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# International Law Practicum

A publication of the International Law and Practice Section
of the New York State Bar Association

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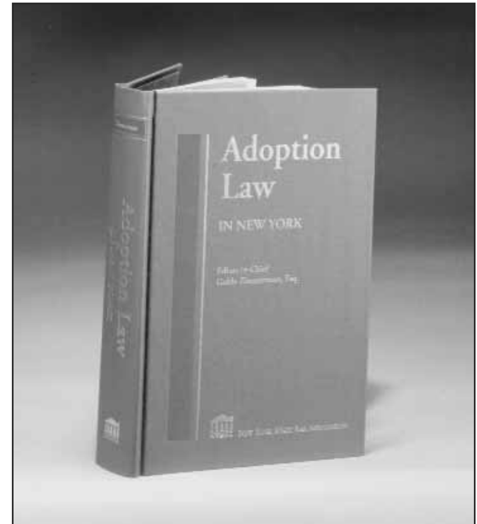


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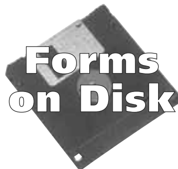


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# United States and International Perspectives on Electronic Marketplaces

## I. Introductory Remarks

DAVID B. PERLMAN: Good morning, everyone. I am David Perlman from the Corporate Counsel Section, and we are of course very pleased to have been able to work on this program with the International Law and Practice Section.

This program is important for several reasons. One, of course, is the transnational nature of the Internet. Another is the increasing economic and business globalization. A third is the evolving real commercial uses of the Internet by real businesses. And, finally, the last reason is to provide a legal cautionary note: as we know, certain words mean one thing in Washington, D.C., and they somehow mean something entirely different in the rest of the country. Similarly, you can do a lot of research about foreign case law and statutes that are available in English, but the problem is that, as you know with terms of art in any profession, when you're dealing in different jurisdictions, they don't mean what you necessarily think they mean.

For that reason, we are very excited about having a multinational panel to address the topics of this morning. And you should also take advantage of the opportunity of networking with your fellow audience members, because you never know when you'll have a question that comes up in somebody else's backyard.

I would like to invite Gerry Ferguson up to make a few remarks and introduce our first panel, which we're taking in a slightly different order, because Ms. DeSanti is pledged to another section, which she'll be addressing after she finishes here.

## II. B2B Arrangements

GERALD J. FERGUSON: The Internet economy is dead. Long live the Internet economy. We've all read the reports of the collapse of the dot-coms and the effect that has had on the tech sector. From some of what you would read in the paper you would think the Internet economy is the modern version of the Dutch tulip phenomenon in the sixteenth century, where it was a bubble and it disappeared. But the real Internet economy is the economy that businesses have been building. It is an economy based on infrastructure, and it is economy based on taking advantage of new ways of doing business that technology makes available. And that economy is still humming along, although the effects of that economy may not be as visible right now. Indeed, the transformative effect of these technologies may not be truly visible until five or ten years from now.

The panelists here today I think are going to give some good concrete advice on how to take advantage of the potentials that these new technologies create and how to do it in such a way so as not to run into legal pitfalls.

I would like to thank David Perlman and the Corporate Counsel Section for giving the International Section an opportunity to cooperate on this panel and to meet together. I think it's a great opportunity to bring together and take advantage of the expertise of both of our Sections.

I would like to start with the antitrust panel by introducing first Susan DeSanti. We're really fortunate to have here today one of the architects of competition law policy in the United States as it relates to business-to-business marketplaces on the Internet.

Susan is a Director of Policy Planning for the Federal Trade Commission, and has had a significant role in producing the two white papers that have really been providing industry guidance in what should be done and what should not be done in this area.

Speaking after Susan will be Susan Hankey. I know that there are antitrust specialists who are not named Susan, but those are the two that we found today.

Susan, from Cameron McKenna in London, specializes in competition law and will help bring the European perspective to these issues: When you're in an Internet environment you are immediately in an international environment, whether you like it or not.

So without further introduction, Susan.

### A. Antitrust Consideration for Buying Groups in the B2B Electronic Marketplace

SUSAN DeSANTI: Thank you very much, Gerry. I'm very pleased to be here today, and what I'm going to try to do in the brief time that we have available is give you an overview of how the Federal Trade Commission has been approaching the issues involved with B2Bs. I will highlight for you as we go through a few of the aspects that relate most to buying groups in particular.

All right, what has the FTC been involved with so far? Well, last spring, when it seemed that you couldn't open a newspaper without reading an article about companies that were in the process of forming a B2B, and then subsequent articles saying that there may be antitrust issues here and asking whether the antitrust issues were going to stand in the way of B2B e-commerce, it occurred to those of us who are responsible for

trying to look ahead and pay attention to policy developments and marketplace developments that maybe we'd better get up to speed on this trend sooner rather than later.

So we held a workshop at the end of June. In preparing for that workshop, and at that workshop, we talked with more than two hundred business people, market analysts, etc. At the workshop we had over sixty-five panelists, most of whom were business people but with a smattering of antitrust practitioners as well, and we also invited written comments to come in. There were over six hundred people who attended the workshop. Not surprisingly, that was last June. It wasn't now.

The main thing I want to convey about that workshop is that we were really listening to businesses. All five commissioners gave brief remarks. I should note for you today that, of course, my remarks are, as usual, my own: They don't necessarily represent the views of the Federal Trade Commission or any particular commissioner.

But if you're interested in Commissioner perspectives, all of the materials from the workshop are on the Web site at www.ftc.gov. And you can find out what they said, which was basically, "We're in a learning mode: We want to understand what this business development means." And we spent a day and a half listening to business people, and then the last half of the second day was spent listening to antitrust practitioners who have been counseling in this area, to get their perspective on what this all means.

That was followed by a staff report. The main issues that the staff report dealt with were the efficiencies B2Bs can create, competitor collaboration guidelines and four central antitrust issues, one of which has to do with joint purchasing. And I'll talk about that in more detail.

In the fall of this year, the Commission closed an investigation into the Covisint B2B that most of you may have heard about. This was the B2B involving the Big 3 automakers, plus Renault-Nissan, plus Commerce One and Oracle—and I'll talk a little bit about what the Commission did and didn't say in closing that investigation. And then I'm going to highlight for you some issues for the future.

