being responsive to the conditional purchase offer;

select one received acceptance, thereby determining a selected seller of the set of sellers; and

provide a payment to the selected seller by using the payment identifier.

36. The apparatus of claim 35, in which the processor is further operative with the program to:

determine a first acceptance received, thereby determining a first seller of the set of sellers; and

provide a payment to the first seller by using the payment identifier.

37. The apparatus of claim 34, in which the financial account is a credit card account.

38. The apparatus of claim 37, in which the processor is further operative with the program to:

determine if a predetermined amount is available in the financial account.

39. The apparatus of claim 34, in which the processor is further operative with the program to:

transfer payment from the buyer to the seller.

40. The apparatus of claim 34, in which the processor is further operative with the program to:

transmit the payment identifier to the seller.

41. The apparatus of claim 34, in which the processor is further operative with the program to:

receive an acceptance from each of a set of sellers.

42. The apparatus of claim 34, in which the conditional purchase offer includes an expiration date and is non-revocable prior to the expiration date.

43. The apparatus of claim 34, in which the processor is further operative with the program to:

determine an active period during which the conditional purchase offer is active; and

receive an acceptance during the active period.

44. The apparatus of claim 34, in which the processor is further operative with the program to:
receive a revocation of the conditional purchase offer after receiving an acceptance;
and
provide a payment of a predetermined amount to the seller.

III. *Rosengard v. Land's End, Inc., et al.*

U.S. District Court, Southern District of New York
Filed October 18, 1999
Case No. 99-CV-10614

A. PARTIES.

Plaintiff: Andrea L. Rosengard

Defendants: Public Technologies Multimedia, Inc.
J.C. Penney Company, Inc.
Land's End, Inc.
Mattel, Inc.
Broderbund Software, Inc.
Hearst Corporation
Federated Department Stores, Inc.

B. ATTORNEYS.

Plaintiff: Fish & Neave

Defendants: Morrison & Foerster, LLP

C. PATENT.

Patent No.: 5,930,769

Application Date: October 7, 1996

Issue date: July 27, 1999

Abstract:

The present invention provides a method of manual fashion shopping and method for electronic fashion shopping by a customer using a programmed computer, CD-ROM, television, Internet or other electronic medium such as video. The method comprises receiving personal information from the customer; selecting a body type and fashion category based on the personal information; selecting fashions from a plurality of clothes items based on the body type and fashion category; outputting a plurality of fashion data based on the selected fashions; and receiving selection information from the customer.

Claims:

1. A method of fashion shopping by a customer comprising the steps of: receiving personal information from the customer; selecting a body type and fashion category based on the personal information; selecting fashions from a plurality of clothes items based on the body type and fashion category; outputting a plurality of fashion data based on the selected fashions; receiving selection information from the customer; and processing order information to place an order for the selected fashions.
2. A method as in claim 1 wherein the personal information includes a digitized image of the customer's face.
3. A method as in claim 1 wherein the personal information includes an electronic commerce identifier for billing purposes.
4. A method as in claim 1 wherein the fashion category provided is selected from the group consisting of petite, short, average, and tall.
5. A method as in claim 1 wherein said clothes items are a clothes category selected from the group consisting of day suits, evening suits, dresses, robes, coats, active sports, sportswear, casual wear, and at home wear.
6. A method as in claim 1 wherein said fashion data comprises providing available colors, manufacturer's prices, styles, and sizes.
7. A method as in claim 1 further comprising the step of determining on availability of selected fashions.

8. A method as in claim 1 wherein the method further comprises the step of receiving an order from the customer.
9. A method as in claim 1 further comprising the step of outputting a personal code number to identify the customer.
10. A method as in claim 1 wherein body type is a stature selected from the group consisting of full-bust/slight hip, normal, without a waistline, and slight bust/fuller hip.
11. A method as in claim 1 wherein the fashion category is selected from the group consisting of slim, athletic, stout, and portly stout.
12. A method as in claim 1 wherein the fashion category is selected from the group consisting of infant, toddler, children, pre-teen, and teen.
13. A method as in claim 1 wherein the fashions and fashion data are contained in a database.
14. A method as in claim 1 wherein the fashion data includes a garment description.
15. A method as in claim 1 wherein the fashion data includes accessory style number, accessory description, and accessory cost.
16. A method as in claim 1 further comprising the step of updating the selected fashions based on said received selection information.
17. A method as in claim 1 wherein the personal information includes the measurements of bust, hips, waist, arm length, height, and center front.
18. A method as in claim 17 wherein the measurements further comprise inseam, center length, and center depth.
19. A method as in claim 1 wherein the personal information includes a plurality of body measurements and a digitized picture of the customer's face.
20. A method as in claim 19 wherein the outputting the plurality of fashion data includes outputting a computerized simulated body type image corresponding to the

customer's body measurements and the digitized picture of the customer's face.

21. A method as in claim 1 further comprising the step of determining size and fit of a selected fashion.

22. A method as in claim 21 wherein determining the size and fit comprises the steps of displaying a closest size for the selected fashion and indicating where adjustments are necessary.

23. A method as in claim 21 further comprising determining an amount the selected fashion needs to be altered.

24. A method of electronic fashion shopping by a customer using an electronic medium comprising the steps of:
receiving a personal code number to access a database of fashions;
accessing a personal information record based on the inputted personal code number;
outputting a body type and body type data based on the personal information record;
receiving a clothes item to shop from the customer;
receiving selection information from the customer; and
outputting an order for the clothes item, an invoice for the customer and an inventory record of all items ordered by the customer.

25. A method as in claim 24 wherein receiving selection information from the customer is a step selected from the group consisting of placing an order, see another fashion, start again and see size and fit information.

26. A method as in claim 24 wherein the personal information record includes a digitized image of the customer's face.

27. A method as in claim 24 wherein the personal information record includes electronic commerce information for business purposes.

28. A method as in claim 24 wherein the clothes item is a clothing category selected from the group consisting of day suits, evening suits, dresses, robes, coats, active sports, sportswear, casual wear, and at-home wear.

29. A method as in claim 24 wherein the body type data is associated with data relating to which styles to wear and which styles to avoid.

30. A method as in claim 24 wherein the body type is a stature selected from the group consisting of full-bust/slight hip, normal, without a waistline, and slight bust/fuller hip.

31. A method as in claim 24 wherein the fashion data comprises providing available colors, manufacturer's prices, styles, and sizes.

32. A method as in claim 24 wherein the method further comprises the step of receiving an order from the customer.

33. A method as in claim 24 wherein the fashion data includes a garment description.

34. A method as in claim 24 further comprising the step of updating the selected fashions based on the received selection information.

35. A method as in claim 24 wherein the personal information record contains a plurality of body measurements for the customer.

36. A method as in claim 35 wherein the body measurements include bust, hips, waist, arm length, height, and center front.

37. A method as in claim 24 further including the step of determining a fashion category based on the personal information record.

38. A method as in claim 37 wherein the fashion category is selected from the group consisting of petite, short, average, and tall.

39. A method as in claim 37 wherein the fashion category is selected from the group consisting of slim, athletic, stout, and portly stout.

40. A method as in claim 37 wherein the fashion category is selected from the group consisting of infant, toddler, children, pre-teen, and teen.

41. A method as in claim 24 further comprising the step of determining size and fit of a selected fashion.

42. A method as in claim 41 wherein determining the size and fit comprises the steps of displaying a closest size for the selected fashion and indicating where adjustments

are necessary.

43. A method as in claim 41 further comprising determining the amount the selected fashion needs to be altered.

44. A method as in claim 41 further comprising the step of determining an availability of selected fashions.

45. A method for assisting in clothing shopping comprising:

receiving personal information from a person including a plurality of body measurements;

providing a database of clothing items, including multidimensional models of fit for the clothing items;

receiving a clothing type from the person;

selecting a clothing item of the clothing type from the database, the clothing item fit model of the selected clothing item, corresponding to the body type as determined by the received body measurements; and

outputting data relating to the result of modeling the person in the selected clothes item based on the personal information and the selected clothing item fit model.

IV. *Amazon.com, Inc. v. Barnesandnoble.com, et al.*

United States District Court for the West District of Washington (Seattle)

Filed October 21, 1999

Case No. 99-CV-1695

A. PARTIES.

Plaintiff: Amazon.com, Inc.

Defendants: Barnesandnoble.com, Inc.

B. ATTORNEYS.

Plaintiff: Perkins Coie
McCutchen Doyle Brown & Enersen

Defendants: Foster Pepper & Shefelman
Pennie & Edmonds

C. PATENT.

Patent No.: 5,960,411

Application Date: September 12, 1997

Issue date: September 28, 1999

Abstract:

A method and system for placing an order to purchase an item via the Internet. The order is placed by a purchaser at a client system and received by a server system. The server system receives purchaser information including identification of the purchaser, payment information, and shipment information from the client system. The server system then assigns a client identifier to the client system and associates the assigned client identifier with the received purchaser information. The server system sends to the client system the assigned client identifier and an HTML document identifying the item and including an order button. The client system receives and stores the assigned client identifier and receives and displays the HTML document. In response to the selection of the order button, the client system sends to the server system a request to purchase the identified item. The server system receives the request and combines the purchaser information associated with the client identifier of the client system to generate an order to purchase the item in accordance with the billing and shipment information whereby the purchaser effects the ordering of the product by selection of the order button.

Claims:

1. A method of placing an order for an item comprising:
under control of a client system,
displaying information identifying the item; and
in response to only a single action being performed, sending a request to order the item along with an identifier of a purchaser of the item to a server system;
under control of a single-action ordering component of the server system,
receiving the request;
retrieving additional information previously stored for the purchaser identified by the

identifier in the received request; and
generating an order to purchase the requested item for the purchaser identified by the
identifier in the received request using the retrieved additional information; and
fulfilling the generated order to complete purchase of the item
whereby the item is ordered without using a shopping cart ordering model.

2. The method of claim 1 wherein the displaying of information includes displaying
information indicating the single action.

3. The method of claim 1 wherein the single action is clicking a button.

4. The method of claim 1 wherein the single action is speaking of a sound.

5. The method of claim 1 wherein a user of the client system does not need to
explicitly identify themselves when placing an order.

6. A client system for ordering an item comprising:
an identifier that identifies a customer;
a display component for displaying information identifying the item;
a single-action ordering component that in response to performance of only a single
action, sends a request to a server system to order the identified item, the request
including the identifier so that the server system can locate additional information
needed to complete the order and so that the server system can fulfill the generated
order to complete purchase of the item; and
a shopping cart ordering component that in response to performance of an add-to-
shopping-cart action, sends a request to the server system to add the item to a
shopping cart.

7. The client system of claim 6 wherein the display component is a browser.

8. The client system of claim 6 wherein the predefined action is the clicking of a
mouse button.

9. A server system for generating an order comprising:
a shopping cart ordering component; and
a single-action ordering component including:
a data storage medium storing information for a plurality of users;
a receiving component for receiving requests to order an item, a request including an
indication of one of the plurality of users, the request being sent in response to only
a single action being performed; and

an order placement component that retrieves from the data storage medium information for the indicated user and that uses the retrieved information to place an order for the indicated user for the item; and
an order fulfillment component that completes a purchase of the item in accordance with the order placed by the single-action ordering component.

10. The server system of claim 9 wherein the request is sent by a client system in response to a single action being performed.

11. A method for ordering an item using a client system, the method comprising: displaying information identifying the item and displaying an indication of a single action that is to be performed to order the identified item; and in response to only the indicated single action being performed, sending to a server system a request to order the identified item whereby the item is ordered independently of a shopping cart model and the order is fulfilled to complete a purchase of the item.

12. The method of claim 11 wherein the server system uses an identifier sent along with the request to identify additional information needed to generate an order for the item.

13. The method of claim 12 wherein the identifier identifies the client system and the server system provides the identifier to the client system.

14. The method of claim 11 wherein the client system and server system communicate via the Internet.

15. The method of claim 11 wherein the displaying includes displaying an HTML document provided by the server system.

16. The method of claim 11 including sending from the server system to the client system a confirmation that the order was generated.

17. The method of claim 11 wherein the single action is clicking a mouse button when a cursor is positioned over a predefined area of the displayed information.

18. The method of claim 11 wherein the single action is a sound generated by a user.

19. The method of claim 11 wherein the single action is selection using a television

remote control.

20. The method of claim 11 wherein the single action is depressing of a key on a key pad.

21. The method of claim 11 wherein the single action is selecting using a pointing device.

22. The method of claim 11 wherein the single action is selection of a displayed indication.

23. The method of claim 11 wherein the displaying includes displaying partial information supplied by the server system as to the identity of a user of the client system.

24. The method of claim 11 wherein the displaying includes displaying partial shipping information supplied by the server system.

25. The method of claim 11 wherein the displaying includes displaying partial payment information supplied by the server system.

26. The method of claim 11 wherein the displaying includes displaying a moniker identifying a shipping address for the customer.

V. *DoubleClick, Inc. v. L90, Inc.*

United States District Court for the Eastern District of Virginia (Norfolk)

Filed November 12, 1999

Case No. 99-CV-1914

A. PARTIES.

Plaintiff: DoubleClick Inc.

Defendant: L90, Inc.

B. ATTORNEYS.

Plaintiff: Morrison & Foerster
Willcox & Savage

Defendants: Kaufman & Canoles
Howrey & Simon

C. PATENT.

Patent No.: 5,933,811

Application Date: August 20, 1996

Issue date: August 3, 1999

Abstract: The present invention is a system and method for delivering customized electronic advertisements in an interactive communication system. The customized advertisements are selected based on consumer profiles and are then integrated with offerings maintained by different content providers. The preferred interactive communication system interconnects multiple consumer computers, multiple content provider computers and multiple Internet provider computers with an advertisement provider computer. Whenever a consumer directs one of the consumer computers to access an offering existing in one of the content provider computers, an advertising request is sent to the advertisement provider computer. Upon receiving the advertising request, the advertising provider computer generates a custom advertisement based on the consumer's profile. The custom advertisement is then combined with the offering from the content provider computer and displayed to the consumer. The advertisement provider computer also credits a consumer account, a content provider account and an internet provider account each time a consumer views a custom advertisement. Furthermore, the advertisement provider computer tracks consumer responses to the customized advertisements.

Claims:

1. An advertisement provider computer for customizing advertisements to be transferred via the internet, comprising:
a registration module executable at an advertisement provider computer, said registration module configured to allow a consumer to register consumer demographic information, and configured to allow a content provider to register content provider information;
an advertising module executable at said advertisement provider computer, said advertising module configured to select an advertisement based on said consumer demographic information and configured to transfer said advertisement to said consumer; and
an accounting database, wherein said advertisement provider computer is configured to access said accounting database to bill an advertiser and credit said content provider when said advertisement is transferred to said consumer.
2. The advertisement provider computer according to claim 1, wherein said registration module is further configured to create an advertisement request and to transfer said advertisement request to said content provider.
3. The advertisement provider computer according to claim 2, where said advertisement request comprises an advertisement provider computer identifier and a content provider script.
4. The advertisement provider computer according to claim 2, wherein said registration module is further configured to assign a consumer identification code to said consumer, and configured to transfer a consumer identification code to said consumer.
5. The advertisement provider computer according to claim 4, wherein said advertising module is further configured to accept said advertisement request and said consumer identification code from said consumer.
6. The advertisement provider computer according to claim 1, wherein said content provider information comprises content provider demographic information, and wherein said advertisement is selected based on both said consumer demographic information and said content provider demographic information.
7. The advertisement provider computer according to claim 1, further comprising:
a registration database configured to store registration information; and
an advertisement database configured to store advertisement information.

8. The advertisement provider computer according to claim 1, wherein said advertisement provider computer is further configured to access said accounting database to credit said consumer when said advertisement is transferred.

9. The advertisement provider computer according to claim 1, wherein the advertising module is further configured to track consumer activities.

10. The advertisement provider computer according to claim 9, wherein said consumer activities relate to said advertisement, and wherein said accounting database is further configured to update billing information based on said consumer activities.

11. The advertisement provider computer according to claim 1, wherein said advertisement provider computer is associated with a website which is comprised of a plurality of computers.

12. A method of providing a customized advertisement, comprising:
registering a consumer and consumer demographic data at an advertisement provider computer;
registering a content provider and content provider data at said advertisement provider computer;
receiving a request for an advertisement at said advertisement provider computer;
accessing with said advertisement provider computer, a database of advertisements which associates an advertisement with one or more advertisers;
selecting with said advertisement provider computer, at least one of said advertisements from said database of advertisements based on said consumer demographic data;
transferring said selected advertisement from said advertisement provider computer to said consumer through the internet;
providing a bill from said advertisement provider computer to the associated advertiser, said bill based on said selected advertisement; and
providing a credit from said advertisement provider computer to said content provider, said credit based on said selected advertisement.

13. The method according to claim 12, wherein said request identifies at least said advertisement computer, said content provider, and said consumer.

14. The method according to claim 12, wherein said content provider data comprises content provider demographic data, and wherein said selection of at least one advertisement is based on both said consumer demographic data and said content

provider demographic data.

15. The method according to claim 12, further comprising providing a consumer credit from said advertisement provider computer to said consumer, said consumer credit based on said selected advertisement.

16. The method according to claim 12, further comprising tracking activities of said consumer.

17. The method according to claim 16, further comprising updating one of said bill, said credit, and said consumer credit, based on said activities .

VI. Suggested Readings.

1. James Gleik, *Patently Absurd*, NEW YORK TIMES MAGAZINE, p. 44 (March 12, 2000).
2. John Roemer, *Are Soft Patents Hard On E-Commerce?* THE INDUSTRY STANDARD'S NET LAW (Feb. 29, 2000).
3. George Washington University Law School and Oracle Corporation Symposium on Intellectual Property Rights In Methods of Doing Business, FORDHAM INTELLECTUAL PROPERTY, MEDIA & ENTERTAINMENT LAW JOURNAL, Vol. 10 (Fall 1999).
4. Gary N. Frischling and Tami K. Lefko, *Online Patents: Navigating the Minefield*, THE COMPUTER LAW ASSOCIATION BULLETIN, Vol. 14, No. 4, p. 127 (1999).
5. Michael Geist, *A Patently Obvious Threat to E-commerce*, GLOBE TECHNOLOGY.COM (<http://www.globetechnology.com/archive/gam/E-Business/20000127/TWGEIS.html>) (visited March 11, 1999).
6. Robert P. Merges, *As Many As Six Impossible Business Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 BERKELEY TECHNOLOGY LAW JOURNAL p. 577 (Spring 1999).
7. Jeff Bezos, *An Open Letter From Jeff Bezos On The Subject Of Patents* (<http://www.amazon.com/exec/obidos/subst/misc/patents.html/102-5312131-3713602>) (visited 3/11/00).

APPENDIX

Amazon.com, Inc. v. Barnesandnoble.com, Inc., et al

**United States District Court
Western District of Washington at Seattle
No. C99-1695P**

Order On Plaintiff's Motion For Preliminary Injunction

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE**

**AMAZON.COM, INC.,
*Plaintiff,***

v.

**BARNESANDNOBLE.COM, INC., and
BARNESANDNOBLE.COM, LLC,
*Defendants.***

No. C99-1695P

**ORDER ON PLAINTIFF'S
MOTION FOR PRELIMINARY
INJUNCTION**

I. INTRODUCTION

On October 21, 1999, Plaintiff Amazon.com filed a complaint in this Court alleging patent infringement by Defendants Barnesandnoble.com Inc. and Barnesandnoble.com LLC (hereinafter referred to collectively as "Barnesandnoble.com"). The patent in question is United States Patent No. 5,960,411 (the '411 patent), which was issued on September 28, 1999. The '411 patent describes a Method and System for Placing a Purchase Order Via a Communications Network and includes 26 claims.

The '411 patent, in essence, describes a method and system in which a consumer can complete a purchase order for an item via the Internet using only a single action (such as a single click of a computer mouse button) once information identifying the item is displayed to the consumer. This method and system is only applicable in situations where a retailer already has in its files various information about the purchaser (such as the purchaser's address and credit card number) and where the purchaser's client system (e.g., a personal computer) has been provided with an identifier that enables the retailer's server system to identify the purchaser.

Amazon.com alleges that Defendants' "Express Lane" ordering feature infringes various claims of the '411 patent. Concurrently with its complaint, Amazon.com filed a motion for a preliminary injunction to enjoin Barnesandnoble.com from infringing the '411 patent. Amazon.com properly noted a hearing on the motion for a preliminary injunction in accordance with the local rules of this Court for November 12, 1999. After the Court denied Defendants' motion to reschedule the hearing to January of 2000, the parties fully briefed their arguments and conducted expedited discovery, including a number of depositions. An evidentiary hearing on Plaintiff's motion began on November 16, 1999, and was conducted over five days.

Amazon.com presented live testimony at the hearing from the following witnesses: Mr. Henry Manbeck, an attorney and former Commissioner of Patents and Trademarks; Mr. Jeffrey Bezos, the chairman and chief executive officer of Amazon.com; and Mr. Geoffrey Mulligan, who was

presented as an expert on electronic commerce ("e-commerce"). Barnesandnoble.com presented live testimony at the hearing from the following witnesses: Dr. John Lockwood, an assistant professor of computer science at Washington University in St. Louis and the developer of a program called Web Basket; Mr. Alexander Trevor, a technology consultant and a former employee of CompuServe, Inc.; Mr. Gary King, the chief information officer for Barnesandnoble.com; and Mr. Jonathan Bulkeley, the chief executive officer of Barnesandnoble.com. In addition, the parties jointly submitted deposition designations from the following individuals: Mr. Shel Kaphan, who is listed as an inventor of the '411 patent; Dr. Eric Johnson, a professor at the Columbia School of Business who was presented as an expert on e-commerce issues; Mr. Martin Adelman, a professor at the George Washington University School of Law; and Mr. Donald Carli, the founder and principal of Nima Hunter, Inc., which provides services related to e-commerce.

Defendants raised a number of defenses in their pleadings and during the hearing. In support of their position that Amazon.com is not likely to succeed at a trial on the merits, Defendants placed particular emphasis on arguments that the '411 patent is invalid on obviousness and anticipation grounds and that the Express Lane feature does not infringe any claims in the '411 patent. To a lesser extent, Defendants also suggested that the '411 patent is unenforceable. In addition, Defendants argued that Amazon.com could not demonstrate irreparable harm, that the balance of hardships did not tip in Amazon.com's favor, and that the public interest would not be served by issuance of a preliminary injunction.

On November 22, 1999, following the testimony of all witnesses and the submission of evidence, the parties presented proposed findings of fact and conclusions of law to the Court. The Court heard closing arguments on November 23, 1999. Based on the papers, pleadings, testimony, evidence, and arguments presented by the parties, the Court finds that Plaintiff has demonstrated: (1) a reasonable likelihood of success on the merits at trial; (2) it will suffer irreparable harm if the preliminary injunction is not granted; (3) the balance of hardships tips in its favor; and (4) the preliminary injunction sought is in the public interest. Although Defendants have raised a number of defenses concerning the validity of the patent and infringement of the patent, Plaintiff has shown that the defenses asserted by Defendant lack substantial merit. Therefore, the Court hereby GRANTS Plaintiff's motion for a preliminary injunction.

The Preliminary Injunction is effective at 12:01 a.m. P.S.T. on Saturday, December 4, 1999, and upon Amazon.com's filing an undertaking in the sum of \$10,000,000, and shall remain in effect during the pendency of this action. Defendants may, however, continue to offer an Express Lane feature if the feature is modified in a manner that is consistent with this Order to avoid infringement of the '411 patent.

Pursuant to Fed.R.Civ.P. 52(a), the Court's findings of facts and conclusions of law are set forth below.

II. FINDINGS OF FACT

Background

1. Plaintiff Amazon.com, Inc. ("Amazon.com") is a Delaware corporation with its principal place of business at Seattle, Washington. Through its website, www.amazon.com, the company enables customers to find and purchase books, music, videos, consumer electronics, games, toys, gifts, electronic greeting cards, and other items over the World Wide Web. (Ex. 11, Bezos Decl. §3).

Amazon.com is the leading online retailer of books. (Ex. A-18 at 19, §2).

2. Defendant Barnesandnoble.com LLC is a Delaware limited liability company with its principal place of business at New York, New York. Barnesandnoble.com LLC operates a website through which it distributes books, software, music, and other items. (Ex. 36 at 6).

3. Defendant Barnesandnoble.com Inc. is a Delaware corporation with its principal place of business at New York, New York. Barnesandnoble.com Inc. is a holding company whose sole asset is a 20% share in Barnesandnoble.com LLC, and whose business is acting as sole manager of Barnesandnoble.com LLC. Barnesandnoble.com Inc. controls all major business decisions of Barnesandnoble.com LLC. Collectively, these two defendants are referred to herein as "Barnesandnoble.com." (Ex. 36).

4. Sometime before May 1997, Amazon.com CEO Jeffrey Bezos conceived of an idea to enable Amazon.com customers to purchase items with a single-click of a computer mouse button. (Tr. at 123:4-22, 124:1-12 (Bezos)). This idea was commercially implemented by Amazon.com in September of 1997. (Tr. at 125:9-13 (Bezos)).

5. On September 28, 1999, United States Patent No. 5,960,411 (the "'411 patent'"), entitled "Method and System for Placing a Purchase Order Via a Communications Network," was issued. (Complaint, Ex. A). The filing date for the '411 patent is September 21, 1997. (*Id.*). The patent was assigned to and is owned by Amazon.com.

6. The evidence indicates that before granting the patent, the examiner assigned to the patent searched the data base of patents available at the Patent and Trademark Office (PTO), and obtained a search of private databases through the PTO's Science and Technology Information Center ("STIC"). Additionally, the examiner commissioned a third-party search firm to perform a search for potential non-patent prior art. (Tr. at 62:20-25 (Manbeck); Ex. 13, Manbeck Decl. at ¶¶8, 9). The examiner also conferred with more senior examiners and counsel to insure that the patent involved patentable subject matter. (Tr. at 60:16-63:14; 65:2-10; 72:20-73:9 (Manbeck); Ex. 13, Manbeck Decl. at ¶10). The evidence from the patent's file history and the testimony of former Commissioner Manbeck indicates that the patent was thoroughly examined by the PTO before issuance. (Tr. at 73:10-13 (Manbeck); Ex. 13, Manbeck Decl. at ¶11).

Prior Art

7. Plaintiff's expert Geoffrey Mulligan testified that except for single-action ordering and the implementation of single-action ordering without a shopping cart model, everything in the independent claims of the '411 patent (claims 1, 6, 9, and 11) is in prior art. (Tr. at 180:14-181:3).

8. In support of their arguments that the single-action ordering element of the '411 patent is invalid on obviousness and anticipation grounds, Defendants offered evidence concerning several prior art references. This evidence of prior art falls into two general categories: systems for ordering tangible items online (such as groceries or computer equipment) and electronic document delivery systems. In the former category were Dr. John Lockwood's Web Basket system, the Netscape Merchant System described in the "Creating a Virtual Store" reference, and the "Oliver's Market" web pages. In the latter category were the CompuServe financial information service represented by Mr. Alexander Trevor's testimony regarding the "Trend" feature, and U.S. Patent No. 5,708,780 (the '780 patent). It is undisputed that these prior art references were not before the PTO when the '411 patent was

examined.

Web Basket

9. Defendants presented evidence regarding an on-line ordering system called "Web Basket" that was developed in and around August 1996 by Defendants' expert Dr. John Lockwood. (Tr. at 214:23-216:2; 218:13-229:18 (Lockwood); Ex. A-56, Lockwood Decl. ¶9). Defendants argue that Web Basket anticipates at least claims 6-8 of the '411 patent and that this reference, either alone or in combination with other prior art references, renders the claims of the '411 patent obvious.

10. Web Basket requires users to accumulate items into a virtual shopping basket and to check these items out when they are finished shopping. (Tr. at 175:6-17; 176:7-179:13 (Mulligan); Ex. 12, Mulligan Supp. Decl. at ¶29). Web Basket also requires several confirmation steps for even preregistered users to complete their purchases. (Ex. 12, Mulligan Supp. Decl. at ¶¶18-22; Ex. A-56, Lockwood Deck ¶¶41-44).

11. The Court finds that Web Basket requires a multiple-step ordering process from the time that an item to be purchased is displayed. (See Tr. at 275:7-276:5). These multiple steps are inconsistent with the single-action requirements of the '411 patent.

12. On cross-examination, Dr. Lockwood admitted that it "could have" been simpler for a person purchasing from Web Basket to purchase items using only one click of a computer mouse, but he admitted that he never considered making single-action ordering an available option to users. (Tr. at 277:19-23 (Lockwood)).

Netscape Merchant System

13. Defendants also presented as a prior art reference an excerpt from a book entitled "Creating the Virtual Store" that was copyrighted in 1996. (Ex. A-63; Ex. 27). Defendants focused on the following language from this reference: "Merchants also can provide shoppers with an instant buy button for some or all items, enabling them to skip check out review. This provides added appeal for customers who already know the single item they want to purchase during their shopping excursion." (Ex. 27 at 7; Tr. at 309:23-310:18; 312:3-20 (Lockwood)). Defendants argue that the Netscape Merchant System reference anticipates each of the independent claims of the '411 patent and that this reference, either alone or in combination with other prior art references, renders the claims of the '411 patent obvious.

14. The balance of the Netscape article describes a multi-step shopping cart ordering model that requires both checkout and checkout review steps, (Ex. 27). A first step is required to put an item in the user's cart. Information identifying the item is then stored on the user's computer. A second "check-out" step is required to send that information to the merchant's computer. A third step of checkout review must occur after the transfer of the list of purchased items to the merchant's computer during the check-out step. The standard Netscape shopping cart therefore would appear to require a minimum of three steps by the user. (Tr. at 324:12-327:18 (Lockwood)).

15. Read in context, the few lines relied on by Defendants appear to describe only the elimination of the checkout review step, leaving at least two other required steps to complete a purchase. (Tr. at 327:10-18 (Lockwood); see also Ex. 27 at 7). Thus, apart from the words "instant buy," there is no indication that the Netscape system implements a single-action ordering component as required by

claims 6 and 9 of the '411 patent or a single action as required by claims 1 and 11 of the '411 patent. Moreover, Defendants' expert acknowledged that he did not know how the Netscape instant buy feature worked. (Tr. at 312:3-20; 350:7-12 (Lockwood)).

Oliver's Market

16. Defendants presented pages from a website entitled "Oliver's Market The Ordering System." (Ex. A-106). This web site may be accessed at www.sonic.net/~raptor/current/how2ordr.html. Defendants contend that the Oliver's Market system anticipates all of the independent claims of the '411 patent and that this reference, either alone or in combination with other prior art references, renders the claims of the '411 patent obvious.

17. Though the Oliver's Market reference begins with the sentence: "A single crick on its picture is all it takes to order an item," the ordering system described by the reference is a multi-step shopping cart model. (Ex. A-106).

18. The "single click" referred to in the first sentence is the click required to add an item to the user's shopping cart and does not complete the ordering process. After a single action is taken to select an item, the method described by this reference explicitly requires the user to take further actions to complete a purchase order, including: (1) specifying whether items will be picked up or delivered; (2) specifying the time that pickup or delivery is desired; and (3) indicating that the user is done shopping, which would appear to be the checkout procedure required by a standard shopping cart model. These additional actions are inconsistent with the single-action requirements of independent claims 1, 6, 9, and 11.

'780 patent

19. Defendants also presented testimony by Dr. Lockwood in support of their argument that U.S. Patent No. 5,708,780 (the '780 patent) anticipates or renders obvious claims of the '411 patent. The '780 Patent lists a filing date of June 7, 1995 and an issue date of January 13, 1998. (Ex. A-67). The title of the '780 patent is "Internet Server Access Control and Monitoring System." The description of the '780 patent is directed towards a service for controlling access to web documents within a particular domain. Defendants argue that the '780 patent anticipates claims 1 and 11 of the '411 patent.

20. In the '780 patent's preferred embodiment, a user browses the web conventionally. (Ex. A-67 at Col. 3, ll 21-22). A content server provides web documents to the user and determines when the user seeks access to "controlled" content, i.e., web pages for which the user needs authorization to browse. (*Id.* at Col. 3, ll 22-25; Fig. 2A).

21. The '780 patent does not explicitly show generating an order for an item. The record regarding whether and how the system of the '780 patent generates an order for an item consists entirely of Dr. Lockwood's testimony. Dr. Lockwood's testimony on this point is confusing and the witness appeared not to understand how the system described would function. Dr. Lockwood testified that generating an order takes place when the server system opens a file on its disk drive to read a controlled page. (Tr. at 305:1-19). Dr. Lockwood also testified that the user places an order by selecting a link to a controlled page. (Tr. at 302:5-303:5).

22. The testimony of Dr. Lockwood regarding this patent, as well as the '780 patent itself, describe a system in which controlled pages are simply returned to the user's browser when an authorized

request is received by the content server. (See Ex. A-67, fig. 3; Tr. at 309:2-16).

23. It appears that if billing is to take place at all in the '780 Patent system it would take place based on the logged transactions. (Tr. 306:9-15). In this regard, the '780 Patent system shows no more than a method for tracking what documents the users of an on-line information service like LEXIS or WESTLAW would request and then billing them based on these requests.

CompuServe Trend System

24. Defendants presented evidence that CompuServe offered a service called "Trend" beginning in the mid-1990s whereby CompuServe subscribers could obtain stock charts for an additional surcharge. Defendants presented screen shots from the current system and the testimony of a former CompuServe employee that the current screen shots were substantially the same as those provided to CompuServe subscribers in the mid 1990s. (Tr. at 369:12-20 (Trevor)). Defendants argue that the Trend System anticipates claim 11 of the '411 patent and renders obvious various claims of the patent.

25. The CompuServe system was not a world wide web application. (Tr. at 380:21-381:7 (Trevor)). Instead, after a user logged in, a persistent connection was established between the user's computer and CompuServe which lasted until the user logged off. (Tr. at 368:24-369:8; 380:25-381:16 (Trevor)). CompuServe, therefore, did not solve the problem of identifying users.

26. To order a chart from CompuServe, the user must first log in to the CompuServe service with his or her user ID and password, then select the Trend application dialogue box. Once that box appears, the user at a minimum must first (1) type in a stock ticker tape symbol and then (2) click on the chart button which becomes active once the user has typed the first letter of the ticker tape symbol. (Tr. at 377:25-378:18; 388:4-14 (Trevor)). The Court finds that this method involves two actions, not one. In addition, CompuServe does not begin processing any surcharge to the user's account until the user's computer performs an additional step of sending back a confirmation to CompuServe that the requested chart image was in fact accessed. (Tr. at 384:5-14 (Trevor)).

Summary of Prior Art

27. There are key differences between each of the prior art references cited by Defendants and the method and system described in the claims of the '411 patent. The Court finds that none of the prior art references offered by Defendants anticipate the claims of the '411 patent. On the question of obviousness, the Court finds that the differences between the prior art references submitted by Defendants and the '411 patent claims are significant. Moreover, there is insufficient evidence in the record regarding a teaching, suggestion, or motivation in the prior art that would lead one of ordinary skill in the art of e-commerce to combine the references. The Court finds particularly telling Dr. Lockwood's admission that it never occurred to him to modify his Web basket program to enable single-action ordering, despite his testimony that such a modification would be easy to implement. This admission serves to negate Dr. Lockwood's conclusory statements that prior art references teach to one of ordinary skill in the art the invention of the '411 patent. (Tr. at 319:5-320:22 (Lockwood)).

Barnesandnoble.com's Shopping Cart and Express Lane

28. Barnesandnoble.com offers customers two purchasing options. One is called Shopping Cart and the other is called Express Lane. (Ex. 9, Mulligan Decl. at ¶¶ 7, 8.i, Ex. H). The two methods are

separate and cannot be combined. (Tr. at 429:6-10 (King); Ex 9, Mulligan Decl. at Ex. I (noting "Express lane and the Shopping Cart are two different ways to place your order. You can't combine them.")). The Barnesandnoble.com Shopping Cart option includes the steps of a standard shopping cart model, including adding items to a virtual shopping cart and "checking out" to complete the purchase. (Ex. 9, Mulligan Decl. at ¶14j).

29. Barnesandnoble.com's Express Lane allows customers who have registered for the feature to purchase items by simply clicking on the Express Lane button shown on the detail or product page that describes and identifies the book or other item to be purchased. (Ex. 9, Mulligan Decl. at Ex. R). The text beneath the Express Lane button invites the user to "Buy it now with just click!" (*Id.*).

30. Throughout its web site, Barnesandnoble.com consistently describes Express Lane as a one-click ordering method. (Tr. at 463:15-464:10 (Bulkeley)). In its May 1999 prospectus, Barnesandnoble.com consistently described Express Lane as making one-click ordering possible. (*See, e.g.*, Ex. 36 at 6, 44, 47). In its November 1999 10-Q Report to shareholders, Barnesandnoble.com describes Express Lane as a one-click ordering system. (Ex. 39 at 13). It does not appear that Barnesandnoble.com has ever described the Express Lane ordering process as requiring more than one action, other than in the course of this litigation. (Tr. 471:1-4 (Bulkeley)).

31. Barnesandnoble.com began using the Express Lane feature in May of 1998, describing the feature in a press release as "Express Lane (SM) One Click Ordering" and noting that "[n]ow, visitors can click one button to order books, software and magazines." (Ex. 37).

32. Clicking on the shopping cart icon on the top of every Barnesandnoble.com page will not show the items that the user has purchased using the Express Lane. (Tr. at 430:14-17 (King)).

33. The strong similarities between the Amazon.com 1-click feature and the Express Lane feature subsequently adopted by Barnesandnoble.com suggest that Barnesandnoble.com copied Amazon.com's feature. (Ex. 10, Johnson Decl., ¶13).

Direct Evidence of Nonobviousness

34. Amazon.com has provided direct evidence of nonobviousness. Jeff Bezos, Amazon.com's founder and an inventor on the '411 patent, testified that because "many customers were tentative and somewhat fearful of on-line purchasing, conventional wisdom was that they had to be slowly and incrementally led to the point of purchase. In addition, consumers were not acclimated to rely without confirmation on stored personal information for correct shipping and billing." (Ex. 11 Bezos Decl. ¶9).

35. Professor Eric Johnson of Columbia Business School testified in his declaration that "Amazon.com's 1-Click® purchasing was a major innovation in on-line retailing that allows for purchasing without disrupting the consumer's shopping experience; and by eliminating additional confirmation requirements, recasts the default in a way that both maximizes the likelihood that consumers will complete their purchases and minimizes consumer anxiety over real or perceived issues of internet security." (Ex. 10, Johnson Decl. ¶12).

36. Moreover, despite their experience with prior art shopping cart models of on-line purchasing, both sides' technical experts acknowledged that they had never conceived of the invention. Mr. Mulligan testified that ordering with one click was "a huge leap from what was done in the past." (Tr.

at 190:25). Mr. Mulligan testified further that: "I've been working in electronic commerce for years now. And I've never thought of the idea of being able to turn a shopping cart or take the idea of clicking on an item and suddenly having the item ship-having the complete process done." (Tr. at 199:3-7). Mr. Mulligan also testified that he believed it was "a huge leap of faith for the website and the consumer to implement something like this." (Tr. at 199:12-14). Additionally, as noted above, Dr. Lockwood testified that he never thought of modifying Web Basket to provide single-action ordering. (Tr. at 277:19-23).

Objective Factors

37. plaintiff's single-action ordering method addressed an unsolved need that had been long-felt (at least in the relatively short period of time that e-commerce has existed), namely streamlining the on-line ordering process to reduce the high percentage of orders that are begun but never completed, *i.e.*, abandoned shopping carts. The problem of on-line consumers starting but abandoning shopping carts was acknowledged by both parties and their experts (Ex. 10, Johnson Dec. ¶8; Ex. 11, Bezos Decl. ¶8; Tr. at 473:14-474:5; (Bulkeley); Tr. at 418:1-420:12 (King)).

38. In the on-line industry in general and at Barnesandnoble.com in particular, over half of the shopping carts started by customers are abandoned before checkout. (Tr. at 418: 9-11 (King)). In an attempt to alleviate the problem of abandoned shopping carts, Barnesandnoble.com attempts to make the checkout process as simple and easy as possible. (Tr. at 473:24- 474:5 (Bulkeley); Tr. at 419:24-420:8 (King)). The single-action ordering invention of the '411 patent solves the problem by eliminating the checkout process entirely.

39. Barnesandnoble.com presented evidence that a number of other e-commerce retailers have offered single-action ordering to customers. (Tr. at 453:11-456:15 (Bulkeley)).

40. Amazon.com's single-action ordering is used by millions of customers, indicating the commercial success of the feature. (Ex. 11, Bezos Decl. ¶14). Barnesandnoble.com's Express Lane also accounts for a significant portion of its sales. (Ex. 28). Further evidence of commercial success of single-action ordering is suggested by the fact that Barnesandnoble.com promoted its Express Lane feature in a press release after it was announced (Ex. 37) and in its prospectus (Ex. 36 at 6, 44, and 47). Indeed, Barnesandnoble.com described Express Lane as one of its "major enhancements" to its on-line business. (*Id.* at 6).

41. Industry analysts and the popular press also found Amazon.com's single-action ordering process to be innovative. Patricia Seybold, an e-commerce observer and consultant, described Amazon.com's 1-Click® purchasing as "legendary." (Ex. 11, Bezos Decl. ¶14; Ex. A). Joseph Grallivan in *The New York Post* described Amazon.com's 1-Click® purchasing as a "seductive innovation." (Ex. 11, Bezos Decl. ¶14; Ex. B). *InfoWorld* indicated: "Net retailers are starting to realize that potential customers often don't make it as far as the virtual checkout line - - they fill their on-line shopping carts with products, then simply abandon them . . . Faced with these problems, it's no surprise that retailers have been eyeing Amazon.com's 1-click purchases with envy for some time now." (Ex. 11, Bezos Decl. ¶14).

Irreparable Harm

42. The harm that would be suffered by Amazon.com due to Barnesandnoble.com's infringement during the pendency of this case would be irreparable. The invention described in the '411 patent is of

significant commercial value, as evidenced, among other things, by the large number of customers who make use of single-action ordering available on the websites of both Amazon.com and Barnesandnoble.com, and by the large number of other e-commerce retailers whom Barnesandnoble.com claims have adopted single-action ordering. (Ex. 11, Bezos Decl. ¶14; Ex. 28; Tr. at 453:11-456:15 (Bulkeley)).

43. The harm Amazon.com would suffer if denied the benefit of using its invention to distinguish itself from its competitor Barnesandnoble.com could not easily be measured in dollars. (Tr. at 474:19-475:19 (Bulkeley)).

44. Amazon.com has pursued a strategy of innovating to distinguish its shopping experience from the competition, and it has made substantial investments to build customer relationships and broaden its customer base during the current growth phase of electronic commerce. (Tr. at 107:22-109:1 (Bezos); Ex. 10, Johnson Decl. ¶7).

45. Customers become loyal to sites with which they become familiar. Considerations such as ease of use and the availability of time-saving features are significant factors in determining the relative success of on-line enterprises. (Ex. 10, Johnson Decl. ¶4; Tr. at 122:4-11; 419:25 & 420:1-12). Creating easy-to-use and easy-to-learn consumer interfaces is a key aspect of e-commerce competition. Amazon.com's commercial success depends in part on its efforts to reduce its customers' time and effort in using its site. (Ex. 10, Johnson Decl. ¶7, *see also* Ex. 37, at 41).