Okay, the materials from the workshop are on the Web site, and I would encourage any of you who are really interested and involved in B2Bs to go there. There are a number of written statements that are very, very useful. The transcript itself is very, very useful. There's a lot to be learned, and we did feel that we learned a lot from the workshop.

The staff report is also on the Web site. And I'm going to move into what the staff report dealt with first, which were the potential sources of efficiencies from B2Bs. I want to highlight for you in particular that I think we at the FTC have listened and have learned that there are very significant efficiencies that can be provided by B2Bs.

Yes, there is some degree of hype. Yes, there's a slowdown in the tech sector now, but I want to actually go with Gerry on this. I think that over the long run these efficiencies are so significant in their potential that this is not a phenomenon that is likely to go away. But it is likely to take longer than everybody thought at the beginning.

One of the interesting things that we heard from the old-timers in B2Bs—these are people who had actually started operating as early as August of 1998, you know, the old-timers—was that, "It turns out it is like anything else in the world, it is more complicated, it is tougher to put together than one might think. These efficiencies just don't come with a snap of the fingers, but the efficiencies are there."

It's impossible not to be impressed with the potential in this area. So I don't think B2Bs are likely to go away. You are likely to be dealing with the kinds of issues that they raise for a while to come.

I am going to now talk first briefly about competitor collaboration guidelines. They are discussed in the staff report on B2Bs. Obviously B2Bs are joint ventures; they are competitors collaborating. In April of 2000 the Federal Trade Commission and the Department of Justice Antitrust Division issued new guidelines for how the agencies will analyze competitor collaborations. Now, believe it or not, work on these guidelines had started a few years earlier. They were not in response to the B2B phenomenon. The issuance turned out to be timely in relation to B2Bs, because they do provide some of the guidance that you need to think through when counseling a B2B in terms of potential antitrust issues.

Now, the premise of these guidelines is important. The premise is that in order to compete in modern markets, competitors sometimes need to collaborate, by expanding into foreign markets, funding expensive innovation efforts, lowering production and other costs. There's a recognition that collaborations among rivals may be pro-competitive and have sound business reasons. There's not a presumption against them as to put them into a *per se* area.

And I do want to also highlight that there's a safe harbor in the competitor collaboration guidelines that may be relevant in your B2B counseling. Now, I do this with some trepidation, because frankly there's always a discussion in the antitrust agencies any time we come up with safe harbors and guidelines. And the reason for that is that we have run into problems whenever we put safe harbors in some guidelines—health care being a prime example. What's happened is that the health care

community responded by saying, "Oh, we can't do anything outside of these safe harbors; we have to structure all our transactions to fall within the safe harbors." That is not true. A safe harbor is simply where we won't even take a look at it. You may well have transactions that fall outside the safe harbors that are also perfectly fine from an antitrust perspective. It just means you need to think through the issues a little bit more and anticipate that they might be looked at a little harder. But that's all a safe harbor is.

Having said that, let me note that the language of the safe harbor says it applies when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected. However, of course it is inapplicable to *per se* agreements or agreements that would be challenged without a detailed market analysis, which are basically agreements that are so close to *per se* that they don't warrant a lot of scrutiny because their anti-competitive effects are fairly obvious.

Let me note for you that, in terms of the buying groups, there are two relevant markets that you need to think about. And we'll talk a little bit more about the basis for this in a couple of minutes. First, you need to think about whether the purchasers in the buying group account for more than twenty percent of the sales of that product. In other words, if the purchasers are buying widgets, do the purchasers account for more than twenty percent of the purchases of those widgets?

Second, you also need to think about the downstream market where they sell the product into which the widgets have been made. And you need to think about whether they account for more than twenty percent of the sales in that downstream product market. The antitrust consideration there is whether the purchasers who are in this buying group learned enough about each other's production costs, etc., through buying widgets together that there might be a possibility that the buying group itself could facilitate some kind of collusion in the downstream market. That's just a flag for you.

There are two markets to think about that are potentially relevant. I want to highlight that this is different from the safety zone that was in the health care guidelines. Many people were counseling buying groups based on the health care guidelines safety zones, before the competitor collaboration guidelines came out.

This is a perfectly reasonable thing to do, because there weren't general guidelines for competitor collaborations before last April. There are now. They have a twenty percent figure; that is lower than the thirty-five and twenty that the health care guidelines use. So I just want to flag that. The health care guidelines are now for health care alone. The competitor collaboration guidelines are for general industry.

All right, what are the basics to take from the workshop and the staff report? Okay, first point: B2B e-marketplaces—just like more traditional marketplaces—have the potential to raise traditional antitrust questions.

Second point: many B2Bs are pro-competitive and we recognize that.

And the final point: Most antitrust issues, at least at this point in time, appear to be solvable if you pay attention to them up front and think about how you're going to deal with them ahead of time.

What are those issues that you should be thinking about? Let me discuss a number of them briefly.

*Information exchange*. The key issue there to think about is what kind of information is being exchanged? How old is the information? Could it possibly facilitate tacit or explicit collusion among the participants? Joint purchasing, or monopsony—which I'm going to talk about in a little more detail in a second, so I'll put it aside for the moment.

*Exclusion*. What is exclusion? Keeping outsiders out of the B2B. Let me flag a couple of points there. One, if you exclude other companies from the B2B, that is in and of itself not necessarily an antitrust problem. Antitrust is about protecting competition, it is not about protecting competitors. But you could get into problems if the rivals who are excluded from the B2B can't compete because, for example, the B2B has such great efficiencies compared to any other way of doing business. And importantly, if that has an impact on competition in the downstream market.

*Final issue: Exclusivity*. What is exclusivity? It is keeping insiders in. Lots of B2Bs have come up with different kinds of rules to encourage members and owners and other participants to send their volume through the B2B. This is not surprising. B2Bs need liquidity in order to succeed and to become profitable. The question that arises from an antitrust perspective is whether there are going to be sufficient competitors to that B2B, or is all the volume in the relevant market going to end up going through that B2B? This is an issue that I think is likely to come up more often in the future as we see more consolidation among B2Bs. But it is something that you should be thinking about ahead of time.

Let me highlight joint purchasing. Monopsony, classical monopsony in economic terms, is the exercise of market power by a group that gets together to drive down the purchase price of an input by buying less of it and thereby depressing output.

There are not a lot of monopsony cases in antitrust law, and one of the reasons for that is that it can be very

hard to distinguish that situation from a situation where a group of purchasers gets together and, because of the way they are proposing to do business, there are efficiencies that they are creating that then can justify getting a lower price from the sellers of the product. And the Antitrust Division thinks that that is pro-competitive: that's not a problem. It can be very difficult to distinguish between the two. But basically if you have a situation where you think that you are going to be involved in forming a purchasing group that has market power and that's why you're getting the lower price, that's a case where you want to be looking at it.

In closing, I'll just note that in the Covisint joint venture, because there were no operating rules, bylaws or terms for participant access, it wasn't yet operational and in particular because it represents such a large share of the automobile market, the Federal Trade Commission said, "We can not say that the implementation of the venture will not cause competitive concerns." This is basically not a red light, not a green light; it is a yellow light with respect to B2Bs.

My conclusion is what I've said before: An ounce of prevention is worth a pound of cure. If you pay attention to the antitrust issues up front, you're likely to be able to resolve them. Also keep in mind that antitrust compliance is not a one-time thing, but rather involves follow-up during implementation and operation.

MR. PERLMAN: Does anyone have any questions for Susan DeSanti regarding her presentation? I actually have one. Is there more concern about B2B buying groups at a particular stage of distribution? By that I mean generally there are fewer manufacturers or suppliers of a raw material at the beginning of a distribution chain and many, many more wholesalers or retailers, what have you. Do you look with a particular scrutiny at one level or another?

MS. DeSANTI: The scrutiny is not defined by the level. Yes, you're right about your general characterization, but there are some situations where it is the distributors who are fewer rather than the raw material producers. There is the question of what's the market concentration, and the market concentration is definitely a significant factor in looking at buying power.

### B. The B2B Electronic Marketplace from a European Perspective

SUSAN HANKEY: As Gerry said, we have two Susans, who in fact talked to each other for the first time a few months ago and learned that that's very much the same song on antitrust issues in the USA and Europe. So it all fits together very nicely. But what I'm going to do this morning is to try to explain a few of the issues which you will encounter specifically in the European Union in regard to the B2B issues.

Therefore I would reiterate, if I had time, everything that Susan has said this morning, and here are some extras which you need to know about when you're in the EU.

Now, what I would take as my context is a pretty typical B2B structure, and I've chosen this because it allows me then to focus on two or three particular areas where the EU rules are very specific.

We have perhaps a group of sellers who have got together; they own a B2B company. The B2B company owns and operates some sort of exchange activity and the top and bottom of these chains do their business. And what this allows me to do is to say, "Well, let's look at the buyer issues related to this sort of an arrangement."

And I would put them into three streams. The first one allows me to talk about these people as owners of the B2B company, the company that provides the exchange activity.

First of all, they have some quite tricky questions to answer when they are thinking about setting this thing up in the first place. So I want to talk a little bit about the structure and the findings that would be required in the EU if you were setting up such a thing, whether as a buyer group or as a seller group or even as a group which is setting up a B2B exchange in order to offer the exchange activity as a service to third parties. There are filing requirements which very often will catch you.

And then I want to look at my other two streams altogether. Then I want to think about all the possibilities that they have of violating the antitrust rules in the EU.

So let's go back for a bit of context in the EU itself. We've heard what the FTC has been doing here. And you'll see that our commissioner for competition law, Mario Monti, echoes some of the things we have already heard. We are not opposed to the creation of B2B electronic marketplaces as such. Normally we find that such things can lead to all sorts of pro-competitive, helpful, useful new innovations. But we are used to the old economy. We have rules for the old economy. We have practice in the old economy, and this is very new to all of us. That's why we are a bit suspicious, and we see some dangerous pitfalls, in particular in the structures which could be put together to make a B2B work. And we also think that we need to be particularly vigilant against discriminatory access and use and the potential that these exchanges do provide for collusion. And here Commissioner Monti is thinking particularly of the information exchange issues, which are always thought of as suspicious in our environment because of the many things that you can do when you get some quasi-confidential information from one of your competitors.

So experience in the old economy is being brought to bear on the new economy. What are the things that make them nervous? Well in the EU here is a list you've already heard from the FTC. These are the things which always—if there's a suggestion around they might be happening—make our antitrust people a bit nervous. First, competitors talking together: just for the sake of the fact that they are competitors. Second, access and use criteria: Who can be allowed to use a B2B exchange? Third, the use of confidential information: the possibility that that gives for price fixing, upstream, downstream, whatever. Finally, anything else that remotely suggests the word cartel in any shape or form. So the usual story, if you like.

Let's go back to my three streams, and discuss setting up your B2B. If you are a group (let's have it this time as a group of purchasers getting together to set up some sort of B2B company or corporation), they might in the EU have to do one of two sorts of notification: The first would be obligatory under EU merger regulation and the second might be a question of whether to make some sort of filing under our general anti-competitive agreements prohibition in Article 81 of our Treaty of Rome. The second set of issues on operation I'll come back to later and reference up with my other two streams.

Let's look at what you'd have to do if you were setting up a B2B. If you think back, you will remember that we were putting together the B2B company, a joint venture company owned thirty-five, thirty-five, thirty by the three companies, and they were to own the B2B which was offering the activity. Now that's a classic joint venture concentration in the EU merger regime. What it produces is a joint venture which performs on a lasting basis all the functions of an autonomous economic entity. It speaks for the sort of full function joint venture which is covered always by the European merger regulation. If you have parties, no matter where they are based in the world, which are setting up such a structure, they have that sort of structure which is covered by our definition. If they also come over our merger regulations thresholds, there's an obligatory filing with the European Commission, an obligatory finding. The requirement is that the filing be made, and one must wait for clearance before one can get on with any of the activities of the B2B. The thresholds are pretty high. They come first at worldwide, then at EU Community and then at Member State level.

So there's a big flag there, that if you have or are involved in the setting up of such a joint venture and it has in its parent company some fairly hearty turnover in bulk, then you may well have to make such a filing. And if you have to make a filing, the merger task force of our European Commission will look at what you're doing and say, "Well, this joint venture, does it itself do anything which creates a dominant position which would significantly impede competition in the EU?" They'll ask that question because that's the merger regulation clearance test. And if it fails that test, it will be prohibited. So they look of course at the markets affected by the arrangement and they look at the opportunities within that arrangement for restrictions on owner and participant activity. They look for the possibility of access to confidential information and the use of it. They look for the possibility of any sort of quasi-cartel behavior. And if you fail on those examinations, the B2B will not be cleared. It will not be able to go forward.