46. One of Amazon.com's investments to improve its customers' experience and attract new customers was to develop single-action ordering. (Tr. at 123:4-124:6 (Bezos)). The feature has been popular with Amazon.com customers and the one-step ordering innovation has been praised in the industry. (Tr. at 125:9-126:6 (Bezos); Ex. 11, Bezos Decl. at ¶14, Exs. A, B).

47. A number of other e-commerce retailers, including Defendants, subsequently adopted systems that are essentially identical to the features of Amazon.com's single-action ordering process. With respect to Barnesandnoble.com, the Court finds that its later adoption of a single-action ordering system, Express Lane, eliminated a key point of differentiation between its website and Amazon.com's.

48. The harm to Amazon.com would be compounded if Barnesandnoble.com's infringement were permitted to continue during the 1999 holiday shopping season (Ex. 10, Johnson Decl. ¶16; Ex. 11, Bezos Decl. ¶20). There is no dispute that holiday seasons have historically been key periods for e-commerce customer acquisition and that they can have a significant effect on the long-term prospects of e-commerce businesses. (*See* Tr. at 474:9-18 (Bulkeley)). In 1998, for example, Amazon.com increased its customer base nearly 20% in just the last six weeks of the year, adding over a million new customer accounts in this time period. (Ex. 11, Bezos Decl. at ¶20). This year appears likely to be an even more significant season for customer acquisition. (Ex. 10 Johnson Decl. at ¶¶16-17; Ex. 11, Bezos Decl. at ¶20; Tr. at 108:3-16). Industry estimates for the amount that will be spent by consumers online in November and December of this year range from \$6 to 12 billion - - 2 to 3 times the amount spent during the same period in 1998. (Ex. 10; Johnson Decl. at ¶16, Exs. C, D)

49. As many as 10 million new users are expected to make their first on-line purchases during the 1999 holiday season. (Ex. 10; Johnson Decl. ¶16). Millions of these new customers are likely to be shopping at Amazon.com and Barnesandnoble.com for the first time. Long-term success in e-commerce depends on establishing positive relationships with these new on-line buyers now, to

preserve the ability to compete effectively for future sales, which by some estimates will reach \$78 billion by the year 2003. (Ex. 10, Johnson Decl., Ex. C; Tr: at 474:9-18).

50. If Barnesandnoble.com were able to continue to offer Express Lane as currently configured during the 1999 holiday season and for the pendency of this action, Amazon.com would not be able to distinguish itself from a key competitor by offering single-action ordering and would likely lose market share and customers to Barnesandnoble.com. The Court finds that this loss would not be easily compensable in damages. Exclusive rights to the patented invention are important to Amazon.com's ability to differentiate the customer experience available at its site from that of competitor sites such as Barnesandnoble.com.

II. CONCLUSIONS OF LAW

1. This Court has subject matter jurisdiction over Amazon.com's claim for patent infringement pursuant to 28 U.S.C. §§1331 and 1338(a). Defendants are subject to personal jurisdiction in this District because they have purposefully availed themselves of the privileges of conducting business in the State of Washington.
2. Venue is proper in this District pursuant to 28 U.S.C. §§1391(b) and 1400(b) because Defendants reside here (28 U.S.C. §1391(c)).
3. On September 28, 1999, United States Patent No. 5,960,411 (the "'411 patent'"), entitled "Method and System for Placing a Purchase Order Via a Communications Network," was duly and legally issued. The patent was assigned to and is owned by Amazon.com.

Preliminary Injunction Standard

4. "[T]o obtain a preliminary injunction, pursuant to 35 U.S.C. §283, a party must establish a right thereto in light of four factors: (1) reasonable likelihood of success on the merits; (2) irreparable harm; (3) the balance of hardships tipping in its favor; and (4) the impact of the injunction on the public interest." *Hybritech, Inc. v. Abbott Labs.*, 849 F.2d 1446, 1451 (Fed Cir. 1988).

A. Likelihood of Success on the Merits

Validity

5. The statutory presumption of validity, 35 U.S.C. §282, applies to all patents and is meant "to contribute stability to the grant of patent rights." *Magnivision, Inc. v. Bonneau Co.*, 115 F.3d 956, 958 (Fed. Cir. 1997). This presumption operates at every stage of the litigation, including in a motion for preliminary injunction against an alleged infringer. See *Canon Computer Systems, Inc. v. Nu-kote Int'l, Inc.*, 134 F.3d 1085, 1088 (Fed. Cir. 1998). A defendant may overcome this presumption, however, if he raises a "substantial question" concerning the validity of a patent and if the party seeking the injunction fails to show that this defense lacks "substantial merit." See *New England Braiding Co. v. A.W. Chesterton Co.*, 970 F.2d 878, 883 (Fed. Cir. 1992) (noting that "[w]hile it is not the patentee's burden to prove validity, the patentee must show that the alleged infringer's defense lacks substantial merit"). Defendants raise a number of questions regarding the '411 patent's validity, which the Court discusses below.

Anticipation

6. Anticipation is a question of fact, *see Atlas Powder Co. v. Ireco Inc.*, 190 F.3d 1342, 1346 (Fed. Cir. 1999), and is a defense only if "all of the same elements are found in exactly the same situation and united in the same way . . . in a single prior art reference." *Perkin-Elmer Corp. v. Computervision Corp.*, 732 F.2d 888, 894 (Fed. Cir. 1984). Although anticipation is a factual inquiry, the Court reiterates its findings and the applicable law here for ease of reference.

7. The Court finds that Web Basket does not anticipate any claim of the '411 patent. Each claim of the '411 patent requires either "a single-action ordering component" [claims 1-10] or "a single action that is to be performed to order the identified item" [claims 11-26]. The Web Basket ordering process requires that the user perform at least five actions to complete the order. Web Basket, therefore, does not include "a single-action ordering component" or "a single action that is to be performed to order the identified item."

8. In addition, claims 1-5 and 11-26 require that "the item is ordered without using a shopping cart ordering model" [claims 1-5] or "the item is ordered independently of a shopping cart model" [claims 11-26]. Because Web Basket is itself a shopping cart model, it lacks these required elements as well.

9. The description of the Netscape Instant Buy option presented by Defendants consisted of a total of four lines. Defendants' expert Dr. Lockwood was unable to supply any additional information regarding the feature described by this reference and ultimately admitted that he did not know how the feature worked. (Tr. at 312:3-20; 350:7-12). The Netscape reference therefore does not teach the invention to one of ordinary skill in the art (e.g., Dr. Lockwood) as is required of an anticipatory reference.

10. Moreover, when read in context, the reference appears to describe a shopping cart model with an option to skip one of the required checkout steps. Thus viewed in the best light for Defendants, the Netscape reference fails to anticipate any of the claims of the '411 for the same reasons as Web Basket: it does not include a single-action ordering component. Moreover, it does not appear to be independent of a shopping cart model, as required by claims 1 and 11.

11. Similarly, the Oliver's Market reference, when read as a whole, plainly discloses a multi-step shopping cart model. It, therefore, also lacks the same elements that are missing from Web Basket and Netscape: a single-action ordering component that is independent of a shopping cart model.

12. The '780 patent entitled "Internet Server Access Control and Monitoring System" also fails to anticipate any claim of the '411 patent. As discussed above, the system described in the '780 patent controls access to certain web pages. Even assuming that a web page is an "item" to be ordered as that term is used in the claims of the '411 patent, the access control system described in the '780 patent is not an ordering system.

13. Each claim of the '411 patent requires that the server system generate an order for the item requested by the customer. The requirement is described in slightly different terms in each of the independent claims but the import is the same: "generat[e] an order to purchase the requested item" (claim 1); "Locate additional information needed to complete the order and so that the server system can fulfill the generated order" (claim 6); "uses the retrieved information to place an order for the indicated user for the item" (claim 9); "whereby the item is ordered independently of a shopping cart model and the order is fulfilled to complete a purchase of the item" (claim 11).

14. The system described by the '780 patent merely delivers the requested web page to authorized users as would any other web server. The fact that the user may later be billed based on a log of pages that he or she has visited does not turn the standard delivery of web pages requested by a client into an order generation and fulfillment system as required by the claims of the '411 patent.

15. In addition, claims 6-10 of the '411 patent require a shopping cart ordering component in addition to the single action ordering component. The '780 patent does not disclose a shopping cart ordering component. That it appears impossible to "order" web pages using a shopping cart model suggests that web pages are not items to be ordered within the meaning of the claims '411 patent. In any case, the access control system of the '780 patent lacks the other claim elements, i.e., order generating step/component and the shopping cart ordering component required by the claims of the '411 and, therefore, does not anticipate them.

16. Finally, the CompuServe Trend service does not anticipate any claim of the '411 patent. Each claim of the '411 patent (except 9 and 10) requires (with slightly different language) displaying information identifying the item to be ordered and a single action to be taken to order the item: "displaying information identifying the item; and in response to only a single action being performed, sending a request to order the item" (claim 1); "a display component for displaying information identifying the item; a single action ordering component that in response to performance of only a single action, sends a request to a server system to order the identified item" (claim 6); "displaying information identifying the item and displaying an indication of a single action that is to be performed to order the identified item" (claim 11).

17. In the CompuServe Trend system, to receive a chart the user has to type in the ticker symbol identifying the stock for which they want to order a chart. The system does not, therefore, identify an item that a user could order with a single action. Thus, CompuServe does not anticipate claims 1-8 or 11-26.

18. As described above with respect to the '780 patent, claims 6-10 of the '411 patent require a shopping cart ordering component in addition to the single-action ordering component. There is no evidence that the CompuServe Trend service included a shopping cart component. It therefore does not, as Defendants acknowledge, anticipate claims 6-10.

Obviousness

19. "Included within the presumption of validity mandated by 35 U.S.C. §282 is a presumption of nonobviousness which the patent challenger must overcome by proving facts with clear and convincing evidence. The presumption remains intact even upon proof of prior art not cited by the Patent and Trademark Office (PTO), though such art, if more relevant than that cited, may enable the challenger to sustain its burden." *Perkin-Elmer Corp. v. Computervision Corp.*, 732 F.2d 888, 894 (Fed. Cir. 1984) (citations omitted).

20. The issue of obviousness is a mixed question of fact and law. The ultimate question is one of law, but it is based on several factual inquiries, including: (1) the scope and content of the prior art; (2) the differences between the prior art and the claims; (3) the level of ordinary skill in the pertinent art; and (4) applicable secondary considerations. *See Weatherchem Corp. v. J.L. Clark, Inc.*, 163 F.3d 1326, 1332 (Fed. Cir. 1998).

21. Defendants' evidence relating to invalidity of claims of the '411 patent on the ground of obviousness consists largely of Dr. Lockwood's statements that he could modify his Web Basket system to actually be a single-action ordering system, and that doing so would be an "obvious" or "trivial" modification of the Web Basket system. (Tr. at 229; Ex. A-56, Lockwood Deck ¶51) Dr. Lockwood, however, testified (as did Mr. Mulligan), that it had never occurred to him to do this. (Tr. at 277:19-23 (Lockwood); Tr. at 199:2-15 (Mulligan)). Mr. Mulligan further produced credible testimony why one skilled in the art would not, at the time the invention was made, have considered this modification. (Tr. at 190:21-191:2; 199:2-15).

22. In any event, whether it would be, at the present time, an "obvious" or "trivial" modification of the Web Basket system to include the "single action" feature of the '411 patent is legally irrelevant. The law is clear that the time period for any obviousness determination is "at the time the invention was made." 35 U.S.C. §103(a). *See also, In re Dembiczak*, 175 F.3d 994, 998-99 (Fed. Cir. 1999).

23. "[O]bjective indicia 'may often be the most probative and cogent evidence of nonobviousness in the record.'" *Gambro Lundia AB v. Baxter Healthcare Corp.*, 110 F.3d 1573, 1579 (Fed. Cir. 1997) (quoting *Stratoflex, Inc. v. Aeroquip, Corp.*, 713 F.2d 1530, 1538 (Fed. Cir. 1983)); *see also, Arkie Lures Inc. v. Gene Larew Tackle, Inc.*, 119 F.3d 953, 957 (Fed. Cir. 1997) ("Indeed, evidence of secondary considerations may often be the most probative and cogent evidence in the record. It may often establish that an invention appearing to have been obvious in light of the prior art was not.").

24. "Such secondary considerations as commercial success, long felt but unsolved needs, [and] failures of others" are relevant as evidence of obviousness. *Graham v. John Deere Co.*, 383 U.S. 1, 17-18, 86 S.Ct. 684, 15 L.Ed.2d 545 (1966). *See also, Arkie Lures Inc.*, 119 F.3d at 957 (Considerations of commercial success, licensing activities, and copying may be "highly probative of the issue of nonobviousness.").

25. Copying of the invention by Barnesandnoble.com and others is additional evidence of nonobviousness. "It gives the tribute of its praise to the prior art; it gives the [invention] the tribute of its imitation, as others have done." *Diamond Rubber Co. v. Consolidated Rubber Tire Co.*, 220 U.S. 428, 441, 31 S.Ct. 444, 55 L.Ed. 527 (1911).

26. The adoption of single-action ordering by other e-commerce retailers following Amazon.com's introduction of the feature, coupled with the need to solve the problem of abandoned shopping carts by e-commerce customers, is additional evidence of nonobviousness. *See Hayes Microcomputer Prod. Inc. v. Ven-tel, Inc.*, 982 F.2d 1527, 1540 (Fed. Cir. 1992) ("[T]he commercial success of the invention, the failure of others to solve the problem addressed by the patented invention, and the fact that the [invention] has become the industry standard is compelling objective evidence of the nonobviousness of the claimed invention.").

27. In light of its consideration of the factors and evidence related to the question of obviousness, the Court finds Barnesandnoble.com is unlikely to succeed in showing by clear and convincing evidence that the claims of the '411 patent were obvious. Barnesandnoble.com's reliance on the simplicity of the invention is unavailing. "Defining the problem in terms of its solution reveal improper hindsight in the selection of the prior art relevant to obviousness." *Monarch Knitting Machinery Corp. v. Sulzer Morat GMBH*, 139 F.3d 877, 881 (Fed. Cir. 1998).

Enforceability

28. In their initial opposition to Plaintiff's motion for a preliminary injunction, Defendant argued that the '411 patent was unenforceable due to alleged inequitable conduct on the part of the one of the inventors, Shel Kaphan. Specifically, Defendants alleged that Mr. Kaphan's failure to cite to the PTO an Internet Engineering Task Force draft entitled "State Management Mechanism" ("IETF Draft"), in which he is acknowledged as a contributor by the authors, constituted inequitable conduct. Defendants deposed Mr. Kaphan and submitted brief excerpts from his deposition to the Court. None of those excerpts related to his knowledge of the IETF Draft or any intent to deceive the patent office. The Court assumes that Defendants have abandoned their inequitable conduct claim, at least for the purposes of their opposition to the preliminary injunction motion. Indeed, Defendants presented no arguments based on unenforceability in their closing argument or in their proposed findings of fact and conclusions of law.

29. In any event, the Court finds that Defendants' arguments regarding unenforceability lack substantial merit. The testimony of Mr. Mulligan, a member of the IETF, that the IETF Draft is less relevant to the '411 patent than cited references including one in a publication entitled "Dr. Dobbs Journal" that itself references the IETF Draft, is unopposed and dispositive. (Tr. at 174: 13-25 (Mulligan)) A "patentee need not cite an otherwise material reference to the PTO if that reference is merely cumulative or is less material than other references already before the examiner." *Barter Int'l, Inc. v. McGaw, Inc.*, 149 F.3d 1321, 1328 (Fed. Cir. 1998).

Infringement Analysis

30. Defendants have also argued that Plaintiff has not demonstrated that the "Express Lane" feature infringes any claims of the '411 patent. "[A]nalysis of patent infringement involves two steps: (1) claim construction to determine what the claims cover, i.e., their scope, followed by (2) determination of whether the properly construed claims encompass the accused structure." *Cole v. Kimberly-Clark Corp.* 102 F.3d 524, 528 (Fed. Cir. 1997). The former is a question of law; the latter is a question of fact. *See Voice Techs. Group v. VMS Sys, Inc.*, 164 F.3d 605, 612 (Fed. Cir. 1999)

For ease of reference, the Court includes its entire infringement analysis in the Conclusions of Law section, even though it presents mixed questions of law and fact.

Claim Construction

31. The parties do not dispute the meaning of most of the terms in the patent claims including: "client system"; "server system"; and "method for ordering." (See Tr. at 434:1-435:13 (King)). The parties disagree, however, as to the meaning of the terms "shopping cart model," "fulfillment," "single action," and "single-action ordering component."

32. Claims must be read in view of the specification of which they are a part. *See Markman v. Westview Instruments, Inc.*, 52 F.3d 967, 979 (Fed. Cir. 1995). Words defined in the specification should be given the same meaning in the claims. *McGill, Inc. v. John Zink Co.*, 736 F.2d 666, 674 (Fed. Cir. 1984), cert. denied, 469 U.S. 1037, 105 S.Ct. 514, 83 L.Ed.2d 404 (1984), overruled on other grounds, *Markman*, 52 F.3d at 967. *See also Standard Oil Co. v. American Cyanamid Co.*, 774 F.2d 448, 452 (Fed.Cir. 1985) (the specification is the primary basis for construing claims).

33. The term "shopping cart model" is described in the Background of the Invention section of the '411 patent beginning at column 2 line 17: "The selection of various items is generally based on the

'shopping cart' model. When the purchaser selects an item from the electronic catalog, the server computer system metaphorically adds that item to a shopping cart. When the purchaser is done selecting items, then all the items in the shopping cart are 'checked out' (i.e. ordered) when the purchaser provides billing and shipping information." As described at column 2 lines 34 through 43, in some cases the billing and shipping information may be prestored by the merchant and need only be confirmed to complete the checkout process.

34. The definition of shopping cart model in the background section of the '411 patent is consistent with that provided by Amazon.com's e-commerce experts Dr. Johnson and Mr. Mulligan. (See Ex. 10, Johnson Decl. at ¶14; Ex. 12, Mulligan Decl. at ¶7; Tr. at 167:19-168:9 (Mulligan)).

35. Dr. Lockwood defined a shopping cart model more broadly in a manner that could potentially include any method of buying on-line. (Tr. at 279:5-282:4). In general, the Court found Dr. Lockwood's description of the term "shopping cart model" to be confusing and inconsistent. Barnesandnoble.com's Chief Information Officer, Mr. King, gave a similarly broad definition of shopping cart model. (Tr. at 428:1-21). According to its own expert Dr. Lockwood, under Defendants' definition of shopping cart model, claims 1 and 11 would appear to be internally inconsistent. (See Tr. at 284:22-285:22). Similarly, Mr. King testified that with Barnesandnoble.com's definition of shopping cart model, claims 1 and 11 would not cover the single-action purchasing method described in the '411 patent. (Tr. at 428:1-21).

36. A claim interpretation that excludes the preferred embodiment is "rarely, if ever, correct." *Vitronics Corp. v. Conceptronic, Inc.*, 90 F.3d 1576, 1583 (Fed. Cir. 1996). "When claims are amenable to more than one construction, they should when reasonably possible be interpreted so as to preserve their validity." *Modine Mfg. Co. v. U.S. Int'l Trade Comm'n*, 75 F.3d 1545, 1557 (Fed. Cir. 1996). The Court, therefore, rejects the definition of "shopping cart model" propounded by Defendants.

37. The Court adopts instead a definition which is consistent with the patent specification preserves the validity of the claims, and allows the claims to be read on the preferred embodiment described in the patent specification. In construing the claims, the Court, therefore, takes the term "shopping cart model" to mean a method for on-line ordering in which a user selects and accumulate items to be purchased while browsing a merchant's site and then must proceed to one or more checkout or confirmation steps in order to complete the purchase. (Ex. 12, Mulligan Supp.Decl. ¶¶5-6).

38. The second point of disagreement is the meaning of the terms "fulfill" and "order fulfillment component" in claims 6 and 9, and in particular whether "fulfill" or "fulfillment" refer to computer or physical processes. Though the patent specification does not explicitly define the phrase, order "filling" and "fulfillment" is discussed at length at column 8 and figure 7 in the context of Amazon.com's order consolidation algorithm. That discussion and the entire specification describe only computer processes and an order is defined to be filled "when all its items are currently in inventory (i.e. available) and can be shipped." In addition, Amazon.com's expert Mr. Mulligan testified that an "order fulfillment component" of a "server system" as required by claim 9 is "the software that takes the information provided by the database of the user information and the inventory database and combines those into a shipment order . . . and then notifies that the order is ready for shipment." (Tr. at 165:7-12).

39. Mr. Mulligan's above definition of "order fulfillment component" as a computer program is consistent with the out of court statements by Barnesandnoble.com's Chief Information Officer, Mr.

King, regarding Barnesandnoble.com's "fulfillment application" in a recent interview with an industry trade press. (*See* Ex. 8). During cross-examination Mr. King testified that "fulfillment application" was a commonly used term in the industry to refer to computer programs associated with the fulfillment process. (Tr. at 432:25-433:8). The Court therefore finds that "order fulfillment component" as used in claim 9 refers to order fulfillment application software described by Mr. Mulligan and Mr. King.

40. Similarly, the Court finds that the term "fulfill" as used in claim 6 in the phrase, "so that the server system can fulfill the generated order," refers to processes performed by the order fulfillment component of (or order fulfillment application running on) the server system and does not include the physical steps of handling or packing tangible items.

41. The third point of disagreement concerns the terms "single action" and "single-action ordering component" as used in claims 1, 6, 9, and II.

42. The term "single action" is not defined by patent specification. However, the patent specification provides that "once the description of an item is displayed, the purchaser need only take a single action to place the order to purchase that item." (Ex. A-1 at col. 3, II. 64-66). The specification also provides that "a single action may be preceded by multiple physical movements of the purchaser (*e.g.*, moving a mouse so that a mouse pointer is over a button)." (Ex. A-1 at col. 10, II. 2-4). In addition, the specification indicates "[i]n general, the purchaser need only be aware of the item or items to be ordered by the single action *and* of the single action needed to place the order." (Ex. A-1 at col. 4, II. 14-17 (*emphasis added*)). As a result, the term "single action" as used in the '411 patent appears to refer to one action (such as clicking a mouse button) that a user takes to purchase an item once the following information is displayed to the user: (1) a description of the item and (2) a description of the single action the user must take to complete a purchase order for that item.

43. The parties dispute what mouse clicks "count" in determining whether the single-action requirement of the '411 patent claims is satisfied. The Court finds that clicks "count" after both information identifying the item and a description of the single action the user must take to complete a purchase order for that item are displayed to the user.

Comparison of the '411 Patent Claims to Defendants' Express Lane Feature

44. In its opening papers, Amazon.com provided a declaration from its expert Mr. Mulligan explaining in detail where every element of claims 1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 12, 14, 15, 16, 17, 21, 22, 23, 24 is present in Barnesandnoble.com's Express Lane ordering system. (Ex. 9, Mulligan Decl.). Mr. Mulligan described his analysis with respect to independent claims 9 and 11 in his testimony before the Court. (Tr. at 161:2-169:4).

45. In their pre-hearing briefing, Defendants only disputed Mr. Mulligan's analysis with respect to the meaning of fulfillment in claims 6 and 9 and the meaning of "shopping cart model" in claims 1 and 11. (Ex. A-16, King Decl. ¶¶8-12). Mr. King acknowledged that Barnesandnoble.com's Express Lane included every element of claim 11 except the last, which requires that the item is ordered independently of a shopping cart model. (Tr. at 434:1-435:13).

46. Because the Court adopts the patent specification's description of the term "shopping cart model," which is consistent with Mr. Mulligan's testimony, the Court finds that Barnesandnoble.com infringes claims 1, 2, 3, 5, 11, 12, 14, 15, 16, 17, 21, 22, 23, 24.

47. The Court has also found that the terms "fulfill" and "order fulfillment component" in claims 6 and 9 do not include the retailer's acts of physically locating, packaging, and shipping a tangible item after a purchase order is completed. The Court, therefore, finds that Barnesandnoble.com also infringes claims 6-10 of the '411 patent.

48. At the hearing on this motion, Defendants argued that Barnesandnoble.com's Express Lane option was not a "single-action ordering component" as required by claims 1, 3, 5, 6, 7, 8, 9, 10, because a user of Express Lane must take more than one action from the first time that some information regarding an item is displayed. The Court finds this argument unavailing. Except in court, Barnesandnoble.com everywhere has described its Express Lane option as "one-click ordering," including on its web site and its communications with shareholders and prospective shareholders filed with the Securities Exchange Commission. (Tr. at 464:3-8; Tr. at 464:24 467:22 (Bulkeley); Ex. 36 at 6, 44, 47). Moreover, the Court agrees with the testimony of Mr. Mulligan that browsing a site is not ordering and that one does not begin the ordering process until one is past the home page and is presented with an opportunity to order an item. (Tr. at 185:3-8; Tr. at 191:7-15). This occurs for the first time at the product or detail page on the Barnesandnoble.com site. (*Id.* and 9, Mulligan Decl., Ex., R). From there, as noted on Barnesandnoble.com's own web page, ordering with the Express Lane option requires only a single click. (*Id.*).

49. Mr. King testified that he was provided with a copy of the '411 patent by Barnesandnoble.com's outside counsel in early October, 1999. (Tr. at 417:9-19). It was the first time that Mr. King had ever received a patent from Barnesandnoble.com's outside counsel. (Tr. at 417:20-22). "Where, as here, a potential infringer has actual notice of another's patent rights, he has an affirmative duty to exercise due care to determine whether or not he is infringing." *Underwater Devices, Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389 (Fed. Cir. 1983).

Summary

50. Based on the foregoing, the Court finds that Plaintiff has demonstrated a reasonable likelihood of success on the merits at trial.

B. Irreparable Harm

51. The Court finds that Plaintiff has made a strong showing that the '411 patent is valid and that Defendants' Express Lane feature infringes the patent. Plaintiff is therefore entitled to a presumption of irreparable harm. *See, e.g., Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1581 (Fed. Cir. 1983) (holding "where validity and continuing infringement have been clearly established . . . immediate irreparable harm is presumed"). While Defendants have raised a number of defenses regarding validity, noninfringement, and enforceability, the Court finds that Plaintiff has established that these defenses lack substantial merit.

52. In light of Plaintiff's strong showing of validity and infringement, Defendants can rebut the presumption of irreparable harm only in limited circumstances not applicable here, such as that (1) the allegedly infringing activities have ended or will soon end; (2) the movant has engaged in a pattern of granting licenses; or (3) the movant unduly delayed in bringing suit. *See Polymer Techs., Inc. v. Bridwell*, 103 F.3d 970, 974 (Fed. Cir. 1996). Absent these facts or Defendants' "proffer of similar evidence," the Federal Circuit has indicated that "infringement of a valid patent inherently causes irreparable harm." *Id.* at 975.

53. Defendants attempt to invoke the category, of undue delay, arguing that Amazon.com should have filed their suit immediately upon issuance of the patent. However, Amazon.com filed this action 22 days after its patent was issued. The Court is unaware of any authority indicating that filing a motion for a preliminary injunction less than a month after a patent is issued constitutes an undue delay. Instead, cases citing undue delay as a factor to be considered on a motion for preliminary injunction address delays of months or years, not days. See *Mentor Graphics Corp. v. Quickturn Design Systems, Inc.*, 999 F.Supp. 1388 (D. Or. 1997) (delay of more than one year between the filing of patent infringement action and the filing of a motion for a preliminary injunction did not bar the patentee from obtaining a preliminary injunction), *aff'd* 150 F.3d 1374 (Fed. Cir. 1998); *Rubbermaid Commercial Prods., Inc. v. Contico Int'l., Inc.*, 836 F.Supp. 1247 (W.D. Va. 1993) (eight months no bar); *Motorola, Inc. v. Alexander Mfg. Co.*, 786 F.Supp. 808 (N.D. Iowa 1991) (three months no bar); *SMI Indus. Canada Ltd. v. Caelter Indus., Inc.*, 586 F.Supp. 808 (N.D.N.Y. 1984) (six months no bar).

54. Defendants also suggest that Amazon.com engaged in undue delay by not paying its Issue Fee for the '411 patent until six weeks after receiving the Notice of Allowability for the patent. Defendants cite no authority which indicates that this type of delay is either undue or even relevant. Moreover, as former PTO Commissioner Harry Manbeck testified, taking six weeks between the Notice of Allowability and payment of the Issue Fee is not unusual, and is probably shorter than average period. (Ex. 13, Manbeck Dec. ¶17).

55. Beyond the presumption of irreparable harm, there is additional evidence of irreparable harm in the record. Irreparable harm can also be shown by demonstrating that damages are an inadequate remedy. The Federal Circuit uses a variety of factors to determine whether irreparable harm exists. See Mills, "The Developing Standard for Irreparable Harm in Preliminary Injunctions to Prevent Patent Infringement," 81 J. Pat. & Trademark Off. Soc'y 51, 65-66 (Jan. 1999) (listing factors); see also *Jacobson v. Cox Paving Co.*, 19 U.S.P.Q.2d 1641, 1653 (D. Ariz. 1991) (listing factors and noting that courts have issued injunctions after finding only a few), *aff'd*, 949 F.2d 404 (Fed. Cir. 1991).

56. All of the following factors here weigh in favor of a finding of irreparable harm: the parties are direct competitors trying to influence the same group of customers; Amazon.com spent significant time and effort on market development; Defendants' continuing infringement is likely to undermine Amazon.com's market position; and Defendants' unchecked infringement will encourage others to infringe. See Mills, *supra*; see also *Atlas Powder Co.*, 773 F.2d at 1233 ("If monetary relief were the sole relief afforded by the patent statute then . . . infringers could become compulsory licensees for as long as the litigation lasts."). These sorts of indirect effects are the reason the statute includes injunctive remedies. See *Hybritech*, 849 F.2d at 1457 ("The patent statute provides injunctive relief to preserve the legal interests of the parties against future infringement which may have market effects never fully compensable in money.").

57. Amazon.com has presented the testimony of its founder and chairman, Jeff Bezos, and of an e-commerce expert, Dr. Eric Johnson, explaining the significance of single-action ordering and of reducing "friction" in customer experiences of shopping on-line. They provided both opinion and empirical evidence that reducing the number of steps a customer must take to make a purchase increases the likelihood that the customer will complete that purchase. (See Ex. 10, Johnson Decl. ¶10; Ex. 11, Bezos Decl. ¶8) A single-action ordering method is valuable because it reduces the steps that an on-line customer must take when making a purchase. The evidence adduced from

Barnesandnoble.com regarding the problem of abandoned shopping carts (an "industry standard" 65% of them are never checked out) and the popularity of its single-action Express Lane feature corroborate the commercial value of the '411 patent. (See Ex. 28; Tr. at 418:1-11; 420:9-421:18 (King); 473:14-474:5 Bulkeley)).

58. Amazon.com's witnesses also described how and why the upcoming holiday season will be critical to the online retailing industry. (Ex. 10, Johnson Decl. ¶¶16-17; Ex. 11, Bezos Decl. ¶20). They presented evidence that invaluable customer loyalty and goodwill will be irreparably lost to Defendants if they are allowed to continue to infringe, particularly in the next two critical months for e-commerce retailing. As the Federal Circuit has explained, "Competitors change the marketplace. Years after infringement has begun, it may be impossible to restore a patentee's . . . exclusive position by an award of damages and a permanent injunction." *Polymer Tecit*, 103 F.3d at 975-76. Again, the testimony from Barnesandnoble.com corroborates Amazon.com's claim that the 1999 holiday season will be extremely important commercially to on-line retailers. (See Tr. at 474:9-18 (Bulkeley)).

59. Defendants argue that Amazon.com is not entitled to an injunction because its injuries can be compensated in money damages. The cases they cite all hinge on a finding, not applicable here, that the patentee was not entitled to a presumption of irreparable harm because it had not made a clear showing of validity and infringement. See *Nutrition 21 v. Thorne Research, Inc.*, 930 F.2d 867, 871 (Fed. Cir. 1991); *Eli Lilly & Co. v. American Cyanamid Co.*, 896 F.Supp 851, 860 (S.D. Ind. 1995). Where the presumption of irreparable harm applies, that plaintiff's injuries are fully compensable cannot alone justify a finding that defendants rebutted the presumption of irreparable harm. *Polymer Techs.*, 103 F.3d at 975-76.

60. Here, Amazon.com has presented ample evidence that the harm it asks the Court to prevent - - losing the opportunity to distinguish itself and build customer loyalty at a critical time - - cannot be reduced to a simple formula. See *Hybritech*, 849 F.2d at 1456-57 ("It is well-settled that .. the nature of the patent grant weighs against holding that monetary damages will always suffice to make the patentee whole."). There is no easy way to determine the value of the relationships and loyalties that millions of customers establish with Internet retailers over the next several months.

61. Neither side is able to offer any formula that is readily available for determining what damages might be.

62. Amazon.com's patent entitles it to the exclusive right to offer its single-action ordering invention, and to reap the value that feature adds to its site. Defendants' use of the Express Lane feature, as currently configured, would deny Amazon.com of the benefit of its patent.

Barnesandnoble.com has failed to demonstrate that the value of the use of the patent can be calculated in dollars.

63. Amazon.com is presumptively and actually suffering irreparable injury because of Defendants' infringement. The Court concludes that only a preliminary injunction will prevent that harm.

C. Balance Of Hardships

64. The balance of hardships between the parties also favors granting Amazon.com's motion for preliminary injunction. The Court must weigh the threatened injury to the patent holder if injunctive relief is not granted against the injury to the accused infringer if the preliminary injunction is granted.

See Hybritech Inc., 849 F.2d at 1457. Here, the balance of hardships tips in Amazon.com's favor. Any harm suffered by Barnesandnoble.com would result directly from its misappropriation of Amazon.com's patented purchasing method. The balance of hardships does not favor a defendant where the defendant "took a calculated risk that it might infringe [plaintiff's] patents." *Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1581 (Fed. Cir. 1983).

65. Moreover, the evidence indicates that Barnesandnoble.com can modify its "Express Lane" feature with relative ease to avoid infringement of the '411 patent. For instance, infringement can be avoided by simply requiring users to take an additional action to confirm orders placed by using Express Lane. (Tr. at 530:8-13).

66. The harm to Amazon.com is more extensive. Without this injunction, Amazon.com will lose the primary value of the 1-Click® option: its role in distinguishing the Amazon.com site from the site of a key competitor. (See Ex. 10, Johnson Dec. ¶¶8-12).

67. Aside from the need to take steps to modify its Express Lane feature, Defendants' only testimony or evidence of any harm it will suffer if it is enjoined from infringing the '411 patent is that calls to its customer service phone lines will increase because of the change to its users' experience. (Tr. at 458:15-19). Barnesandnoble's concerns about customer service calls or possible temporary interruptions in its website operation would not tip the balance in favor of an infringing defendant. *See PPG Indus., Inc. v. Guardian Indus. Corp.*, 75 F.3d 1558, 1567 (Fed. Cir. 1996) (it was less burdensome on infringer to suffer "a temporary interruption" in the infringer's production and sale of its product where patentee would suffer significant harm from denial of preliminary injunction).

68. As Dr. Johnson points out, on-line retailers have great freedom with which they can create their own unique consumer experiences. (Ex. 10, Johnson Decl. ¶ 15). As noted above, Barnesandnoble.com could modify Express Lane to employ any non-infringing ordering system, including any that requires two or more actions. Moreover, in addition to "Express Lane," Barnesandnoble.com offers a multi-step "shopping cart" ordering system, so it does not need single-action ordering to keep its site running. Many other on-line retailers operate their businesses using multi-step ordering, and Barnesandnoble.com can as well. (See Ex. 11, Bezos Decl. at ¶21).

69. Mr. King testified that it would be possible to remove the Express Lane feature from the Barnesandnoble.com site and that he has already met with his developers to discuss it. (Tr. at 435:14-19).

70. Finally, the question of whether the balance of hardships tips in Amazon.com's favor is necessarily related to its showing of a likelihood of success on the merits. "Because the court must balance the hardships, at least in part in light of its estimate of what is likely to happen at trial, it must consider the movant's showing of likelihood of success." *Illinois Tool Works, Inc. v. Grip-Pak, Inc.*, 906 F.2d 679, 683 (Fed. Cir. 1990). Amazon.com's strong showing of likelihood of success further tips the balance of hardships in its favor.

D. Public: Interest

71. The public is served by innovation on the Internet and in electronic commerce, particularly now while it is still developing rapidly. Competition to provide unique, effective and enjoyable consumer experiences will lead to innovation and diversity in on-line commerce. (Ex. 11, Bezos Decl. ¶22). On the other hand, innovation will be discouraged if competitors are permitted a free ride on each other's

patented inventions. Protection of intellectual property rights in innovations will foster greater competition and innovation. (Ex. 11, Bezos Decl. ¶22; Ex. 10, Johnson Decl. ¶15).

72. Granting Amazon.com's preliminary injunction will serve the public interest. The public has a strong interest in the enforcement of intellectual property rights. The purpose of the patent system is to reward inventors and provide incentives for further innovation by preventing others from exploiting their work. See *E.I. du Pont de Nemours & Co. v. Polaroid Graphics Imaging, Inc.*, 706 F.Supp. 1135, 1146 (D.Del. 1989), *aff'd* 887 F.2d 1095 (Fed. Cir. 1989). Encouraging Amazon.com to continue to innovate - - and forcing competitors to come up with their own new ideas - - unquestionably best serves the public interest.

73. Defendants' argument that the injunction would not serve the public interest presupposes that the '411 patent is invalid and not infringed. Amazon.com has established that Defendants' defenses lack substantial merit. The Amazon.com inventors are therefore entitled "to reap the benefits of their labor" and "prevent others from practicing what they have invented." *E.I. du Pont de Nemours & Co.*, 706 F.Supp. at 1146. This is particularly true in a rapidly developing industry where the window of opportunity to reap the benefits is likely to be short-lived, given the fertile climate for e-commerce inventions.

E. Other Arguments

74. Defendants have also offered a variety of other arguments against issuance of the preliminary injunction. They have suggested, for instance, that: (1) Amazon.com should have warned potential infringers that a patent application was pending for the '411 patent prior to its issuance; (2) Amazon.com somehow inequitably timed the issue date of the patent to fall near the 1999 holiday season; and (3) Defendants' due process rights would be abrogated if they only had a few weeks to prepare for a hearing on Amazon.com's motion for a preliminary injunction. Defendants have cited no relevant case law to the Court in support of these arguments, and the Court finds these arguments unpersuasive.

IV. CONCLUSION

Therefore, the Court hereby ORDERS that Defendants Barnesandnoble.com LLC and Barnesandnoble.com Inc., their officers, agents, servants, employees and attorneys and those in active concert or participation with them or Defendants ARE HEREBY RESTRAINED AND ENJOINED from continuing to infringe United States Patent No. 5,960,411, including by continuing to make or use within the United States Defendants' Express Lane feature as currently configured or any other single-action ordering system that employs the methods or systems of the '411 patent, or by inducing others to make or use within the United States Defendants' Express Lane feature as currently configured or any other single-action ordering system that employs the methods or system of the '411 patent. Defendants may continue to offer an Express Lane feature if the feature is modified to avoid infringement of the '411 patent in a manner that is consistent with the findings of fact and conclusions of law set forth above.

The above Preliminary Injunction is effective at 12:01 a.m. P.S.T. on Saturday, December 4, 1999, and upon Amazon.com's filing an undertaking in the sum of \$10,000,000, and shall remain in effect during the pendency of this action.

The clerk is directed to provide copies of this order to all counsel of record.

Dated: December 1, 1999.

/s/ .

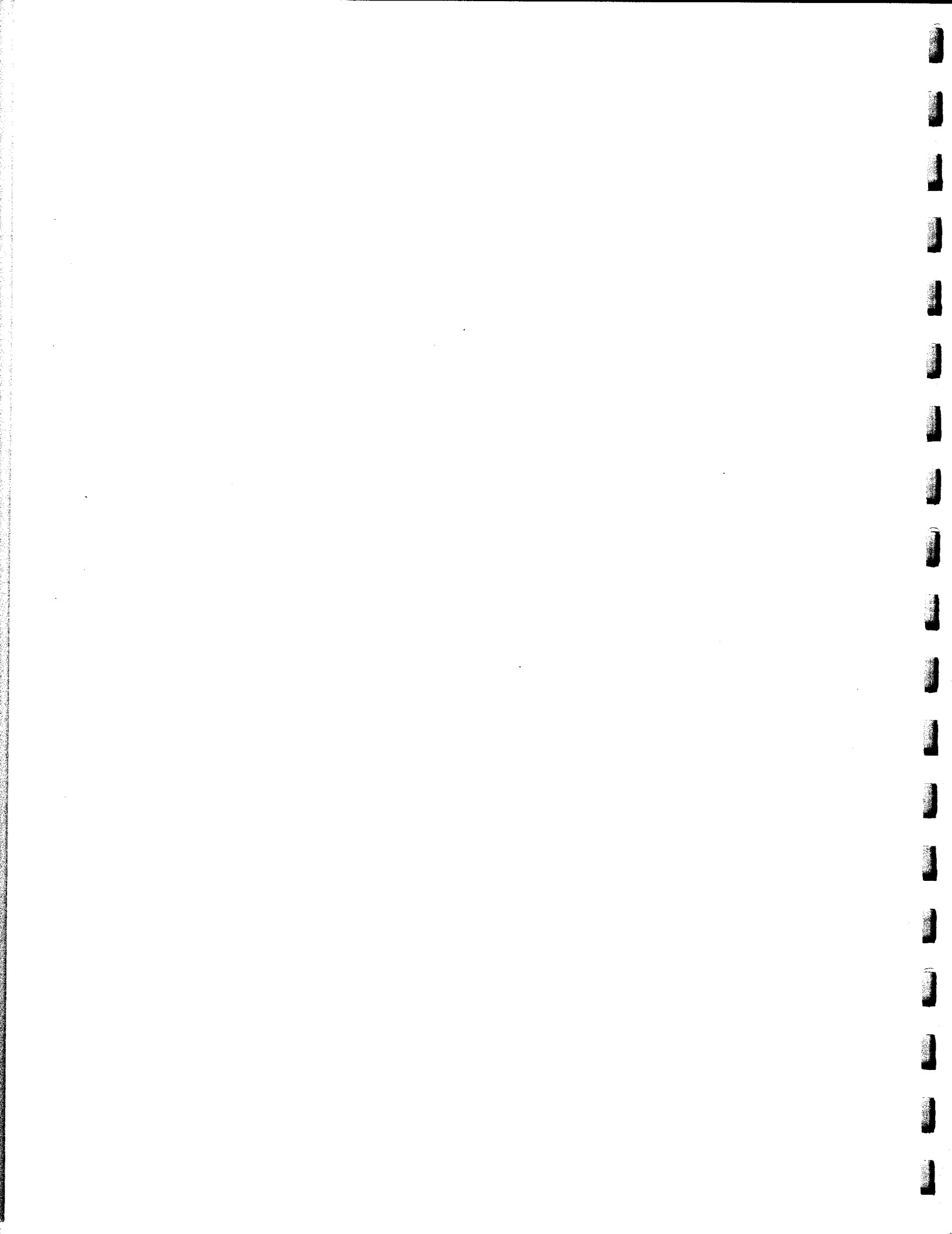
Marsha J. Pechman
U.S. District Judge

ON-LINE PRIVACY

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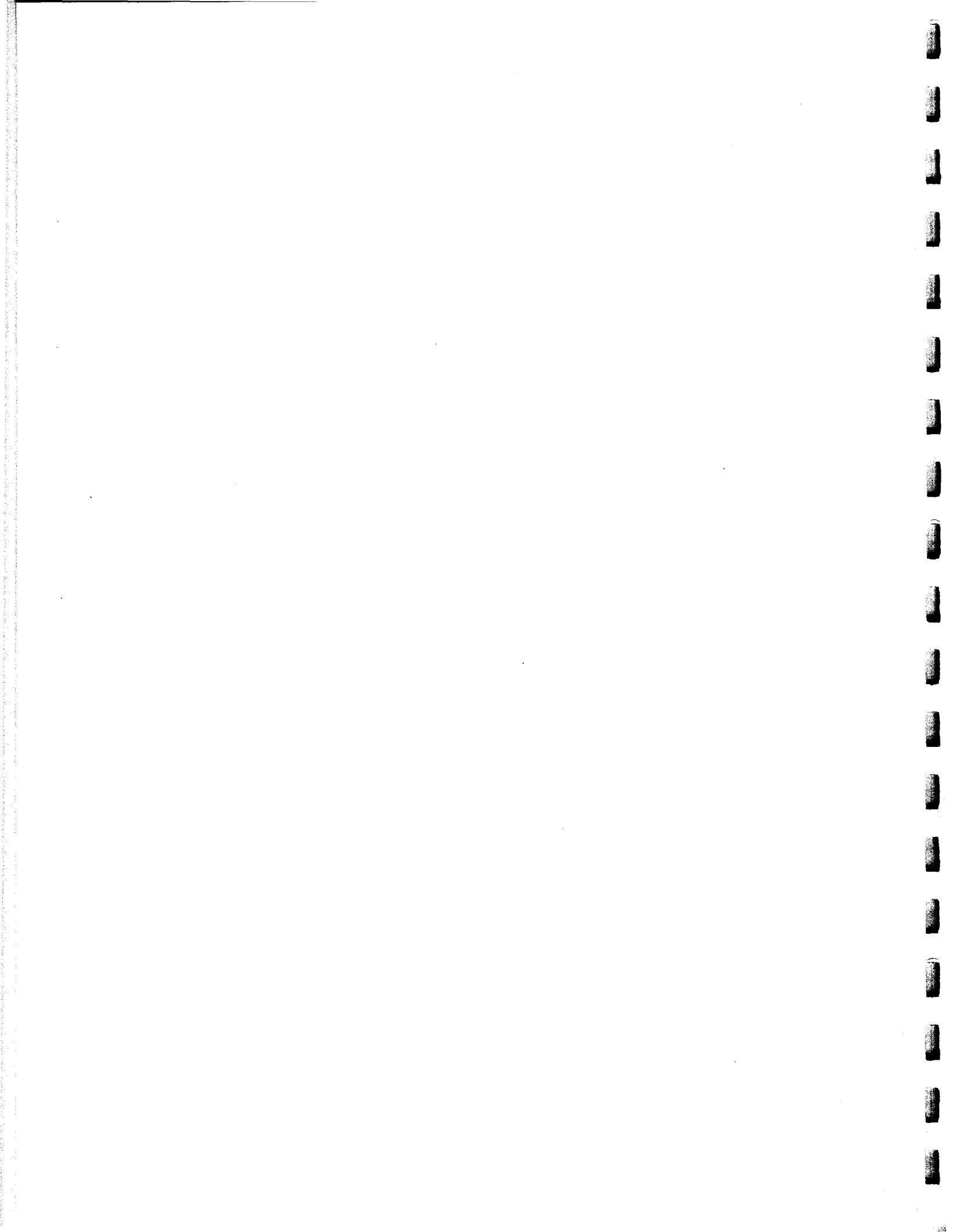
SECTION H



ON-LINE PRIVACY

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ON-LINE PRIVACY: IS THERE ANY? SHOULD THERE BE ANY? BALANCING THE INTERESTS OF CONSUMERS AND BUSINESS.