There hasn't been very much of this so far which is of real help in how we should analyze these things. The one B2B which has been cleared and which is definitely caught by all these rules and gives us good guidance is MyAircraft.com, which is, I think, familiar to most people right now. There have been two or three other cases in the market cleared by the same regime, but they have by and large been involved in setting up B2Bs which offered the services of the exchange to third parties outside their own markets, and therefore they caused no competition problems.

That was the structural test: Now let's think then about my other two streams. That is the first question you should always ask, because that's an obligatory requirement for filing. Then we go back to the other activities, my second streams of participant and operational activities: people who use the exchange, people who are facilitated in what I call extracurricular activities by the B2B exchange, which might have a trade association parallel. They may well be caught by the prohibition in our Article 81. And we have recently finally published our EC guidelines on horizontal cooperation, which give some help in how we should now look at our joint purchasing in this context. And again, I'll spend two minutes talking about each of those.

Article 81, probably familiar to many people in the audience, prohibits arrangements which will have the object or effect of preventing or restricting or distorting competition and which affect interstate trade in the EU. Such an arrangement is *de facto* prohibited. What happens if you breach that prohibition? Well, if you get found out and you can't explain yourself to the European Commission sufficiently, fines of up to ten percent of worldwide turnover are applicable and you'll end up in court. It is a pretty strong prohibition.

We have our new Commission Guidelines on horizontal cooperation. And again, this echoes exactly what Susan has been saying about the issues which are covered by the competitor guidelines in the U.S. The same sorts of questions come up again and again. What our horizontal guidelines do is to set out a general approach, a framework for analysis of horizontal cooperation, and then they deal in detail with particular activities: R&D; specialization agreements; cooperation in joint purchas-

ing; etc. And they reiterate the themes throughout each of those topics. The main themes are in all of our antitrust investigations.

There is no general safe harbor in these guidelines. There they differ from the U.S. competitor guidelines. But as for joint purchasing groups, an indication that if the persons involved have less than fifteen percent of both the selling and the purchasing markets, they are likely to be safe. But that fifteen percent is specifically for joint purchasing groups, it is not generally for all the cooperation guidelines.

And what sorts of issues do these guidelines pick up on buying groups? Well, again, what we have already been talking about: There's a lot of commonality in our two approaches. We look at market share and market power, and the fifteen percent threshold I've mentioned. We have examples in these guidelines which show, for example, the approach that looks at small and medium-sized enterprises getting together and finds that the increase of their power by forming buying cooperatives is in fact pro-competitive. An example in the guidelines is of one hundred fifty small retailers who have got together to make minimum purchases through their buying group: that is found to be pro-competitive because it simply raised their profile against all the big bad sharks against whom they otherwise would be too small to compete.

As usual, when you are making any sort of antitrust case, you have to see whether the benefits that you're putting out will outweigh the technicality of your breaches, and whether all the restrictions that you've put together are indispensable to what you have done. And you have to look at the general effect on competition. What that does in the guidelines is simply to echo our general rule in Article 81: First the prohibition, then a way out of the prohibition.

If you're explaining yourself therefore to the EC, these are the things you have to do: Demonstrate your efficiency benefits; show how open and objective your criteria are; show that you've got safeguards in place on your confidentiality issues; show that there are other ways of doing this business; show that there is pricing freedom available; and show that the only restrictions you have put into this B2B or into your joint buying arrangement are those that are absolutely necessary to make it all happen.

### C. Questions

MR. FERGUSON: I want to exercise the organizer's prerogative and ask the first question. I think we have room for a few questions, and then we'll move on to the next topic.

My experience with these B2B marketplaces is that a general feature of their organization is that they have these rules of the road, and they can exclude participants or remove participants who don't follow the rules. These rules are generally geared towards people who are abusing the marketplace. For instance, someone who is coming online to make an arrangement but then taking the deal offline to avoid the transaction fees or perhaps just coming on to learn about or get information on competitors but never to close a deal or coming on, making deals but never following through, never executing. And I hear from both of you that excluding people from the marketplace is something that's generally going to be a no-no and is going to attract attention. Are these sorts of rules of the road going to be *per se* a problem if a marketplace becomes very successful, or are they going to be something that should be acceptable?

MS. HANKEY: I think from the EU perspective the restriction on use or the kicking out of somebody who doesn't follow your rules all comes back to the same point, which is to look at the rules you set up for using the marketplace in the first place, and how wide were they, and were they sufficiently broad to allow the majority of players in the marketplace to come in and use the system. And were they set up in an objective fashion, which means that there was a threshold which lets you in there, and they said why it was you are using this exchange.

So, in fact, if you set up therefore your rules of the road with objective access criteria, objective usage rules, then it seems to me the corollary of that (which is to kick somebody out if they abuse the system) is not an abuse of an anti-competitive practice. I don't find it anti-competitive to knock somebody away because they have broken a rule which was itself objective for the use of the system. I would find it abusive if somebody was knocked out of the way because you didn't want him using your system, because he interfered with the cozy little quasi-cartel that you were setting up for yourself. But if you have an objective reason for getting rid of somebody, I have no problem with it.

MS. DeSANTI: And I think that the United States would take a very similar approach. And I should note that I did not mean to convey that exclusion is generally going to be a no-no. It is an issue to think about: Why are other companies being excluded? But it is not in any case going to be generally a no-no for precisely the reason that you've identified. In order to make any joint venture work, you have to have rules that people are going to follow. And if they don't follow these objectively created rules that have a clear, legitimate business justification, then, of course, you're going to be excluding them.

So the kinds of questions that Susan is asking—Were they objectively created? What's the legitimate business justification for the rule? And what's the impact?—are appropriate. As a practical matter I can

imagine that you might have rules that looked objective but might operate in such a way that they actually excluded particular rivals. Absent that kind of a situation, you're probably going to be just fine with those kinds of rules.

MS. HANKEY: I don't think any of us is quite sure what will happen. If you're looking at this sort of access arrangement to begin with, you're saying, "Well, we have to make everything wide enough so that we are not to begin with being exclusionary." So it is not just a club for the big boys that automatically knocks the little ones out so they can't join. So we always have a general rule that there must be some other way of doing business. There shouldn't be restrictions on participants which say a hundred percent of your activity in this area is now through this B2B or you're not in the club. So we generally have a no-no on that sort of a rule.

But what happens of course is that what you try to do with B2Bs to make them successful is you want everybody to join in, and everybody does join in. So what then happens in the Covisint arena when it does become successful, when everybody is in? Because there you have almost a *de facto* barrier to entry for people to do business in that industry at all. What none of us is quite sure about is what's going to happen if any of these B2Bs in a particular industry were to become really super healthy.

MS. DeSANTI: One thing—I don't want to speak about Covisint in particular, but the issue that Susan is flagging is exactly the issue that I would say is for the future—not now, but for the future—to be concerned about. There is consolidation going on in B2Bs, so they are going to become larger and more successful. One of the questions will be whether most people do business through a B2B or are they still purchasing offline as well. Another question is what is the relevant market in which to take a look at this.

And one final point: One difference I think between the EU and the U.S. approaches—and you can correct me if you think I'm going off, Susan—is that in the U.S. there's a lot of hesitation to mandate open access. My general sense is that there's less of a hesitation in Europe.

MS. HANKEY: I think you're right.

MR. FERGUSON: I've not only used my prerogative, I've abused it by hogging all the question time. But thank you, that was very informative.

## III. Forming Contracts on the Internet

MR. FERGUSON: Our next topic is going to be electronic signatures. We'll first have Michael Maney, who is one of the founders of the International Section and a real leader in international law. He is going to be speaking from a U.S. perspective on electronic signature and electronic contract formation. We did have lined up Boris Otto from the Mexico office of Thacher Proffitt & Wood, who is unable to speak. Manuel Campos, who works with Boris at the New York office and who is a Mexican lawyer licensed in New York as a foreign licensed legal consultant, is going to be talking about a Latin American perspective on electronic document formation.

### A. The U.S. Perspective

MICHAEL M. MANEY: Good morning. The topic is formation of contracts, not just signatures. I'm assuming for this audience that everyone is familiar with the basic rules of formation of contracts. So the question is: How does the Internet make this different? And I submit there are three ways in which contract formation over the Internet is different from your normal offer, acceptance and binding contract.

First, how do you deal with the laws requiring a writing or signature, or how do you identify that you have somebody who is actually contracting with you? Second, there are things like the statute of frauds and other similar laws, but also how do you assure that the person you think you're contracting with is really contracting? You all know that wonderful cartoon of the dog typing away on the computer saying on the Internet "They don't know I'm a dog." You may be forming a contract with a dog.

Second, how do you deal with issues that require a disclosure in advance? It may be a consumer contract; it may be a securities contract where you have to deliver a prospectus in advance of the contract formation and follow other similar rules.

And third and perhaps the most difficult is how do you know what jurisdiction's laws apply? If you're contracting over the Internet, you may be contracting with anyone in the world. Whose laws govern?

Now, on the first issue, namely, the question of signatures and writing and how do you form a contract, I think the starting point, at least in the United States, would be the Electronic Signatures in Global and National Commerce Act, known by its acronym E-Sign. You can locate this at THOMAS—which is actually for some reason the acronym for the Library of Congress—THOMAS.loc.gov, and under the bill number, which is Senate 761, or the Public Law number, which is 106-229. That law is rather bizarre in that it is a federal law that says electronic signatures and electronic writings are just as good as paper writings and manual signatures, but does not apply the substantive law of how you form it so much as to say that, if a state follows substantially the uniform law, it's okay. And if it varies from that, it is preempted.

Now the uniform law, which is the Uniform Electronics Transactions Act, or UETA, is a model of rapidity. The Uniform Commissioners cranked this out in no time at all. It was promulgated in July of 1999 and a number of states have adopted it. Certain important states have not, New York being one of them. The UETA can be located at www.uetaonline.com. And it is important to focus on that because that is the model in regard to which the federal law says, "If you follow this you're not preempted."

Now, where does that leave New York? Well, New York enacted an Electronic Signatures and Records Act, chapter 4 of Laws 1999, which would be part of Chapter 57A of the Consolidated Laws. You can find that at www.irm.state.ny.us/esra.htm.

It takes the outline of UETA and then it delegates to the Office of Technology of the state the obligation to promulgate regulations that will keep up to date on the technology. While UETA is technology neutral (it merely says whatever works is okay), New York has basically said the Office of Technology will promulgate what is the proper technology under regulations. That office did promulgate regulations, which went into effect on October 18th of last year. They are at 9 Code of Regulations, Part 540. It's the same Web site as before, except at the end, after esra/esra_regs, and you would find it there. They are pretty specific on digital signatures and the other necessities.

Now, what is involved here? Well, many acts or many contracts or actions that require a writing are not governed by this—and for some fairly obvious reasons. You do not want to run the risk of having electronic living wills, for example, because it may be a mistake, or testamentary wills or conveyancing real estate or, very interestingly, the E-Sign statute does not apply to anything governed by the Uniform Commercial Code except for the article on sales, Article 2 and certain general provisions of Article 1. So anything governed by Article 9 on secured transactions is not governed by E-Sign. Likewise, Article 8 on investment securities or commercial paper, electronic funds transfers would not be governed.

Second, it also says—and this is particularly interesting—that if an electronic signature is valid, an electronic notarization is also valid. Now that I think poses a very interesting question as to how many notaries are going to get up the security necessary in order to do an electronic notarization, because security is the really most critical element here. That is the real issue in terms of electronic signatures: How do you deal with security?

Now, digital signatures, as used generically in this field, do not mean that someone does a graphic image of their handwritten signature so you could then just pop it in like a URL, or whatever they call those things. It's not a photograph of the person. And it's not, as we all know from watching "Mission Impossible"—because it could be duplicated, not a digital picture of your iris or of your fingerprint. It normally deals with some form of encrypted signature or saying that identifies the sender conclusively. It is supposed to do three things: first, provide security for the communication; second, prove the author; and third, have some form of detection if the document is changed after it's signed.