Information has been gathered by businesses about consumers for as long as there have been businesses and consumers. Some of the more popular retail outlets have become successful based on their ability to identify and use appropriately a customer's name and preferences. No doubt everyone reading this article has had the experience of ordering an item from a specialty catalog, and then, in the following weeks, being deluged by catalogs, magazines and other solicitations for similar or related products and services.

Even the government is guilty of making money from private information. In the past, practically all states sold personal information gathered as a part of the motor vehicle licensing process, even if the information was otherwise not publicly available. *Privacy of Driver's License Data Upheld*, LOS ANGELES TIMES, January 13, 2000. States such as New York, Florida, Wisconsin and others earned tens of millions of dollars selling such information to marketing companies. In 1994, Congress passed the Driver's Privacy Protection Act to force all states to refrain from releasing certain DMV information, unless the motorist consented to the transfer of such information. In 1998, the 4th Circuit Court of Appeals, which has the reputation of favoring states' rights, struck down the statute as unconstitutional. Recently, however, in a 9-0 ruling, the U.S. Supreme Court upheld the constitutionality of the statute.

Your bank has also likely sold your name and address in the past, and possibly some information about your income level, to marketing companies and other businesses. New regulations proposed by the Federal Reserve and the Treasury Department permit bank customers to opt out of having certain non-public information sold or shared with telemarketers or other third parties. *Barring Banks From Giving Away Your Personal Data*, APBnews.com, February 4, 2000. So, to answer the first question posted above, "Is There Any?", the answer up to now may well be "Not Much!"

So What's Different About the Internet?

Americans are becoming increasingly sensitive to privacy issues, and this is likely due to several reasons. First, in the past while consumers may have known or sensed that information was being gathered about them, consumer perception, to the extent it existed, was that the information gathering process was proceeding at a slow and dysfunctional pace. With the Internet, the ability to quickly and efficiently gather, organize and transmit data is nothing less than miraculous. While in the past the manual gathering and matching of names, addresses and preferences might take a retailer months or years, now that information can be gathered, sorted and transferred almost instantaneously.

Concern over data privacy is exemplified by the complaints recently lodged against DoubleClick, Inc., the world's largest banner ad server. The Washington based Electronic Privacy Information Center ("EPIC") recently filed a request with the Federal Trade Commission to look into the data collection practices of DoubleClick, Inc. In November 1999, DoubleClick merged with Abacus Direct Corp., a marketing research company that apparently maintains a data base of names, addresses and other marketing information for approximately 90% of American households.

EPIC claims that, prior to the announcement of the merger, DoubleClick had represented that the information it collected, *i.e.*, clickstream data from visitors to web sites that featured DoubleClick ads would be anonymous. Beginning in June 1999, DoubleClick apparently revised its privacy policy to say that DoubleClick might combine personally identifiable data with clickstream data. *Privacy Group Seeks FTC Investigation of Net Marketer's Information Collection Practices*, Electronic Commerce & Law, February 16, 2000, Vol. 5, No. 7, p. 157.

Second, Americans are becoming more sensitized to the privacy issue as a result of the media coverage received by the European Union in connection with its strong stance on privacy and its negotiations with the U.S. on privacy issues. Along the same lines, the widespread use of the Internet by children has caused many American consumers who might not otherwise be interested to focus on the issue.

Last but not least, tiring of being bombarded with solicitations, Americans are looking for opportunities to throw a few stumbling blocks in the pathway of telemarketers.

So What Parameters Exist for The On-Line Gathering And Use of Personal Data?

While there are several industry specific laws and regulations governing privacy, and laws and regulations governing children's privacy have been recently adopted, there is no broad reaching law or regulation in effect that governs privacy. Currently, the Federal Trade Commission asserts jurisdiction over on-line privacy through its enforcement power to regulate "deceptive acts and practices" under the FTC Act. 15 U.S.C. § 45. Under the FTC Act, there is currently no private right of action for consumers who have suffered a breach of privacy. The Federal Trade Commission first exercised its enforcement power under the FTC Act in the Geocities matter.

As of April of 1998, the Geocities web site was one of the 10 most frequently visited sites. The Geocities site was a virtual neighborhood featuring web sites of its members divided into topics of interest and including web sites of interest to children, such as the "Enchanted Forest." The Geocities site did not have a comprehensive privacy statement but instead had short privacy statements scattered throughout the site that discussed the information being gathered. For example, one statement on the site indicated that if certain optional information were provided, it would not be shared with anyone without the provider's permission. In addition, on some of the pages that targeted children, Geocities would collect information as a part of allowing participation in contests or other activities. Geocities was apparently providing user information (including information gathered from children) to third parties without a user's permission. Because Geocities was not complying with its own privacy statements and further because the site was targeting children and then transferring to third parties the information gathered from children, the FTC asserted jurisdiction. *In the Matter of Geocities*, Complaint, www.ftc.gov/os/1999/9902/9823015.cmp.htm and *In the Matter of Geocities*, Decision and Order, www.ftc.gov/os/1999/9902/9823015d&o.htm.

The FTC required Geocities to adopt a privacy policy that disclosed the following:

- * what information is being collected;

- * its intended use;
- * third parties to whom it would be disclosed;
- * the consumer's ability to obtain access or to directly access the information and the means by which the consumer may do so;
- * the consumer's ability to remove directly or to have the information removed from the web site database and the means by which the consumer may do so; and
- * the procedures to delete personal identifying information from the web site's database and any limitations related to such deletion. *In re Matter of Geocities*, Decision and Order.

In addition, the FTC required that Geocities' privacy notice be placed in a prominent location and that the following notice be placed at locations in the site where any personal identifying information would be collected: **NOTICE: We collect personal information on the site. To learn more about how we use your information, click here.**

With respect to information gathered from children, the Geocities' site was required to comply with certain requirements that correspond with the requirements of the now in effect Children's Online Privacy Protection Act of 1998. In addition, Geocities was required to contact parties to which it had transferred personally identifying information and request that the use of certain information be discontinued. Further, the FTC has required the following notice to appear on the Geocities website for five years after the date of the FTC Order: **NOTICE: Click here for important information about safe surfing from the Federal Trade Commission.**

The FTC has publicly conceded that it cannot force a web site to display a privacy statement. *Prepared Statement of the Federal Trade Commission, "Consumer Privacy on the World Wide Web": Hearings before the Subcommittee on Telecommunications, Trade and Consumer Protection of the House Committee, 105th Cong. N. 23 (1998)* (statements of Robert M. Pitofsky, Chairman of the FTC). However, the position of the FTC was made clear in the Geocities matter that if a business does have a privacy policy, it is required to follow it. Consistent with the FTC's position in Geocities, it also investigated and entered into a consent order with Liberty Financial Companies concerning web site privacy issues. See *In re Liberty Fin. Cos.*, www.ftc.gov/os/1999/9905/lbtyord.htm.

Should a Web Site Have a Privacy Policy?

In determining whether to adopt a privacy statement, a business must weigh risks associated with having a privacy policy against the distinct advantages of having a privacy policy. One clear advantage of having a privacy policy is a marketing advantage. Consumers who are sensitized to the issue will allocate a measure of credibility to a site that has a policy and may discredit a site that has no privacy policy. Second, the FTC has not yet recommended that Congress adopt broad legislation to govern privacy, with the expectation that businesses on the web will act responsibly and engage in self regulation. Clearly, from a business perspective, self regulation is preferable to

government regulation, and the unwillingness of a significant number of e-businesses to adopt privacy policies will likely spawn federal legislation on the subject. Third, the U.S. and the European Union will eventually agree on a safe harbor approach to enable U.S. companies to access European data under the E.U. privacy directive, and one component of the safe harbor requirements will be the adoption of and adherence to a privacy policy.

What Now?

Now that an e-commerce business has decided to adopt a privacy policy, what is the next step? There are several options to getting started, including working with one of the recognized seal programs or drafting a policy of its own based upon the business' practices, on the criteria laid out in the Geocities order and other FTC guidelines and, if applicable, the E.U. Privacy Directive.

Seal Programs.

One action the private sector has taken to encourage self-regulation and to fend off federal legislation is the creation of seal programs. Currently, the most widely-used seal program is TRUSTe, an independent non-profit organization founded by the CommerceNet Consortium and Electronic Frontier Foundation and launched on June 10, 1997. *Self Regulation and Privacy Online: A Report to Congress, Federal Trade Commission, July 1999, www.ftc.gov/os/1999/9907/privacy99.pdf*. By working with TRUSTe and meeting its requirements, a business may display the TRUSTe seal of approval. TRUSTe requires the completion of a detailed questionnaire, the adoption of a privacy policy that provides notice, disclosure, choice and consent, the adoption of certain data security measures and compliance with TRUSTe's standards. (See www.truste.org). TRUSTe is allowed certain oversight and audit powers with respect to companies that bear its seal and provides a complaint resolution procedure. TRUSTe is also permitted to engage in "seeding," which involves tracking the way that the site treats certain personal information. As of January 2000, TRUSTe had 1,000 members, which included 15 of the top 20 sites and 1/2 of the top 100 sites. *TRUSTe Approves 1000th Web Site*, TRUSTe Press Release, January 12, 2000, www.truste.org/about/1000.html.

The other most prominent seal program is BBBOnline, which is sponsored by the Better Business Bureau. BBBOnline operates in much the same way as TRUSTe. BBBOnline has 250 sites as members. See www.bbbonlines.org. In addition there are a few industry specific seal programs such as CPA WebTrust, created by the American Institute of Certified Public Accountants and the Canadian Institute of Chartered Accountants and ESRB Privacy Online, developed by the Entertainment Software Rating Board.

The advantages to approaching privacy through a seal program are that the seal programs are becoming well known by consumers and lend the site some credibility. In addition, the programs mandate that serious attention be given to the privacy process and facilitate in the development of the privacy statement and maintenance program, which decreases the chance that a business will fail to comply with its own policy.

On the downside, if a business does not comply in some manner with its privacy policy or does comply but has a complaint, it is forced not only to deal with the complaining consumer, but

may be required to engage in a mandatory dispute resolution process under the control of the relevant seal program. In addition, the business is subject to surprise audits and the seeding activities of the seal program. Finally, a seal program may refer a case of noncompliance to the FTC for its review.

Fair Information Practice Principles

While the FTC's current position appears to be that it cannot force companies to adopt a privacy policy and can only require that companies adhere to their privacy policy, the FTC has clearly endorsed certain fair information practices (see *Self Regulation and Privacy Online: A Report to Congress, Federal Trade Commission, July 1999*, www.ftc.gov/os/1999/9907/privacy99.pdf), and *Privacy Online: A Report to Congress, Federal Trade Commission, June 1998*, www.ftc.gov/reports/privacy3/toc.htm). To the extent federal legislation is proposed by the FTC, it is safe to assume that these fair information practices will become an integral part of the legislation. As is typical of the FTC, the approach currently taken by that agency is one centered on disclosure.

There are five core principles of privacy protection endorsed by the FTC: (1) notice/awareness; (2) choice/consent; (3) access/participation; (4) integrity/security; and (5) enforcement/redress. These principles were first developed by government agencies in the United States, Canada and Europe in the early 1970's and were articulated in the report of the 1973 United States Department of Health, Education and Welfare entitled *Records, Computer and the Rights of Citizens*. The principles apparently also served as a resource for the European Union when it developed its privacy directive. These core principles of privacy protection were intended to be used as safeguards for the protection of privacy whether or not information was gathered online.

Notice/Awareness: Notice is the most fundamental of the five privacy principles. Notice is necessary for a consumer to make an informed decision about whether to disclose personal information. Specifically, the FTC believes that the following notice is essential:

- Identification of the entity collecting the data;
- Identification of any potential recipients of the data;
- The nature of the data collected and the means by which it is collected if not obvious (passively, by means of electronic monitoring, or actively, by asking consumer to provide the information);
- Whether the provision of the requested data is voluntary or required, and the consequences of a refusal to provide the requested information;
- The steps taken by the data collector to ensure the confidentiality, integrity and quality of the data.

The notice must be clear and conspicuous, posted in a prominent location on the web site, and readily accessible from the home page and any web page where information is collected from the consumer.

Choice/Consent: This principle requires that consumers be provided a choice with respect to secondary uses of consumer information, including secondary uses by the web site provider.

Access/Participation: The FTC believes that access is essential to ensure that the data is accurate and complete. The access must be relatively simple and inexpensive and allow the correction of errors and/or the registration of objections with respect to a consumer's data.

Integrity/Security: Companies must take appropriate steps, from a managerial and technical perspective, to protect against the loss, unauthorized access, misuse, destruction or disclosure of consumer data.

Enforcement/Redress: The FTC believes that without an enforcement mechanism, the other principles are not effective. The FTC recommends that enforcement and redress be provided either through self-regulation enforcement or through legislation and government regulation. *Privacy Online: A Report to Congress*, June 1998.

European Union Privacy Directive

In October of 1998, the European Union Privacy Directive took effect. The Directive prevented E.U. companies from transferring any personal information to companies in other countries where such countries did not provide adequate privacy protection. Due to its disjointed approach to privacy, the United States is considered one of the countries that did not provide adequate privacy protection. Since the adoption of the Directive, representatives of the European Union and the United States have been negotiating to establish a safe harbor with which U.S. companies can comply to enable them to receive European data. The U.S. and European Union have apparently reached a tentative agreement, expected to be finally announced in March of 2000. *Diplomats: European Union Likely to Approve Data Privacy Agreement with U.S. Next Month*, *Electronic Commerce & Law*, Vol. 5, No. 9, March 1, 2000.

Although the latest draft of the international safe harbor privacy principles has not yet been released by the U.S. Department of Commerce, it is likely to require that companies desiring to benefit from the safe harbor adhere to the following principles that the E.U. believes are necessary to ensure adequate privacy protection:

Notice: A company must inform individuals about the purposes for which it collects and uses information, how to contact the company with any inquiries or complaints, the types of parties to which the company discloses its information, the choices and means the company offers individuals for limiting use and disclosure, and when the company is using or disclosing information for a purpose other than that for which it was originally collected or for which it was processed by the transferring company. The notice must be provided in clear and conspicuous language when individuals are first asked to provide personal information to the company or as soon as is practical, but in any event before the company uses or discloses the information.

Choice: The company must offer individuals the opportunity to choose whether and how personal information they provide is used or disclosed to third parties, where such use or disclosure is incompatible with the purposes for which it was originally collected or subsequently authorized by the individual. For sensitive information (*i.e.*, personal information specifying medical or health conditions, racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership or information relating to the sex life of the individual), individuals must be given an affirmative or explicit choice (opt in) if the information is to be used or disclosed in a manner other than as authorized by the individual. Individuals must be provided with clear and conspicuous, readily available common and affordable mechanisms to exercise choice.

Onward Transfer: The company may only disclose personal information to third parties consistent with the principles of notice and choice. Where a company has not provided choice (because a use is not incompatible with the purpose for which the data was originally collected or which was subsequently authorized by the individual), and the company wishes to transfer the data to a third party, it may do so if it first either ascertains that the third party subscribes to the directive principles, is subject to the directive or another adequacy finding, or enters into a written agreement with such party requiring the third party to provide at least the same level of privacy protection as is required by the directive.

Security: Companies creating, maintaining, using or disseminating personal information must take reasonable precautions to protect such information from loss, misuse, unauthorized access, disclosure, alteration or destruction.

Data Integrity: Consistent with the directive principles, a company may not process personal information in a way that is incompatible with the purposes for which it has been collected or subsequently authorized. To the extent necessary for other purposes, the company should take reasonable steps to ensure that the data is reliable for its intended use, and is accurate, complete and current.

Access: Individuals must have access to personal information about them that a company holds and must be able to correct, amend or delete that information where it is inaccurate, except when the burden of expense of providing access would be disproportionate to the risk of the individual's privacy in question, or where the rights of persons other than the individual would be violated.

Enforcement: Effective privacy protection must include mechanisms for assuring compliance with the principles, recourse for individuals affected by noncompliance with the principles, and consequences for the company when the principles are not followed. November 15, 1999, *Draft International Safe Harbor Privacy Principles Issued by the U.S. Department of Commerce*, www.ita.doc.gov/td/ecom/principles1199.htm. [As edited by author to shorten text.]

A serious point of contention in the negotiations between the European Union and the United States in relation to the privacy directive safe harbor was what enforcement mechanism would be used against companies that violated the privacy principles. Based on reports discussing the recent agreement between the U.S. and E.U., companies will be able to satisfy the enforcement component of the safe harbor by: (1) subjecting themselves to the authority of a data protection commissioner in one of the 15 E.U. member countries; (2) showing that the company is already covered by U.S. privacy laws, such as those that regulate credit card applications; (3) signing up with a self-regulatory privacy organization in the United States, such as BBBOnline, that is monitored by the Federal Trade Commission; or (4) agreeing to refer privacy related disputes with individuals to a panel of European data protection authorities for resolution. *Diplomats: European Union Likely to Approve Data Privacy Agreement With U.S. Next Month*, *Electronic Commerce and Law*, Vol. 5, No. 9, p. 206.

Children's On-line Privacy Protection Act 1998

On October 21, 1998, President Clinton signed into law the Children's Online Privacy Protection Act of 1998, which imposes privacy obligations on commercial web sites that are directed to children under 13 or sites that have knowingly collected personal information from children under 13. 15 U.S.C. § 6501 *et seq.* The Act requires that web site operators: (1) provide parents notice of the web site's information practices; (2) obtain prior verifiable parental consent for the collection, use and disclosure of personal information from children; (3) upon request, provide a parent with the ability to review the personal information collected from a child; (4) provide a parent with the opportunity to prevent the further use of personal information that has already been collected, or the future collection of personal information from the child; (5) limit collection of personal information from a child's online participation in a game, prize offering or another activity to information that is reasonably necessary for the activity; and (6) establish and retain reasonable procedures to protect the confidentiality, security and integrity of the information collected (*Self-Regulation and Privacy On Line: A Report to Congress, Federal Trade Commission*, July 1999). One helpful provision in the statute is a safe harbor for companies that subscribe to self-regulation programs approved by the FTC. Regulations for the statute are at 16 C.F.R. 312, and were issued October 20, 1999. Compliance with this statute is a challenging task and should cause companies that do not target children to take precautions to better ensure that children under 12 do not provide information through the company's web site.

Industry Specific Statutes and Regulations.

There are other industry-specific statutes that relate to privacy including the following: Fair Credit Reporting Act, 15 U.S.C. § 1681 *et. seq.* (governing consumer credit reports); Electronic Communications Privacy Act of 1986, 18 U.S.C. § 2510 *et. seq.* (governing electronic mail and voice mail communications); Cable Communications Policy Act of 1984, 47 U.S.C. §551 (governing cable television subscriber information); Right to Financial Privacy Act of 1978, 12 U.S.C. § 3401 *et. seq.* (governing individual bank records); Video Privacy Protection Act of 1988, 18 U.S.C. § 2710 (governing video rental records); Family Educational Rights and Privacy Act of 1974, 20 U.S.C. § 1232g (governing student records); Communications Act of 1934, as amended by the Telecommunications Act of 1996, 47 U.S.C. § 222 (governing information relating to the use of telecommunication services); Privacy Act of 1974, 5 U.S.C. § 552a (governing data collected by the federal government); 1999 Gramm-Leach-Bliley Act (S.900, enacted November 12, 1999) (relating to, among other issues, restrictions on the disclosure of personally identifiable financial information acquired by institutions); Electronic Funds Transfer Act, 15 U.S.C. § 1693-1693r (relating to accounts with electronic funds transfer features); Health Insurance Reportability and Accountability Act of 1996, 29 U.S.C. § 1181; 42 C.F.R. 9482.24 (1998); 42 U.S.C. § 290dd-3 (1994) and recently announced proposed regulations offering privacy protection for health information (64 Fed. Reg. 59918 (1999) (proposed November 3, 1999)).

Privacy Hurdles

The implementation of a privacy program can be a daunting task. Among other practical issues in implementing a program, one basic hurdle to clear is to identify all of the uses that a company makes of information it gathers on its site and the ways in which it gathers that information. Because web sites are constantly evolving, making these identifications is like shooting at a moving target. Companies need to also keep in mind that third parties who advertise on or link to their site may independently gather information about visitors to the site.

Implementing an opt in/opt out option can be more difficult than it might first appear. A company must have the technology and resources in place to support an opt in/opt out approach and further have the ability to document and record choices made by web site visitors.

In addition, the question is still open as to what access a web site operator should give a party to information gathered. Access to basic personal information such as name, age, address, etc., is one thing. Access to information gathered through clickstream monitoring and cookies is another.

One way to address the ability to use gathered data for secondary uses is to acquire the consent of a user. The question is still open, however, as to whether putting a consent obligation in a non-click wrap user agreement or a privacy policy clears the way for the web site operator to use such information in the consented manner.

Conclusion

The privacy programs currently in place are many and varied, ranging from no privacy policy to extremely complex and detailed privacy policies. The resolution of the safe harbor requirements of the E.U. directive will require companies that wish to accept data from their European counterparts to address privacy issues. For the rest of the World Wide Web, who are not otherwise regulated by industry specific laws and regulations, the goals should be to adopt a privacy policy that is as simple as it can be in light of the company's practices and then to follow such policy religiously until such time as federal laws or regulations are adopted that mandate a particular approach to privacy. For companies that want to be aggressive with respect to the use and collection of data, such companies must be prepared to devote significant time and resources to develop a policy that reflects its practices and to carefully monitor its practices.

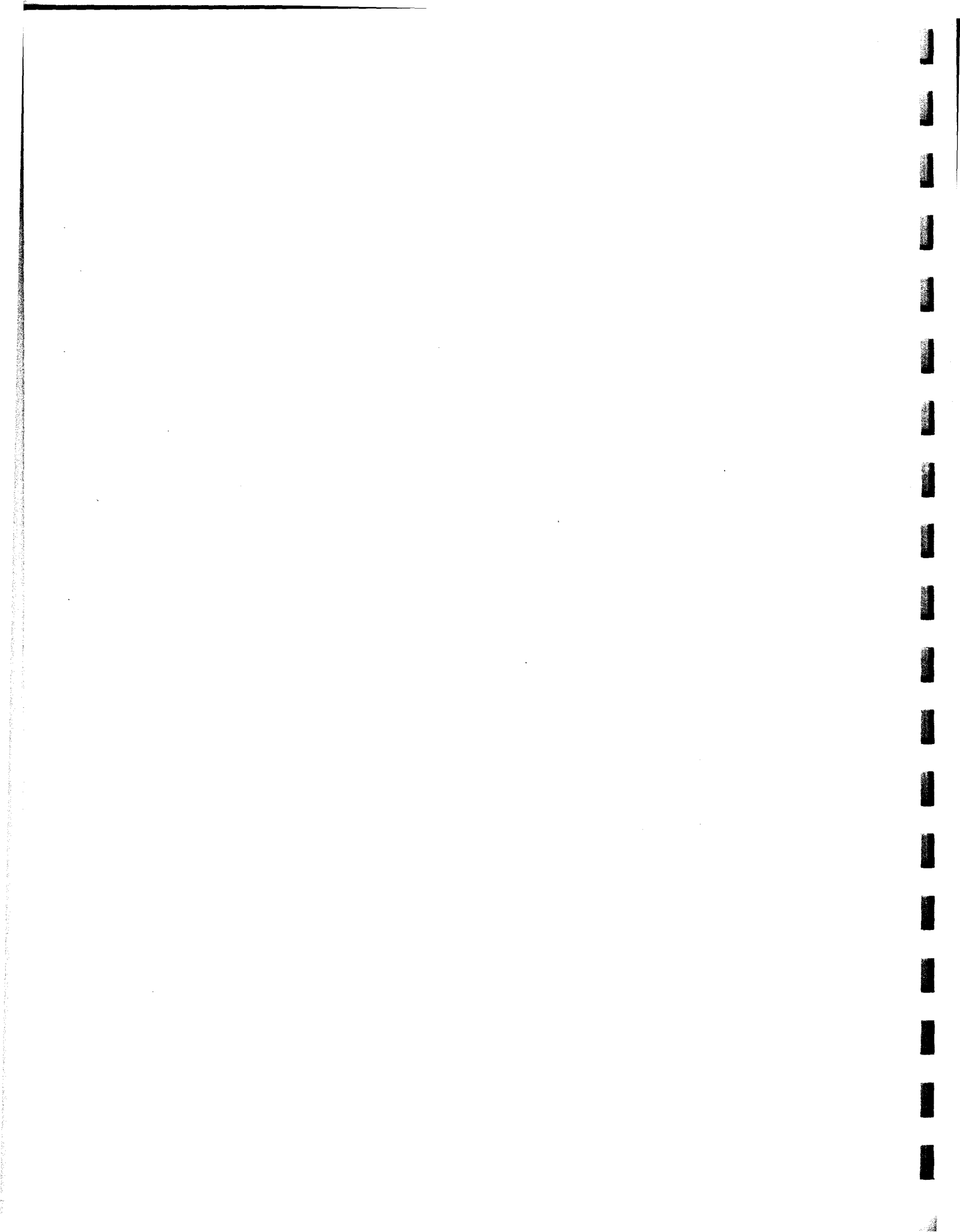
To answer the second question posed in the title of this article, "Should there be any [privacy on-line]?", the reality of the situation is that e-commerce will be greatly facilitated if there are some basic privacy standards in place and e-commerce expansion is an event that greatly benefits both businesses and consumers.

**CYBERSPACE
JURISDICTION**

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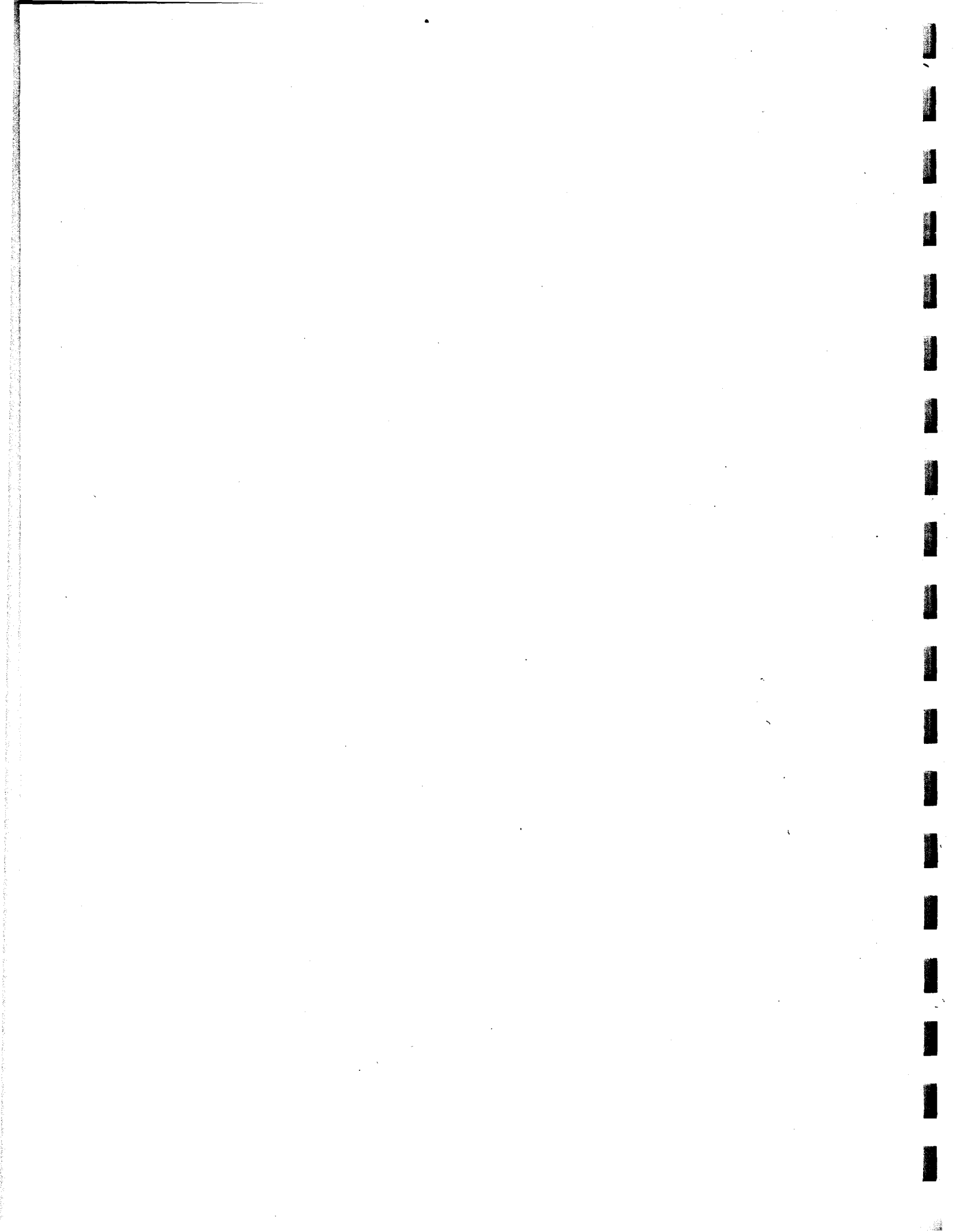
SECTION I



CYBERSPACE JURISDICTION

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CYBERSPACE JURISDICTION

As the Christmas recently past demonstrated, electronic commerce ("E-Commerce") over the Internet has become a huge business. Although conventional commerce still dwarfs it, E-Commerce already amounts to billions of dollars annually. Moreover, the dollar volume is growing rapidly, not just in transactions between businesses and consumers (B to C transactions) but, perhaps more important, in transactions among businesses (B to B transactions).

With the rise in volume of E-Commerce, can litigation be far behind? Of course, not. After all, this is America.

Already, there exists over 100 reported cases involving cyberspace jurisdictional issues. The attached Case List of Cases Finding No Personal Jurisdiction and Cases Finding Personal Jurisdiction contain their citations. The attached Articles List discusses many of these cases and the legal concepts underlying them. This paper examines a number of these cases with an eye toward exposing the logic of some of the judicial decisions, developing some fundamentals of cyberspace jurisdiction and suggesting some protective actions being haled into unanticipated and/or unwelcome forums.

In Morantz v. Hang & Shine Ultrasonics, Inc., 79 F.Supp.2d 537 (E.D. Pa. Dec. 20, 1999), the court succinctly summarized the current situation noted that the exponential growth of the Internet, the arrival of the World Wide Web as a business medium and the "jurisdiction-confounding" nature of cyberspace spawned new strains of jurisdictional analysis. The court also noted the three-category continuum for analyzing web site jurisdiction. The first category is the passive web site that merely posts information. At the other extreme are highly interactive sites over which business is conducted. The latter usually involve a high volume of deliberate exchanges of information through the web site, including formation of contracts. In the middle category jurisdiction depends on the level of commercial information exchange that takes place on the web site.

In Morantz, the site was not highly interactive. Contracts and sales were not consummated through the web site. Order forms for a promotional video could be printed out but not sent over the Internet. Also a link was provided which allowed a user to send an e-mail directly to the defendant's site. The court concluded that these web site features were not interactive enough to justify the exercise of personal jurisdiction and declined to exercise it. Instead, the court transferred plaintiff's trademark infringement action to the Western District of New York.

To place this case, the others discussed in this paper and the 100 plus cases on the attached Case Lists in proper perspective, it is helpful to briefly review the existing jurisprudence on personal jurisdiction. In doing so, recall that until the arrival of the Internet, a territory that defies all boundaries, personal jurisdiction tracked somewhat closely geographical and territorial boundaries, and, indeed, was rooted in them and defined by them.

JURISDICTIONAL FUNDAMENTALS

Personal jurisdiction concerns a court's power to decide a matter in controversy before it, and the court's authority over the subject matter and the parties involved in such controversy. In federal courts, issues about personal jurisdiction may be raised at any time. Indeed, a judgment rendered by a court without proper personal jurisdiction will not be enforced when properly challenged.

Personal jurisdiction is of two types: "general jurisdiction" extends to all cases and controversies that may be brought before the court within the bounds of legal rights and remedies; "specific jurisdiction" covers only a specified case or class of cases. More limited in nature than general jurisdiction, specific jurisdiction requires less proof to establish. Thus far, most U.S. cases concerning personal jurisdiction over Internet activities have rested on specific jurisdiction.

Traditionally, the courts have considered various facts in determining whether jurisdiction, general or specific, exists. Absent a Federal statute expressly conferring jurisdiction over a given matter on a specific court, federal courts apply the law of the state where the action is brought and use a two-step analysis to determine if proper personal jurisdiction exists. In such an analysis, the court first determines if jurisdiction is proper under the State's long-arm statute. If it is, the court next determines if the exercise of personal jurisdiction over the defendant comports with due process under the U.S. Constitution. World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 289-90 (1980).

Long-arm statutes are of two types: Those that limit a court's exercise of jurisdiction in one or more ways; and those that permit the exercise of personal jurisdiction to the full extent permitted by the U.S. Constitution. In states where the statute permits full exercise, the court's analysis really consists of a single step evaluation of whether personal jurisdiction is proper under the due process clause of the U.S. Constitution.

In now familiar language, International Shoe Co. v. Washington, 326 U.S. 310 (1945), states due process mandates that the defendant have "minimum contacts such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice'". Id. at 316. Later, World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980), held the defendant's minimum contacts must be "conduct and connection with the forum State . . . such that he should reasonably anticipate being haled into court." Id. at 297. Due process does not require that the defendant have ever been physically present in the forum. Due process does require that the defendant's contacts be more than merely "random," fortuitous" or "attenuated" ones. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985).

Under Hansen v. Denckla, 357 U.S. 235 (1958), to establish general jurisdiction over a defendant, constitutional due process requires a showing that the defendant's contacts were "substantial" or "continuous and systematic"; in short, that the defendant "purposely avail[ed] of the privilege of conducting activities within the forum state, thus invoking the benefits and protection of its laws." Id. at 253. However, for specific jurisdiction, Supreme Court decisions

require only that the defendant's efforts are directed toward the forum state. So long as a commercial actor's efforts are "purposefully directed" toward residents of another state, "jurisdiction may not be avoided merely because the defendant did not physically enter the forum state." Burger King Corp., supra, at 476.

What do these land mark cases tell us about jurisdiction over E-Commerce on the Internet? In truth, these cases supply the language of and framework for analysis, but their principles are only indirectly related to the results that the courts reach. An understanding of the function of the Internet, a willingness and ability to explain it to the court and the creativity to concoct a persuasive solution on the facts are important additional requirements for reaching correct decisions. What emerges is a realization that the case results are somewhat diverse, the principles of analysis are still under development and consistent results have been (relatively) slow to develop. Unfortunately, the situation makes it difficult for lawyers for Internet merchants to advise their clients how to do business on the Internet and avoid the jurisdictional reach of a host of states. To address this concern, this paper includes cases where Internet jurisdiction was found absent and uses them to propose conduct to avoid Internet jurisdictional snares.

APPLYING JURISDICTIONAL FUNDAMENTALS TO ONLINE CONTACTS

As noted, 100 or more cases exist which apply the jurisdictional fundamentals in litigation involving online contacts. In approximately 60 of the cases on the attached Case List, the Court found no personal jurisdiction. In another 40, the Court found personal jurisdiction. The pages which follow examine some of the cases to expose the logic of the decisions and to develop some fundamentals of cyberspace jurisdiction. Then, I suggest some protective actions that persons doing business using the Internet might take to avoid successful assertions of jurisdiction.

Cases Finding No Jurisdiction

One of the earliest and most widely cited cases in which a court found a web site did not provide the necessary minimum contacts is Bensusan Restaurant Corp. v. King, 937 F.Supp.2d 295 (S.D.N.Y. 1996), aff'd, 126 F.3d 25 (2d Cir. 1997). Bensusan operated "The Blue Note" jazz club in New York City. King operated "The Blue Note" club in Columbia, Missouri. Bensusan held a federally registered mark "The Blue Note" to promote his club and ticket sales. King put up a web site that advertised his Columbia Blue Note with a telephone number and ticket purchasing information. Bensusan claimed that King's web site constituted trademark infringement. At issue was whether King's web site evidenced an intent to sell merchandise in New York justifying personal jurisdiction over him.

Granting King's Motion to Dismiss For Lack of Personal Jurisdiction, the Court refused to view King's web site as "purposeful availment," because a New York resident would have to take several affirmative steps to access and utilize the web site. Further, the New York resident would actually have to go Missouri to pick up tickets he purchased because King did not mail tickets to his Columbia, Missouri club to purchasers. The Court rejected Bensusan's claim that

King should have foreseen that the web site would be viewed in New York. There were no facts indicating that King encouraged any New Yorkers to access his site. In response to Bensusan's argument that King should have foreseen that his web site would be viewed in New York, the Court held that "mere foreseeability of an in-state consequence" was not an adequate basis to assert personal jurisdiction over King. Moreover, the Bensusan court analogized creating a web site to "placing a product in the stream of commerce," in that its effects " may be felt nationwide - - or even worldwide - - but, without more, it is not an act purposefully directed toward to forum state." 937 F. Supp.2d at 301. In short, King's web site in simply did not rise to the level of doing business in New York. The Second Circuit affirmed the District Court, relying on the language of the New York Long Arm statute and avoiding the due process issue. The District Court in Bensusan was one of the first to pay close attention to the facts, analyze them and conclude that the online contacts did not support personal jurisdiction.

In Cybersell, Inc. v. Cybersell, Inc., 130 F.3d 414 (9th Cir. 1997), the 9th Circuit concluded that a web site or other electronic contact, alone, was not "purposeful availment" of the benefits of the forum state. Cybersell, Inc., an Arizona corporate plaintiff ("Cybersell Arizona"), sued a Florida corporation (Cybersell Florida) in an Arizona court for alleged trademark infringement through a web site. Cybersell Florida had no contacts with Arizona. It did not attempt to market in Arizona. It did not sell any products or services in Arizona. It did not solicit business in Arizona. It did not receive any telephone calls from Arizona. Even so, Cybersell Arizona claimed that its assertion of jurisdiction met due process requirements in that Cybersell Florida "should be amenable to suit in Arizona because cyberspace is without borders and a web site is necessarily intended for use on a worldwide basis." Unpersuaded, the Court recognized that anyone could access a web site, but that fact did not compel a conclusion that the web site alone was an attempt to target anyone in any specific forum. Here, Cybersell Florida did not intentionally aim its conduct at Arizona knowing it would cause harm there. The 9th Circuit recognized that some cases found a web site to be sufficient contact for the assertion of jurisdiction, but noted there was usually "something more" to show that the defendant purposefully directed substantial activity to the forum state. In Cybersell there were no other contacts between the Florida defendant and the State of Arizona. In short, it was simply a passive web site. Cybersell Florida did not undertake any actions that qualify as purposeful activity invoking the benefits and protections of Arizona.

The cases finding no jurisdiction include ones in which the court declined to uphold personal jurisdiction based on the mere existence of a web site without anything more. Indeed, according to Morantz, supra, it is now at least somewhat settled that "a mere presence on the World Wide Web does not support the minimum contacts necessary to subject a corporation to personal jurisdiction on a worldwide basis." Morantz, supra, 39 F.Supp.2d at 539-540. See Harbuck v. Aramco, Inc., 1999 WL 999431 (E.D.Pa., Oct 21, 1999) (NO.CIV. A. 99-1971); Molnlycke Health Care AB v. Dumex Medical Surgical Products, Ltd., 64 F.Supp.2d 448 (E.D.Pa., Sep 07, 1999) (NO. CIV. A. 99-1725); Edberg v. Neogen Corp., 17 F.Supp.2d 104 (D.Conn., Aug 04, 1998) (NO. 3:98CV00717 (GLG)). A number of other cases finding no jurisdiction appear on the attached Case List: Cases Finding No Personal Jurisdiction.