Now, let's take this simple hypothetical. A company is asking for bids, and you want to submit a bid. You want to be sure that none of your competitors read the bid, because otherwise they would be coming in just below you. You want the recipient to know who it is coming from; you want the recipient to be able to read it, obviously. Now, the way they've done this is as follows—and I'll run the risk of showing my total ignorance by taking about two minutes to discuss asymmetric encryption. Most encryption is what they call symmetric. If I do a substitution, you know, A is Z, B is Y, etc., the key that I use to encrypt is exactly the same key that I use to decrypt. Which means that both parties to a communication have to know the key, whether it is a key to Rebecca or something else, you have to know the key. And that's your normal site and normal codes. What you want is a method of encryption in which the decryption is a different key. Some brilliant scientist came up with a system where you have a private key and a public key. You can encrypt using one; you can decrypt using the other. You cannot decrypt using the same crypt you used to encrypt. And this is used with something like factoring huge prime numbers.

So if I am putting in a bid, and let's say everyone posts their public key on some Internet site, so I know that General Motors is asking for a bid, I can go to the Web, and I can see what is the General Motors public key. I then encrypt my bid using the General Motors public key, which only General Motors can decrypt using its private key. I sign it using my private key, which General Motors can decrypt using my public key, which I have also posted. So that I do accomplish two things: Only GM can read the bid. GM can then come back and verify that I am the sender because only I could have encrypted it using my private key. And then there's something else that I don't understand, which will trigger some red light if somebody changes it after I've signed it, if it's a contract. Anyway, that's all I know of that. Now these registries I think are developing, and it's a great opportunity if somebody wants to start a business.

I mentioned consumer contracts, obviously today if you're doing mail orders by, you know, telephone, everybody knows pretty much and assumes they know what they are doing if you do mail orders. But when you're dealing with the Internet, with e-commerce, I think there's a legitimate concern that you want to be

sure that the people who are doing this understand what they are doing. And, for example, if you have an obligation, let's say a mutual fund has an obligation to provide prospectuses of periodic annual reports to people. Before they can do this electronically, you want to be sure the recipient, the individual, understands what they are consenting to. They have to consent in advance, and E-Sign requires that. It has to be a consent in advance. They have to be able to read what they are consenting to. You know, you go on these long things and you have to say I agree, after paging through pages and pages of license agreement or other agreements. You have to be able to read that, download it or print it before you have to say I agree. You have to know how you can withdraw your consent. You have to know whether you're consenting to a single instance or to a series of instances of a particular type. Like I agree to have the annual reports sent to me electronically, or I agree to have only this one sent electronically. These have to be conspicuous. And that's what an E-Sign provides that this must be done.

There are others. I mentioned mutual funds. Obviously the mutual funds industry is a pretty good lobbyist, because the SEC was to put out regulations which would permit mutual funds to provide a lot of the material electronically, the prospectus material and other information electronically, if people consented to do so. In other instances electronic use is limited—and I've used the sales of securities, since that's an area I know somewhat. There frequently you cannot contract to buy a security until you have received a prospectus or you have received some disclosures. And of course, it's interactive, because the person selling the securities is supposed to know the customer and know what kind of customer they have and that this is not an inappropriate purchase. You can, with proper consent, deliver these disclosures electronically, but they have to be based upon a proper consent, and they have to have a record of that. And electronic records are also as good as paper records, but you have to maintain these records. Obviously, these will vary with the particular issue, whether you're talking about securities or you're talking about widgets or talking about munitions.

The third issue is the jurisdictional one. I think we English speakers have a more difficult problem than most because English is sort of the international language. So when you put something out on the Internet, you're looking at a worldwide audience. And you may want to impose limits, because of the laws that are applicable if you're selling securities for example. Thus, you may want to limit to whom you are offering. I'm sure those of you who do securities will see these prospectuses that have page after page of language that this is not being offered in New Hampshire, this is not registered in Liberia, or whatever. It would be very simple to say these securities are being offered only in the United States, other than California. But for example, the UK FSA says no, you can't say that. You have to say it is not being offered in England and Wales. So then somebody else will say you have to say it is not being offered in Italy or it is not being offered in Tahiti, and you can imagine the kind of disclosures you'd have to have. So there has to be some compromise worked out with that.

There's a recent decision by a Paris court which said that someone who tried to deal with only the U.S., but since it was something that was of interest to French purchasers, ought to have published this information in French. *Mon Dieu*! And they were enjoined.

The issue of jurisdiction I'm not going to go into, because you can have a whole-day panel on it. But it is an issue that comes up every time you deal with something over the Internet. It may not be particularly important if you're just selling dog food, but if you're selling securities or selling, let's say, chemicals or pharmaceuticals, it is important. I'm sure all of us have been getting spam mail offering all kinds of pharmaceuticals from New Zealand that would be prescription drugs here that are not over the Internet. How do you regulate that? That's a big issue.

I said language is important, but obviously Spanish is sort of the second language in the United States, and there are a number of Web sites in the U.S. that are in Spanish; there are a number of Web sites in Latin America that are in English. That becomes a jurisdictional issue there too. So I'll turn it over to my colleague now.

If anyone is interested in the question of the encryption, there's a pretty succinct little article in the November-December 2001 issue of the *New York State Bar Journal*, with Hamlet on the cover, that goes into that. Thank you.

MR. FERGUSON: If anyone has any questions for Mike based on his presentation, I open the floor to that at this point.

FIRST AUDIENCE MEMBER: I have one question. It's my understanding that the federal law, as you said, preempts the state laws. So I think the state of the law in New York is that we have a fairly strict encryption standard for valid digitally signed documents in New York State, but the federal law is pretty loosy-goosy, to the effect that whatever the parties agree to is more or less going to give you a legal contract. Is it correct, then, that if we're contracting in New York, we can more or less ignore the stricter standards of New York? Do we somehow have to be involved in intrastate commerce for the New York law to apply? I'm just wondering if you can comment on how the federal and state laws interact, especially in New York.

MR. MANEY: Yes, the E-Sign says that the state statute may modify or limit the E-Sign provisions only if they are an enactment of the UETA, except if they are inconsistent with it. So that it is unclear whether, for example, a specific proscription in the state regulations as to the type of signature that is valid would be effective if you used a different signature under the federal statute. That has not been worked out yet, but it certainly causes a certain concern.

I think what the federal statute is trying to accomplish is to say, "Let's not freeze any technology: Let us allow the marketplace to develop the best technology." And that would still be valid. So from a legal standpoint, if you were dumb enough to just put your name down in the sense that anybody could duplicate it, that theoretically is a valid contract. Then of course you always have the problem of trying to prove that it was forgery. But that is not, I think, a question of validity. It may be a question of the proof of enforceability.

SECOND AUDIENCE MEMBER: You didn't talk about the certification agencies, with their certification of a signature. I wonder if those agencies should be authorized by any government. Or shall just contract rules play in that part?

MR. MANEY: There are some of these payment mechanisms that you have, eBay and whatever, that are certification agencies where you register your name or credit card number and you go through the merchant to that site to authenticate and to certify. I think that is certainly appropriate. It's not mandated, and I think that there will be a number of them showing up. There are a number of companies in the signature authentication field, and there are other alternative ways (particularly in the payment system for example) of using either a certification agency or something like Mondex or some other form. And I think that's something where the marketplace is going to have to work it out over time. But what the statutes do is basically say that, in terms of forming a contract, anything is okay. But you may have an evidentiary problem.

AUDIENCE MEMBER: They are not like a notary public?

MR. MANEY: No, it is not like that outfit that now assigns domain names, that started off as an affirmative action thing and became too rich and now they've been taken over. It is not like the domain name thing. It may eventually lead to that, but right now I think that for certification or other digital signatures there is a competitive market.

MR. FERGUSON: Thank you, Mike. I've always admired Mike's ability to expand or contract his presentation to fill the time that needs to be filled. Thank you for filling that technical gap.

### B. The Latin American Perspective

MR. MANUEL CAMPOS: I'll try to be brief. As Michael was saying, Spanish is almost a second language in the U.S., so maybe we'll try to carry out this presentation in Spanish.

In any case, what I'm trying to do here is to give you an idea as to what is basically the framework for e-commerce in Latin America, with a special perspective as to Mexico. All countries in South America, including Argentina, Bolivia, Colombia, Peru, either have enacted statutes or have to some extent proposed some amendments to their legislation, amendments which have been followed by all with some interest because of the quick rise and fall now of the e-business situation.

One of the main problems with these types of legislation is the fact that in all of Latin America, because of our Spanish heritage, our legal systems are based on the Spanish civil code, which has a very strong influence from French and Roman law. It is a place where, as you already know, formality takes precedence over substance. We are based on paper. Basically, if you don't have it on paper, you may as well not have it. So this creates a huge problem for the e-business. Out of all these different jurisdictions, we have in Colombia a very aggressive and innovative amendment to the legislation. But Colombia is to some extent out of the scope of my practice, so I decided to focus on Mexico and see what the newly enacted developments are.

Unlike other jurisdictions, in Mexico the decision of the legislative body was to amend—not to create a new body of law, but basically to amend—four different sets of laws that to some extent govern all of what could be considered economic or commercial activity. That included the Federal Civil Code, the Federal Code of Civil Procedure, the Commerce Code and the Consumer Protection Law. These amendments were made based on the United Nations model law. They follow, much to our satisfaction in Mexico, the concept of neutrality of technology. What does that mean? Well, it means we are not married to any specific technology, with VeriSign or any other technology that's used at the present time.

We have the amendments in the Federal Civil Code that allow now e-business to exist. This includes recognition of the concept of data messages. Why is this important? Because in the past basically anything that was not put on paper was not recognized. You could form a contract through mail and telegram, but you wouldn't want to do that because you usually would not have the basis of the signature—a signature which would allow you to accept responsibility for the obligation or the offer or the person who issued the acceptance. What happens to data messages? They now have equal standing with other documents, and that's great.

However, there's a small caveat. They should meet certain requirements, requirements as to determine their authenticity. Since we have paper documents, we need to make sure they have not been altered, but we'll talk a little bit more about it further down the line.

The scope of consent and acceptance was brought in. Why? Because the only specific issues of consent and acceptance were either person to person, an exchange of documents or mail and telegram (but these latter two now are basically out of the picture).

Now, as in basically all jurisdictions, I would assume we have two basic elements of consent. The Code now says that, besides being expressed verbally or in writing, consents can now be expressed in electronic, optical or other technological means. Now what does that mean? Not only could I send you an e-mail and say I accept, I can also click through an agreement, and by clicking that specific button I could give you my acceptance. Also, I could send you a file, a word processing file, an MP3 and/or voice recognition file.

Then we go over to the acceptance. What happens? When is the offer accepted? When am I going to start relying on that offer? When the offer is made, you will only be released if the offer is not accepted immediately. What this means is that in the electronic context you are allowed to be considered as a present person, so you have an immediate acceptance that allows you to sign through the famous click-through agreements without needing to have a specific e-mail or acceptance later in time. The same rule is applied now if you do the deal by telephone or any other technological means. Again, the law is neutral and opens the door to new technologies that might come in.

Now, something that's very common in our jurisdiction is the fact that for almost everything you need a notary public: You need to authenticate documents. That is, you need to make sure that the parties were those who signed the documents. What does the law say about notaries public? Basically you can do certain acts electronically with notaries public. However, their authorization is not electronic as in the U.S. Basically, what would happen is that offer and acceptance would go to a notary public. The notary public would draw up a deed, just like at any other time, put it in writing, and he would be the custodian of record of those items. Now keep in mind that notaries are regulated on a state level. So you're going to have different criteria and different issues that will arise in different jurisdictions. For example, a notary in Mexico City might already be accepting offers and acceptances as sent by the parties by electronic means. However, maybe a notary in another state, in Chiapas, might not be doing the same. That is something that will take some time to develop.

Now, the next part of the law that was amended was the Federal Code of Civil Procedure. This provides that data messages are now admissible as evidence. Before now they really had no weight at all because of the easiness with which data messages could be altered or modified. However, we still have a caveat. They are admissible as evidence, but their evidentiary value is going to be determined by the court and the judge. On what is the judge going to base his determination of how that evidence should be weighed? Well, there is authenticity: Is this the original message? Has this been altered in any way? To this extent, then, the offeror of proof has the burden to prove that the data message was not altered; that it was kept in a safe storage system; that it was subject to some technology that avoided its subsequent alteration from the time that it was originated. Another issue is trustworthiness: Do we know that that data message in fact originated from the person to whom it is being attributed? Again, electronic signatures come to mind and other different authentication technologies.