As the Cybersell court had stated: "[S]o far as we are aware, no court has ever held that an internet advertisement alone is sufficient to subject the advertiser to jurisdiction in the

plaintiff's home state...." Cybersell, supra, 130 F.3d at 418. However, as the Morantz court observed, the jurisdictional jurisprudence of the Internet contains at least two cases which unfortunately find very minimal contacts are sufficient to establish personal jurisdiction. Inset Systems, Inc. v. Instruction Set, Inc., 937 F.Supp 161 (D. Conn. 1996), holds that maintaining a web site and telephone number is sufficient to establish personal jurisdiction in every state. Heroes, Inc. v. Heroes Found., 958 F.Supp. 1 (D.D.C. 1996) found where a web site that explicitly solicited donations and provided a toll free number subject to the jurisdiction of the court. Fortunately, these misguided cases have been widely criticized in other opinions and have seldom been followed, but you can expect to see them when a plaintiff is scrambling to find minimum contacts.

Cases Finding Jurisdiction

Another early and widely cited Internet jurisdiction case, CompuServe, Inc. v. Patterson, 89 F.3d 1257 (6th Cir. 1996) occurred close to home. CompuServe, headquartered in Columbus, Ohio, was an early "information utility." Patterson, a Texas resident, developed software attractive to CompuServe and its customers. In 1991, CompuServe and Patterson agreed to make Patterson's shareware available to all CompuServe subscribers. Their agreement was negotiated and consummated by e-mail. Thereafter, Patterson transmitted (from Texas) to CompuServe (in Ohio) 32 master software files which CompuServe placed on its server for access by its subscribers. A couple of years later, CompuServe began to market and sell software similar to Patterson's. Upon learning of CompuServe's actions, Patterson e-mailed CompuServe that its efforts constituted an infringement on his common law trademark rights. CompuServe changed the name of its software. However, Patterson continued to complain and threaten suit. (Unsurprisingly, Patterson was a lawyer.) His continued complaints and demands for compensation caused CompuServe to seek a declaratory judgment in Ohio Federal Court. Patterson moved to dismiss for lack of personal jurisdiction. The trial court granted his motion, but the 6th Circuit reversed.

In CompuServe, the 6th Circuit noted the crucial federal constitutional inquiry was whether, given the facts of the case, the non-resident defendant had sufficient contacts with the forum state that the District Court's exercise of jurisdiction would comport with "traditional notions of fair play and substantial justice. [citations omitted]" The 6th Circuit employs three criteria to make this determination:

"First, the defendant must purposefully avail himself the privilege of acting in the forum state or causing a consequence in the forum state. Second, the cause of action must arise from the defendant's activities there. Finally, the acts of the defendant or consequences caused by the defendant, must have a substantial enough connection with the forum to make the exercise of jurisdiction over the defendant reasonable. Id. at 1262.

The 6th Circuit concluded that Patterson had knowingly made an effort to market his products through CompuServe. Accordingly, the 6th Circuit believed it reasonable to subject Patterson to suit in Ohio, the state which is home to the computer network service he chose to employ.

Discussing each of the three criteria, the court found that, by his actions, Patterson took steps that created a connection with Ohio. He subscribed to CompuServe. He entered into the shareware registration agreement when he loaded his software on to the CompuServe system for others to use or purchase. He repeatedly sent his computer software electronically to CompuServe. He advertised that software on CompuServe. Finally, he initiated the events that lead to the filing of the suit by making demands of CompuServe by both electronic and regular mail. The 6th Circuit found these contacts with Ohio "substantial" enough that Patterson could reasonably have anticipated being haled into an Ohio court. Indeed, Patterson's relationship with CompuServe as a software provider and marketer was a crucial fact in this case. Specifically, "although all of this happened with the distinct paucity of tangible, physical evidence, there can be no doubt that Patterson purposely transacted business in Ohio." *Id.* at 1264. Other events showed that CompuServe and Patterson intended the relationship to be ongoing. And, Patterson deliberately set in motion an ongoing marketing relationship with CompuServe that he could have reasonably foreseen would have consequences in Ohio. Finally, Patterson entered into a contract expressly stating that it would be governed by and construed in the light of Ohio law.

The 6th Circuit found that there was a substantial enough connection between Patterson and Ohio to make it reasonable for an Ohio court to assert personal jurisdiction over him. Someone like Patterson who employed a computer network service like CompuServe to market a product can reasonably expect disputes with that service to yield law suits in the service's home state finding Patterson had sufficient contact with Ohio to support the exercise of personal jurisdiction over him, the 6th Circuit reversed the District Court's dismissal and remanded the case for further proceedings consistent with its opinion.

Another seminal case Zippo Manufacturing Company v. ZippoDot Com, Inc., 952 F.Supp. 1119 (W.D. PA. 1997), is significant because the court offered a framework to analyze personal jurisdiction in cyberspace, one of the few courts to do so. Zippo Manufacturing Co. ("Manufacturing Co.") sued Zippo Dot Com, Inc. ("Dot Com") for the several alleged violations of Federal and state trademark protection laws by use of the domain names "zippo.com," "zippo.net," and "zipponews.com." Dot Com was incorporated and based in California. Manufacturing was incorporated and based in Pennsylvania. Almost all of Dot Com's contacts with Pennsylvania occurred over the Internet. After reviewing cases and holdings cited in *Jurisdictional Fundamentals*, supra, the Zippo court stated:

Enter the Internet, a global 'super-network' over 15,000 computer networks used by over 30 million individuals, corporations, organizations and educational institutions worldwide. [Citations omitted.] In recent years, businesses have begun to use the Internet to provide information and products to consumers and other businesses. [Citation omitted.] The Internet makes it possible to conduct business throughout the world entirely from a desktop. With this global revolution looming on the horizon, the development of the law concerning the permissible scope of personal jurisdiction based on the Internet use is in its infant stages. The cases are scant. Nevertheless, our review of the available cases and materials reveals that the likelihood of personal jurisdiction can be constitutionally exercised is directly proportionate to the nature and quality

of commercial activity that an entity conducts over the Internet. This *sliding scale* is consistent with well-developed personal jurisdiction principals. At one end of the spectrum are situations where a defendant clearly does business over the Internet. If a defendant enters into contracts with residents of a foreign jurisdiction that involve the knowing and repeated transmission of computer files over the Internet, personal jurisdiction is proper. E.g. Compu Serve, Inc. v. Patterson, 89 Fed.3d 1257 (6th Circuit, 1996). And at the opposite end are situations where a defendant has simply posted information on an Internet web site which is accessible to users in foreign jurisdictions. A passive Web site that does little more than make information available to those who are interested in it is not grounds for the exercise of personal jurisdiction. E.g. Bensusan Restaurant Corp. v. King, 397 F. Supp. 295 (S.D. NY. 1996). The middle ground is occupied by interactive Web sites where a user can exchange information with the host computer. In these cases, the exercise of jurisdiction is determined by examining the level of interactivity and commercial nature of the exchange of information that occurs on the web site. E.g. Maritz, Inc. v. CyberGold, Inc. 397 F.Supp. 1328 (E.D. Mo. 1996). Zippo, supra, at 1123-1124. The Zippo court went on to say that “. . . when an entity intentionally reaches beyond its boundaries to conduct business with foreign residents, the exercise of specific jurisdiction is proper. [Citation omitted.] Different results should not be reached simply because business is conducted over the Internet. Id. at 1124. (Italics supplied)

The Zippo court found Dot Com's claim that its web site was not “purposeful availment” of Pennsylvania law “wholly unpersuasive”. In essence, the court found that by receiving and processing subscription applications from Pennsylvania and then assigning passwords to applicants, Dot Com deliberately and systematically availed itself of the privileges and benefits of doing business in Pennsylvania. The court found irrelevant the fact that only 2% of Dot Com's accounts came from Pennsylvania. It is the nature and quality of forum contacts that are of primary relevance, not their quantity. Dot Com made a conscious choice to conduct business with the residents of Pennsylvania and was therefore on notice that it could be subject to suit there. Notably, here, as in Patterson, the court was aware that the virtual contacts were buttressed by contracts and other physical, real space contacts.

The court found nothing unreasonable about the exercise of jurisdiction over Dot Com here. Dot Com consciously chose to conduct business in Pennsylvania, pursuing profits from actions that are in question. “The Due Process clause is not a “territorial shield to inter-state obligations that have been voluntarily assumed. [Citation omitted.]”

Of the cases on the Case List, approximately sixty find no jurisdiction while approximately forty find jurisdiction. In those finding jurisdiction, Patterson and Zippo have provided the analytical framework that a number of later cases have followed. A discussion of some or many of the cases on the Case List, Cases Finding Personal Jurisdiction might provide additional information, but little additional wisdom. However, at least one of the decisions provide interesting examples of the court accepting the jurisdictional challenge and finding jurisdiction, apparently because it wants the defendant before it.

In Archdiocese of St. Louis v. Internet Entertainment Group, Inc. 34 F. Supp.2d 1145 (E.D. Mo. Jan. 20, 1999), the owners of the common law trademarks and trade name commemorating the Pope's 1999 visit to St. Louis sought a preliminary injunction prohibiting the defendant from using its Internet domain names or colorful variations on the holder's common law trademarks and/or trade names. Finding that the owners demonstrated a probability of success in proving defendant had been diluting the distinctiveness of the owner's family of marks, the court granted the motion. In a rather terse Preliminary Injunction, the court found that the defendant has been diluting the distinctiveness of the plaintiffs' family of marks by using the name "Papal visit 1999" and derivatives therefrom to identify a sexually explicit Internet site and by using the name string "Papal visit 1999.com" "Papal visit.com" as Internet domain names which provided Internet users throughout Missouri and elsewhere with access to those sites. The court found the defendant's use tarnished the plaintiff's family of marks by associating them with adult entertainment venues that are inconsistent with the positive and spiritual uplifting image plaintiff is striving to create and maintain in connection with the Pope's upcoming visit to St. Louis." Id. at 1146. One has the feeling that the court was eager to have the defendants before it to put an end to their tarnishing.

Although the cases finding personal jurisdiction resists easy categorization, in each case the court found the fundamentals necessary for personal jurisdiction, usually specific jurisdiction, but occasionally general jurisdiction. If you find yourself adrift and desire a quick survey of the cases to date, consult Cendali and Weinstein's article, *Personal Jurisdiction And the Internet*, 520 PLI/Pat 975, (June, 1998). There, the authors review twenty-three of the cases finding personal jurisdiction, describing each of them briefly. Then, the authors review seventeen cases finding no personal jurisdiction, again summarizing the salient facts of the holdings. This resort should be sufficient for you to pick and choose among these cases for ones that support or oppose your particular situation and allow you to collect the authorities you need to make your own argument.

CYBERSPACE JURISDICTIONAL FUNDAMENTALS

As the preceding discussion shows, courts are applying traditional jurisdictional rules to determine the existence of personal jurisdiction over Internet transactions. From these cases, I submit the following jurisdictional fundamentals will be true more often than not:

1. General Jurisdiction based on Internet presence alone is extremely unlikely. Rather, a significant amount of forum contact in both cyberspace and physical space is likely to be required.
2. In considering the role of the Internet in establishing contacts for personal jurisdiction, the courts have analogized Internet contacts to more traditional communication media. However, for all their explanatory usefulness, analogies can be quite misleading. Even so, the courts have applied a number of them, analogizing:

- a. telephone calls and mail sent to the forum to e-mail;

- b. the physical distribution of goods within the forum to the electronic distribution of goods;
- c. national print or broadcast advertisements and 1-800 numbers to web pages; and,
- d. contracts executed in the forum or entered into with residents to “point and click” contracts.

As an exercise, think through some of the cases under discussion using these analogies to see if you feel they give satisfactory results. I submit that analogizing the telephone to the Internet is better than most.

3. Specific jurisdiction is unlikely to arise from a mostly or even predominantly passive web site.

4. Provision of goods and services or transactions of business through a web site may well lead to specific jurisdiction. Pure Internet advertising cases are unlikely to give rise to a personal jurisdiction. But, in cases where the defendant actively solicits or transacts business through the web site, personal jurisdiction often occurs.

5. In many of the cases where the court found a specific jurisdiction, the court considered the defendant’s non-Internet contacts such as contracts with residents, toll-free advertisements in forum publications, mailings into the forum and toll-free telephone numbers as important factors.

6. In any case where a defendant has purposefully directed his activity to the forum state in a substantial way, the courts have been generous in finding specific jurisdiction, even more so when there exists non-Internet contacts.

7. Last, the incidental activity that typically arises in these specific jurisdiction cases usually takes the form of either commercial activity or effects directed toward the forum state, i.e., a “targeting” the forum state or one of its residents.

Finally, in conducting your analysis, be mindful of some of Andrew Costa’s well-founded distinctions in his seminal article *Minimum Contacts in Cyberspace: A Taxonomy of the Case Law*. For example, Costa points out that some courts have had difficulty separating the defendant’s conduct from the medium in which it takes place. Costa believes an important distinction exists between the Internet itself, as the purposefully availing contact, and the Internet, as the *vehicle* for the purposefully availing conduct.

Costa’s distinction between the Internet itself and the conduct which takes place on it illustrates the fallacy in Maritz, Inc. v. Cybergold, supra, where the court characterized Cybergold’s web site as evidence of intent to reach all Internet users regardless of geographical location. Similarly, in Inset Systems, Inc. v. Instruction Set, Inc., the court viewed the defendant’s Internet advertising and toll free numbers as indicating it intended to avail itself of

the privilege of doing business in all states. Costa correctly observes that these cases would subject those with an Internet presence to suit any of the fifty states. Costa also accurately observes that where the Internet by itself is viewed as a pervasive medium that demonstrates an intent to avail oneself of all forum states, the result cannot be harmonized with the Jurisdictional Fundamentals stated earlier.

Similar cautions are useful to insure that the court making a minimum contacts analysis does not mistake technological possibility with foreseeability. The fact that a party can reasonably foresee citizens of each of the fifty states accessing his web site is not the same thing as that same party reasonably anticipating that his Internet presence, without more, would render him amenable to suit in any jurisdiction in the United States. After all, a web site is not automatically projected to a user's computer. Rather, the user must take affirmative action to access the web site.

SAFEGUARDS AGAINST ASSERTION OF JURISDICTION

1. Operate a passive, information only, web site with little or no consumer interaction. Do not solicit or fill orders through the web site. Have the order solicitation and acceptance occur through more conventional means.
2. Restrict access to the web site to persons from "friendly" jurisdictions, and decline business from jurisdictions where you do not wish to be subject to jurisdiction.
3. Remember to limit the degree of consumer/customer interaction on the web site.
4. Put contractual terms on the web site, call them to the attention of web site users and require web site users to accept them before undertaking significant activities on the web site.
5. The contractual terms may include, among other things,
 - a. Contractual choice of forum and choice of law clauses;
 - b. Jurisdictional disclaimers;
 - c. Non-judicial remedies in advance of, but in the event of, a dispute including arbitration or mediation clauses, credit card charge off agreements and escrow agreements.

CONCLUSION

Although the Internet is new and exciting, and its proponents claim great things for it, be mindful that not all courts share that enthusiasm. In St. Clair v. Johnny's Oyster and Shrimp, Inc., 76, F. Supp., 2d 773 (S.D. Tex, December 17, 1999), an action for personal injuries seamen sustained aboard a vessel, the defendant moved to dismiss contending that it did not, at the time of the suit or at the time of the alleged incident, own or operate the vessel CAPT. LE'BRADO. Plaintiff responded that he had discovered evidence taken off the World Wide Web on December 1, 1999, revealing that the defendant did "in fact" own the vessel. Here is the court's rejoinder:

“Plaintiff’s electronic ‘evidence’ is totally insufficient to withstand Defendant’s Motion to Dismiss. While some look to the Internet as an innovative vehicle for communication, the court continges to wearily and wearily view it as largely one large catalyst for rumor, innuendo and misinformation. So as not to mince words, the court reiterates that this so called web provides no way of verifying the authenticity of the alleged contentions the plaintiff wishes to rely upon in his response in the defendant’s motion to dismiss. There is no way plaintiff can overcome the presumption that the information he discovered on the Internet is inherently untrustworthy. Anyone can put anything on the Internet. No web-site is monitored for accuracy and nothing contained therein is under oath or even subject to independent verification absent underlying documentation. Moreover, the court holds no illusions that hackers can adulterate the content on any web-site from any location at any time. For these reasons, any evidence procured off of the Internet is adequate for almost nothing, even under the most liberal interpretations and hearsay exception rules found that Fed. R.Civ. P 807.”.

Instead of relying on the voodoo information taken from the Internet, plaintiff must hunt for hard copy backup documentation in admissible form from the United States Coast Guard or determine alternative information verifying what plaintiff alleges. . . If plaintiff cannot provide the court with credible and legitimate information supporting its position by February 1, 2000, the Court will be inclined to grant Defendant dispositive relief.”

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**CYBERSPACE JURISDICTION
CASE LIST**

**Cases Finding Personal Jurisdiction
1996-1999**

American Network, Inc. v. Access America/Connect Atlanta, Inc., 975 F. Supp. 494 (S.D.N.Y. 1997)

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**TRADEMARK ISSUES
ON THE INTERNET**

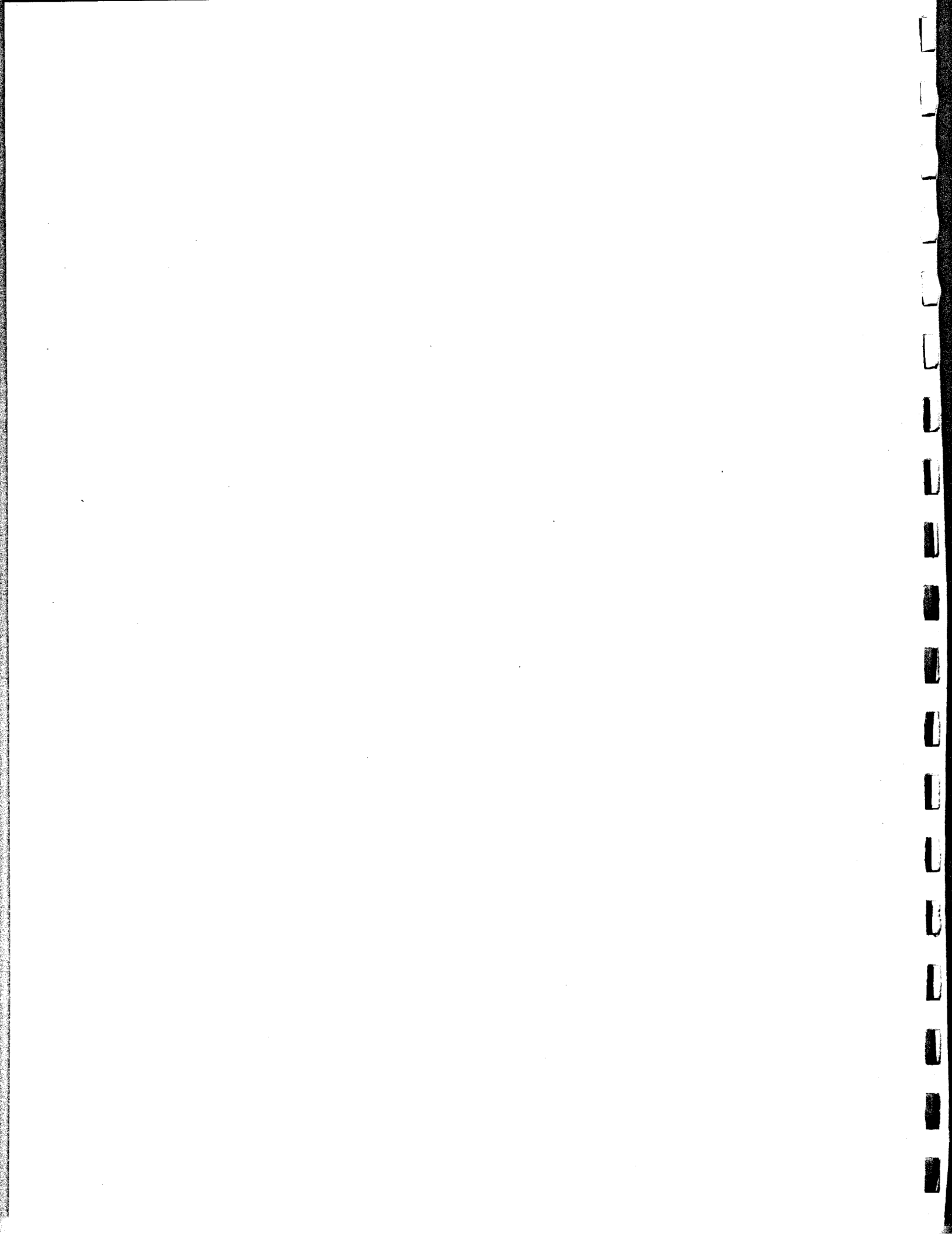
- 2000 Update -

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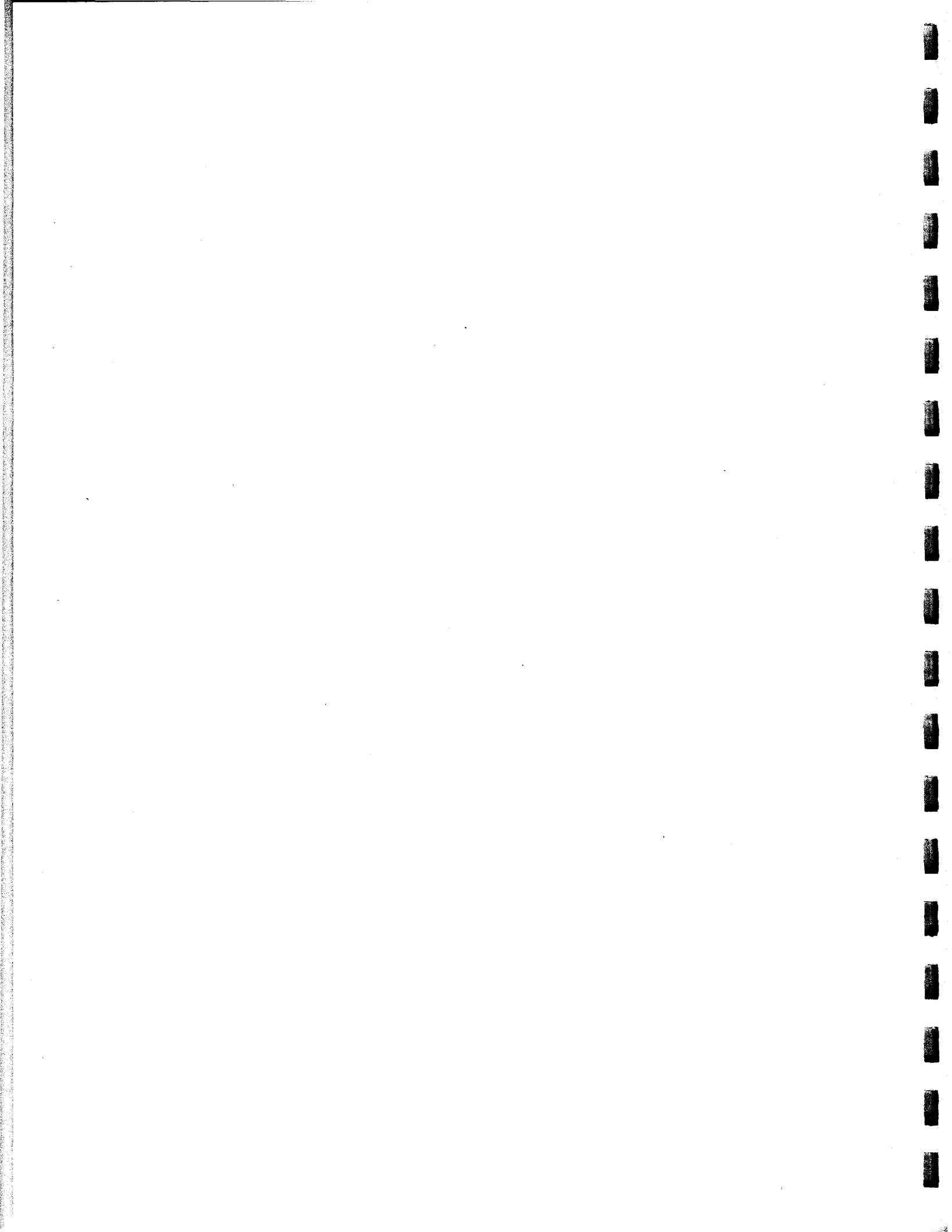
SECTION J



TRADEMARK ISSUES ON THE INTERNET

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A. REMEMBER: THE BASICS APPLY – EVEN IN THE BOLD NEW WORLD OF THE INTERNET!

1. THE PURPOSE OF TRADEMARK LAW.

Trademark law exists both to protect the public and to protect the trademark owner:

The purpose underlying any trademark statute is two-fold. One is to protect the public so that it may be confident that, in purchasing a product bearing a particular trademark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trademark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well established rule of law protecting both the public and the trade-mark owner. [Citation omitted.]

Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 112 S.Ct. 2753, 120 L.Ed.2d 615, 23 USPQ.2d 1081 (1992) (Stevens, J., concurring) at n. 15. Similarly, in Gilson's noted treatise on trademark law the policy is outlined as follows:

A trademark functions and is accorded legal protection because it:

(a) designates the source of origin of a particular product or service, even though the source is to the consumer anonymous;

(b) denotes a particular standard of quality which is embodied in the product or service;

(c) identifies a product or service and distinguishes it from the products or services of others;

(d) symbolizes the good will of its owner and motivates consumers to purchase the trademarked product or service;

(e) represents a substantial advertising investment and is treated as a species of property; or

(f) protects the public from confusion and deception, insures that consumers are able to purchase the products and services they want, and enables the courts to fashion a standard of acceptable business conduct.

1 Gilson, Trademark, Protection and Practice, §1.03. See also 1 McCarthy on Trademarks and Unfair Competition, 3d Ed. §2.10-§2.14.

2. WHAT CONSTITUTES A TRADEMARK, SERVICE MARK OR TRADE NAME .

Trademarks. In the United States, trademarks were originally protected by the individual states, first by common law and subsequently by statute. The most recent version of the Model State Trademark Act, a major portion of which was enacted into law in Kentucky effective July 15, 1994 as KRS 365.561 *et seq.*, defines a trademark as follows:

“Trademark” means any:

[1] word, name, symbol or device including, but not limited to, a distinctive package or container of any kind, or any combination of these

[2] used by a person

[3] to identify and distinguish the goods of that person, including a unique product, from those manufactured or

sold by others, and to indicate the source of the goods, even if that source is unknown.

KRS 365.563(1) (emphasis and numbering added for analytical clarity).

Federal trademark law is set forth in the Lanham Act, 15 U.S.C. §1051 *et seq.* Somewhat similar to the Model State Trademark Act, the Lanham Act defines a “trademark” as follows:

The term “trademark” includes any word, name, symbol or device, or any combination thereof —

[1] used by a person, or

[2] which a person has a bona fide intention to use in commerce and applies to register on the principal register established by this Act,

[3] to identify and distinguish his or her goods including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown.

15 U.S.C. §1127. (Emphasis and numbering added for analytical clarity.) Trademarks are associated only with tangible “goods”.

Service Marks. Marks used in association with “services” are protectible as “service marks” which the Model State Trademark Act defines as follows:

“Service mark” means:

[1] any word, name, symbol or device or any combination of these,

[2] used by a person

[3] to identify and distinguish the services of one (1) person, including a unique service, from the services of others, and to indicate the source of the services, even if that source is unknown.

[4] Titles, character names used by a person, and other distinctive features of radio or television programs may be registered as service marks notwithstanding that they, or the programs, advertise the goods of the sponsor.

KRS 365.563(2) (emphasis and numbering added); see also 15 U.S.C. §1127.

Trade Names. Kentucky statute defines “trade name” as any name used by a person to identify his business or vocation. KRS 365.563[4]. The most common example of a “trade name” is the name of a corporation or a company's fictitious business name. Generally speaking, trade names may be protected in the same ways as trademarks.

Whether a name of a corporation is a trademark, a trade name or both is not entirely clear under the decisions. To some extent the two terms overlap, but there is a difference more or less definitely recognized, which is that generally speaking, the former is applicable to the vendible commodity to which it is affixed, the latter to a business and its good will. . . . A corporate name seems to fall more appropriately into the latter class. But the precise difference is not often material, since the law affords protection against its appropriation in either view upon the same fundamental principles.

American Steel Foundries v. Robinson, 269 U.S. 372, 70 L.Ed. 317, 46 S.Ct. 160 (1926). No person or general or limited partnership, business trust or corporation may do business in Kentucky under an assumed name or any name or style other than his real name (as defined in KRS 365.105(1)) unless one has properly obtained and recorded a certificate of assumed name. KRS 365.015[3]. The standard for obtaining such a certificate is low: the name selected must only be "distinguishable on the record" and there is no check for state or federal trademark registrations or other certificates of assumed names for confusingly similar names. One must merely be distinguishable on the record and pay the required fees.

Failure to properly obtain a certificate of assumed name can expose one to fines ranging between \$25 to \$100 and imprisonment of ten to 30 days, or both -- with each day of continuing violation constituting a separate offense! KRS 365.990[1].

B. TRADEMARK ISSUES IN THE BATTLE FOR "EYEBALLS".

Businesses using the internet are generally trying to make a buck. To be successful, they must have two things: content and customers. Getting both can be a challenge.

Content is the substance of a website. It is the information businesses hope internet users are searching for. Or, if users are not actually searching for a particular business's content, the business at least hopes users will be interested in its content if they find it. Which leads to the problem of attracting "eyeballs" or users. Businesses must find ways to attract internet users to the businesses' websites. Given that there are over 4.3 million sites on the internet now (and that number is growing at the rate of about 250,000 per month), this is no easy task.

Enormous amounts of time, effort and money are being spent on attracting users to businesses' websites and providing content for the sites. But the easiest way to get content and

website visitors is to rip them off from somebody else. Which leads to trademark issues on the internet.

Like the Wild West, the internet is a kind of lawless frontier. For some reason, techies with green hair and multiple body piercings and tattoos tend to ignore old economy conventions. As a result, any number of nefarious schemes have been hatched to get content or website visitors using other peoples' trademarks.

What follows is a quick tour of some rip-off techniques, some of which are apparently legal (at least in the U.S. – you take your chances with the rest of the world on the internet), but most of which aren't or shouldn't be.

(1) DOMAIN NAMES

There are several ways for internet surfers to find content. Using domain name addresses is one way. However, this requires the surfer to have knowledge of the actual domain name of the business they are looking for and is generally a very narrow search. However, as discussed below, it has been a powerful way for cybersquatters to use another's trademark to their advantage.

(2) META TAGS AND IMAGE NAMES

Another, broader way of searching the internet is to use an internet search engine such as Netscape Navigator, Altavista, Lycos or the like. The user enters a keyword and the search engine processes it through an index of websites to produce a list of sites corresponding to the keyword.

Search engines look for keywords in domain names, actual text of web pages, and in meta tags and image names. Meta tags are HTML code used to describe the websites and are meant to facilitate searches. Image names and descriptions are HTML code used to describe a

particular image used on a page. The search engines look for match-ups between the search keyword and meta tag keywords and image names and descriptions. The search engines use the information contained in the meta tags and image names and descriptions as a reference for what the website is about and in prioritizing search results (the more times the keyword appears in the meta tags, the higher the priority of the search result). Meta tags are not visible to the viewer of a website. (Sometimes it is possible to see a site's meta tags by using web browser functions, such as "view source" in Netscape Navigator.)

A practice has developed of using competitors' trademarks as meta tags. As a result, a search engine conducting a search using the competitors' marks as keywords may also find sites where the marks are meta tags, even though the sites may have no connection to the trademark owner. As a result, internet users who enter a particular business's marks for a search may be directed to competitors' websites. Not surprisingly, the trademark owners are generally not overjoyed by this result.

Several court cases have dealt with this meta tag issue. In *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036 (9th Cir. 1999), Brookfield, an entertainment industry information supplier, found its trademark "MovieBuff" was being used as a domain name and in website meta tags by West Coast, the operator of a chain of video rental stores. Brookfield sued to stop West Coast from continuing to use Brookfield's mark.

The Ninth Circuit Court of Appeals reasoned that the use of Brookfield's trademark by West Coast as a meta tag would result in "initial interest confusion" among consumers and was impermissible. The Court stated:

Web surfers looking for Brookfield's "MovieBuff" products who are taken by a search engine to "westcoastvideo.com" will find a data base similar enough to "MovieBuff" such that a sizeable number of consumers who were originally looking for Brookfield's

product will simply decide to utilize West Coast's offering instead. Although there is no source confusion in the sense that consumers know they are patronizing West Coast rather than Brookfield, there is nevertheless initial interest confusion in the sense that . . . West Coast improperly benefits from the goodwill that Brookfield developed in its mark.

174 F.3d at 1062 (emphasis added).

Niton Corp. v. Radiation Monitoring Devices, Inc., 27 F. Supp. 2d 102 (D. Mass. 1998) involved a more blatant rip-off. There, Niton discovered that its competitor RMD had virtually copied Niton's meta tag descriptions of its website. In fact, RMD's meta tags described its site as "The Home Page of Niton Corporation." Because the obvious intent was to divert users looking for Niton's website to RMD's site, the court enjoined RMD from using Niton's marks in RMD's meta tags. 27 F. Supp. 2d at 105.

In Playboy Enterprises, Inc. v. Welles, 7 F. Supp. 2d 1098 (S.D. Cal. 1998), Playboy sued Terri Welles for using its trademarks "Playboy" and "Playmate" on her website, including in the meta tags. Ms. Welles was Playboy's 1981 Playmate of the Year and her website "includes photographs of herself and others (both nude and clothed), a fan club posting board, an autobiography section, and a listing of current events and personal appearances." 7 F. Supp. 2d at 1100.

The court concluded that the use of "Playboy" and "Playmate" as meta tags was not trademark infringement, but rather fair use of Playboy's marks. The court stated:

With respect to the meta tags, the court finds there to be no trademark infringement where defendant has used plaintiff's trademarks in good faith to index the content of her website. The meta tags are not visible to the web surfer although some search engines rely on these tags to help web surfers find certain websites.

Id. At 1104. Equally important was the fact that Ms. Welles was not competing with Playboy,

and was simply using the title previously bestowed by Playboy itself for self-promotion, a practice encouraged by Playboy in other contexts. *Id.* At 1102.

These cases demonstrate that the use of competitors' trademarks in meta tags is an infringing use where it is intended to divert visitors from the competitors' sites to the infringer's site for commercial gain. On the other hand, as the *Playboy v. Welles* case shows, the use of others' trademarks as meta tags may be permissible if it constitutes "fair use." Fair use may exist where the site owner using someone else's trademarks as meta tags is using the trademarks "otherwise than as a mark" or the mark is used in good faith to describe the goods or services of a party or its geographic origin. 15 U.S.C. § 1115(b)(4); e.g., *New Kids on the Block v. News America Publishing, Inc.*, 971 F.2d 302 (9th Cir. 1992); *Bally Total Fitness Holding Corp. v. Faber*, 29 S. Supp. 2d 1161 (C.D. Cal. 1998) (Defendant's "BALLY SUCKS" website was a consumer criticism site, was not likely to be confused with plaintiff's Bally site, and was fair use).

(3) TYPO PIRACY

Another tactic for trying to steal visitors to another website is typo piracy. Typo piracy involves registering a domain name which differs only slightly from someone else's domain name. The difference is meant to be so minor that a web surfer who mistypes the intended domain name will instead get the pirate's site.

Typo piracy was at issue in *Paine Webber Inc. v. WWWPAINWEBBER.COM*, 1999 U.S. Dist. LEXIS 6552 (E.D. Va. 1999). There, Mr. Rafael Fortuny registered "wwwpainewebber.com" as a domain name. This domain name differed from the domain name of the stock brokerage Paine Webber by only the omission of a period after the "www." Mr. Fortuny's site automatically linked to another site offering pornography.

The court concluded that "Paine Webber" is a famous trademark which will be diluted by being linked to pornography. *Id.* Consequently, Mr. Fortuny was enjoined from using the offending domain name. *Id.*

Significantly, the court addressed only the possibility of dilution. Federal trademark protection from dilution applies only to famous trademarks. The court did not address the possibility of confusion between the trademark owner's site and the pirate site. A confusion claim would seem to be the only avenue open to the owner of a non-famous mark to attack typo piracy.

Even so, typo piracy is likely to remain a problem for some domain name registrants. For example, some domain names are generic and not trademark protected (e.g., "loans.com," just purchased by Bank of America for \$3.3 million). Moreover, another registrant may make "fair use" of a very similar domain name (e.g., not a competitive use). In these cases, typo piracy may continue to be a problem. For now, some companies are registering multiple variations of their domain names to ward off typo piracy.

(4) KEYWORD PORTAL REGISTRATION

Keyword portal registration is another way some companies have tried to divert internet traffic intended for competitors' websites. Portals are websites used by consumers as home pages. The portals serve as internet directories and allow the consumers to conduct internet searches from the website. Portals allow other websites to register keywords for their sites to facilitate searches for the sites. The keywords, although registered with the portal, are not visible to consumers.

Some enterprising companies have registered competitors' trademarks as keywords with portals. For example, in *Nettis Environmental, Ltd. v. IWI, Inc.*, 46 F. Supp. 2d 722 (N.D. Ohio

1999), IWI registered Nettis' name with 380 search engines and websites as a keyword for IWI's site. IWI and Nettis are competitors in the same industry. The District Court for the Northern District of Ohio enjoined IWI from continuing its registration of Nettis' trademark as a keyword because it infringed Nettis' trademarks. Id.

A similar case is pending before the U.S. District Court for the Southern District of New York. The case is *Estee Lauder, Inc. v. The Fragrance Counter, Inc.*, No. 99 Cir. 0382 (RWS)(see 189 F.R.D. 269; 1999 U.S. Dist. Lexis 14825 (S.D. N.Y. 1999) for a ruling on a motion to dismiss an affirmative defense of defendant Excite, Inc.). In that case, Estee Lauder, owner of the "Clinique" trademark, has sued The Fragrance Counter and Excite for registering "Clinique" as a keyword for The Fragrance Counter's website. The case is still pending.

These cases raise serious questions about the advisability of registering competitors' trademarks as keywords for other sites. So far the results, in court at least, have not been encouraging.

(5) KEYWORD TRIGGERED BANNER ADVERTISING

The marvels of technology allow portals to display pre-selected banner advertisements whenever a user enters certain keywords for a search. For example, General Motors pays to have its banner advertisements displayed whenever someone enters "Chevrolet" as a keyword search on Excite. G. Miller & D. Maharaj, "Banner Ads on the Web Spark a Trademark Battle," *Los Angeles Times*, Feb. 11, 1999, Part A, Page 1. The practice is so effective that portals charge a substantial premium for keyword triggered banner advertisements. Naturally, some companies are willing to pay to have their banner advertisements appear when someone else's trademark is the keyword. The trademark owners are usually not thrilled.

Playboy Enterprises, Inc. v. Netscape Communications Corp. and Excite, Inc., 55 F.

Supp. 2d 1070 (C.D. Cal. 1999), involved this kind of banner advertising tactic. There, Netscape and Excite sold banner advertisements to various adult entertainment websites. The advertisers could pay extra to have their ads pre-selected for display whenever any one of a number of keywords were entered, including the keywords "Playboy" or "Playmate." Playboy, as the owner of the trademarks "Playboy" and "Playmate," sued to prevent Netscape and Excite from displaying others' ads in response to Playboy's marks.

Playboy lost. The court did not believe that confusion would result from the banner advertisement arrangement. Central to the court's analysis was the fact that the words "playboy" and "playmate" are common English words, even if they also happen to be trademarks. The court stated that a trademark owner "may not remove a word from the English language merely by acquiring trademark rights in it." 55 F. Supp. 2d at 1074.

The court also concluded that Playboy's marks were not diluted by blurring or tarnishment as a result of the ads. There was no evidence that any of the advertisers actually used Playboy's marks, so no blurring occurred. As for tarnishment, Playboy argued that its marks were being tarnished by association with more sexually explicit material. The court rejected this argument because Playboy's marks "are associated with other purveyors of adult entertainment in other marketing channels." Id. at 1076.

This same banner advertising type of claim is also at issue in the Estee Lauder case discussed above. However, the practice of keyword triggered banner advertisements using others' marks is likely to continue. The Playboy court allowed it, and the practice is not a blatant hijacking of internet users trying to find something else. Instead, a web surfer must still affirmatively click on the banner ad to go to the advertiser's website. This requirement of consumer choice may save the keyword triggered banner advertising practice from the internet's

trash bin.

(6) DEEP VS. SHALLOW LINKING

The practices discussed so far involve attempts to attract internet users to websites, mostly by diverting users trying to find someone else's site. The other part of the equation to internet success is content. Some website owners find it easier to use someone else's content rather than creating their own.

One way internet companies can use someone else's content is to link to the other's website. Hyperlinks allow a visitor to one site to quickly connect with another site on the web. A hyperlink is created by inserting a URL into HTML code. When a user clicks on the icon or highlighted text, he or she automatically links to and accesses the other site.

Often, there are logical and good reasons to link to another website, and linking is a widely accepted practice. The problem is that website owners want to attract and keep visitors. Visitors who link to another site may not come back. Most websites consist of many pages and require a fair amount of clicking to get where you want to be. Once there, getting back to where you started can be a daunting task. And much of the required clicking involves navigating pages full of trademarks, advertisements and other attention grabbers meant to keep you there. Accordingly, linking to the home page of a another website ("shallow linking") is often unsatisfactory for the "linkor" site.

To combat this problem, some intrepid website owners use "deep linking." In deep linking, a site may link to another site, but the link is to a specific page or area, generally deep within the site. Usually, many or all of the other website's trademarks and advertisements are bypassed. In fact, the user may not even realize he or she has gone to someone else's website. Upon leaving the deep link, the user may return automatically to the first site, rather than

remaining in the linked site.

As a consequence, the linkor's visitors access the linkee's content, but perhaps without ever knowing it and certainly without being subjected to most of the linkee's trademarks, advertisements and attention grabbers. Naturally, deep linkees are usually not fond of this practice. At least one lawsuit was filed to stop deep linking.

In *Ticketmaster Corp. v. Microsoft Corp.*, Case No. 97-3055 DDP (C.D. Cal., complaint filed Apr. 28, 1997), Ticketmaster sued to stop, among other things, deep links from Microsoft's Seattle Sidewalk website to locations on Ticketmaster's site. The parties settled in 1999, and Microsoft agreed not to continue deep links to Ticketmaster's site.

The Ticketmaster case is probably a good indication that deep linking without permission is a bad idea. Deep linking is likely to create consumer confusion about the origin of the site. It may also be unfair or deceptive. Shallow links are less likely to raise the same concerns.

(7) FRAMING

Framing is another scheme for getting someone else's content on a website. Frames are boxes on a website where content from another website can be displayed or viewed, without leaving the first site. Frames make it difficult to distinguish between content original to the framing site from framed content. In fact, the framing site's URL remains displayed, even while the framed site is on screen.

Problems arise because the framed content may contain trademarked or copyrighted material from the framed site. Or, the framed content may be surrounded by the trademarks of the framing site, making it look as though those marks go with the framed content.

The likelihood of consumer confusion with framing is high. Cases dealing with framing so far have been resolved on terms favorable to the framed site owner. E.g., *The Washington*

Post Co. v. Total News, Inc., Case No. 97 Civ. 1190 (PKL) (S.D. N.Y., complaint filed Feb. 20, 1997) (settled with the framing stopping in favor of agreed-upon linking); Hard Rock Cafe Int'l Inc. v. Morton, 1999 U.S. Dist. Lexis 8340 (S.D. N.Y. 1999) (framing a website is likely to cause consumer confusion).

C. A NEW "STICK" FOR TRADEMARK OWNERS: THE ANTICYBER-SQUATTING CONSUMER PROTECTION ACT OF 1999.

Congress recently added a new "stick" to the trademark owner's arsenal that may be used to protect one's marks: the Anti-Cybersquatting Consumer Protection Act of 1999 (the "ACPA"). The ACPA is effective as of 29 November 1999 and is, with a few exceptions, retroactive in effect.

The act creates a new section 43 (D.) of the Lanham Act and provides remedies against a defendant who, with a "bad faith intent", registers or uses a domain name that (1) is identical or confusingly similar to a distinctive mark; (2) is identical or confusingly similar to, or Duluth say famous mark; or (3) 3 infringes the trademarks owned by the United States Olympic Committee.

Indicia of Bad Faith. The statute lists the following nonexclusive factors as meriting consideration as to when a domain name registrant has a "bad faith intent" in registering a particular name:

(1) the trademark or other intellectual property rights of the defendant, if any, in the domain name;

(2) the extent to which the domain name consists of the legal name of the defendant or a name that is otherwise commonly used to identify the defendant;

(3) the defendant's prior use, if any, of the domain name in connection with the bona fide offering of any goods or services;

(4) the defendant's bona fide noncommercial or fair use of the mark in a site accessible under the domain name;

(5) the defendant's intent to divert consumers from the mark owner's online location to a site accessible under the domain name that could harm the goodwill represented by the marks, either for commercial gain or with the intent to tarnish or disparage the mark, by creating a likelihood of confusion as to the source, sponsorship, affiliation or endorsement of the site;

(6) the defendant's offer to transfer, sell or otherwise assign the domain name to the mark owner or any third party for financial gain without having used, or having an intent to use, the domain name in the bona fide offering of any goods or services, or the defendant's prior conduct indicating a pattern of such conduct;

(7) the defendant's provision of material and misleading false contact information when applying for the registration of the domain name, the defendant's intentional failure to maintain accurate contact information, or the defendant's prior conduct indicating a pattern of such conduct;

(8) the defendant's registration or acquisition of multiple domain names which the defendant knows are identical or confusingly similar to marks of others that are distinctive at the time of the registration of such domain names, or dilutive of famous marks of others that are famous at the time of registration of such domain names, without regard to the goods or services of the parties; and

(9) the extent to which the mark incorporated in the defendant's domain name registration is or is not distinctive and famous within the meaning of subsection (c)(1) of 15 U.S.C. §1125(c).

In addition, domain name registrars may also face liability under the ACPA if it acts in bad faith or reckless disregard of the trademark owner's rights.

Lastly, the ACPA also prohibits the registration of a domain name in bad faith that is identical or confusingly similar to the name of another living person without that person's permission. Here, bad faith means with the intent to profit from the registration by selling the domain name to a third party.

In Rem Action. In addition to providing a new cause of action for trademark owners, the ACPA provides that a trademark owner may proceed *in rem* against the domain name – if the owner's identity is unknown. Of course, to proceed *in rem*, the plaintiff must show that it exercised due diligence in trying to locate the domain name owner or that personal jurisdiction is otherwise unavailable. In addition, remedies are limited to the forfeiture or transfer of the domain name – no damages are recoverable in such an action.

Remedies. The ACPA expands the relief available to trademark owners. Statutory damages are now available to trademark holders, ranging between \$1,000 to \$100,000, per domain name. Like in the copyright remedy context, the ACPA statutory damages are in lieu of actual damages and are awarded at the discretion of the trial court within the range set by statute. However, statutory damages are available only for domain names registered after the effective date of the ACPA.

APPENDIX

Appendix A: Uniform Domain Name Dispute Resolution Policy

Appendix B: Domain Name Complaint Form

**Appendix C: List of Proceedings Under Uniform Domain
Name Dispute Resolution Policy**

APPENDIX A

UNIFORM DOMAIN NAME DISPUTE RESOLUTION POLICY



Uniform Domain Name Dispute Resolution Policy

Policy Adopted: August 26, 1999
Implementation Documents Approved: October 24, 1999

Note: This policy is now in effect. See www.icann.org/udrp/udrp-schedule.htm for the implementation schedule.

Uniform Domain Name Dispute Resolution Policy

(As Approved by ICANN on October 24, 1999)

1. Purpose. This Uniform Domain Name Dispute Resolution Policy (the "Policy") has been adopted by the Internet Corporation for Assigned Names and Numbers ("ICANN"), is incorporated by reference into your Registration Agreement, and sets forth the terms and conditions in connection with a dispute between you and any party other than us (the registrar) over the registration and use of an Internet domain name registered by you. Proceedings under Paragraph 4 of this Policy will be conducted according to the Rules for Uniform Domain Name Dispute Resolution Policy (the "Rules of Procedure"), which are available at www.icann.org/udrp/udrp-rules-24oct99.htm, and the selected administrative-dispute-resolution service provider's supplemental rules.

2. Your Representations. By applying to register a domain name, or by asking us to maintain or renew a domain name registration, you hereby represent and warrant to us that (a) the statements that you made in your Registration Agreement are complete and accurate; (b) to your knowledge, the registration of the domain name will not infringe upon or otherwise violate the rights of any third party; (c) you are not registering the domain name for an unlawful purpose; and (d) you will not knowingly use the domain name in violation of any applicable laws or regulations. It is your responsibility to determine whether your domain name registration infringes or violates someone else's rights.

3. Cancellations, Transfers, and Changes. We will cancel, transfer or otherwise make changes to domain name registrations under the following circumstances:

a. subject to the provisions of Paragraph 8, our receipt of written or appropriate electronic instructions from you or your authorized agent to take such action;

b. our receipt of an order from a court or arbitral tribunal, in each case of competent jurisdiction, requiring such action; and/or

c. our receipt of a decision of an Administrative Panel requiring such action in any administrative proceeding to which you were a party and which was conducted under this Policy or a later version of this Policy adopted by ICANN. (See Paragraph 4(i) and (k) below.)

We may also cancel, transfer or otherwise make changes to a domain name registration in accordance with the terms of your Registration Agreement or other legal requirements.

4. Mandatory Administrative Proceeding.

This Paragraph sets forth the type of disputes for which you are required to submit to a mandatory administrative proceeding. These proceedings will be conducted before one of the administrative-dispute-resolution service providers listed at www.icann.org/udrp/approved-providers.htm (each, a "Provider").

a. Applicable Disputes. You are required to submit to a mandatory administrative proceeding in the event that a third party (a "complainant") asserts to the applicable Provider, in compliance with the Rules of Procedure, that

- (i) your domain name is identical or confusingly similar to a trademark or service mark in which the complainant has rights; and
- (ii) you have no rights or legitimate interests in respect of the domain name; and
- (iii) your domain name has been registered and is being used in bad faith.

In the administrative proceeding, the complainant must prove that each of these three elements are present.

b. Evidence of Registration and Use in Bad Faith. For the purposes of Paragraph 4(a)(iii), the following circumstances, in particular but without limitation, if found by the Panel to be present, shall be evidence of the registration and use of a domain name in bad faith:

- (i) circumstances indicating that you have registered or you have acquired the domain name primarily for the purpose of selling, renting, or otherwise transferring the domain name registration to the complainant who is the owner of the trademark or service mark or to a competitor of that complainant, for valuable consideration in excess of your documented out-of-pocket costs directly related to the domain name; or
- (ii) you have registered the domain name in order to prevent the owner of the trademark or service mark from reflecting the mark in a corresponding domain name, provided that you have engaged in a pattern of such conduct; or
- (iii) you have registered the domain name primarily for the purpose of disrupting the business of a competitor; or
- (iv) by using the domain name, you have intentionally attempted to attract, for commercial gain, Internet users to your web site or other on-line location, by creating a likelihood of confusion with the complainant's mark as to the source, sponsorship, affiliation, or endorsement of your web site or location or of a product or service

on your web site or location.

c. How to Demonstrate Your Rights to and Legitimate Interests in the Domain Name in Responding to a Complaint. When you receive a complaint, you should refer to Paragraph 5 of the Rules of Procedure in determining how your response should be prepared. Any of the following circumstances, in particular but without limitation, if found by the Panel to be proved based on its evaluation of all evidence presented, shall demonstrate your rights or legitimate interests to the domain name for purposes of Paragraph 4(a)(ii):

(i) before any notice to you of the dispute, your use of, or demonstrable preparations to use, the domain name or a name corresponding to the domain name in connection with a bona fide offering of goods or services; or

(ii) you (as an individual, business, or other organization) have been commonly known by the domain name, even if you have acquired no trademark or service mark rights; or

(iii) you are making a legitimate noncommercial or fair use of the domain name, without intent for commercial gain to misleadingly divert consumers or to tarnish the trademark or service mark at issue.

d. Selection of Provider. The complainant shall select the Provider from among those approved by ICANN by submitting the complaint to that Provider. The selected Provider will administer the proceeding, except in cases of consolidation as described in Paragraph 4(f).

e. Initiation of Proceeding and Process and Appointment of Administrative Panel. The Rules of Procedure state the process for initiating and conducting a proceeding and for appointing the panel that will decide the dispute (the "Administrative Panel").

f. Consolidation. In the event of multiple disputes between you and a complainant, either you or the complainant may petition to consolidate the disputes before a single Administrative Panel. This petition shall be made to the first Administrative Panel appointed to hear a pending dispute between the parties. This Administrative Panel may consolidate before it any or all such disputes in its sole discretion, provided that the disputes being consolidated are governed by this Policy or a later version of this Policy adopted by ICANN.

g. Fees. All fees charged by a Provider in connection with any dispute before an Administrative Panel pursuant to this Policy shall be paid by the complainant, except in cases where you elect to expand the Administrative Panel from one to three panelists as provided in Paragraph 5(b)(iv) of the Rules of Procedure, in which case all fees will be split evenly by you and the complainant.

h. Our Involvement in Administrative Proceedings. We do not, and will not, participate in the administration or conduct of any proceeding before an Administrative Panel. In addition, we will not be liable as a result of any decisions rendered by the Administrative Panel.

i. Remedies. The remedies available to a complainant pursuant to any proceeding before an Administrative Panel shall be limited to requiring the

cancellation of your domain name or the transfer of your domain name registration to the complainant.

j. Notification and Publication. The Provider shall notify us of any decision made by an Administrative Panel with respect to a domain name you have registered with us. All decisions under this Policy will be published in full over the Internet, except when an Administrative Panel determines in an exceptional case to redact portions of its decision.

k. Availability of Court Proceedings. The mandatory administrative proceeding requirements set forth in Paragraph 4 shall not prevent either you or the complainant from submitting the dispute to a court of competent jurisdiction for independent resolution before such mandatory administrative proceeding is commenced or after such proceeding is concluded. If an Administrative Panel decides that your domain name registration should be canceled or transferred, we will wait ten (10) business days (as observed in the location of our principal office) after we are informed by the applicable Provider of the Administrative Panel's decision before implementing that decision. We will then implement the decision unless we have received from you during that ten (10) business day period official documentation (such as a copy of a complaint, file-stamped by the clerk of the court) that you have commenced a lawsuit against the complainant in a jurisdiction to which the complainant has submitted under Paragraph 3(b)(xiii) of the Rules of Procedure. (In general, that jurisdiction is either the location of our principal office or of your address as shown in our Whois database. See Paragraphs 1 and 3(b)(xiii) of the Rules of Procedure for details.) If we receive such documentation within the ten (10) business day period, we will not implement the Administrative Panel's decision, and we will take no further action, until we receive (i) evidence satisfactory to us of a resolution between the parties; (ii) evidence satisfactory to us that your lawsuit has been dismissed or withdrawn; or (iii) a copy of an order from such court dismissing your lawsuit or ordering that you do not have the right to continue to use your domain name.

5. All Other Disputes and Litigation. All other disputes between you and any party other than us regarding your domain name registration that are not brought pursuant to the mandatory administrative proceeding provisions of Paragraph 4 shall be resolved between you and such other party through any court, arbitration or other proceeding that may be available.

6. Our Involvement in Disputes. We will not participate in any way in any dispute between you and any party other than us regarding the registration and use of your domain name. You shall not name us as a party or otherwise include us in any such proceeding. In the event that we are named as a party in any such proceeding, we reserve the right to raise any and all defenses deemed appropriate, and to take any other action necessary to defend ourselves.

7. Maintaining the Status Quo. We will not cancel, transfer, activate, deactivate, or otherwise change the status of any domain name registration under this Policy except as provided in Paragraph 3 above.

8. Transfers During a Dispute.

a. Transfers of a Domain Name to a New Holder. You may not transfer your domain name registration to another holder (i) during a pending administrative proceeding brought pursuant to Paragraph 4 or for a period of fifteen (15) business days (as observed in the location of our principal place of business)

after such proceeding is concluded; or (ii) during a pending court proceeding or arbitration commenced regarding your domain name unless the party to whom the domain name registration is being transferred agrees, in writing, to be bound by the decision of the court or arbitrator. We reserve the right to cancel any transfer of a domain name registration to another holder that is made in violation of this subparagraph.

b. Changing Registrars. You may not transfer your domain name registration to another registrar during a pending administrative proceeding brought pursuant to Paragraph 4 or for a period of fifteen (15) business days (as observed in the location of our principal place of business) after such proceeding is concluded. You may transfer administration of your domain name registration to another registrar during a pending court action or arbitration, provided that the domain name you have registered with us shall continue to be subject to the proceedings commenced against you in accordance with the terms of this Policy. In the event that you transfer a domain name registration to us during the pendency of a court action or arbitration, such dispute shall remain subject to the domain name dispute policy of the registrar from which the domain name registration was transferred.

9. Policy Modifications. We reserve the right to modify this Policy at any time with the permission of ICANN. We will post our revised Policy at <URL> at least thirty (30) calendar days before it becomes effective. Unless this Policy has already been invoked by the submission of a complaint to a Provider, in which event the version of the Policy in effect at the time it was invoked will apply to you until the dispute is over, all such changes will be binding upon you with respect to any domain name registration dispute, whether the dispute arose before, on or after the effective date of our change. In the event that you object to a change in this Policy, your sole remedy is to cancel your domain name registration with us, provided that you will not be entitled to a refund of any fees you paid to us. The revised Policy will apply to you until you cancel your domain name registration.

Comments concerning the layout, construction and functionality of this site should be sent to webmaster@icann.org.

Page Updated 03-January-00

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APPENDIX B

DOMAIN NAME DISPUTE COMPLAINT FORM

DOMAIN NAME DISPUTE COMPLAINT FORM

(All references to "Rule" are to ICANN's "Rules for Uniform Domain Name Dispute Resolution Policy."
Utilizing this Complaint form is not a substitute for reading and understanding the ICANN rules)

COMPLAINANT

Name, full address & contact information: *Rule 3(b)(ii)*

Telephone: _____ Fax: _____

E-Mail Address: _____

RESPONDENT

Name, full address & contact information: *Rule 3 (b)(v)*

Telephone: _____ Fax: _____

E-Mail Address: _____

COMPLAINT

File Number: _____
 (Assigned by The Forum)

Filing Date: _____
 (Assigned by The Forum)

The above named Complainant requests that this Complaint be submitted for decision in accordance with ICANN's Uniform Domain Name Dispute Resolution Policy and Rules. *Rule 3(b)(i)*

Name and contact information of person or representative authorized to act for the Complainant in the proceeding if different from above: *Rule (b)(ii)*

Name: _____

Address: _____

City, State, Zip: _____

Telephone: _____ Fax: _____

E-Mail Address: _____

Contact person's preferred method for receiving electronic and hard-copy material (e-mail required): *Rule 3(b)(iii)*

Fax to: _____

E-mail Address: _____

US Postal Service at: _____

The Complainant is seeking a panel of One Three arbitrator(s). **Note: If Complainant seeks only one arbitrator, no arbitrator candidate names are required below.**

Name of Arbitrator candidate(s) - If Available: *Rule 3 (b)(iv)*

Candidate(s) Name	Address	Telephone Number

Specify the domain name(s) that is/are the subject of the complaint: *Rule 3(b)(vi)*

Identify with whom the domain name(s) is/are registered (e.g. Network Solutions): *Rule 3(b)(vii)*

Specify the trademark(s) or service mark(s) upon which the complaint is based: *Rule 3(b)(viii)*

THIS COMPLAINT NOT TO EXCEED 10 PAGES – *Supp. Rules 4(a)*

Please print or type on this form or on a separate document if more space is needed.

Describe the grounds on which the complaint is made. *Rule 3(b)(ix)*. In particular, the complaint must describe:

1. The manner in which the domain name(s) are identical or confusing
2. Why the Respondent should be considered as having no rights or legitimate interest in the domain name(s)
3. Why the domain name(s) should be considered as having been registered in bad faith

The description should, for elements (2) and (3), discuss any aspects of Paragraphs 4(b) and 4(c) of the *ICANN Uniform Domain Name Dispute Resolution Policy* that are applicable.

Specify the remedies sought: *Rule 3(b)(x), Policy Paragraph 4(i)*

Identify any other legal proceedings that have been commenced or terminated in connection with or relating to any of the domain names that are the subject of this complaint. *Rule 3(b)(xi)*

I/We _____ assert the following under penalty of perjury;
 (Print or Type Complainant(s) Name)

1. A copy of this Complaint together with the "Complaint Transmittal Sheet" has been sent or transmitted to the Respondent in accordance with Rule 2(b), Rule 3(b)(xii).
2. Complainant will submit to the jurisdiction of the courts in at least one specified jurisdiction if any challenge is made to a decision in the arbitration proceeding. *Rule 3(b)(xiii)*
3. Complainant agrees that its claims and remedies concerning the registration of the domain name, the dispute, or the dispute resolution shall be solely against the domain-name holder and waives all such claims and remedies against;
 - The dispute-resolution provider and panelists, except in the case of deliberate wrongdoing
 - The registrar
 - The registry administrator
 - The Internet Corporation for Assigned Names and Numbers, as well as their directors, officers, employees and agents.
4. Complainant certifies that the information contained in the Complaint is to the best of the Complainant's knowledge complete and accurate and that this Complaint is not being presented for any improper purpose, such as to harass.
5. That the assertions in this Complaint are warranted under these Rules and under applicable law, as it now exists or as it may be extended by a good faith and reasonable argument.

Signature of Complainant or Representative: _____ Date: _____

Send the Complaint, along with any documents or other evidence applicable to the domain name(s) in dispute and any trademark or service mark registration upon which the complaint relies, together with a table of contents of the evidence, *Rule 3(b)(xv)*, a copy of ICANN's Uniform Domain Name Dispute Resolution Policy, and the Complaint Transmittal Sheet to The National Arbitration Forum by **by email (info@arb-forum.com)** and also **by mail** (P.O. Box 50191, Minneapolis, Minnesota 55405), Supp. Rule 4.d.

Enclose the appropriate Filing Fee with Complaint Submission.

- Check or Money Order Enclosed
- Charge to Credit Card Account Visa MasterCard Discover American Express

Account Number: _____ Expiration Date: _____

Signature: _____

National Arbitration Forum
P.O. Box 50191, Minneapolis, Minnesota 55405
Telephone: 651-631-1105 or 800-474-2371
www.arb-forum.com

APPENDIX C

**LIST OF PROCEEDINGS UNDER
UNIFORM DOMAIN NAME DISPUTE
RESOLUTION POLICY**



List of Proceedings Under Uniform Domain Name Dispute Resolution Policy

UDRP Proceedings--Arranged by Commencement Date

Date Commenced	Proceeding Number	Domain Name(s)	Status
9 Dec 1999	WIPO D99-0001	worldwrestlingfederation.com	Name transfer
10 Jan 2000	WIPO D00-0001	musicweb.com	Name transfer
10 Jan 2000	WIPO D00-0004	americanvintage.com	Name transfer
11 Jan 2000	NAF FA0092015	buyerschoice.com	Pending
11 Jan 2000	NAF FA0092016	icqsms.com	Name transfer
12 Jan 2000	WIPO D00-0003	telstra.org	Name transfer
14 Jan 2000	NAF FA0092048	facetime.com	Name transfer
18 Jan 2000	NAF FA0092049	omniloan.com	Name transfer
19 Jan 2000	NAF FA0092052	cunardcruises.com	Withdrawn without prejudice
19 Jan 2000	NAF FA0092053	cunardcruise.com	Pending
20 Jan 2000	NAF FA0092054	fibershield.net	Pending
21 Jan 2000	DeC AF-0076 a	powrachte.com	Pending
21 Jan 2000	DeC AF-0076 b	powrachte.net	Pending
21 Jan 2000	DeC AF-0076 c	powratches.com	Pending
21 Jan 2000	DeC AF-0076 d	powratches.net	Pending
21 Jan 2000	WIPO D00-0005	telaxis.com	Pending
		telaxis.net	
21 Jan 2000	WIPO D2000-0008	six.net	Pending
		sixnet.com	
24 Jan 2000	NAF FA0092524	destinationpuertorico.com	Pending
		destinationpuertorico.net	
24 Jan 2000	NAF FA0092525	fossilwatch.com	Pending
24 Jan 2000	NAF FA0092526	puertoaventuras.com	Pending
		puertoaventuras.net	

24 Jan 2000	NAF FA0092527	heelquik.com heelquik.org	Pending
24 Jan 2000	NAF FA0092528	cosmeticdocshop.com plasticdocshop.com	Pending
24 Jan 2000	WIPO D2000-0007	alcoholicsanonymous.net	Pending
25 Jan 2000	WIPO D2000-0006	millitec.com	Pending
26 Jan 2000	NAF FA0092531	craftwork.com	Pending
26 Jan 2000	NAF FA0092532	golferswarehouse.com	Pending
26 Jan 2000	NAF FA0092533	tvazteca.com tvazteca.net tvazteca.org	Pending
26 Jan 2000	WIPO D2000-0009	talk-city.com	Pending
27 Jan 2000	DeC AF-0060	narcoticsanonymous.org	Case settled; name transferred
27 Jan 2000	NAF FA0092529	philipsindia.com	Pending
27 Jan 2000	NAF FA0092530	paytrust.net	Pending
27 Jan 2000	NAF FA0092973	planetrx.com	Pending
27 Jan 2000	NAF FA0092974	botox.net	Pending
27 Jan 2000	NAF FA0092975	phonespel.com phonespel.org phonespell.com phonespell.net phonesspell.com	Pending
27 Jan 2000	NAF FA0092976	fishtech.com	Pending
28 Jan 2000	WIPO D2000-0010	homeinteriors.net homeinteriorsandgifts.com	Pending
28 Jan 2000	WIPO D2000-0012	stelladoro.com	Name transfer
31 Jan 2000	NAF FA0093466	westernhay.com westernhay.net	Pending
31 Jan 2000	WIPO D2000-0011	ronson.com	Pending
1 Feb 2000	DeC AF-0092	beveragesandmore.com	Pending
1 Feb 2000	DeC AF-0095	iphones.com	Pending
3 Feb 2000	DeC AF-0090	theartofshaving.com	Pending
3 Feb 2000	DeC AF-0098	follicare.com	Pending
3 Feb 2000	DeC AF-0100	benihanaoftokyo.com	Pending
3 Feb 2000	DeC AF-0103	iphone.com	Pending
3 Feb 2000	NAF FA0093547	concierge.com	Pending
3 Feb 2000	NAF FA0093548	zaploan.com	Pending
3 Feb 2000	NAF FA0093550	sixflag.com	Pending

3 Feb 2000	NAF FA0093551	jerryorbach.com	Pending
3 Feb 2000	NAF FA0093552	fieldcrest.com	Pending
3 Feb 2000	NAF FA0093553	usource.com usource.net	Pending
3 Feb 2000	NAF FA0093554	bigdog.com	Pending
3 Feb 2000	NAF FA0093555	euroconsult.com	Pending
3 Feb 2000	NAF FA0093556	steamist.com	Pending
3 Feb 2000	WIPO D2000-0030	steinlager.com	Pending
4 Feb 2000	WIPO D2000-0013	sizesunlimited.com	Pending
4 Feb 2000	WIPO D2000-0014	theeconomictimes.com	Pending
4 Feb 2000	WIPO D2000-0015	thetimesofindia.com	Pending
4 Feb 2000	WIPO D2000-0020	saint-gobain.net	Pending
4 Feb 2000	WIPO D2000-0021	ingersoll-rand.net ingersoll-rand.org ingersollrand.org	Pending
4 Feb 2000	WIPO D2000-0022	christiandiorcosmetics.com christiandiorfashions.com diorcosmetics.com diorfashions.com	Pending
4 Feb 2000	WIPO D2000-0023	dior.org	Pending
6 Feb 2000	WIPO D2000-0026	4tel.com	Pending
7 Feb 2000	DeC AF-0096	tourplan.com	Pending
7 Feb 2000	DeC AF-0102	biofield.com	Pending
7 Feb 2000	DeC AF-0104	thyme.com	Pending
7 Feb 2000	NAF FA0093557	vybar.com	Pending
7 Feb 2000	NAF FA0093628	celestialseasonings.net	Pending
7 Feb 2000	WIPO D2000-0016	allocation.com	Pending
7 Feb 2000	WIPO D2000-0019	goodfoodguide.net	Pending
7 Feb 2000	WIPO D2000-0029	creditconnection.net creditconnection.org	Pending
7 Feb 2000	WIPO D2000-0031	thelimited.org	Settlement; complaint withdrawn
7 Feb 2000	WIPO D2000-0032	bettercheddars.com harvestcrisps.com milk-bone.com wheatworth.com wheatthins.com	Name transfer
8 Feb 2000	NAF FA0093559	cybergauge.com	Pending
8 Feb 2000	NAF FA0093560	gilbarcoeclipse.com	Pending

8 Feb 2000	NAF FA0093561	den.com	Pending
8 Feb 2000	NAF FA0093562	hewlittpackard.com	Recommended
8 Feb 2000	NAF FA0093563	icqguide.com	Pending
8 Feb 2000	NAF FA0093564	hewlittpackard.com	Recommended
8 Feb 2000	NAF FA0093629	janusfund.com	Dismissed on joint motion
8 Feb 2000	NAF FA0093630	almanauta.com	Pending
8 Feb 2000	NAF FA0093631	soundchoice.net	Pending
8 Feb 2000	NAF FA0093632	adventurecity.com	Pending
8 Feb 2000	NAF FA0093633	buypc.com	Pending
8 Feb 2000	WIPO D2000-0017	drawtite.com	Pending
8 Feb 2000	WIPO D2000-0024	easyjet.net	Pending
8 Feb 2000	WIPO D2000-0028	cellularonechina.com	Pending
9 Feb 2000	NAF FA0093634	cnnheadlinenews.com	Pending
9 Feb 2000	NAF FA0093635	gigantor.com	Recommended
		gigantor.net	
9 Feb 2000	WIPO D2000-0018	banesto.net	Pending
		banesto.org	
9 Feb 2000	WIPO D2000-0025	sgs.net	Pending
		sgsgroup.net	
9 Feb 2000	WIPO D2000-0035	jpmorgan.org	Pending
9 Feb 2000	WIPO D2000-0037	zwackunicum.com	Pending
9 Feb 2000	WIPO D2000-0041	rollasign.com	Pending
10 Feb 2000	NAF FA0093546	thetotalpackage.com	Pending
10 Feb 2000	NAF FA0093637	marriott-hotels.com	Recommended
10 Feb 2000	NAF FA0093666	faithnet.org	Pending
10 Feb 2000	NAF FA0093667	fanuc.com	Pending
10 Feb 2000	NAF FA0093668	oicq.com	Pending
		oicq.net	
10 Feb 2000	NAF FA0093669	youaskedforit.com	Recommended
10 Feb 2000	NAF FA0093670	marriott-hotel.com	Pending
10 Feb 2000	NAF FA0093671	loanmart.net	Pending
		loanmart.org	
10 Feb 2000	NAF FA0093672	halegroves.com	Pending
10 Feb 2000	NAF FA0093673	southernbank.com	Pending
10 Feb 2000	NAF FA0093674	aeroturbine.com	Pending
10 Feb 2000	NAF FA0093675	aeroturbine.net	Pending
10 Feb 2000	WIPO D2000-0027	gamma.com	Pending

10 Feb 2000	WIPO D2000-0038	euro-tunnel.com	Pending
11 Feb 2000	DeC AF-0107a	kittenger.com	Pending
11 Feb 2000	DeC AF-0107b	kittengerfurniture.com	Pending
11 Feb 2000	DeC AF-0108a	kittinger.com	Pending
11 Feb 2000	DeC AF-0108b	kittingercollector.com	Pending
11 Feb 2000	NAF FA0093676	indianamulch.net	Pending
		indymulch.com	
11 Feb 2000	NAF FA0093677	mckennaandcuneo.com	Pending
11 Feb 2000	NAF FA0093679	americanonline.com	Pending
		americaonline.net	
11 Feb 2000	NAF FA0093680	namethattune.com	Pending
11 Feb 2000	NAF FA0093681	dogs.com	Pending
11 Feb 2000	NAF FA0093682	cartoys.net	Pending
11 Feb 2000	NAF FA0093708	websterhall.com	Pending
11 Feb 2000	NAF FA0093709	firefoam.com	Pending
11 Feb 2000	WIPO D2000-0036	efg-private-bank.com	Pending
		efgpb.com	
		efgprivate.com	
		efgprivatebank.com	
11 Feb 2000	WIPO D2000-0043	safmarine.com	Pending
11 Feb 2000	WIPO D2000-0044	toefl.com	Pending
13 Feb 2000	WIPO D2000-0033	moorepushpin.com	Pending
13 Feb 2000	WIPO D2000-0039	budgetsaver.com	Pending
14 Feb 2000	NAF FA0093459	pantyexpress.com	Pending
		pantyexpress.net	
		pantyexpress.org	
14 Feb 2000	NAF FA0093710	breederscrown.com	Pending
		hambletonian.com	
14 Feb 2000	WIPO D2000-0040	phonenphone.com	Pending
14 Feb 2000	WIPO D2000-0046	avnet.net	Pending
14 Feb 2000	WIPO D2000-0048	praline.com	Pending
14 Feb 2000	WIPO D2000-0053	microsoft.org	Pending
15 Feb 2000	WIPO D2000-0042	infopaq.com	Pending
		smartpaq.com	
15 Feb 2000	WIPO D2000-0045	hipercor.com	Pending
16 Feb 2000	DeC AF-0106	computerfutures.com	Pending
16 Feb 2000	NAF FA0093635 (restart)	gigantor.com	Pending
		gigantor.net	
16 Feb 2000	NAF FA0093757	netgrocer.com	Pending

16 Feb 2000	NAF FA0093758	atti.net	Pending
16 Feb 2000	NAF FA0093759	seventysix.com	Pending
16 Feb 2000	NAF FA0093761	foxclassics.com	Pending
		foxdownload.com	
		foxfashion.com	
		foxfashion.net	
		foxflicks.com	
		foxforfun.com	
		foxhomeadultvideo.com	
		foxhomemovies.com	
		foxhomenet.com	
		foxhomevideo.com	
		foxhomevideo.net	
		foxhomevideo.org	
		foxhomevideos.com	
		foxmp3.com	
		foxnetworknews.com	
foxnewsnetwork.com			
foxpictures.com			
foxreleases.com			
foxvideodownload.com			
foxvideos.com			
tcfhv.com			
16 Feb 2000	WIPO D2000-0054	crew.com	Pending
16 Feb 2000	WIPO D2000-0055	guerlain.net	Pending
16 Feb 2000	WIPO D2000-0057	acrobatreader.com	Pending
		adobeacrobat.com	
16 Feb 2000	WIPO D2000-0058	forrent.com	Pending
16 Feb 2000	WIPO D2000-0059	barneysnewyork.com	Pending
16 Feb 2000	WIPO D2000-0060	dodialfayed.com	Pending
16 Feb 2000	WIPO D2000-0061	inforpace.com	Pending
17 Feb 2000	DeC AF-0126	mikimoto.com	Pending
17 Feb 2000	NAF FA0093763	esquire.com	Pending
17 Feb 2000	NAF FA0093764	borderpatrol.com	Pending
17 Feb 2000	NAF FA0093765	clarins.com	Pending
		clarins.com	
17 Feb 2000	NAF FA0093766	go2aol.com	Pending
17 Feb 2000	NAF FA0093767	obagi.com	Pending
17 Feb 2000	NAF FA0093768	netgrocer.net	Pending
17 Feb 2000	NAF FA0093769	thinkquest.com	Pending
17 Feb 2000	WIPO D2000-0047	officespecialists.com	Pending

17 Feb 2000	WIPO D2000-0050	eautolamps.com	Pending
17 Feb 2000	WIPO D2000-0051	bbcde Londres.com	Pending
		bbcenespanol.com	
		bbcenespanol.net	
		bbcenespanol.org	
18 Feb 2000	NAF FA0093884	stainmaster.com	Pending
18 Feb 2000	WIPO D2000-0034	2002worldcup.net	Pending
		2002worldcup.org	
		2006worldcup.org	
		wc02.com	
		wc2002.com	
		worldcup02.net	
		worldcup02.org	
		worldcup10.com	
		worldcup2002.com	
		worldcup2002.net	
		worldcup2002.org	
		worldcup2006.org	
		worldcup2010.com	
		worldcup2010.net	
worldcup2010.org			
18 Feb 2000	WIPO D2000-0056	bellevuesquare.com	Pending
18 Feb 2000	WIPO D2000-0062	potomacmills.net	Pending
		potomacmills.org	
18 Feb 2000	WIPO D2000-0065	surfdog.com	Pending
18 Feb 2000	WIPO D2000-0067	miguard.com	Pending
18 Feb 2000	WIPO D2000-0072	grass-telefactor.com	Pending
		grasstelefactor.com	
18 Feb 2000	WIPO D2000-0074	microinfospace.com	Pending
19 Feb 2000	WIPO D2000-0064	1800rockport.com	Pending
20 Feb 2000	WIPO D2000-0069	wwwinfospaces.com	Pending
21 Feb 2000	NAF FA0091407	hollywood-casino.com	Pending
		hollywood-casino.net	
		hollywoodgoldcasino.com	
		hollywoodgoldcasino.net	
21 Feb 2000	NAF FA0093770	soloinsurance.com	Pending
21 Feb 2000	NAF FA0094108	hydraroll.com	Pending
21 Feb 2000	WIPO D2000-0066	cosco.com	Pending
22 Feb 2000	NAF FA0093562 (restart)	hewlittpackard.com	Pending
22 Feb 2000	NAF FA0094110	cordstrap.com	Pending
22 Feb 2000	WIPO D2000-0063	ram.com	Pending

22 Feb 2000	WIPO D2000-0079	talkabout.com	Pending
22 Feb 2000	WIPO D2000-0080	alaskaairlines.org	Pending
23 Feb 2000	DeC AF00123	paradigm.com	Pending
23 Feb 2000	NAF FA0093564 (restart)	hewlettpackard.com	Pending
23 Feb 2000	NAF FA0094183	aopa.com	Pending
23 Feb 2000	NAF FA0094184	kingsofcomedy.com	Pending
23 Feb 2000	WIPO D2000-0049	tata.org	Pending
23 Feb 2000	WIPO D2000-0052	franpin.com	Pending
23 Feb 2000	WIPO D2000-0070	wwwinfospace.com	Pending
23 Feb 2000	WIPO D2000-0071	csa-canada.com	Pending
		csa-international.net	
23 Feb 2000	WIPO D2000-0073	hamburgerhamlet.com	Pending
23 Feb 2000	WIPO D2000-0075	info-space.com	Pending
23 Feb 2000	WIPO D2000-0082	aerotrader.com	Pending
		boatrader.com	
23 Feb 2000	WIPO D2000-0088	unipart.com	Pending
24 Feb 2000	NAF FA0093637 (restart)	marriott-hotels.com	Pending
24 Feb 2000	WIPO D2000-0078	m-power.net	Pending
24 Feb 2000	WIPO D2000-0083	i-mln.com	Pending
24 Feb 2000	WIPO D2000-0084	muji.com	Pending
25 Feb 2000	DeC AF-0109	anneofgreengables.com	Pending
25 Feb 2000	DeC AF-0121	launchpad.com	Pending
25 Feb 2000	DeC AF-0122	shopzone.com	Pending
25 Feb 2000	DeC AF-0131	fido.com	Pending
25 Feb 2000	NAF FA0093669 (restart)	youaskedforit.com	Pending
25 Feb 2000	NAF FA0094187	jamesdean.net	Pending
25 Feb 2000	NAF FA0094188	networksystems.com	Pending
25 Feb 2000	NAF FA0094190	latinohealthcare.com	Pending
25 Feb 2000	WIPO D2000-0076	indiainfospace.com	Pending
25 Feb 2000	WIPO D2000-0085	truevinyl.com	Pending
		truevinylthefilm.com	
		truevinylthemovie.com	
25 Feb 2000	WIPO D2000-0087	toeic.net	Pending
25 Feb 2000	WIPO D2000-0089	pacificplace.com	Pending

28 Feb 2000	NAF FA0029203	colgate-palmolive.net	Pending
		colgatepalmolive.com	
		colgatepalmolive.net	
28 Feb 2000	NAF FA0094197	drainstation.com	Pending
		northwestplumbing.com	
28 Feb 2000	NAF FA0094204	sidchrome.com	Pending
28 Feb 2000	NAF FA0094205	bonide.com	Pending
28 Feb 2000	WIPO D2000-0091	finter.com	Pending
		finter.org	
29 Feb 2000	DeC AF-0133	rbcinsurance.com	Pending
29 Feb 2000	DeC AF-0134	wwwnationalenquirer.com	Pending
29 Feb 2000	NAF FA0094206	calstore.net	Pending
29 Feb 2000	NAF FA0094207	netgrocer.org	Pending
29 Feb 2000	WIPO D2000-0094	diet-rite.com	Pending
29 Feb 2000	WIPO D2000-0096	eautoparts.com	Pending
29 Feb 2000	WIPO D2000-0098	babydior.com	Pending
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		clarins.com	
1 Mar 2000	NAF FA0094217	improv.com	Pending
1 Mar 2000	NAF FA0094219	epsonstore.com	Pending
1 Mar 2000	NAF FA0094232	playnetwork.com	Pending
1 Mar 2000	WIPO D2000-0090	ink-source.com	Pending
1 Mar 2000	WIPO D2000-0095	netvault.com	Pending
1 Mar 2000	WIPO D2000-0097	avenet.org	Pending
2 Mar 2000	NAF FA0094233	stanleyworks.net	Pending
		thestanleyworks.net	
2 Mar 2000	NAF FA0094234	venusswimwear.net	Pending
2 Mar 2000	WIPO D2000-0092	tonerjet.com	Pending
2 Mar 2000	WIPO D2000-0099	fiddlehead.com	Pending
2 Mar 2000	WIPO D2000-0103	e-automotive.com	Pending
2 Mar 2000	WIPO D2000-0105	petwarehouse.com	Pending
2 Mar 2000	WIPO D2000-0106	gatewaypccountry.com	Pending
2 Mar 2000	WIPO D2000-0109	gate-way.com	Pending
3 Mar 2000	NAF FA0094235	bodyandsoul.com	Pending
3 Mar 2000	NAF FA0094236	whypaymore.com	Pending
3 Mar 2000	NAF FA0094237	sahajmarg.org	Pending
3 Mar 2000	WIPO D2000-0104	eautomotive.com	Pending
3 Mar 2000	WIPO D2000-0110	eresolution.com	Pending

4 Mar 2000	WIPO D2000-0108	niketown.com	Pending
5 Mar 2000	WIPO D2000-0102	nokiagirls.com	Pending
5 Mar 2000	WIPO D2000-0118	chargergirls.com	Pending
		chargergirls.net	

The Proceeding Number consists of the abbreviated name of the dispute-resolution service provider followed by the number assigned by that provider to the proceeding. Provider names are abbreviated as follows:

DeC=Disputes.org/eResolution Consortium

NAF=National Arbitration Forum

WIPO=World Intellectual Property Organization

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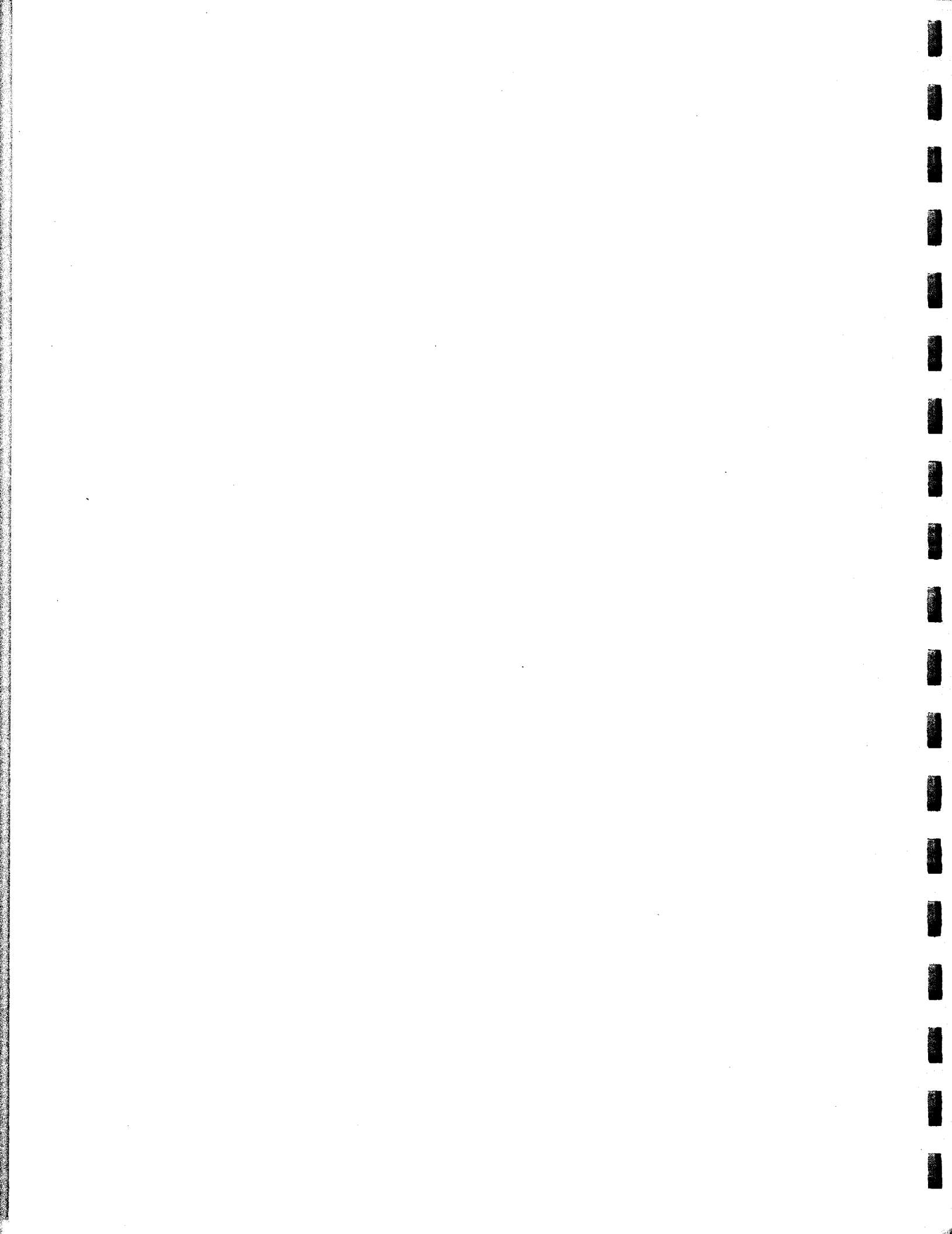
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**NEGOTIATION OF WEB DEVELOPMENT,
SOFTWARE DEVELOPMENT, AND
WEB DESIGN AGREEMENTS:
*WHO OWNS THE CODE?***

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Intellectual Property Group
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Cincinnati, Ohio*

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SECTION K



**NEGOTIATION OF WEB DEVELOPMENT,
SOFTWARE DEVELOPMENT, AND WEB DESIGN AGREEMENTS:
WHO OWNS THE CODE?**

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SECTION K

Negotiation of Web Development, Software Development, and Web Design Agreements: Who Owns the Code?

by Stephen E. Gillen¹

I Introduction

Web site development agreements can run the gamut from:

- the simple -- e.g., a relatively static promotional site with information about the company and its products and services, perhaps based on the developer's pre-existing design template, and with little interactivity beyond the ability to email comments to the webmaster;
- to the complex -- e.g., the development from the ground up of a dynamic, content-rich, interactive site (still focused on information delivery, but perhaps supporting data mining functions);
- to the devilishly complex -- e.g., the creation of a site that is both content- and media-rich, where the publicly accessible portions of the site may include executable programs, databases, text, images, sound, video, animation (some of which may be supplied by the customer, some of which may be developed specifically for this work by the developer, some of which may come from the developer's library of existing works, and some of which may be in turn licensed from third parties) and where the site is designed to support the execution of transactions (including the execution of

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auctions and reverse auctions), the delivery of digital products, the collection and evaluation of sensitive customer data, the generation of leads and referrals, and the sale of advertising space.

There is no one-size-fits-all form of development agreement that can accommodate the entire range of possible circumstances . . . and no 50-minute presentation that can do complete justice to the range of issues that should be addressed or the contract and negotiating options for resolving those issues. There is, however, a core group of issues common to most such deals which, given the circumstance of any particular deal, take on more or less significance, and more or fewer levels of complexity.

For convenience sake, let's talk about the final product as the "Work," though in actuality it may be comprised of a number of different components and deliverables in various stages of development -- preliminary, intermediate, and final. We'll also have to talk about "Services" apart from the development activities, which may include preliminary design consulting, training, launch assistance, hosting, maintenance, and support. The range of core issues, then, includes 1) a description of the Work to be developed and the Services to be rendered; 2) ownership of the Work and its specially commissioned components; 3) a license to use certain pre-existing components incorporated in the Work; 4) a mechanism for determining acceptability of the Work and for dealing with the inevitable modifications to the original specifications; 5) covenants dealing with the quality and timeliness of the Services to be rendered; 6) a schedule; 7) compensation; 8) warranties and indemnification; 9) confidentiality; 10) non-compete provisions; 11) remedies for breach; and 12) the usual menu of miscellaneous contract provisions (some of which take on a special significance in deals involving intellectual property).

II. Description of the Work and the Services

From the perspective of the customer (commissioning party) in a web site development deal, it's undoubtedly correct to say that if you don't get this right, nothing else will matter. But it's also important from the perspective of the developer to be certain that both parties to the deal have the same expectations with respect to the scope of the development being undertaken as well as the nature of associated services to be rendered. As a practical matter, it is unlikely that you as a lawyer will be able to provide the details. Much of this will take the form of schedules and exhibits to the agreement (requirements document, RFP and response, proposal, high level design document, detailed interface and functional specification, storyboards, demos or prototypes, etc.). Your task is to ask the right questions of the right people to be certain that both parties have a common understanding and that the details have been adequately memorialized in the agreement. If the project is complex and carries a big ticket and if the client does not have ready access internally to IS staff familiar with high level web design, you may need to convince your client of the need to bring in an independent consultant experienced in high-level web design to assist in the technical review of the preliminary design documents and in acceptance testing.

As noted above, the Work may include a number of different deliverables. Let's take them one at a time:

A. Preliminary Documents

In a complex web site development project where the developer is starting from ground zero, a lot of work is done before the first line of code is ever written. The first deliverable may be a **requirements definition** -- a statement, based upon interviews with the client and perhaps with focus groups or prospective site visitors, of the requirements which the new site must fulfill.

In a transaction of this type, it is a good idea to commit the parties in stages. If, in the course of the requirements definition process, it becomes apparent that client and developer are not well matched, the client should have the option of paying for and owning the requirements document or high level design document so that the investment in that process can be used to create a **request for proposal** and used to select another vendor. Providing for an opt out at this point in the development process also serves as a disincentive to over specing the project.

Perhaps more likely, again depending upon the scope and complexity of the project, the first document your client will see will be a **high level design document**, progressing through a series of intermediate steps to a detailed set of **specifications**. Ultimately, the client should get a design document or specification which sets forth the functions, features, interface specifications, browser compatibilities, security features, internal audit and report-generating capabilities, performance characteristics, bandwidth requirements, operating environment requirements, and so on for the final Work. It is this specification against which acceptability and performance will ultimately be measured.

B. Software

At the outset of the relationship between developer and client, it will likely be anticipated that the developer will proceed to host and maintain the web site after its completion. Consequently, clients are frequently unconcerned about getting delivery of the completed site in a form that would permit them to operate it or outsource operation to a different vendor. If, however, your client is not willing to be held hostage to a developer whose service declines or whose hosting and maintenance fees skyrocket, then it is important to pay close attention to ensuring that all of the deliverables necessary to an efficient transition of hosting are precisely defined. In defining or describing any software deliverable, be careful that you select the correct terminology and that you understand the terms you choose to use. Consider, for example, the

potential differences between the terms "computer program" and "software". 17 USC §101 defines a computer program as "[a] set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result." Software, on the other hand, is a broader term which can incorporate computer programs, libraries, databases, and utilities.

If the project involves incorporation of existing software, be certain to identify the software as specifically as possible, including the version number and release. Include all modules, if appropriate, or a list of only those modules licensed. Where the software being incorporated is the developer's proprietary software, consider making the definition of software broad enough to cover subsequent releases from the developer. Consider also whether the developer will be incorporating third-party software (server systems, utilities, tools, run-time versions, credit card processing or electronic cash or debiting software) necessary for the operation of the site. In such event, you will want to define that third-party software separately (as it will probably be treated differently for a number of purposes later in the agreement).

Lastly, consider whether the software is to be delivered in executable form only or whether it is also to be provided as source code (likely it will be some of both: source code for custom applets and content; executable for third party applications).

C. Documentation

Avoid including documentation as part of the definition of software: Give it its own definition -- there will probably be separate limitations on its use. Consider also the following concerns in constructing your description:

1. What type of documentation is included?
 - (a) Site administrator or webmaster manuals.
 - (b) Development documentation (necessary for maintenance and modification).

2. Define documentation in as much detail as possible.
 - (a) Site administrator or webmaster manuals might be defined as any written manuals and any other materials, drawings, or writings, whatever the media, electronic, paper, or otherwise, provided by the developer and relating to use or maintenance of the site.
 - (b) Development Documentation might be defined as all documentation, on paper and magnetic media, related to the development of the site, flow charts, data description and requirements, functional specifications, design specifications, results of any testing, and any and all data bases, sufficient in detail and clarity to enable a computer programmer of ordinary skill to easily understand and modify the site without undue experimentation or development time.

3. Can the client copy the documentation?

D. Operating Environment

Any description of the Work would be out of context if you did not also describe the environment in which it is intended to function. In that regard, consider the following points:

1. What are the minimum system/environment requirements? Are the warranties conditioned on such minimums?
2. With respect to the sufficiency of minimum system/environment (hardware and software), is the customer being held responsible for assessing sufficiency of existing equipment/environment or has developer inspected them and made a representation about their sufficiency?
3. Will the developer be providing hardware or third party software?
 - (a) Fix the cost. Preview third party purchase, lease, license, and maintenance agreements. Be certain that payments for hardware are either made directly to the

OEM or, in the alternative, that the payment is contemporaneously exchanged for a bill of sale free and clear of any liens or encumbrances. If the deal is being financed by a third party financing company or capital leasing agent, be sure that your client retains the ability to direct or withhold payments to the developer sufficient to get the developer's undivided attention in the event a deliverable is late or fails to function as intended.

- (b) Provide for pass through warranties for hardware and third party software.

Developer should assign and pass through to the client the third parties' warranties such that client's rights under such third parties' warranties will be the same as if the client had purchased the third party hardware or licensed the third party software directly from the third party. Developer should commit to assist the client in the enforcement of such warranties.

E. Deliverables

It is important to describe what physical materials the client will be receiving (or may be entitled to demand, in the event of a transition in hosting and maintenance):

1. Copies of the software.

- (a) How many copies, what type and size of media, what format, for what.
- (b) If the client changes platforms to another platform supported by the developer, is there a right to delivery of the software in formats for such other platforms? Are additional/replacement copies available? Charges?

2. Copies of Documentation.

- (a) What documentation and in what form?
- (b) How many copies? Is there a charge for additional copies? Can the client make additional copies?

3. Source code.

- (a) Don't list source code as a deliverable unless its delivery is consistent with the scope of the license. If the client has a right to modify the software, source code must be listed as a deliverable.
- (b) Specify in what form, written or electronic (machine readable).
- (c) If source code is provided, make sure the licensor has an obligation to deliver source code with each new version or update delivered.
- (d) From the developer's side, you should include a covenant not to compete if the client has access to the source code for the developer's proprietary routines and applications.
- (e) Also from the developer's side, you should prohibit client from developing, marketing, distributing, etc. similar software during and for a period after access to or possession of source code.
- (f) Special confidentiality provisions may be advisable, limiting who will have access.

4. The client will also have some delivery obligations for the content it provides (originally and with respect to updates). In order to avoid any misunderstanding, the agreement should provide for the form, manner, and timing of the delivery of this content.

F. Services

In addition to the deliverables, it will be important to specify the services that the developer will provide:

1. Types.

- (a) Pre-development assessment or assistance with the requirements definition.
- (b) Implementation.
- (c) Training.

- (d) Support (telephone, remote access, on-site).
- (e) Maintenance -- provide separately for maintenance of content and for maintenance of any licensed software.
- (f) Installation.
- (g) Hosting -- it is important to spell out the scope of those service -- what sort of server equipment and software will be used, what size connection or pipeline is guaranteed, how much disk space will be allocated, how soon will the developer respond to service interruptions, when will routine maintenance be performed, and so on. Be sure that the contract requires the developer to maintain the facilities so that they will be operating and available 24 hours per day, 7 days per week, and that the developer has capable technical support personnel. If the client is going to process transactions electronically via its site, make sure that the developer will take appropriate steps to ensure the security and integrity of these transactions.
- (h) Report generation and data mining.
- (i) Roll out/launch assistance.

2. Training.

- (a) What type of training? System administrator, Developer (for source code modification).
- (b) Is there a minimum/maximum class size? How effective will the training be if classes are large?
- (c) Where will the classes be held?

3. Support.

- (a) How is support defined by the parties?
- (b) Identify to whom the support will be given.

- (c) How long will support be available? For what versions?
- (d) Hours of telephone support (specify time zone) and whether it's toll free.
- (e) On site support?

4. Maintenance.

- (a) By separate agreement?
- (b) Error correction. Example:

The developer will correct any errors in the software or documentation as delivered by the developer, which is attributable to the developer and which significantly affects use or operation of the web site, provided that (i) the client notifies developer in writing of the error(s) during the term of maintenance; (ii) the client can reasonably identify the error, so as to permit its duplication.

- (c) Error correction typically excludes correction of errors not caused by the software itself.

5. Charges.

- (a) Watch for "estimate only" per hour charges.
- (b) Training can be specified in terms of number of classes, number of students, number of instructors/class.
- (c) Support -- flat periodic fee, by the call, by the hour? How does either side keep track? Who pays for telephone charges? Frequently it is the developer.
- (d) The client wants fixed fees, the developer wants to change the charges at will, or at least periodically.

6. How long will the services be available?

- (a) Perpetual?
- (b) Is there a scheduled time or a minimum time period.

7. What constitutes acceptance of services.
 - (a) What standards are they to be measured against? How do you measure/guarantee adequacy of services? Tied to warranties? Other ways?
8. "Additional Services" Not Covered (e.g., custom programming, porting, installation, training, database or file conversion).
 - (a) Require the developer to provide written notice before performing any such service for which there will be an additional charge. Require the client's written approval prior to delivery of any such additional services.
9. Employee Raiding.
 - (a) Limit party's ability to offer or employ employees of the other for a limited time, such as a year, following termination of the employee's work done for the other party.

III. Ownership

Most web sites will be comprised of a number of different types of components, from a number of different sources, subject to a variety of types of intellectual property claims. Your challenge will be in identifying the various components and in memorializing who owns what. The best (albeit most difficult) approach is to schedule in the agreement the various components that will be provided, who will provide them, and who will own the associated intellectual property rights. This may prove unworkable at the agreement stage, however, and a more practical alternative may be to develop a mechanism for identifying exactly what is being transferred to the client in contrast to what the developer retains -- perhaps through a notice and amendment process or perhaps by obliging the developer to tag (in the code) those components which it claims are proprietary.

A. Content (text, images, video and audio files, and databases)

1. There will likely be pre-existing content provided by the client for inclusion in the site. Some of this client-provided content may be owned by the client, and some of it may have been previously provided to the client by contractors subject to some sort of limited license.
2. There may be new content created by the developer specifically for the client and only useful for the client's site.
3. In some cases there may be content procured, by the developer or by the client, from third parties.

B. Design (the layout or architecture of the site, the interrelationship between and among the various pages, and aesthetic aspects of the user interface)

1. The design may be a custom work prepared by the developer specifically and solely for the client.
2. The design may be based on a template that the developer uses across multiple sites for multiple clients.

C. Software (executable applications or applets which provide the functionality)

1. The developer will probably have incorporated in the Work various applications and subroutines from the developer's inventory of existing work -- components that are more or less standard and used frequently by the developer in other projects.
2. The developer may also have incorporated third party applications from other vendors (particularly in connection with any transaction processing features of the site)
3. Occasionally, the developer will build an application specifically for the client's site.

D. Forms of Intellectual Property

1. Copyrights -- the content, design, and software are all subject to copyright claims. As

noted above, much of the content for a site may already exist, in the form of catalogs, sales literature, maintenance manuals, and so on. The key question here is ensuring that the client does indeed hold the necessary rights, particularly when creation of that material has been outsourced rather than completed in house by company employees. Default ownership rules under copyright law favor the human creator or his/her employer over the one who simply pays the bill (the commissioning party).

- (a) The problem in outsourcing development of creative expression arises from the statutory prejudice in favor of vesting copyright ownership in the human creators.

Copyright in a work protected under this title vests initially in the author or authors of the work. . . . 17 USC §201(a)

Note that the term "author" in the statute subsumes all those who create copyrightable works -- including the writer, artist, photographer, programmer, and so on. Thus, a copyrightable work developed at the instance of (and paid for by) a company belongs *not to the company but to the human creator unless* 1) that human is also an employee acting within the scope of his/her duties or 2) there is a *written* transfer of rights. This comes as a surprise to many managers, a problem that is best dealt with on the front end by adopting reasonable, written ownership policies and by establishing procedures and documents for routinely implementing those policies (and for making informed exceptions when the circumstances warrant). A company that elects to use its PO system for outsourcing creative work should take care to adapt its PO forms to address the intellectual property issues. Without a written agreement that expressly addresses who owns what rights, the best the business owner will get is an implied, non-exclusive license to use the work. How long and for what purposes that business will get to use the

work are questions that are ripe for dispute.

(b) **Work-Made-for-Hire.** Work that is done in house by employees, within the scope of their duties, is considered to be work-made-for-hire. Work-made-for-hire is the exception to the rule that rights in a copyrightable work vest automatically in the human creator. In the case of such works, the employer or commissioning party is considered to be the "author" for copyright purposes and becomes the owner of all the rights comprised in the copyright -- the transfer of rights is comprehensive and permanent. The rationale for distinguishing works-made-for-hire was first recognized in 1903 in the Supreme Court case of *Bleistein vs. Donaldson Lithographing Co.*, 188 U.S. 239, and traces its roots to the precept that ownership of a work created to the specification and at the risk of an employer should belong to the employer, with the employee (retained for the purpose of creating the work) taking his or her compensation in the form of a salary, benefits, and the other associated emblems of employment. Since its inception, the for-hire doctrine has evolved through case law and legislation to encompass two circumstances:

- the true employer/employee relation, or
- by written agreement of the parties under certain, statutorily enumerated circumstances.

In the first scenario, the creative is treated as an employee (full-time or part-time) in terms of the control exercised by the employer and in terms of access to benefits, tax withholding, social security contributions and so on. For copyright purposes, however, this determination is driven by the federal common law of

agency, not by state law principles or decisions.

The second scenario ignores the true nature of the relationship and focuses on the intentions of the parties. Its reach is limited to nine classes of works:

- a contribution to a collective work (e.g., periodical article)
- a part of a motion picture or other audiovisual work
- a translation
- a supplementary work
- a compilation
- an instructional text
- a test
- answer material for a test
- an atlas

and requires that the work be specially commissioned and that the parties agree in advance of creation of the work that the work will be considered to have been made-for-hire. Note that computer programs, data files, and advertising materials - - all examples of copyrightable works that are frequently outsourced -- do not fall neatly into any of these nine categories (though in some cases they may fit as an audiovisual work or a contribution to a collective work). If you are attempting to create a work-for-hire on the margins of the statutory authorization, you would be well advised to take a "belt and suspenders" approach and couple your work-for-hire acknowledgements with an assignment of all rights. If you intend that a work be done on a for-hire basis you should endeavor to memorialize the terms of your deal before that work is created and you should be certain to use the term of art "work-made-for-hire" or to be clear that the assignment of all rights includes not

only the physical article but also the intellectual property rights in the expression. If you are documenting a sloppy transaction after the fact, you should include in the statement to be signed an acknowledgment that the document confirms a deal struck prior to creation of the work.

- (c) All Rights and other more limited transfers. If the client's existing content was not created by an employee and doesn't fall into one of the nine categories of works that can be deemed "for-hire" by written agreement, then the next best alternative is to get an assignment of "all rights." The second most comprehensive transfer of rights possible, a grant of all rights means *almost* what it says. It is a complete transfer of all right, title, and interest in and to the subject work. A grant of all rights, without further modification, would be construed to include not only print rights but also what have come to be known as electronic (or display) rights as well. Notwithstanding the comprehensive and permanent sound of the term, however, such a transfer is subject to a statutory right of termination during a five-year window 35 to 40 years after the grant was made. In plain English, the creative or the creative's heirs can take back the rights to a work (free of charge) 35 years after they were first signed away. There are a few other rights terms that you might encounter in evaluating whether or not a client holds the requisite rights to existing content destined for inclusion on a web site, particularly when dealing with commercial photographers (a group that has historically been very shrewd in selling limited use privileges rather than ownership to their work product). "One-time rights" represent a grant of the right to publish a work in one issue of a periodical or one sales piece. If the photographer's invoice says "single-use" or

"one-time rights," then the client has paid for the right to use the photo in one ad insertion or one sales piece. Running the ad a second time or using it on a web site would be outside the scope of the client's license and would require the payment of an additional fee. "Electronic rights" is an amorphous term that does not have one settled definition across industry lines. Sometimes it is treated as a synonym for "display rights," generally understood to encompass the right to include text or images on a CD-ROM for recall and display on a PC screen. In contrast, are "interactive" (or multimedia) rights which encompass the right to combine text with sound and video incorporating some level of interactivity. The entertainment industry views these interactive rights as a subset of pay television rights and, as a consequence, negotiation over interactive rights can be vigorous where the licensed work has any potential pay TV applications. General contract law resolves any questions about the nature of a transfer in favor of the creative in two ways: first, by providing that rights not expressly granted are interpreted to be retained by the creative; and second, by providing that any ambiguity in a transfer document will be resolved against the party who drafted the document (this will almost always be the business or commissioning party). Thus, if there is no signed writing evidencing an appropriate transfer of rights (or an exchange of writings that collectively accomplish the same thing), then the client should not assume that it has the right to make the works available electronically.

2. Patents -- certain aspects of the software and the processes it enables have, in the wake of *State Street Bank*, been recognized as the proper subject of aggressive patent claims. Until the dust settles on this volatile area of intellectual property law, the cautious attorney will assume that the web site software may well incorporate patentable or patented

technology and will provide for ownership and/or appropriate licenses for same.

3. Trade secrets -- whether or not patentable, the software is certainly subject to trade secret claims to the extent that the source code has been adequately secured. Accordingly, ownership and licensing of this aspect of the work should be handled with the same degree of care employed in apportioning rights to the copyrights and patents. Appropriate confidentiality provisions should be included in the agreement -- with respect to both the proprietary components and with respect to the scope of the project itself, pre-launch (the client will, in all likelihood, not want its competitors to know what it is up to until it is too late for them to respond).
4. Trademarks -- the site will likely carry trademarks belonging to the client. While there is not likely to be an issue over ownership of these marks simply by virtue of the developer's hosting of the site, conservative practice suggests that the agreement include an acknowledgement of exclusive ownership in the client and a disclaimer of any interest or license in the developer. Of more concern is the ownership of any trademark or service mark rights in the domain name selected for the site.
5. Factors in negotiating ownership/licensing -- If the client has specially commissioned the development of components that have no significant commercialization prospects, it is likely that the client will want to own all rights in those components and that the developer will agree to such an arrangement. If, on the other hand, the project involves customization of existing components or the development of components that have significant commercialization prospects beyond what the client is positioned to effectively exploit, it may make more sense to leave ownership with the developer (in return for a concession on cost) and to take only a license for the uses the client intends. As noted above, where the objective is to vest the broadest possible rights in the client,

getting agreement to characterize the various components as "work-made-for-hire" is the preferred solution. It is not possible in every instance, however, and the requirements for effecting this feat are technical and offer many opportunities for miscue. The next best option is a transfer of all rights, title, and interest (including, without limitation, all patent rights, trade secret rights, copyrights, and other property rights throughout the world) in and to the specified components. With respect to those components which will continue to be owned by the developer, the client will need a license to use them in connection with its use of the Work.

IV. License

A. Scope

The license for developer-owned components can take many forms, depending on the following factors:

1. What activities are being licensed
 - (a) To use?
 - (b) To modify?
 - (c) Is it portable, i.e., can the client carry the license to another host?
2. Exclusive or non-exclusive?
3. Is it transferable (to an affiliate or to a purchaser of substantially all of the relevant assets?)
4. Are there territorial limits.
5. Is the license limited to the original platform and environment.

B. License Term, Fees and Termination

There are other issues you will want to specifically address with respect to any license:

1. Clearly state the term of the license.
 - (a) Perpetual.
 - (b) Limited duration.
2. License Fees.
 - (a) Probably tied to the license term.
 - (b) One time, paid in full license fee -- especially for perpetual license.
 - (c) Periodic payment -- limited duration or perpetual (as long as payments are made)
3. Timing of payments.
4. Early Termination.
 - (a) By the client.
 - (b) By the developer.

V. Acceptance Testing and Performance Criteria

Success cannot be assumed when it comes to web site development. The much sought after (and infrequently achieved) triad in this industry is 1) on spec, 2) on time, and 3) within budget. While it is important to set targets, it is equally important to anticipate adjustment of those targets and to provide a mechanism for notification of deviations, agreement that they *are* deviations and that they *are* necessary, notice of the impact on price and schedule, and memorialization of the client's acceptance of those impacts.

A. Defining the Target

1. What is acceptance?
2. Acceptance Criteria vs. Performance Specifications.
 - (a) Acceptance Criteria must be met before the software is accepted.
 - (b) Frequently can be spelled out in terms of specific tests, runs with data, response

times, etc.

- (c) Acceptance Criteria may be in more detail, but less breadth than Performance Specifications.
 - (d) Should it be different?
3. Performance Specifications.
- (a) To the extent possible, finalize before signing the agreement or making any significant payments (unless the deal is designed to be done in phases).
4. Capabilities beyond Performance Specifications.
5. Automatic Acceptance.
- (a) The developer wants automatic acceptance, preferably on delivery, perhaps on successful installation, more reasonably on implementation or "go live."
 - (b) The client wants actual notice of acceptance to be required, preferably after a sufficient shake down period.
6. Initial Test Period, Cure Period, Subsequent Test Period.
- (a) When does the Test Period start? Upon delivery of software? of all hardware? Upon installation? Upon end of training?
 - (b) When does the Cure Period start?
 - (c) Make the periods consecutive, with each starting at the conclusion of the preceding one.
 - (d) Reinstallation/setup following cure period.
 - (e) Additional hardware requirements following correction during cure period.
 - (f) Is an iterative process beneficial? How many cycles must the client permit?
7. Importance of acceptance.
8. Remedy during acceptance testing vs after acceptance.

9. Will development and testing be done on a secure server?

B. Modifications

1. What sort of notice is required?

2. What is the response time, and the impact of a failure to object or reject in the time and manner specified?

VI. Compensation

Payments to the developer can take a wide variety of forms depending upon the nature of the deal. The ends of the spectrum, however, are marked by flat fee deals on the one hand and (although infrequent in most commercial deals outside of web-based publishing) royalty or commission arrangements on the other.

A. Fee Transactions

Most web site development deals are structured around payment of a fee, fixed or variable. The client naturally has an interest in capping its costs -- preferably as low as possible. Where the project involves a high degree of certainty and predictability, the developer is likely to be accommodating. Where, on the other hand, the project is complex or less predictable, the developer is likely to press for some alternative, and more flexible arrangement -- time and materials, or cost plus. In between, you may get the developer to agree to a fixed fee, a firm estimate, or a not-to-exceed cap (based on reasonable, good faith projections taking into account articulated assumptions). This assumption, by the developer, of some or all of the price risk will not come without cost, however, and it is likely that any limits to which the developer agrees will include a cushion for that risk.

B. Royalty/Commission Deals

Where the deal involves web-based publishing, it is more likely that the compensation

arrangement will involve royalties (or a share of the proceeds from that commercial exploitation).

In cases such as these, it is important to specify the revenue stream on which royalties will be paid.

1. Gross sales (specify the business model and revenue streams and anticipate the possibility of adjustment or refinement in same).
2. Net Sales.
3. Gross receipts.
4. Net receipts (or net cash received).
5. Defining the exclusions from "net" amounts.
6. Responsibility for bad debts or uncollectibles.
7. Reporting and payment cycles.
8. Audit rights.
9. Best efforts to promote; advances (refundable and non-refundable); minimum guarantees; and other assurances of performance.
10. Associated non-competes.

C. Hosting and maintenance fees.

1. If the developer will also be hosting the site, what are the charges for disk space and volume of traffic? Is there a credit for service interruptions? Is there a maximum on the volume of change in content in any period? If so, how is this measured or determined? Will the client get advance notice of maintenance for which there will be additional charges?

VII. Warranties, Remedies, and Indemnification

It is an unfortunate fact (perhaps more pervasive in the software industry than elsewhere)

that things do not always go as planned. Against this possibility, the client will want some assurances about the Work -- broadly grouped into performance warranties and warranties of non-infringement -- and some comfort that they will have adequate recourse if these assurances are not borne out. The developer, conversely, will want to limit its promises as well as its exposure.

A. Warranties

1. When does the Warranty Period start?
2. How long will it be?
3. What happens during the Warranty Period?
 - (a) Performance warranties in effect.
 - (b) Error Correction.
 - (c) Updates, enhancements or other new releases.
 - (d) Support.
 - (e) Overlap with maintenance.
4. Warranties for the client.
 - (a) Site performs in accordance with Performance Specifications.
 - (b) Sufficiency of documentation.
 - (c) Sufficiency of training.
 - (d) Sufficiency of specified environment/hardware/third party software. For example
The developer warrants that when the software is operated on and with the third party products, without additional hardware or software, (i) the software will be fully compatible and functional; (ii) the software will have all of the functionality set forth in the performance specifications; and (iii) the client's license to use developer-owned or third party components is sufficient for the client to exercise

all of its rights under this agreement.

- (e) Warranties of ownership, sufficient rights to enter the agreement and grant the license, and of non-infringement.
- (f) Additional reps and warranties re security, compliance with relevant e-commerce standards or protocols; compliance with card issuer and sponsoring bank requirements.

5. Exclusions and Disclaimers From Warranty (or Liability) By Developer.

- (a) Modifications made by the licensee.
- (b) Implied warranties of merchantability, fitness for a particular purpose, and of non-infringement.
- (c) Uninterrupted or error free operation.
- (d) Loss of Data.
- (e) Cost to the client for changes to other the components, training, etc. necessitated by error correction, updates, or enhancements.

6. Requisites For Warranty Service (such as error correction).

- (a) In order to correct a problem, the developer must be able to reproduce it.

7. Developer's reluctance to guarantee or warrant error free performance of software (substitute a covenant to repair defects or deficiencies).

B. Remedies for Performance Deficiencies

- 1. Correct any error(s) in the components as delivered by the developer which significantly affect use or operation of the web site.
- 2. Refund and conditions therefor; credit for service interruptions.

C. Infringement (these are likely to be bi-lateral as a result of client-provided content)

- 1. Type of third party rights usually addressed.

- (a) Patents.
 - (b) Copyrights.
 - (c) Trade secrets.
 - (d) Trademarks.
 - (e) Other intellectual or proprietary rights.
2. Duty to defend/indemnification.
- (a) Should be based on the event of a claim of infringement or misappropriation, not arising out of actual infringement.
 - (b) Should the indemnitor have sole authority to control defense of the claim and settlement?
 - (c) Conditions to indemnification or obligation to defend.
 - (d) The difference between a breach of an affirmative covenant and a breach of warranty.
3. The remedies.
- (a) Frequently a four part remedy for functional components, usually at the developer's option.
 - (1) modify the software so that it is rendered non-infringing;
 - (2) procure for the licensee the right to continue use of the software;
 - (3) substitute software having equivalent capabilities; or
 - (4) refund the unused portion of the license fee based on straight line 3 year amortization.
 - (b) The trigger event for these remedies might be when a claim is made or, in the developer's opinion, is likely to be made, or upon preliminary or final judgement, or upon settlement of a claim.

4. Exclusions.
 - (a) Claims which arise out of modifications made by the client.
 - (b) Claims which arise out of the developer's compliance with the client's instructions or requests.

5. Indemnification/Duty to defend shouldn't be limited by any limitations on liability.

D. Escrow of Source Code (for proprietary software components)

1. Does source code really need to be escrowed? Will the client be able to use it?
2. Separate escrow agreement with escrow agent, setting forth the details of the escrow.
3. Who will be the escrow agent?
4. Exclude access/withdrawal by the developer.
5. How many versions will be maintained on deposit?
6. Verification that deposited source code is correct code.
7. What will be the trigger event for release of the source code to the client?
8. Make sure that the client is licensed to make modifications, etc. upon release of escrow.
9. What will be the deposited media?
10. What documentation will be deposited?

VIII. Two Important Miscellaneous Provisions

A. Assignability

In contrast to the general contract rule favoring assignability in the absence of an express restriction, *non-exclusive* licenses of technology are *not* assignable by the licensee unless the license agreement expressly provides that they may be assigned. Moreover, some agreements (together with the accompanying maintenance agreements and source code escrows) contain express restrictions against assignment by the client in combination with termination rights

triggered by a change in control.

Developers include these provisions for a number of reasons:

- in order to avoid displacing subsequent sales -- the acquirer who gets access to a site by assignment will not have to build a new one;
- because fees are sometimes based on the size of the client -- the developer's exposure under the warranty and indemnification provisions may increase for a larger client;
- because the developer may be concerned about the possibility of proprietary components falling into the hands of a potential competitor;
- because the credit worthiness of the acquirer may be inferior; and,
- because the continuing obligations of the developer may be materially affected by the size and nature of the acquirer.

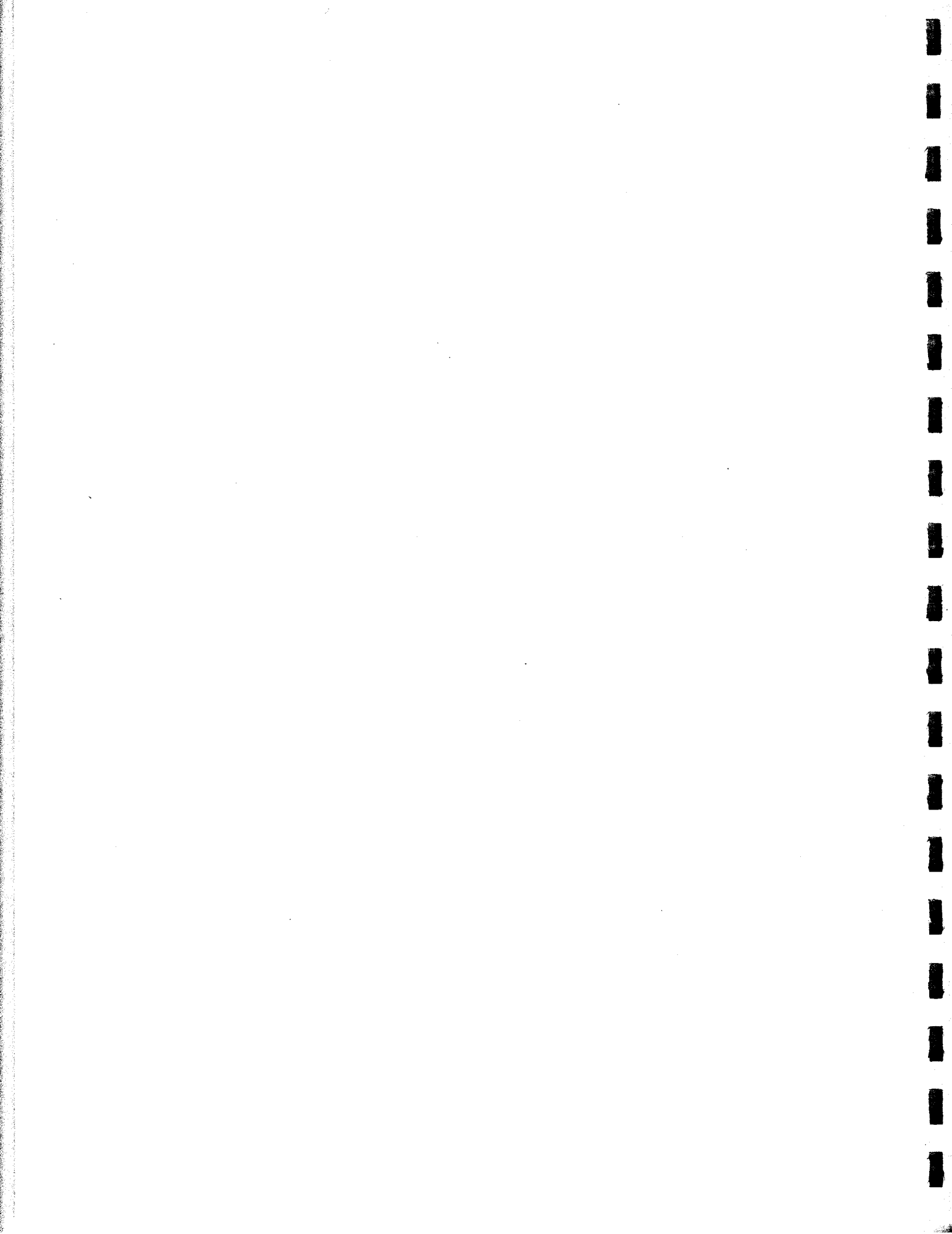
Accordingly, it will be important to provide for any restrictions on transfer. Look not only for provisions that expressly preclude assignment and for provisions that render the agreements terminable at the election of the developer in the event of a change in ownership or control, but look also for qualifications in the grant or license language that might have the same impact -- e.g., "Developer hereby grants to client a *personal*, non-exclusive right and license . . ."; or "Developer hereby grants to client a non-exclusive, *non-transferable* right and license . . ."

B. ADR

Another "miscellaneous" provision too often included without due consideration for the practical implications is a commitment to utilize some form of Alternative Dispute Resolution mechanism before resorting to litigation. While there may be very good reasons for adopting this approach in a web site development transaction (not least among them the speed with which the process can be effected as well as the ability to select a neutral decision maker more familiar with the sometimes highly technical nature of the dispute), there are at least an equal number of

reasons to be cautious.

1. Availability of injunctive relief.
2. Limited discovery (who is likely to have the relevant records?)
3. Is it important to establish binding precedents?



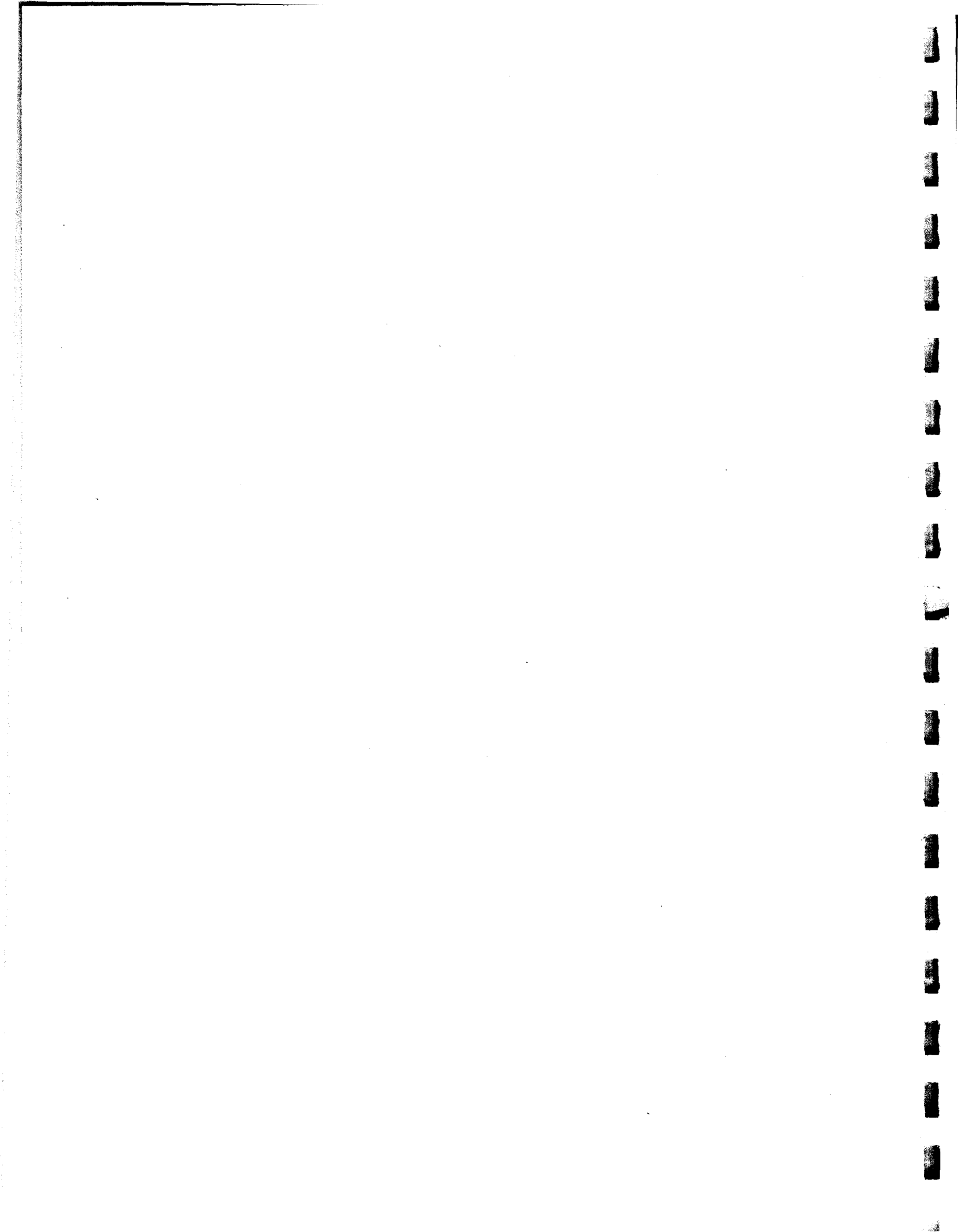
DIGITAL ETHICS

*Ethical & Professional Responsibility
Issues For The Lawyer In The
Computer Age*

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DIGITAL ETHICS
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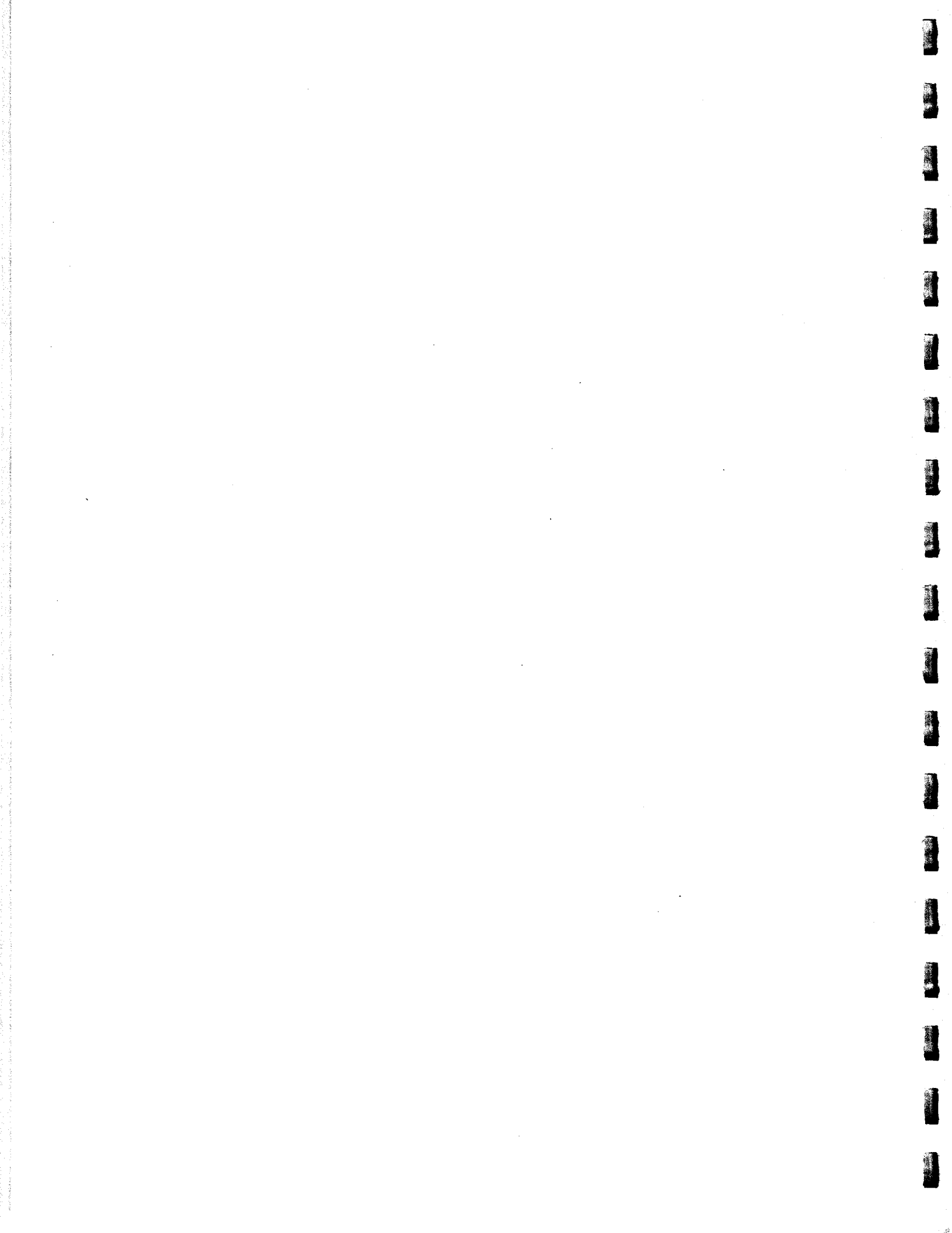
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DIGITAL ETHICS

In the binary world of digital electronics, everything is either black or white. But ethics are always gray, shaded by reason, morality, and opinion. The rapid acceptance of computers by lawyers has bucked the profession's historical resistance to technological advances. In the past five years, lawyers have flocked to the Internet and cyberspace at an unprecedented rate. The burgeoning use and embracement of electronic communications has radically transformed the practice of law. The purpose of this paper is to discuss the top five hot topics where legal ethics intersect with information technology, creating all new attorney-client issues for the Digital Age. The following topics are covered (in no particular order):

1. Use of unencrypted e-mail
2. Attorney web site advertising
3. Creating the lawyer-client relationship online
4. Giving legal advice or "information" online
5. Internet legal referral services

1. Use of unencrypted e-mail

The three common types of electronic mail (e-mail) are: (1) point-to-point; (2) private network; and (3) public network. It is fairly well established that the use of all forms of unencrypted e-mail is an acceptable means of communicating with clients. See KBA E-403 (July 1993) (www.uky.edu/Law/kyethics/kba403.htm) (see appendix) which poses the question:

Question 1: May a lawyer use electronic mail services including the Internet to communicate with clients without encryption?

Answer: Yes, unless unusual circumstances require enhanced security measures.

The Kentucky Bar Association adopted the above ethics opinion from the Illinois State Bar Association Opinion No. 96-10 (May 16, 1997), which provides in part:

The duty to maintain the confidentiality of client information implies the duty to use methods of communication with clients that provide reasonable assurance that messages will be and remain confidential. * * * Courts and ethics committees have uniformly held that persons using ordinary telephones for confidential communications have a reasonable expectation of privacy. The three common types of electronic mail messages appear no less secure.

The Illinois Bar opinion drew an analogy to permissibility of cordless and cellular telephones, but made a distinction that the illegality of the unauthorized access of information somehow gives rise to an expectation of privacy.

The third type of electronic mail, that carried on the Internet, typically travels in another fashion. Rather than moving directly from the sender's host computer to the recipient's host computer, Internet messages are usually broken into separate

"packets" of data that are transmitted individually and then re-assembled into a complete message at the recipient's host computer. Along the way, the packets travel through, and may be stored temporarily in, one or more other computers (called "routers") operated by third parties (usually called an "internet service provider" or "ISP") that help distribute electronic mail over the Internet. * * * Unlike a cordless cellular telephone message, for example, an Internet e-mail is not broadcast over the open air waves, but through ordinary telephone lines and the intermediate computers. When an Internet message is transmitted over an ordinary telephone line, it is subject to the same protections and difficulties of interception as an ordinary telephone call. To intercept an Internet communication while it is in transit over telephone lines requires an illegal wiretap. * * * The unauthorized interception of an Internet message is a violation of the ECPA [Electronic Communications Privacy Act], which was amended in 1986 to extend the criminal wiretapping laws to cover Internet transmissions. 18 USCA §2510 *et seq.*

The Illinois opinion, as adopted in KBA E-403, concludes as follows:

In summary, the Committee concludes that because (1) the expectation of privacy for electronic mail is no less reasonable than the expectation of privacy for ordinary telephone calls, and (2) the unauthorized interception of an electronic message subject to the ECPA is illegal, a lawyer does not violate Rule 1.6 by communicating with a client using electronic mail services, including the Internet, without encryption. Nor is it necessary, as some commentators have suggested, to seek specific client consent to the use of unencrypted e-mail. The Committee recognizes that there may be unusual circumstances involving an extraordinarily sensitive matter that might require enhanced security measures like encryption. These situations would, however, be of the nature that ordinary telephones and other normal means of communication would also be deemed inadequate.

More recently, on March 10, 1999 the American Bar Association's Standing Committee on Ethics and Professional Responsibility released its Formal Opinion No. 99-413 on "Protecting the Confidentiality of Unencrypted E-mail" (www.abanet.org/cpr/fo99-413.html) (See appendix) which reinforces the Kentucky and Illinois opinions that e-mail communications, including those sent unencrypted over the Internet, pose no greater risk of interception or disclosure than other modes of communication commonly relied upon as having a reasonable expectation of privacy.

A lawyer may transmit information relating to the representation of a client by unencrypted e-mail sent over the Internet without violating the Model Rules of Professional Conduct (1998) because the mode of transmission affords a reasonable expectation of privacy from a technological and legal standpoint. The same privacy accorded U.S. and commercial mail, land-line telephonic transmissions, and facsimiles applies to Internet e-mail. A lawyer should consult with the client and follow her instructions, however, as to the mode of transmitting highly sensitive information relating to the client's representation.

The ABA opinion recognizes the risk of unauthorized interception and inadvertent disclosure exists in every medium of communication, including e-mail, but concludes that an expectation of privacy in this electronic medium is reasonable:

Lawyers have a reasonable expectation of privacy in communications made by all forms of e-mail, including unencrypted e-mail sent on the Internet, despite some risk of interception and disclosure. It therefore follows that its use is consistent with the duty under Rule 1.6 to use reasonable means to maintain the confidentiality of information relating to a client's representation

Problems for discussion:

1. Frequency of misdirected e-mail
 - Improper addressing
 - Bounce backs
 - Default mailboxes
2. Ease of erroneous transmissions
 - Reply All - Inadvertent mailings
 - Errors in Reply-Addresses perpetuated
 - Reasonable expectation of delivery (probable expectation)
3. Reliability of deliverability - "Mailbox Rule" v. "Sent Folder Rule"?
 - ISP or mail servers down
 - Backbones or lines down
 - Problems with PC, user gone
4. Hackers and viruses
 - Intentional attacks on ISP, OSP, etc.
 - Viruses - Melissa (word macro)
 - Liability if you infect client

Summary:

Risk of misdirection much higher, reliability of delivery much lower.
Reasonable versus probable expectation of delivery.

2. Attorney web site advertising

It is likewise fairly well established that lawyers may advertise on the web under similar constraints as for traditional publications and advertising. See KBA E-403 (July 1993) (www.uky.edu/Law/kyethics/kba403.htm) (see appendix) which addresses the question:

Question 2: Is the creation and use by a lawyer of an Internet "web site" containing information about the lawyer and the lawyer's services that may be accessed by Internet users, including prospective clients, a communication falling within KRPCs 7.09 [Prohibited Solicitation] or 7.30 [Direct Contact With Prospective Client]?

Answer: Qualified No. Unless the lawyer uses the Internet or other electronic mail service to direct messages to a specific recipient [in which case the rules governing solicitation would apply] only the general rules governing

communications regarding a lawyer's services and advertising [KRPCs 7.10, 7.20, and the so-called advertising rules set forth at KRPCs 7.01-7.08] should apply to a lawyer's "web-site" on the Internet.

The KBA Ethics Opinion No. E-403 again incorporated the reasoning expressed in Illinois State Bar Association Opinion No. 96-10, which analogizes web site advertising to passive forms of publication such as Yellow Pages or firm brochures:

With respect to the second general issue, the extent to which a lawyer may use an Internet web site to communicate with clients and prospective clients, the Committee believes that the existing Rules of Professional Conduct governing advertising, solicitation and communication concerning a lawyer's services provide adequate and appropriate guidance to a lawyer using the Internet. For example, the Committee views an Internet home page as the electronic equivalent of a telephone directory "yellow pages" entry and other material included in the web site to be the functional equivalent of the firm brochures and similar materials that lawyers commonly prepare for clients and prospective clients. An Internet user who has gained access to a lawyer's home page, like a yellow pages user, has chosen to view the lawyer's message from all the messages available in that medium. Under these circumstances, such materials are not a "communication directed to a specific recipient" that would implicate Rule 7.3 and its provisions governing direct contact with prospective clients. Thus, with respect to a web site, Rule 7.1, prohibiting false or misleading statements concerning a lawyer's services, and Rule 7.2, regulating advertising in the public media, are sufficient to guide lawyers and to protect the public.

However, attorney participation in two-way communications and exchanges of information with individuals crosses the line from passive push technology to proactive pull techniques, and therefore are held to higher scrutiny with respect to solicitation. The test is usually whether the lawyer's communication is general information or specific advice to the individual:

On the other hand, lawyer participation in an electronic bulletin board, chat group, or similar service, may implicate Rule 7.3, which governs solicitation, the direct contact with prospective clients. The Committee does not believe that merely posting general comments on a bulletin board or chat group should be considered solicitation. However, if a lawyer seeks to initiate an unrequested contact with a specific person or group as a result of participation in a bulletin board or chat group, then the lawyer would be subject to the requirements of Rule 7.3. For example, if the lawyer sends unrequested electronic messages (including messages in response to inquiries posted in chat groups) to a targeted person or group, the messages should be plainly identified as advertising material. * * * The Committee believes that [Illinois] lawyers may appropriately make use of the Internet in serving and communicating with clients and prospective clients subject to the existing rules governing confidentiality, advertising and solicitation.

More recently, the State Bar of California's Committee on Professional Responsibility and

Conduct released a proposed formal ethics opinion (no. 96-0014) on attorney web sites (see: www.calbar.org/2bar/3com/3cp9903a.htm) The opinion concludes that web sites are "advertisements" within the meaning of the rules but are not automatically deemed "solicitations" by virtue of the inclusion of e-mail contact capabilities. One attorney's web site containing information for the public regarding her availability for professional employment was both a "communication" and an "advertisement," and as such was subject to the applicable prohibitions on false, misleading, and deceptive messages for all words, sounds and images on the site. However, under the facts presented the web site was not a "solicitation" even if it included e-mail facilities allowing direct communication to and from the attorney. The attorney was warned that her web site may be subject to regulation by other jurisdictions or that it might be considered the unauthorized practice of law in other jurisdictions.

3. Creating the lawyer-client relationship online

There are a number of ways to communicate on the Internet. The most common use of e-mail from sender to a known receiver is but one method, albeit the most obvious, but a growing number of lawyers have begun to use cyberspace to give specific legal advice to laypeople who request it. One way to seek legal advice on the Internet is through *newsgroups*, such as *alt.lawyers.sue.sue.sue*, which are online discussion forums categorized by subject, where people post and read messages from other people, say, who have been injured in accident, fired from jobs, going through a divorce, buying a house, probating a will, *etc.* There is also a mailing list program, or *listserv*, where messages are sent to a central e-mail address and then redistributed to the list's subscribers, where some *listservs* are dedicated for requests for legal advice. A more interactive version of these discussion groups is the "chat room," in which two or more individuals can communicate in real time, receiving responses on the screen as soon as they are typed in. Lawyers may join chat rooms and participate in largely unregulated speech and usually without either party having any reliable verification of the identity of the person with whom they are chatting. A variation of the chat room is the *netmeeting*, in which the individuals may have audio or video capabilities to talk or see the other. Further, specific web sites have been established to facilitate requests for legal advice, such as *FreeAdvice* (www.freeadvice.com) and *LawGuru*.(www.lawguru.com), which encourage laypeople to post legal questions, identifying their state of residence, and suggest that lawyers who are licensed to practice in those states post responses. Another way for laypeople to seek legal advice online is to go to the web sites of individual attorneys or law firms and to send questions directly to the attorneys by e-mail. These sites differ from the preceding web sites in that neither the questions nor the answers are visible to the public. Some lawyers have begun charging a fee to answer such questions, such as www.legalquestions.com, which provides the following terms:

You, the Questioner/Client will ask a short legal question of 200 words or less and our firm will provide a written e-mail response for a fee of \$25 which will be billed to your credit card via our secure server. Each question will be responded to within a reasonable time and although both parties understand that an Attorney/Client relationship may be created hereby, it is understood and agreed to that such relationship will terminate upon the sending of our e-mail response to your e-mail address and no further legal services or advice will be required. It is

further agreed to by you that the submission of your question shall not place upon Attorneys the duty to protect any statute of limitations or any other rights on your behalf or cause Attorneys to have a duty to take any action in any court of law, unless we agree in writing

While the fee-based legal sites tend to acknowledge the possibility of an attorney client relationship, they often try to limit the scope of engagement with the use of disclaimers. A Villanova law professor has summarized the "parade of horrors" of online advice:

The specter of lawyers casually typing out off-the-cuff responses to questions posed by strangers and posting them online for all the world to see must be the stuff of a bar regulator's nightmares. Online advice-giving raises a host of ethical issues. Public exchanges of often-sensitive personal information and specific legal advice present questions of confidentiality. Lawyers answering legal questions about which they have little or no expertise may violate the duty of competency. The possibility that a lawyer might inadvertently create a conflict of interest by answering legal questions from someone with an interest adverse to a current or former client is particularly troubling in the sometimes-anonymous world of cyberspace. Lawyers answering questions about the law in jurisdictions in which they are not licensed to practice may violate restrictions against the unauthorized practice of law. Most notably, the likelihood that some disgruntled recipient of negligent online legal advice will sue for malpractice lurks over all.

Lanctot, Catherine J., *Attorney-Client Relationships in Cyberspace: The Peril and the Promise*, 49 Duke L.J. 147, 156 (1999) (www.law.duke.edu/shell/cite.pl?49+Duke+L.+J.+147).

Because giving legal advice on the Internet raises ethical questions that are likely to be confronted by every state bar disciplinary authority in the next several years, the issue warrants close examination now. The key seems to be that giving specific legal advice to online questioners ordinarily will create an attorney-client relationship.

The organized bar has attempted since the 1930s to regulate the giving of specific legal advice in a variety of other contexts, such as radio and television call-in shows, newspaper advice columns, books, seminars, and 900-number telephone lines. In each instance, the bar has attempted to distinguish between the transmission of general legal knowledge, which it has viewed as permissible, and the presentation of specific legal advice tailored to an individual's particular problem, which it has treated as impermissible. *Lanctot*, at 163.

According to the *Restatement (Third) of the Law Governing Lawyers*, approved by the American Law Institute in early 1998, Section 26 of the Restatement outlines the principles governing the formation of the attorney-client relationship as follows:

A relationship of client and lawyer arises when:

(1) a person manifests to a lawyer the person's intent that the lawyer provide legal services for the person; and either

(a) the lawyer manifests to the person consent to do so; or

(b) the lawyer fails to manifest lack of consent to do so, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services.

Thus, the Restatement contemplates that the attorney-client relationship arises either by consent of both parties, or under an estoppel theory, where the putative client reasonably has relied on the lawyer to perform legal services. There are at least three situations where the attorney-client relationship may be formed on the Internet:

1. The client manifests an intent to receive legal services.
2. The lawyer manifests consent to provide legal services
3. The lawyer fails to manifest lack of consent, and the lawyer knows or reasonably should know that the person reasonably relies on the lawyer to provide the services.

Again, the linchpin to the analysis is the point at which specific legal information is given to a specific person in response to a particular set of facts. There is no bright line test between general information and specific legal advice.

In *In re Raynard*, 171 B.R. 699 (Bankr. N.D.Ga.1994), an attorney-client relationship was found in a "free telephone consultation" where the attorney gave the caller advice on filing an answer in a collection matter. In *Togstad v. Velevy, Otto, Miller & Keefe*, 291 N.W. 2d 686 (Minn. 1990), the lawyer subjected himself to malpractice liability because he gave specific legal advice to someone who had requested it, even though he did not charge any fee.

4. Internet Referral Service

There is yet another emerging means by which means lawyers may receive business from the Internet. There are a number of websites that field questions from laypersons and attempt to match that question up with an attorney in a particular geographic area and area of practice. Some of these referral web sites charge a fee for services.

Under the facts of on Arizona case, a web site claiming to be a clearing-house service for clients with legal questions, offered lawyers to "deliver potential clients directly to you." There was a one-time fee to join and a fixed amount for each question from a potential client that is routed to that member. Alternatively, the lawyer could pay the service a percentatge of any fee unlimately received, somewhere in the range of one to five percent.

The Arizona Bar Association released an opinion 99-06 in June 1999 , which states that Arizona lawyers may not ethically participate in an Internet service that sends legal questions from individuals to attorneys based upon the subject matter of the question. (www.azbar.org/EthicsOpinions/Data/99-06.pdf). The opinion also notes that lawyers can not pay a fee for such referrals or give the service a portion of the legal fees earned from the referral. Another Illinois case found that for-fee telephone referrals was improper. Illinois State Bar Opinion No. 94-11 (Nov. 1994). A Nebraska Opinion #95-3 also found that lawyers may not participate in a "for-profit" Internet lawyer referral program.

APPENDIX

- Kentucky Bar Association Ethics Opinion: KBA E-403
- ABA Standing Committee On Ethics And Professional Responsibility:
Formal Opinion 99-413
- www.legalethics.com: Announcements & Ethics Opinions

KENTUCKY BAR ASSOCIATION ETHICS OPINION

KBA E-403 (July 1993) (<http://www.uky.edu/Law/kyethics/kba403.htm>)

Question 1: May a lawyer use electronic mail services including the Internet to communicate with clients without encryption?

Answer: Yes, unless unusual circumstances require enhanced security measures.

Question 2: Is the creation and use by a lawyer of an Internet "web site" containing information about the lawyer and the lawyer's services that may be accessed by Internet users, including prospective clients, a communication falling within KRPCs 7.09 [Prohibited Solicitation] or 7.30 [Direct Contact With Prospective Client]?

Answer: Qualified No. Unless the lawyer uses the Internet or other electronic mail service to direct messages to a specific recipient [in which case the rules governing solicitation would apply] only the general rules governing communications regarding a lawyer's services and advertising [KRPCs 7.10, 7.20, and the so-called advertising rules set forth at KRPCs 7.01-7.08] should apply to a lawyer's "web-site" on the Internet.

References: Illinois Op. 96- 10 (1997); Kurt Metzmeier & Shaun Esposito, How to Avoid Losing Your License on the Information Superhighway: Ethical Issues Raised by the Use of the Internet in The Practice of Law (Kentucky Bench & Bar, Spring 1998).

OPINION

Despite widespread use of the Internet, the Committee has received few inquiries regarding its use. Still, the Committee is of the view that this opinion should be issued to provide some guidance and some comfort. The subject is addressed in a recent article cited in the references, which is available from the UK Law Library, and which has been submitted for publication in the Bench & Bar.

The Committee finds persuasive the comprehensive and thoughtful opinion of the Illinois State Bar Association, ISBA Advisory Opinion No. 96-10, excerpts of which we attach as an Appendix.

APPENDIX

ILLINOIS STATE BAR ASSOCIATION
ISBA Advisory Opinion on Professional Conduct
Opinion No. 96-10 (May 16, 1997)

Topic: Electronic communications; confidentiality of client information; advertising and solicitation.

Digest: Lawyers may use electronic mail services, including the Internet, without encryption to communicate with clients unless unusual circumstances require enhanced security measures. The creation and use by a lawyer of an Internet "web site" containing information about the lawyer and the lawyer's services that may be accessed by Internet users, including prospective clients, is not "communication directed to a specific recipient" within the meaning of the rules, and therefore only the general rules governing communications concerning a lawyer's services and advertising should apply to a lawyer "web site" on the Internet. If a lawyer uses the Internet or other electronic mail service to direct messages to specific recipients, then the rules regarding solicitation would apply.

Ref.: Illinois Rules of Professional Conduct, Rules 1.6, 7.1, 7.2, 7.3 and 7.4
ISBA Opinion Nos. 90-07 and 94-11
Electronic Communications Privacy Act, 18 USC §2510, et seq.

QUESTIONS

The Committee has received various inquiries regarding ethical issues raised by use of electronic means of communication, including electronic mail and the "Internet," by lawyers. These inquiries usually involve two general areas of concern. The first is whether electronic mail may be used to communicate with clients regarding client matters in view of a lawyer's duty under the ethics rules to maintain the confidentiality of client information. The second is whether the creation and use of a "web site" and other forms of contract with prospective clients may be conducted by lawyers on the Internet, and if so, whether the rules regarding "in person" solicitation should apply to such contact.

Because of the technical nature of the discussion, the Committee will use the following commonly accepted definitions in this opinion. The Internet is a super network of computers that links together individual computers and computer networks located at academic, commercial, government and military sites worldwide, generally by ordinary local telephone lines and long-distance transmission facilities. Communications between computers or individual networks on the Internet are achieved throughout the use of standard, nonproprietary protocols.

Electronic mail, commonly known as e-mail, is an electronic message that is sent from one computer to another, usually through a host computer on a network. E-mail messages can be sent through a private or local area network (within a single firm or organization), through an electronic mail service (such as America Online, CompuServ or MCI Mail), over the Internet, or through any combination of these methods.

A bulletin board service (sometimes called a "BBS") is an electronic bulletin board on a network where electronic messages may be posted and browsed by users or delivered to e-mail boxes. A "newsgroup" is a type of bulletin board service in which users can exchange information on a particular subject. A "chat" group is a simultaneous or "real time" bulletin board or newsgroup among users who send their questions or comments over the Internet.

The World Wide Web is that part of the Internet consisting of computer files written in a particular format (the "HTML" format) that includes "hyperlinks" (text or symbols that the user may click on to switch immediately to the item identified) as well as graphics and sound, to enable the creation of complex messages. A "home page" is a computer file containing text and graphics in the HTML format usually containing information about its owner, which can be obtained over the Internet and viewed by transmitting it from the owner's computer to the user's terminal. A "web site" is a set of computer files containing text and graphics in the HTML format and organized around a central home page.

The Electronic Communications Privacy Act, 18 USC §2510, et seq. (the "ECPA"), is the federal codification of the intrusion arm of the common law tort of invasion of privacy applied to electronic communication and provides criminal and civil penalties for its violation. The ECPA is actually the 1986 revision of the federal wiretap statute originally enacted in 1968, but the term ECPA is now commonly used to refer to the entire statute, as amended.

OPINION

The first issue, whether a lawyer may use electronic mail services including the Internet to communicate with clients, arises out of a lawyer's duty to protect confidential client information. Rule 1.6(a) of the Illinois Rules of Professional Conduct provides that "...a lawyer shall not, during or after termination of the professional relationship with the client, use or reveal a confidence or secret of the client known to the lawyer unless the client consents after disclosure." AS the Terminology provisions of the Rules state, the information a lawyer must protect includes information covered by the lawyer-client privilege (a "confidence") as well as information that the client wishes to be held inviolate or the revelation of which would be embarrassing or detrimental to the client (a "secret").

The duty to maintain the confidentiality of client information implies the duty to use methods of communication with clients that provide reasonable assurance that messages will be and remain confidential. For that reason, the Committee concluded in Opinion No. 90-07 (November 1990) that a lawyer should not use cordless or other mobile telephones that were easily susceptible to interception when discussing confidential client matters. The Committee also opined that a lawyer conversing with a client over a cordless or mobile telephone should advise the client of the risk of the loss of confidentiality.

With the increased use of electronic mail, particularly electronic mail transmitted over the Internet, have come

suggestions that electronic messages are not sufficiently secure to be used by lawyers communicating with clients. At least two state ethics opinions have concluded that because it is possible for Internet or other electronic mail service providers to intercept electronic mail messages, lawyers should not use electronic mail for "sensitive" client communications unless the messages were encrypted or the client expressly consented to "non-secure" communication. South Carolina Bar Advisory Opinion 94-27 (January 1995); Iowa Supreme Court Board of Professional Ethics and Conduct Opinion 96-1 (August 29, 1996). After reviewing much of the available literature on this issue, the Committee disagrees with these opinions.

Among the numerous recent articles regarding a lawyer's use of electronic mail, the Committee found three to be particularly useful and informative. These are: Joan C. Rogers, "Malpractice Concerns Cloud E-Mail, On-Line Advice," ABA/BNA Lawyers' Manual on Professional Conduct (March 6, 1996); Peter R. Jarvis & Bradley F. Tellam, "High-Tech Ethics and Malpractice Issues," 1996 Symposium Issue of the Professional Lawyer, p. 51 (1996); David Hricik, "Confidentiality and Privilege in High-Tech Communications," 8 Professional Lawyer, p. 1 (February 1997). From these and other authorities, there is a clear consensus on two critical points. First, although interception of electronic messages is possible, it is certainly no less difficult than intercepting an ordinary telephone call. Second, intercepting an electronic mail message is illegal under the ECPA.

Courts and ethics committees have uniformly held that persons using ordinary telephones for confidential communications have a reasonable expectation of privacy. The three common types of electronic mail messages appear no less secure. For example, electronic messages that are carried on a local area or private network may only be accessed from within the organization owning the network. Such messages would therefore clearly appear subject to a reasonable expectation of privacy.

Other electronic messages are carried by commercial electronic mail services or networks such as America Online, CompuServ or MCI Mail. Typically, these services transmit e-mail messages from one subscriber's computer to another computer "mailbox" over a proprietary telephone network. Typically, the computer mailboxes involved are password-protected. Because it is possible for dishonest or careless personnel of the mail service provider to intercept or misdirect a message, this form of electronic mail is arguably less secure than messages sent over a private network. AS a practical matter, however, any ordinary telephone call may also be intercepted or misdirected by dishonest or careless employees of the telephone service provider. Again, this possibility has not compromised the reasonable expectation of privacy of ordinary telephone users. The result should be the same for electronic mail service subscribers.

The third type of electronic mail, that carried on the Internet, typically travels in another fashion. Rather than moving directly from the sender's host computer to the recipient's host computer, Internet messages are usually broken into separate "packets" of data that are transmitted individually and then re-assembled into a complete message at the recipient's host computer. Along the way, the packets travel through, and may be stored temporarily in, one or more other computers (called "routers") operated by third parties (usually called an "internet service provider" or "ISP") that help distribute electronic mail over the Internet.

Unlike a cordless cellular telephone message, for example, an Internet e-mail is not broadcast over the open air waves, but through ordinary telephone lines and the intermediate computers. When an Internet message is transmitted over an ordinary telephone line, it is subject to the same protections and difficulties of interception as an ordinary telephone call. To intercept an Internet communication while it is in transit over telephone lines requires an illegal wiretap.

Consequently, the real distinction between an Internet electronic message and an ordinary telephone call is that Internet messages may be temporarily stored in, and so can be accessed through, a router maintained by an ISP. It is possible that an employee of an ISP (as part of the maintenance of the router) could lawfully monitor the router and thereby read part or all of a confidential message. As in the case of telephone and proprietary electronic mail providers, it is also possible for dishonest employees of an ISP to intercept messages unlawfully. The Committee does not believe that the opportunity for illegal interception by personnel of an ISP makes it unreasonable to expect privacy of the message.

As noted above, it is also clear that unauthorized interception of an Internet message is a violation of the ECPA, which was amended in 1986 to extend the criminal wiretapping laws to cover Internet transmissions. As part of the 1986 amendments, Congress also treated the issue of privilege in 18 USCA §2517(4), as follows:

No otherwise privileged wire, oral, or electronic communication intercepted in accordance with, or in violation of, the provisions of this chapter shall lose its privileged character.

This provision demonstrates that Congress intended that Internet messages should be considered privileged communications just as ordinary telephone calls.

In summary, the Committee concludes that because (1) the expectation of privacy for electronic mail is no less reasonable than the expectation of privacy for ordinary telephone calls, and (2) the unauthorized interception of an electronic message subject to the ECPA is illegal, a lawyer does not violate Rule 1.6 by communicating with a client using electronic mail services, including the Internet, without encryption. Nor is it necessary, as some commentators have suggested, to seek specific client consent to the use of unencrypted e-mail. The Committee recognizes that there may be unusual circumstances involving an extraordinarily sensitive matter that might require enhanced security measures like encryption. These situations would, however, be of the nature that ordinary telephones and other normal means of communication would also be deemed inadequate.

With respect to the second general issue, the extent to which a lawyer may use Internet web site to communicate with clients and prospective clients, the Committee believes that the existing Rules of Professional Conduct governing advertising, solicitation and communication concerning a lawyer's services provide adequate and appropriate guidance to a lawyer using the Internet. For example, the Committee views an Internet home page as the electronic equivalent of a telephone directory "yellow pages" entry and other material included in the web site to be the functional equivalent of the firm brochures and similar materials that lawyers commonly prepare for clients and prospective clients. An Internet user who has gained access to a lawyer's home page, like a yellow pages user, has chosen to view the lawyer's message from all the messages available in that medium. Under these circumstances, such materials are not a "communication directed to a specific recipient" that would implicate Rule 7.3 and its provisions governing direct contact with prospective clients. Thus, with respect to a web site, Rule 7.1, prohibiting false or misleading statements concerning a lawyer's services, and Rule 7.2, regulating advertising in the public media, are sufficient to guide lawyers and to protect the public.

On the other hand, lawyer participation in an electronic bulletin board, chat group, or similar service, may implicate Rule 7.3, which governs solicitation, the direct contact with prospective clients. The Committee does not believe that merely posting general comments on a bulletin board or chat group should be considered solicitation. However, if a lawyer seeks to initiate an unrequested contact with a specific person or group as a result of participation in a bulletin board or chat group, then the lawyer would be subject to the requirements of Rule 7.3. For example, if the lawyer sends unrequested electronic messages (including messages in response to inquiries posted in chat groups) to a targeted person or group, the messages should be plainly identified as advertising material.

Finally, lawyers participating in chat groups or other on-line services that could involve offering personalized legal advice to anyone who happens to be connected to the service should be mindful that the recipients of such advice are the lawyer's clients, with the benefits and burdens of that relationship. In Opinion No. 94-11 (November 1994), the Committee addressed an analogous situation arising out of a "call-in" legal advice service as follows:

The committee believes that callers to the legal advice service are clients of the law firm who are entitled to the protection of clients afforded by the Rules of Professional Conduct. However, it does not appear that either the law firm or the cellular telephone service makes any effort to determine the identity of the callers and check for potential conflicts of interest prior to the time that the callers' questions are asked and the legal advice is given. (Presumably the callers' identities are revealed after the advice is rendered through the billing process. If the cellular telephone company handles the billing for the law firm, this procedure may also violate client confidences. See ISBA Opinion No. 93-04) Under these circumstances, it would be possible for the law firm to give legal advice to callers whose interest are directly adverse to other firm clients, including other callers, in violation of Rule 1.7(a), or whose interests are materially adverse to the firm's former clients, including other callers, concerning the same or a substantially related matter, in violation of Rule 1.9

For these reasons, the Committee believes that Illinois lawyers may appropriately make use of the Internet in serving and communicating with clients and prospective clients subject to the existing rules governing confidentiality, advertising and solicitation. * * * * *

**AMERICAN BAR ASSOCIATION
STANDING COMMITTEE ON ETHICS AND PROFESSIONAL
RESPONSIBILITY**

Formal Opinion No. 99-413
March 10, 1999
Protecting the Confidentiality of Unencrypted E-Mail
<http://www.abanet.org/cpr/fo99-413.html>

A lawyer may transmit information relating to the representation of a client by unencrypted e-mail sent over the Internet without violating the Model Rules of Professional Conduct (1998) because the mode of transmission affords a reasonable expectation of privacy from a technological and legal standpoint. The same privacy accorded U.S. and commercial mail, land-line telephonic transmissions, and facsimiles applies to Internet e-mail. A lawyer should consult with the client and follow her instructions, however, as to the mode of transmitting highly sensitive information relating to the client's representation.

The Committee addresses in this opinion the obligations of lawyers under the Model Rules of Professional Conduct (1998) when using unencrypted electronic mail to communicate with clients or others about client matters. The Committee (1) analyzes the general standards that lawyers must follow under the Model Rules in protecting "confidential client information"1 from inadvertent disclosure; (2) compares the risk of interception of unencrypted e-mail with the risk of interception of other forms of communication; and (3) reviews the various forms of e-mail transmission, the associated risks of unauthorized disclosure, and the laws affecting unauthorized interception and disclosure of electronic communications.

The Committee believes that e-mail communications, including those sent unencrypted over the Internet, pose no greater risk of interception or disclosure than other modes of communication commonly relied upon as having a reasonable expectation of privacy. The level of legal protection accorded e-mail transmissions, like that accorded other modes of electronic communication, also supports the reasonableness of an expectation of privacy for unencrypted e-mail transmissions. The risk of unauthorized interception and disclosure exists in every medium of communication, including e-mail. It is not, however, reasonable to require that a mode of communicating information must be avoided simply because interception is technologically possible, especially when unauthorized interception or dissemination of the information is a violation of law.2

The Committee concludes, based upon current technology and law as we are informed of it, that a lawyer sending confidential client information by unencrypted e-mail does not violate Model Rule 1.6(a) in choosing that mode to communicate. This is principally because there is a reasonable expectation of privacy in its use.

The conclusions reached in this opinion do not, however, diminish a lawyer's obligation to consider with her client the sensitivity of the communication, the costs of its disclosure, and the relative security of the contemplated medium of communication. Particularly strong protective measures are warranted to guard against the disclosure of highly sensitive matters. Those measures might include the avoidance of e-mail,3 just as they would warrant the avoidance of the telephone, fax, and mail. See Model Rule 1.1 and 1.4(b). The lawyer must, of course, abide by the client's wishes regarding the means of transmitting client information. See Model Rule 1.2(a).

A. Lawyers' Duties Under Model Rule 1.6

The prohibition in Model Rule 1.6(a) against revealing confidential client information absent client consent after consultation imposes a duty on a lawyer to take reasonable steps in the circumstances to protect such information against unauthorized use or disclosure.4 Reasonable steps include choosing a means of communication in which the lawyer has a reasonable expectation of privacy.5 In order to comply with the duty of confidentiality under Model

Rule 1.6, a lawyer's expectation of privacy in a communication medium need not be absolute; it must merely be reasonable.

It uniformly is accepted that a lawyer's reliance on land-line telephone, fax machine, and mail to communicate with clients does not violate the duty of confidentiality because in the use of each medium, the lawyer is presumed to have a reasonable expectation of privacy.⁶ The Committee now considers whether a lawyer's expectation of privacy is any less reasonable when she communicates by e-mail.

B. Communications Alternatives To E-Mail

In order to understand what level of risk may exist without destroying the reasonable expectation of privacy, this Section evaluates the risks inherent in the use of alternative means of communication in which lawyers nonetheless are presumed to have such an expectation. These include ordinary U.S. mail; land-line, cordless, and cellular telephones; and facsimile transmissions.

1. U.S. and Commercial Mail

It uniformly is agreed that lawyers have a reasonable expectation of privacy in communications made by mail (both U.S. Postal Service and commercial). This is despite risks that letters may be lost, stolen or misplaced at several points between sender and recipient. Further, like telephone companies, Internet service providers (ISPs), and on-line service providers (OSPs), mail services often reserve the right to inspect the contents of any letters or packages handled by the service. Like e-mail, U.S. and commercial mail can be intercepted and disseminated illegally. But, unlike unencrypted e-mail, letters are sealed and therefore arguably more secure than e-mail.⁷

2. Land-Line Telephones

It is undisputed that a lawyer has a reasonable expectation of privacy in the use of a telephone.⁸ For this reason, the protection against unreasonable search and seizure guaranteed by the Fourth Amendment applies to telephone conversations.⁹ It also is recognized widely that the attorney-client privilege applies to conversations over the telephone as long as the other elements of the privilege are present.¹⁰ However, this expectation of privacy in communications by telephone must be considered in light of the substantial risk of interception and disclosure inherent in its use. Tapping a telephone line does not require great technical sophistication or equipment, nor is the know-how difficult to obtain.¹¹

Multiple extensions provide opportunities for eavesdropping without the knowledge of the speakers. Technical errors by the phone company may result in third parties listening to private conversations. Lastly, phone companies are permitted by law to monitor phone calls under limited conditions.

Despite this lack of absolute security in the medium, using a telephone is considered to be consistent with the duty to take reasonable precautions to maintain confidentiality.¹²

3. Cordless and Cellular Phones

Authority is divided as to whether users have a reasonable expectation of privacy in conversations made over cordless and cellular phones.¹³ Some court decisions reached the conclusion that there is no reasonable expectation of privacy in cordless phones in part because of the absence, at the time, of federal law equivalent to that which protects traditional telephone communications.¹⁴ After the 1994 amendment to the Wiretap Statute, which extended the same legal protections afforded regular telephone communications to cordless phone conversations,¹⁵ at least

one ethics opinion addressed the advisability of using cordless phones to communicate with clients and concluded that their use does not violate the duty of confidentiality.¹⁶

The nature of cordless and cellular phone technology exposes it to certain risks that are absent from e-mail communication. E-mail messages are not "broadcast" over public airwaves.¹⁷ Cordless phones, by contrast, rely on FM and AM radio waves to broadcast signals to the phone's base unit, which feeds the signals into land-based phone lines. Therefore, in addition to the risks inherent in the use of a regular telephone, cordless phones also are subject to risks of interception due to their broadcast on radio signals that may be picked up by mass-marketed devices such as radios, baby monitors, and other cordless phones within range.¹⁸ Further, the intercepted signals of cordless and analog cellular telephones are in an instantly comprehensible form (oral speech), unlike the digital format of e-mail communications.

Similarly, cellular phones transmit radio signals to a local base station that feeds the signals into land-based phone lines. The broadcast area from the phone to the station is larger than that of a cordless phone, and receivers and scanners within range may intercept and overhear the conversation. Although the Committee does not here express an opinion regarding the use of cellular or cordless telephone, it notes that the concerns about the expectation of privacy in the use of cordless and cellular telephones do not apply to e-mail transmitted over land-based phone lines.¹⁹

4. Facsimile

Authority specifically stating that the use of fax machines is consistent with the duty of confidentiality is absent, perhaps because, according to some commentators, courts assume the conclusion to be self-evident.²⁰ Nonetheless, there are significant risks of interception and disclosure in the use of fax machines. Misdirection may result merely by entering one of ten digits incorrectly. Further, unlike e-mail, faxes often are in the hands of one or more intermediaries before reaching their intended recipient, including, for example, secretaries, runners, and mailroom employees. In light of these risks, prudent lawyers faxing highly sensitive information should take heightened measures to preserve the communication's confidentiality.

C. Characteristics Of E-Mail Systems

The reasonableness of a lawyer's use of any medium to communicate with or about clients depends both on the objective level of security it affords and the existence of laws intended to protect the privacy of the information communicated. We here examine the four most common types of e-mail and compare the risks inherent in their use with those of alternative means of communication, including the telephone (regular, cordless and cellular), fax, and mail.

Like many earlier technologies, "e-mail" has become a generic term that presently encompasses a variety of systems allowing communication among computer users. Because the security of these e-mail systems is not uniform, the Committee here evaluates separately the degree of privacy afforded by each. As set forth below, we conclude that a lawyer has a reasonable expectation of privacy in such use.

1. "Direct" E-Mail²¹

Lawyers may e-mail their clients directly (and vice versa) by programming their computer's modem to dial their client's. The modem simply converts the content of the e-mail into digital information that is carried on land-based phone lines to the recipient's modem, where it is reassembled back into the message. This is virtually indistinguishable from the process of sending a fax: a fax machine dials the number of the recipient fax machine and digitally transmits information to it through land-based phone lines. Because the information travels in digital form,

tapping a telephone line to intercept an e-mail message would require more effort and technical sophistication than would eavesdropping on a telephone conversation by telephone tap.

Based on the difficulty of intercepting direct e-mail, several state bar ethics opinions and many commentators recognize a reasonable expectation of privacy in this form of e-mail.²² Further, in two recent federal court decisions, the attorney-client and work-product privileges were considered applicable to e-mail communications.²³ The Committee agrees that there is a reasonable expectation of privacy in this mode of communication.

2. "Private System" E-Mail

A "private system" includes typical internal corporate e-mail systems and so-called "extranet" networks in which one internal system directly dials another private system. The only relevant distinction between "private system" and "direct" e-mail is the greater risk of misdirected e-mails in a private system. Messages mistakenly may be sent throughout a law firm or to unintended recipients within the client's organization. However, all members of a firm owe a duty of confidentiality to each of the firm's clients.²⁴ Further, unintended disclosures to individuals within a client's private e-mail network are unlikely to be harmful to the client.

The reliance of "private system" e-mail on land-based phone lines and its non-use of any publicly accessible network renders this system as secure as direct e-mail, regular phone calls, and faxes. As a result, there is a widespread consensus that confidentiality is not threatened by its use,²⁵ and the Committee concurs.

3. On-line Service Providers

E-mail also may be provided by third-party on-line service providers or "OSPs."²⁶ Users typically are provided a password-protected mailbox from which they may send and retrieve e-mail.

There are two features of this system that distinguish it from direct and private-system e-mail. First, user mailboxes, although private, exist in a public forum consisting of other fee-paying users. The added risk caused by the existence of other public users on the same network is that misdirected e-mails may be sent to unknown users. Unlike users of private system e-mail networks who, as agents of their employers, owe a duty of confidentiality to them and, in the case of a law firm, to all firm clients, the inadvertent user owes no similar duties.²⁷ The risk of misdirection is, however, no different from that which exists when sending a fax. Further, the misdirection of an e-mail to another OSP can be avoided with reasonable care.²⁸

The second distinctive feature of e-mail administered by an OSP is that the relative security and confidentiality of user e-mail largely depends on the adequacy of the particular OSP's security measures meant to limit external access and its formal policy regarding the confidentiality of user e-mail. Together, they will determine whether a user has a reasonable expectation of privacy in this type of e-mail.

The denial of external access ordinarily is ensured by the use of password-protected mailboxes or encryption²⁹. The threat to confidentiality caused by the potential inspection of users' e-mail by OSP system administrators who must access the e-mail for administrative and compliance purposes is overcome by the adoption of a formal policy that narrowly restricts the bases on which system administrators³⁰ and OSP agents^{31 32} are permitted to examine user e-mail.

Moreover, federal law imposes limits on the ability of OSP administrators to inspect user e-mail, irrespective of the OSP's formal policy. Inspection is limited by the ECPA to purposes "necessary to the rendition of services" or to the protection of "rights or property."³³ Further, even if an OSP administrator lawfully inspects user e-mail within the narrow limits defined by the ECPA, the disclosure of those communications for purposes other than those provided by the statute is prohibited.³⁴

Accordingly, the Committee concludes that lawyers have a reasonable expectation of privacy when communicating by e-mail maintained by an OSP, a conclusion that also has been reached by at least one case as well as state bar ethics committees and commentators.35

4. Internet E-Mail

E-mail may be sent over the Internet between service users without interposition of OSPs. Internet e-mail typically uses land-based phone lines and a number of intermediate computers randomly selected to travel from sender to recipient. The intermediate computers consist of various Internet service providers or "routers" that maintain software designed to help the message reach its final destination.

Because Internet e-mail typically travels through land-based phone lines, the only points of unique vulnerability consist of the third party-owned Internet services providers or "ISPs," each capable of copying messages passing through its network. Confidentiality may be compromised by (1) the ISP's legal, though qualified, right to monitor e-mail passing through or temporarily stored in its network, and (2) the illegal interception of e-mail by ISPs or "hackers."36

The ISPs' qualified inspection rights are identical to those of OSPs.37 The same limits described above therefore apply to ISPs. In addition, the provider of an electronic communications service may by law conduct random monitoring only for mechanical or service quality control checks.38

The second threat to confidentiality is the illegal interception of e-mail, either by ISPs exceeding their qualified monitoring rights or making unauthorized disclosures, or by third party hackers who use ISPs as a means of intercepting e-mail. Although it is difficult to quantify precisely the frequency of either practice, the interception or disclosure of e-mail in transit or in storage (whether passing through an ISP or in any other medium) is a crime and also may result in civil liability.39

In addition to criminalization, practical constraints on the ability of third parties and ISPs to capture and read Internet e-mail lead to the conclusion that the user of Internet e-mail has a reasonable expectation of privacy. An enormous volume of data travelling at an extremely high rate passes through ISPs every hour. Further, during the passage of Internet e-mail between sender and recipient, the message ordinarily is split into fragments or "packets" of information. Therefore, only parts of individual messages customarily pass through ISPs, limiting the extent of any potential disclosure. Because the specific route taken by each e-mail message through the labyrinth of phone lines and ISPs is random, it would be very difficult consistently to intercept more than a segment of a message by the same author.

Together, these characteristics of Internet e-mail further support the Committee's conclusion that an expectation of privacy in this medium of communication is reasonable. The fact that ISP administrators or hackers are capable of intercepting Internet e-mail - albeit with great difficulty and in violation of federal law - should not render the expectation of privacy in this medium any the less reasonable, just as the risk of illegal telephone taps does not erode the reasonable expectation of privacy in a telephone call.40

CONCLUSION

Lawyers have a reasonable expectation of privacy in communications made by all forms of e-mail, including unencrypted e-mail sent on the Internet, despite some risk of interception and disclosure. It therefore follows that its use is consistent with the duty under Rule 1.6 to use reasonable means to maintain the confidentiality of information relating to a client's representation.

Although earlier state bar ethics opinions on the use of Internet e-mail tended to find a violation of the state analogues of Rule 1.6 because of the susceptibility to interception by unauthorized persons and, therefore, required express client consent to the use of e-mail, more recent opinions reflecting lawyers' greater understanding of the technology involved approve the use of unencrypted Internet e-mail without express client consent.

Even so, when the lawyer reasonably believes that confidential client information being transmitted is so highly sensitive that extraordinary measures to protect the transmission are warranted, the lawyer should consult the client as to whether another mode of transmission, such as special messenger delivery, is warranted. The lawyer then must follow the client's instructions as to the mode of transmission. See Model Rule 1.2(a).

ENDNOTES

1 As used in this opinion, "confidential client information" denotes "information relating to the representation of a client" under Model Rule 1.6(a), which states:

(a) a lawyer shall not reveal information relating to representation of a client unless a client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation.

2 The Electronic Communications Privacy Act of 1986, Pub. L. No. 99-508, 100 Stat. 1848 (1986), amended the Federal Wiretap Statute of 1968 by extending its scope to include "electronic communications." 18 U.S.C.A. (2510, et seq. (1998) (the "ECPA"). The ECPA now commonly refers to the amended statute in its entirety. The ECPA provides criminal and civil penalties for the unauthorized interception or disclosure of any wire, oral, or electronic communication. 18 U.S.C.A. (2511.

3 Options other than abandoning e-mail include using encryption or seeking client consent after apprising the client of the risks and consequences of disclosure.

4 See also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (112 cmt. d (Proposed Official Draft 1998), which provides that confidential client information must be "acquired, stored, retrieved, and transmitted under systems and controls that are reasonably designed and managed to maintain confidentiality."

5 Whether a lawyer or a client has a reasonable expectation of privacy also governs whether a communication is "in confidence" for purposes of the attorney-client privilege. As a result, analysis under the attorney-client privilege is often relevant to this opinion's discussion of e-mail and the duty of confidentiality. The relevance of privilege is not exhaustive, however, because of its more restrictive application in prohibiting the introduction of privileged communications between a lawyer and client in any official proceeding. In contrast to the requirement imposed by the duty of confidentiality to avoid disclosing any information "relating to the representation" of the client, see Model Rule 1.6(a), supra n.1, the attorney-client privilege applies only to actual "communications" made "in confidence" by the client to the lawyer. See JOHN H. WIGMORE, 8 EVIDENCE § 2295 (McNaughton rev. 1961).

6 See infra Section B. It should be noted that a lawyer's negligent use of any medium - including the telephone, mail and fax - may breach the duty of confidentiality. The relevant issue here, however, is whether, despite otherwise reasonable efforts to ensure confidentiality, breach occurs solely by virtue of the lawyer's use of e-mail.

7 A.C.L.U. v. Reno, 929 F. Supp. 824, 834 (E.D. Pa. 1996), aff'd 521 U.S. 844 (1997) ("Unlike postal mail, simple e-mail is not 'sealed' or secure, and can be accessed or viewed on intermediate computers between the sender and recipient (unless the message is encrypted).").

8 Frequently, what we understand to be regular or land-line telephone conversations are transmitted in part by microwave. For example, many corporate telephone networks are hard-wired within a building and transmitted by microwave among buildings within a corporate campus to a central switch connected by land-line or microwave to a local or interstate carrier.

9 It should be noted that the ECPA preserves the privileged character of any unlawfully intercepted "wire, oral, or electronic communication." 18 U.S.C.A. (2517(4)). The inclusion of e-mail in this provision is important for two reasons. First, implicit in this provision is the assumption that electronic communications are capable of transmitting privileged material. To argue that the use of e-mail never is "in confidence" or constitutes an automatic waiver of otherwise privileged communications therefore appears to be inconsistent with an assumption of this provision of federal law. Second, the identical federal treatment of e-mail with other means of communication long assumed consistent with the maintenance of privilege likewise is inconsistent with the assertion that the use of e-mail poses unique threats to privileged communications.

10 See Peter R. Jarvis & Bradley F. Tellam, High-Tech Ethics and Malpractice Issues 7 (1996) (paper delivered at the 22nd National Conference on Professional Responsibility, May 30, 1996, in Chicago, Illinois) (on file with its author), reported in 1996 SYMPOSIUM ISSUE OF THE PROFESSIONAL LAWYER, 51, 55 (1996) (hereafter "Jarvis & Bradley"); David Hricik, E-mail and Client Confidentiality: Lawyers Worry Too Much about Transmitting Client Confidences by Internet E-mail, 11 GEO. J. LEGAL ETHICS 459, 479 (1999) (hereafter "Hricik").

11 See Jarvis & Tellam supra n.10, at 57; Hricik supra n.10, at 480.

12 See Hricik supra n.10, at 481.

13 See, e.g., Jarvis & Tellam supra n.10, at 59-61; Hricik supra n.10, at 481-85. Compare Mass. Ethics Opinion 94-5 (1994) (if risk of disclosure to third party is "nontrivial," lawyer should not use cellular phone); N.C. Ethics Op. 215 (1995) (advising lawyers to use the mode of communication that best will maintain confidential information); State Bar of Arizona Advisory Op. 95-11 (1995) (lawyers should exercise caution before using cellular phones to communicate client confidences) with United States v. Smith, 978 F.2d 171, 180 (5th Cir. 1992) (finding that there may be reasonable expectation of privacy in cordless phone communications for Fourth Amendment purposes).

14 McKarney v. Roach, 55 F.3d 1236, 1238-9 (6th Cir. 1995), cert. denied, 576 U.S. 944 (1995); Askin v. United States, 47 F.3d 100, 103-04 (4th Cir. 1995).

15 By 1986, the protection under federal law for cellular phone communications was equal to traditional land-line telephone communications. The Communications Assistance for Law Enforcement Act, Pub. L. No. 103-414, 202(a), 108 Stat. 4279 (1994), deleted previous exceptions under the Federal Wiretap Act that limited the legal protections afforded cordless phone communications under 18 U.S.C.A. ((2510(1), 2510(12) (A). Existing law criminalizes the intentional and unauthorized interception of both cordless and cellular phone communications, 18 U.S.C.A. (2511; the privileged status of the communication preserves in the event of intentional interception, 18 U.S.C.A. (2517(4); and bars the introduction of the unlawful interception as evidence at trial even if it is not privileged, 18 U.S.C.A. (2515.

16 State Bar of Arizona Advisory Op. 95-11 (1995). Some commentators have argued that in light of the 1994 amendment and the recent improvements in the security of both media (including the introduction of digital cellular phones), the expectation of privacy in communications by cordless and cellular telephones should not be considered unreasonable. Jarvis & Tellam supra n.10, at 60-61. See also Hricik supra n.10, at 483, 485 (arguing that despite the fact that their privileged status would not be lost if cellular and cordless phone conversations were intercepted, lawyers should consider whether the cost of potential disclosure is outweighed by the benefit derived from the use of cordless or cell phones). Further, 18 U.S.C.A. (2512 prohibits the manufacture and possession of scanners capable of receiving cellular frequencies, and cordless and cellular phone communications have been afforded greater legal protection under several recent state court decisions. See, e.g., State v. Faford, 128 Wash.2d 476, 485-86, 910 P.2d 447, 451-52 (1996) (reversing trial court's admission of defendants' cordless phone conversations violated state privacy act because defendants had reasonable expectation of privacy in such communication); State v. McVeigh, 224 Conn. 593, 622, 620 A.2d 133, 147 (1995) (reversing trial court's admission of defendants' cordless telephone conversations because such communications were within scope of state law forbidding the intentional interception of wire communications).

17 Hricik supra n.10, at 497.

18 See *United States v. Maxwell* 42 M.J. 568, 576, 43 Fed. R. Evid. Serv. (Callaghan) 24 (A. F. Ct. Crim. App. 1995) (holding that user of e-mail maintained by OSP was protected against warrantless search of e-mails because user had reasonable expectation of privacy in such communications, unlike cordless phone communication) *aff'd in part and rev'd in part*, 45 M.J. 406 (U.S. Armed Forces 1996) (expectation of privacy exists in e-mail transmissions made through OSP).

19 The risks of interception and disclosure may be lessened by the recent introduction of digital cellular phones, whose transmissions are considered more difficult to intercept than their analog counterparts. New communications technology, however, does not always advance privacy concerns. The use of airplane telephones, for example, exposes users to the interception risks of cellular telephones as well as a heightened risk of disclosure due to eavesdropping on the airplane itself. Most recently, a world-wide, satellite-based cellular telephone system called Iridium has been introduced by Motorola. The principles articulated in this opinion should be considered by a lawyer when using such systems.

20 See, e.g., Practice Guide, Electronic Communications, in ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 55:403 (1996) ("[C]ourts seem to have taken it for granted that fax machines may be used [to transmit confidential information]," citing *State ex rel. U.S. Fidelity and Guar. Co. v. Canady*, 144 W.Va. 431, 443-44, 460 S.E.2d 677, 689-90 (1995) (holding that faxed communication was protected by the attorney-client privilege)). See also *Jarvis & Tellam supra n.10*, at 61 ("[T]here seems to be no question that faxes are subject to the attorney-client privilege . . . no one asserts that the use of a fax machine or the possibility of misdirection destroys any hope of a claim of privilege," citing ABA Comm. on Ethics and Professional Responsibility, Formal Ops. 94-382 and 92-368).

21 The names for the varieties of e-mail described in this section of the opinion are based on those used by Hricik, *supra n.10*, at 485-92.

22 See, e.g., Alaska Bar Ass'n Op. 98-2 (1998); Ill. State Bar Ass'n Advisory Op. on Professional Conduct No. 96-10 (1997); S.C. Bar Ethics Advisory Comm. Op. No. 97-08 (1997); Vermont Advisory Ethics Op. No. 97-5 (1997). See also, *Jarvis & Tellam, supra n.10*, at 61; *Hricik supra n.10*, at 502-06.

23 In *re Grand Jury Proceedings*, 43 F.3d 966, 968 (5th Cir. 1994) (court considered e-mail messages along with other documents in work-product privilege analysis); *United States v. Keystone Sanitation Co. Inc.*, 903 F. Supp. 803, 808 (M.D. Pa. 1995) (defendants waived privileged nature of e-mail messages due to inadvertent production).

24 *Hricik supra n. 10*, at 487.

25 See e.g., Alaska Bar Ass'n Op. 98-2 (1998); Ill. State Bar Ass'n Advisory Op. on Professional Conduct No. 96-10 (1997); S.C. Bar Ethics Advisory Comm. Op. No. 97-08 (1997); Vermont Advisory Ethics Op. 97-5 (1997). See also, *Hricik supra n.10*, at 486-87.

26 Examples include America Online ("AOL"), CompuServe, and MCI Mail.

27 *Hricik supra n.10*, at 487-88.

28 If the inadvertent recipient is a lawyer, then the lawyer must refrain from examining the information any more than necessary to ascertain that it was not intended for her and must notify the sender, ABA Comm. on Ethics and Professional Responsibility, Formal Op. 92-368 (1992), an obligation that extends to information received by e-mail or fax, ABA Comm. on Ethics and Professional Responsibility, Formal Op. 94-382 (1994).

29 For a basic explanation of encryption technology, including the use of digital signatures, see Kenneth E. Johnson, *Dealing with Security, Encryption, and Ethics Concerns*, in THE LAWYER'S QUICK GUIDE TO E-MAIL 93-105 (ABA Law Practice Management Section 1998) ("Johnson").

30 For a discussion of some additional matters such formal policies might address (deletion and retention of e-mail messages, remote checking of messages while out of office, etc.), see Johnson, supra n. 29, at 104-05.

31 For example, the terms of AOL's policy forbid access to e-mail except (1) to comply with the law, (2) to protect its own rights, or (3) to act in the belief that someone's safety is at risk. Hricik supra n. 10, at 489.

32 18 U.S.C.A. (2511(2) (a) (i) (It is "not unlawful under this chapter for an operator of a switchboard, or an officer, employee, or agent of a provider of wire or electronic communication service, whose facilities are used in the transmission of a wire or electronic communication, to intercept, disclose, or use that communication in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service, except that a provider of wire communication service to the public shall not utilize service observing or random monitoring except for mechanical or service quality control checks"). The qualified right of interception of OSPs cannot be argued to create unique risks to the confidentiality of e-mail communications because phone companies (and other providers of wire or electronic communication services) are given identical rights under 18 U.S.C.A. (2511(2) (a) (i)). Moreover, many commercial mail services reserve the right to inspect all packages and letters handled, yet no one suggests this diminishes the user's expectation of privacy. See Hricik supra n.10, at 492. It also is noteworthy that in 1998, the New York Legislature amended the state's rules of evidence to provide that no otherwise privileged communication "shall lose its privileged character for the sole reason that it is communicated by electronic means or because persons necessary for the delivery or facilitation of such electronic communication may have access to the content of the communication." N.Y. Civ. Prac. L. & R. § 4547 (1998).

33 18 U.S.C.A. (2511(3) (a).

34 See e.g., supra n.18. See also Alaska Bar Ass'n Op. 98-2 (1998); D.C. Bar Op. 281 (1998); Ill. State Bar Ass'n Advisory Op. on Professional Conduct No. 96-10 (1997) (users of e-mail maintained by OSP have reasonable expectation of privacy despite greater risks than private network e-mail); S.C. Bar Ethics Advisory Comm. Op. No. 97-08 (1997); Vermont Advisory Ethics Op. 97-5 (1997); Jarvis & Tellam supra n.10, at 61; Hricik supra n.10, at 492.

35 Confidentiality also may be compromised by computer viruses, some of which have the capability of causing the user's document to be propagated to unintended recipients. However, a virus scanning program containing up-to-date definition files will detect and clean such viruses. See generally Carnegie Mellon Software Engineering Institute's CERT(r) Coordination Center Website, <http://www.cert.org/index.html>, for descriptions of these and other computer viruses.

36 See supra notes 30 & 31 and accompanying text.

37 18 U.S.C.A. (2511(2) (a) (i).

38 See 18 U.S.C.A. ((2511, 2701, 2702.

39 See Katz v. U.S., 389 U.S. 347, 352 (1967) (Fourth Amendment protection extended to conversation overheard by listening device attached to outside of public telephone booth).

40 See, e.g., Alaska Bar Ass'n Op. 98-2 (1998) (lawyers may communicate with clients via unencrypted e-mail; client consent is unnecessary because the expectation of privacy in e-mail is no less reasonable than that in the telephone or fax); D.C. Bar Op. 281 (1998) (lawyers' use of unencrypted e-mail is not a violation of duty to protect client confidences under District of Columbia Rule of Professional Conduct 1.6); Ky. Bar Ass'n Ethics Comm. Advisory Op. E-403 (1998) (absent "unusual circumstances" lawyers may use e-mail, including unencrypted Internet e-mail, to communicate with clients); New York State Bar Ass'n Comm. on Professional Ethics Op. 709 (1998) (lawyers may use unencrypted Internet e-mail to transmit confidential information without breaching the duty of confidentiality under state analogue to ABA Model Rule 1.6); Ill. State Bar Ass'n Advisory Op. on Professional Conduct No. 96-10 (1997) (lawyers may use unencrypted e-mail, including e-mail sent over the Internet, to communicate with clients without violating Rule 1.6 of the Illinois Rules of Professional Conduct; client

consent is not required absent "extraordinarily sensitive" matter; expectation of privacy in e-mail is no less reasonable than that in ordinary telephone calls); N.D. St. B. Ass'n Ethics Comm. Op. 97-09 (1997) (attorneys may communicate with clients using unencrypted e-mail unless unusual circumstances warrant heightened security measures); S.C. Bar Ethics Advisory Comm. Op. No. 97-08 (1997) (finding reasonable expectation of privacy when sending confidential information by e-mail, including that sent through a private network, commercial service, and the Internet; use of e-mail to communicate client confidences does not violate South Carolina Rule of Professional Conduct 1.6); Vermont Advisory Ethics Op. 97-5 (1997) (lawyers may use unencrypted Internet e-mail to transmit confidential information without breaching the duty of confidentiality under state analogue to ABA Model Rule 1.6). Two opinions similarly endorsed e-mail as a means of communicating client confidences, but advised lawyers to seek client consent or consider the use of encryption prior to its use, unlike the present opinion: Pa. Bar Ass'n Comm. on Legal Ethics Op. 97-130 (1997) (lawyers should not use unencrypted e-mail to communicate with or about a client absent client consent); State Bar of Arizona Advisory Op. 97-04 (1996) (lawyers should caution client or consider the use of encryption before transmitting sensitive information by e-mail). Two other opinions advised lawyers to avoid the use of e-mail to communicate with or about clients: Iowa Bar Ass'n Op. 1997-1 (1997) (sensitive material should not be transmitted by e-mail - whether through the Internet, a non-secure intranet, or other types of proprietary networks - without client consent, encryption, or equivalent security system); N.C. State Bar Opinion 215 (1995) (advising lawyers to use the mode of communication that will best maintain confidential information, and cautioning attorneys against the use of e-mail). Commentary supportive of the conclusions reached in this opinion, in addition to Hricik supra n.10 and Jarvis & Tellam supra n.10, include William Freivogel, Communicating With or About Clients on the Internet: Legal, Ethical, and Liability Concerns, ALAS LOSS PREVENTION JOURNAL 17 (1996) (concluding that it is not ethically or legally necessary to encrypt Internet e-mail but cautioning them in light of the absence of controlling legal authority). For a list of Web pages containing articles on e-mail and confidentiality, see Johnson, supra n. 29, at 103.

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First-time Visitors and users of version 2.0 (or lower) browsers: Read the [Introduction](#) and [Site Index](#).

Repeat Visitors: Read the [Site Index](#) -- we have re-located some resources.

Everyone: Read the [disclaimers](#) and [copyright notice](#).

AWARDS:

[A top research site](#) for legal professionals voted by Lawyer Computing Magazine, LegalOnline Best of Web for Lawyers 1997 + 1998, Featured Site of the Week at the Ethics Connection, Legalonline 5-Star Site, Features Site of MN Online, NOBC Pick of the Month.

Announcements:

o (2/24/00) Added [Minnesota Opinion #19](#) to the [opinions listing](#). The Minnesota opinion notes that a lawyer may use technological means such as unencrypted electronic mail (e-mail) and cordless and cellular telephones to communicate confidential client information without violating Rule 1.6 under specified conditions.

o (2/22/00) The Committee on Professional Ethics of the Massachusetts Bar issued an [opinion \(#00-01\)](#) in January 2000 on the use of unencrypted Internet e-mail. Like the ABA and other opinions on the issue, the opinion states that it is not an ethical violation to exchange unencrypted e-mail with a client.

o (1/19/00) Catherine Lanctot, professor of law at Villanova University Law School, recently published Attorney-Client Relationships in Cyberspace: The Peril and the Promise, 49 Duke L.J. 147 (1999), analyzing the nature and scope of online legal advice. It is [available online](#).

o (1/12/00) State Bar of California's Committee on Professional Responsibility and Conduct released proposed formal ethics opinion on attorney web sites (proposed formal opinion interim no. 96-0014). The comment period expires at 5 p.m., Wednesday, March 22, 2000. [Contact information](#) and the [text of the opinion](#) are available on the Bar's Web Site. Not surprisingly, the opinion states that Web Sites are "advertisements" within the meaning of the rules but are not automatically deemed "solicitations" by virtue of the inclusion of e-mail contact capabilities. The digest of the proposed formal opinion states that an attorney's internet web site, which contains information for the public regarding her availability for professional employment, is a "communication" under rule 1-400(A) of the California Rules of Professional Conduct and an "advertisement" under Business and Professions Code sections 6157-6158. As such, it is subject to the applicable prohibitions on false, misleading, and deceptive messages. All words sounds and images that make up the presentation on the web site must conform to the requirements of the rules. Under the facts presented, the web site is not a "solicitation" under rule 1-400(B) even if it includes e-mail facilities allowing direct communication to and from the attorney. The attorney also must be aware that her web site may be subject to regulation by other jurisdictions or that it might be considered the unauthorized practice of law in other jurisdictions.

o (11/8/99) We offer reprints of two recent presentations by Peter Krakaur at the Glasser LegalWorks seminars in New York and [Los Angeles](#): ["Secure Surfing -- How to Cover Your Digital Tracks"](#) and [DisplayText cannot span more than one line!](#)

o (9/8/99) Added links to the searchable [Missouri Informal Advisory Opinions](#).

o (8/24/99) Arizona released opinion [99-06 \[pdf\]](#) in June 1999, which states that Arizona lawyers may not ethically participate in an Internet service that sends legal questions from individuals to attorneys based upon the subject matter of the

question. The opinion also notes that lawyers can not pay a fee for such referrals or give the service a portion of the legal fees earned from the referral.

o (7/19/99) Tennessee released formal ethics opinion 99-F-144 on June 14, 1999, noting that lawyers listing areas of practice on the Internet, including listings on law directories, should comply with certification of specialization requirements under applicable state rule 2-101(C).

o (7/15/99) The Report of the Commission on Multidisciplinary Practice to the ABA House of Delegates is available on line at <http://www.abanet.org/cpr/mdpfinalreport.html>.

o (7/12/99) The North Carolina State Bar disciplined an attorney for posting "misleading" information on his law firm web site (Action #99 DHC-3). More details about the disciplinary action and censure decision are available in the article *Internet Advertising Now 'On the Radar Screen' of State Bars*, by Michael Bowden published in the *In Practice* Section of *Lawyers Weekly USA* on July 12, 1999 (1999 LWUSA 643-44).

o (6/15/99) The Ethics 2000 Commission is now circulating for public comment drafts of several of the Model Rules of Professional Conduct.

o (5/20/99) Missouri released opinion 990007 dealing with the scope of a client consent form relating to the use of e-mail between the lawyer and client. The opinion notes that it would be difficult to create a comprehensive form to cover all concerns raised by e-mail. Lawyers are encouraged to discuss with their clients the risks associated with e-mail communication and storage.

o (5/6/99) The ABA Standing Committee on Ethics and Professional Responsibility published the full text of ABA 99-413 which states that there is a reasonable expectation of privacy in e-mail. Although the opinion states that there is no automatic duty to encrypt Internet e-mail, lawyers should still consider the dangers associated with the transmission of client confidences via any medium and reach an understanding with their clients regarding appropriate means to transmit sensitive client information.

o (4/17/99) The ABA Standing Committee on Ethics and Professional Responsibility formal opinion was renamed to ABA Formal Opinion 99-413 (previously designated #1999-01).

o (4/15/99) The ABA Standing Committee on Ethics and Professional Responsibility approved formal opinion (#1999-01) addressing the need to protect the confidentiality of unencrypted e-mail (March 10, 1999). The essence of the opinion is that a lawyer may transmit information relating to the representation of a client by unencrypted e-mail sent over the Internet without violating the Model Rules of Professional Conduct. The rationale supporting this is that the mode of transmission affords a reasonable expectation of privacy from both a technological and legal standpoint. The opinion noted that the same privacy accorded U.S. and commercial mail, land-line telephonic transmissions and facsimiles also applies to Internet e-mail. In addition, like other ethics opinions issued on the subject to date, the opinion states that a lawyer should consult with the client and follow the client's instructions as to the mode of transmitting highly sensitive information relating to the client's representation.

o (3/10/99) The Association of the Bar of the City of New York Committee on

Professional and Judicial Ethics released opinion 1998-2 on December 21, 1998. The opinion deals with Web Site advertising, referral services, and encryption. For further information, check out the opinions listing.

o (3/9/99) LegalEthics.com voted as a top research site for legal professionals in 1999 by Law Office Computing Magazine. Check the April/May for the entire list of winners. We have picked up a number of awards over the years and thank everyone for the continued interest and support.

o (2/16/99) Arizona now offers ethics opinions on line.

o (2/1/99) South Dakota now offers ethics opinions on line. South Dakota also issued Opinion #98-10 (1/12/99) finding that a South Dakota lawyer may not participate in an Internet Referral Service taking an advertising fee and a share of legal fees to refer cases to a South Dakota lawyer but providing no legal services.

o (1/16/99) Added a reference in the opinions list to Connecticut Informal Opinion (#97 - 29) dealing with the applicability of advertising solicitation rules to Connecticut and out-of-state lawyer web sites.

o (1/15/99) Added a reference in the opinions list to Tennessee Advisory Opinion (#98-A-650(a)) dealing with the question of encryption and e-mail. This opinion amends opinion 98-A-750 to permit the use of e-mail via the Internet to transmit client confidences and secrets.

o (1/4/99) Added a link in the opinions list to DC Bar's Legal Ethics Committee Opinion (No. 281) entitled "Transmission of Confidential Information by Electronic Mail."

o (12/6/98) We publish an article **DisplayText cannot span more than one line!** by Drew L. Kershen, Earl Sneed Centennial Professor of Law, University of Oklahoma, analyzing the ethical issues that professional legal organizations, in contrast to individual lawyers or law firms, must consider when they create a website.

o (11/22/98) Added a copy of Pennsylvania Inquiry 98-85 which deals with jurisdictional issues associated with lawyer web site publishing.

o (11/01/98) The ABA Center for Professional Responsibility now offers headnote summaries of recent ABA ethics opinions.

o (10/23/98) Added New York 709 to the opinions list. Opinion 709 addressed the questions whether an attorney may operate and advertise a trademark practice over the Internet. The opinions addressed a number of ethical issues as noted in the summary in the opinions list. Following the vast majority of other opinions addressing the associated confidentiality issue, the NYSBA Committee on Professional Ethics stated, "In considering the ethical issue, we believe that the criminalization of unauthorized interception of e-mail certainly enhances the reasonableness of an expectation that e-mails will be as private as other forms of telecommunication. That prohibition, together with the developing experience from the increasingly widespread use of Internet e-mail, persuades us that concerns over lack of privacy in the use of Internet e-mail are not currently well

founded."

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Issues Index

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Ethics Opinions

Updated February 1, 1999

The following ethics opinions relate to Internet or electronic communications.

- I. ABA (#99-413 3/10/99): There is no automatic duty to encrypt Internet e-mail to protect client confidences and secrets. Although there is a "reasonable expectation of privacy" in Internet e-mail, lawyers should still consider the dangers associated with the transmission of client confidences via any medium and reach an understanding with their clients regarding appropriate means to transmit sensitive client information. The summary of the opinion states, "A lawyer may transmit information relating to the representation of a client by unencrypted e-mail sent over the Internet without violating the Model Rules of Professional Conduct [] because the mode of transmission affords a reasonable expectation of privacy from a technological and legal standpoint. The same privacy accorded U.S. and commercial mail, land-line telephonic transmissions, and facsimiles applies to Internet e-mail. A lawyer should consult with the client and follow her instructions, however, as to the mode of transmitting highly sensitive information relating to the client's representation."
- II. Alabama (#RO-96-07, 10/23/96): Information made available to the public, regardless of means used, must comply with Rules of Professional Conduct.
- III. Alaska Bar Association (98-2, 1/16/98), E-mail communications need not be automatically encrypted to protect client confidences; attorneys should discuss the issue with their clients.
- IV. Arizona (99-06, 6/99) [pdf]: Arizona lawyers may not ethically participate in an Internet service that sends legal questions from individuals to attorneys based upon the subject matter of the question. The opinion also notes that lawyers can not pay a fee for such referrals or give the service a portion of the legal fees earned from the referral.
- V. Arizona (#97-04, 4/7/97) [pdf]: Discusses advertising "housekeeping" requirements, such as need to include the cities where the lawyer has offices and/or will actually perform work (citing ER 7.1); client consent needed before providing a list of existing clients; and explanations regarding whether or not firms are affiliated if site provides links to other firms. (ER 7.1(p)). Direct e-mail to a prospective client may be a solicitation if the lawyer initiates the contact and the client has a known legal need for a particular matter. If it is solicitation, then specific disclosure must be made and copy must be sent to Clerk of Supreme Court. Lawyers probably may not join an on-line referral service. Generally, lawyers need not submit copy of Web site to State Bar and Supreme Court.

Lawyers must retain copy of Web site in some retrievable format" AND record of when and where the web site was used.

- VI. Colorado: (#90, 11/14/92): Lawyer must exercise reasonable care to protect client confidences from inadvertent disclosure when using electronic communications devices such as telephones, cellular phones, and facsimile machines. The opinion does NOT specifically address e-mail but is included to show prior treatment of inadvertent disclosure rules.
- VII. Connecticut: (#97 - 29, 10/22/97): Advertising Rules apply to web site advertising, but Rule 7.3's solicitation rules does not as a general matter. The applicability of Connecticut's rule to out-of-state advertisements by lawyers is a question of law and beyond the ethics committee's jurisdiction.
- VIII. District of Columbia: (#281, 2/18/98): In most circumstances, transmission of confidential information by unencrypted electronic mail does not per se violate the confidentiality rules of the legal profession. However, individual circumstances may require greater means of security.
- IX. Illinois (#96-10, 5/6/96): Web site equivalent to telephone directory yellow pages. Participation in bulletin board, chat group, or similar service may implicate solicitation rules. If lawyer seeks to initiate an unrequested contact with a specific person as a result of participation in a chat room or bulletin board, then lawyer subject to solicitation rules and messages must be labeled as advertising materials.
- X. Illinois (#94-11, 11/94): Confidentiality of cellular telephone use and participation in legal advice service. Included in materials for treatment of referral services.
- XI. Iowa: (#97-11, 9/18/97): Discussed lawyer referral service issues.
- XII. Iowa: (#97-01, 9/18/97): Amending opinion 96-01 and Iowa's e-mail encryption requirement; now client consent needed, not necessarily encryption.
- XIII. Iowa: (#96-33, 6/5/97): Describing meaning of sensitive material" as the term relates to e-mail encryption requirements.
- XIV. Iowa: (#96-14, 8/29/96): Advertisements by out-of-state firm with offices in Iowa must comply with Iowa's ethics rules. Can have two separate, unconnected web sites.
- XV. Iowa: (#96-02, 8/29/96): addressing some issues associated with Web Site language (e.g., specialization, disclosures).
- XVI. Iowa: (#96-02, 8/26/96): Web Site disclaimer language on association web site.
- XVII. Iowa: (#96-01, 8/29/96): E-mail encryption (see 97-01 for amended version) and Web site disclosure requirements.
- XVIII. Iowa: (#95-30, 5/16/96): OUt of state home page and confidentiality.
- XIX. Iowa: (#95-21, 2/22/96): Addressing Bulletin Board/Internet lawyer referral services.
- XX. **Kentucky E-403 (July 1998): This official advisory opinion authorizes unencrypted email communications and a characterizes web pages as advertising, rather than solicitation.**
- XXI. Massachusetts 00-01 (1/2000): Deals with th ethics of unencrypted e-mail. Like the ABA and other opinions on the issue,

the opinion states that it is not an ethical violation to exchange unencrypted e-mail with a client.

- XXII. Mass 1998-2 (5/29/98): Applicability of advertising and lawyer referral rules where bar association intends to establish an Internet site that contain membership directory and links to member home pages.
- XXIII. Massachusetts: (#1997-130, 9/18/97): Addresses issues associated with publication of Web directory of lawyers and lawyer referral services (see 1998-2 for formal opinion).
- XXIV. Massachusetts: 94-5 (3/22/94): Lawyers should disclose dangers regarding disclosing confidences when speaking with client on cellular telephone.
- XXV. Michigan (#RI-276, 7/11/96): Web sites regulated by Rule 7.1 and copies retained pursuant to Rule 7.2 E-mail to one or more e-mail addresses must follow rules relating to general and direct mail solicitation (Rule 7.3). A chat room" interactive communication is like a direct solicitation and outside the activity permitted by Rule 7.3. Layers may not solicit legal business unless follow Rule 7.3.
- XXVI. Minnesota (#19, 1/22/99): A lawyer may use technological means such as unencrypted electronic mail (e-mail) and cordless and cellular telephones to communicate confidential client information without violating Rule 1.6 under specified conditions.
- XXVII. Missouri (990007) deals with the scope of a client consent form relating to the use of e-mail between the lawyer and client. The opinion notes that it would be difficult to create a comprehensive form to cover all concerns raised by e-mail. Lawyers are encouraged to discuss with their clients the risks associated with e-mail communication and storage.
- XXVIII. Missouri (#97-10): A lawyer who sets up a website referring to a specific area of practice, invites people to send the attorney E-mail on that area, and lists the website address and the E-mail address on letterhead should include in the website a statement that E-mail is not necessarily confidential.
- XXIX. Nebraska (#95-3): Lawyers may not participate in a "for-profit" Internet lawyer referral program.
- XXX. **DisplayText cannot span more than one line!** : The Association of the Bar of the City of New York Committee on Professional and Judicial Ethics opinion says that a law firm should maintain a copy of its website for at least one year, but need not file a copy with the Departmental Disciplinary Committee. A law firm that establishes a discussion area on its website should exercise caution and vigilance to avoid the establishment of an attorney-client relationship and impermissible advertising or solicitation. A law firm may not pay a fee to an Internet service provider calculated by reference to fees earned by the law firm from the provision of on-line services. A law firm may not post a form for a new customer to request a trademark or copyright search, but may do so for existing clients. A law firm need not encrypt all e-mail communications containing confidential client information, but should advise its clients and prospective clients communicating with the firm by e-mail that security of communications over the Internet is not as secure as other forms of communications.
- XXXI. Nassau County (N.Y.) Bar Ass'n Comm. on Professional Ethics, Op. 99-3 (9/29/99): Lawyers may pay to be listed as "sponsor" in banner advertisements on Internet sites that provide viewers with

information about particular fields of law, provided that certain disclaimers are used.

XXXII. DisplayText cannot span more than one line! :

Lawyer may advertise in Internet Web site sponsored by another organization, though use of title "Attorney Referral Board" is potentially misleading.

XXXIII. New York 709 addressed the question whether an attorney may operate and advertise a trademark practice over the Internet. The NYSBA Committee on Professional Ethics held that using the Internet to take orders for trademark searches, conduct trademark searches, render legal opinions and file trademark applications is analogous to conducting a law practice by telephone or facsimile machine and is permissible, subject to the same restrictions applicable to communication by those means.

XXXIV. North Carolina Opinion (#RPC 215 (4/13/95)): Lawyers must minimize the risk of disclosing confidential information when using cellular phones or e-mail. If the lawyer is aware that the communication can be intercepted, the lawyer must notify the parties to the conversation.

XXXV. North Carolina (#RPC 239, 7/25/96): Must indicate the jurisdictions in which the lawyer is licensed to practice and the geographic location of the layer's principal office. Listing may indicate areas of concentration or interest. Lawyer must retain copy of advertisement and a record of when and where it was used.. Compliance with this requirement by print hard copy of all screens of site and any material changes in format or content.

XXXVI. North Carolina (#RPC 241, 10/16/96): Lawyer may participate in Internet directory of lawyers, but listing must indicate the jurisdictions in which the lawyer is licensed to practice and the geographic location of the layer's principal office. Listing may indicate areas of concentration or interest.

XXXVII. North Dakota: (#99-03, 6/21/99): Lawyers may use online data backup service if the lawyer ensures that data transmission is secure and that the information storage system adequately safeguards sensitive records.

XXXVIII. North Dakota: (#97-09, 9/4/97): Lawyers need not use encryption to send routine e-mail to clients.

XXXIX. Ohio (#99-2, 4/9/99): Ohio lawyers may communicate with clients via unencrypted e-mail.

XL. Ohio (#99-3, 6/4/99): Ohio lawyers may be included in professional association's online membership directory, with a link from lawyer's listing to lawyer's e-mail address, law firm Web site, ir Web site of related professional association.

XLI. Ohio (#99-4, 6/4/99): Ohio lawyer need not use firm's name as part of "domain name" for firm's Web site, but name that is used must not be false, fraudulent, misleading, deceptive, self-laudatory, or unfair and may not imply special competence or experience.

XLII. Ohio (#99-9, 12/2/99): Ohio ethics rules permit rendering of online legal advice for a fee, subject to same constraints that govern other methods of delivering legal services. The board offered a list of suggestions for avoiding ethical problems in the course of providing online legal representation through e-mail answers to e-mail questions from nonlawyers.

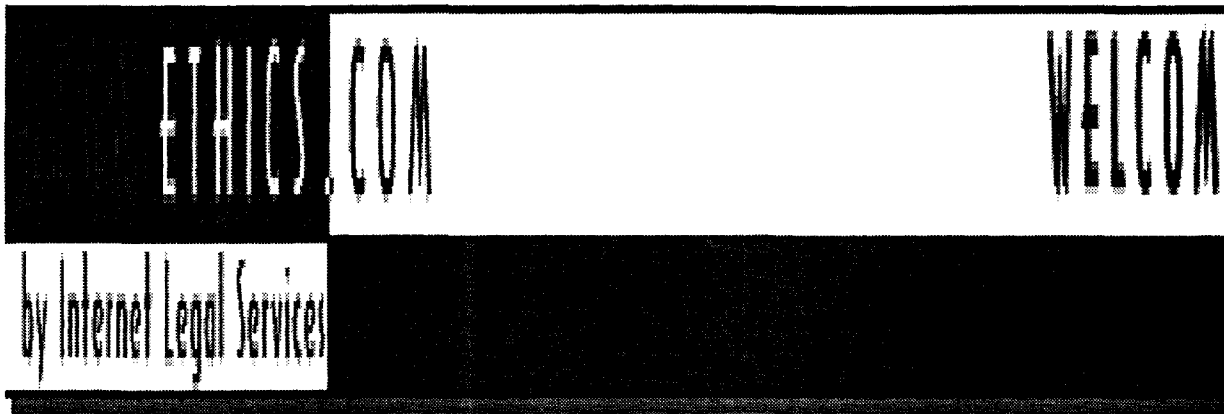
XLIII. Oregon (#1994-137, 8/94): Lawyers may participate in online, self-help legal information system providing information on

substantive, procedural, and jurisdictional matters

- XLIV. Pennsylvania 98-85 (7/24/98): Discusses jurisdictional issues associated with lawyer web site publication.
- XLV. Pennsylvania 97-130 (9/26/97): Analyzing ethical obligations relating to e-mail and confidentiality.
- XLVI. Pennsylvania (#96-17, 5/3/96): Addressing Web Site advertising requirements. Retain copy of ad along with record of when and where it was used. (Rule 7.2(b)). Also disclose the geographic location of office in which the lawyer who will actually perform the services principally practice law.
- XLVII. Philadelphia Bar Association 98-6 (3/98) Ethical issues associated with lawyer participation in Internet discussion groups and chats.
- XLVIII. South Carolina (#99-09): Deals with a lawyer whose client unilaterally created a web site advertising for additional plaintiffs in a pending litigation. The lawyer has a duty to verify that the web site complies with applicable advertising rules. If the lawyer determines that the Web Site does not comply with ethical advertising rules and the client refuses to make changes, the lawyer can withdraw.
- XLIX. South Carolina (#97-08) Discussing e-mail confidentiality issues. Finds a reasonable expectation of privacy when sending confidential information through electronic mail (whether direct link, commercial service, or Internet). The Opinion also states that the use of electronic mail will not affect the confidentiality of client communications under South Carolina Rule of Professional Conduct 1.6. This opinion revisited the e-mail confidentiality issue as originally addressed in Opinion 94-27 addressing on line legal advice.
- L. South Carolina (#94-27): Addressing advertising and e-mail issues. Must identify the geographic limitations of the lawyer's practice, so that it is clear that he may not practice law except in those states in which he is admitted to practice." (citing Rule 7.2(a)). NOTE: see opinion 97-08 for updated requirements regarding e-mail.
- LI. South Dakota (#98-10, 1/12/99) finds that a South Dakota lawyer may not participate in an Internet Referral Service taking an advertising fee and a share of legal fees to refer cases to South Dakota lawyer but providing no legal services.
- LII. Tennessee (#98-A-650(a), 11/19/98): Amends Advisory opinion 98-A-650 to allow the use of e-mail to transmit client confidences and secrets via the Internet. Notes that "[t]he reasoning in these new opinions [SC 97-08 and DC 281] is that the technology involved in e-mail is now better understood and the use of e-mail is more widespread. The technology has also improved. It is generally accepted that the security of e-mail is probably no more problematic than the security of a non-cordless telephone line."
- LIII. Tennessee (Formal Op. 99-F-144, 6/14/99): Lawyers who list practice areas on the Internet must comply with disclosure requirements regarding specialization. This includes listing in law directories or other Web Sites available to the public.
- LIV. Tennessee (#95-A-576, 7/6/95): Advertising/publicity rules generally inapplicable when an lawyer responds through private electronic mail to an individual inquiry on a legal matter posted to the Internet.

- LV. Tennessee (#95-A-570, 5/17/95): Newsgroup postings are a form of improper solicitation similar to unsolicited phone contacts. Web sites must contain certification disclaimer if an area of practice is listed (DR 2-101(C)) and it must contain statement "This Is An Advertisement" (2-101(N)). The lawyer must furnish a copy to the Board of Professional Responsibility 3 days before it is placed on the Web (2-101(F)).
- LVI. Canter Disciplinary Judgment (#95-831) Posting on bulletin board is violation of Tennessee DR 1-102(A)(1), (5),(6), and DR 2-103. Must include "This Is An Advertisement" disclaimer. Description as "Immigration Attorneys" presented the attorneys as specialists without the requisite disclaimer. Additional violation for failure to sent a copy to Board 3 days prior to publication.
- LVII. Utah 97-10 (10/24/97) Addressing lawyer Web site, e-mail, newsgroup, and chat use for advertising purposes.
- LVIII. Vermont (#97-5): General advertising rules apply to Web sites, but the opinion may change with push technology where lawyers can direct information to subscribers. This could raise solicitation and direct mail issues. Internet "home page" is not "directed to a specific recipient" and is similar to a phone book's "yellow pages." Importantly, the Vermont Committee stated specifically that it did NOT address the use of push technology, chat rooms, news groups, discussion groups, or other "potentially interactive means of communicating."
- LIX. Virginia A-0110 (04/14/98): The Virginia State Bar's Standing Committee on Lawyer Advertising and Solicitation issued this advisory opinion dealing with Internet lawyer advertising. It states states that Web Sites are covered by the existing advertising rules, but that additional rules may need to be drafted. In addition, lawyers who communicate on the Internet in "real time" chat rooms must abide by the restrictions on solicitation. Moreover, a lawyer who solicits employment in a "real time" chat room may not solicit employment in personal injury or wrongful death cases by communicating with the victim or their immediate family.
- LX. Virginia 1702 (11/24/97): Addressing duty of zealous representation and inadvertent receipt of information transmitted via e-mail and facsimile.

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