Now, although this looks great on paper, it's going to take some time for this whole system to change. I believe there's a steep learning curve here. Why? Because we've had a long time being distrustful, being more than our share of the devil's advocate on this. So probably a judge will be up front with the fact that he has a data message, and that it is a key part of proving right or wrong: We'll have a very large curve to accept whether he can use that or not. Again, this is only for the Federal Code of Civil Procedure. We expect the states to mirror these regulations soon, but what right now might be admissible on the federal level might not be admissible on the state level.

Also, data messages can carry just about anything. You can use a Word document because of the amendment of technologies. You can presumably have a statement from a witness coming in a voice file, an MP3 file.

The third law that was amended was the Commerce Code. It now specifically states that companies and individuals may offer goods and services through electronic means, which was not the case before. That's significant because it narrows the speculation or the interpretation that the judge or the parties will have to do at the time any dispute arises. Electronic agreements are now recognized for mercantile matters. Again acceptance comes into play.

Also we have special storage requirements. For example, for regular files you have the requirement also to maintain on file for ten years any correspondence or any electronic documents for which you have obligations for any type of rights, and you have specific rules for making them available. And you must make sure that they cannot be modified. And this is only in the context of business to business. Some overlaps, including some provisions of the Consumer Protection Law, were also amended.

Again we go to issues of perfection. Was the agreement perfected upon the acceptance of the offer? They are also narrowing the issue of when acceptance was received. For example, you say, "I sent it to JFerguson@tpw.com, and he is related to tpw.com." Well, in that case the law gives you a chance to argue that the acceptance was achieved the moment that he actually got note of it, notwithstanding the fact that he never received the e-mail.

Then we go quickly to the concept of data message. Data information, information that has been generated, transmitted, received, archived or communicated through electronic, optical or any other technological means. Again, this is open-ended: it allows you to include faxes or word processing documents and any other file or any other means that will come up later. Also data messages can now fulfill the written formality in those jurisdictions. If you have it on paper, it is good. If you have it verbally, it is effectively gone with the wind.

Lastly, the Federal Consumer Protection Law. I would consider it to be very advanced. Unlike the prior law, you have now policy requirements. There are broader powers to review e-disputes with e-retailers, and also special requirements for business-to-consumer commerce. For example, data collection is allowed: Businesses can collect whatever information they want on all the consumers they sell to. However, release is subject to the express consent of the consumer. Businesses are also obligated by the law to use the latest technology to safeguard that information. They cannot say, "Oh, sorry, someone hacked into my system and stole the credit card numbers." They could be liable for that. But we don't know how effective it will be. It prohibits illicit e-mail, or "spamming" as it is already known in the States.

As a closing remark, these are national regulations. We don't know yet how well they are going to be accepted, for the time being, the learning curve is still gathering momentum in different states, for we still have to implement them in different states. But I believe it is a big and remarkable jump for Mexico and e-commerce legislation. Thank you.

### C. Questions

MR. PERLMAN: Thank you very much. I have one question for the two of you. Considering the fact that E-Sign can be overridden or superseded by the states if state legislation specifically references E-Sign, it just seems to me that this is an area that is just becoming more and more fractured in terms of what are the rules of the road for digital signatures and just cries out for some sort of an international treaty or convention of some kind. Are either of you gentlemen aware of anything moving along that road, or is it going to continue to be more and more fractionalized?

MR. MANEY: Well, I think it isn't "and/or"; it is an "and." The E-Sign says that the state law is permissible; it is not preempted, provided it generally conforms to the UETA, and, if enacted after the date of E-Sign, contains a specific reference to E-Sign. If it is enacted before E-Sign, it doesn't have to refer to E-Sign. But the fact that it makes reference to E-Sign does not get it out from under the need not to be inconsistent with the more generic things.

I think the federal law is imposing a requirement of some type of uniformity on the various states. I think the concern in the federal Congress when UETA was enacted in July of '99 was that many states were starting to enact a similar law, but they kept making local modifications, and there were concerns about balkanization that way. That's why the federal law is written the way it is.

MR. FERGUSON: Thank you.

## IV. Marketing and Advertising on the World Wide Web

MR. FERGUSON: We'd like to move on now to our next segment on marketing and advertising on the Web. In addition to having its own special rules (in fact the FTC has given out standards on this), there are also issues of conflicting rights with existing marketing channels. For example, the Webcasting of an international sporting event compared to the rights that a television broadcaster might have. Likewise, the issues of territorial rights with respect to marketing products that generally follow geographically limited trademark rights.

To address these subjects and others I'm going to have Mr. Reed Freeman and Jamie Malet. Reed.

### A. The U.S. Perspective on Marketing and Advertising on the World Wide Web

D. REED FREEMAN, JR.: Well, a little while ago Michael said, "Imagine the disclosures for this or that." Well, that's all I do: imagine the disclosures for this or that. And that's what I'm going to try to convey to you today. The purpose of this talk is to leave you with some sense of what to do when somebody puts advertising copy in front of you and says, "I need to have this approved in fifteen minutes."

So let's just jump right in. First of all, the first question you need to ask is: "Does the ad I'm looking at require any disclosure at all, or can I just approve it and move on to the next thing?" Well, a disclosure is necessary if the ad either makes a claim that is true but nevertheless misleading or doesn't convey the full amount of information. For example, a number one claim such as "We are the number one in our category." Well, believe it or not, the law holds you, if you say that, to be number one in sales, number one in service, number one in

just about everything you can imagine because it is unqualified. If you mean to say, "We're number one in sales in August of 1983," you need to say that. And you need to disclose any limitation to the claim. So there is a problem if the statement is truthful, but nevertheless doesn't tell the whole story, or is a little bit misleading. It goes without saying that a disclosure can never contradict a claim outright.

So enter the Internet. Up until now we had a comfortable time figuring out where to put disclosures on the television, and how to do disclosures on the radio, and where to put disclosures in print. Well, the question became, "What can you do on the Internet?" The page is a little smaller. The page is different in some instances. We now have the availability to link, to put disclosures down on the same page, but where you have to scroll down. How do you deal with that? Well, the FTC (I'm glad Susan has left, because I typically bash the FTC while I'm talking) has put out some guidelines which don't tell you exactly what to do: you need to infer from them what to do. But they are reasonably helpful.

First of all, there is the matter of the prominence of the disclosure. Obviously, you can't have it in tiny little print in white against a white background. It can't be in the middle of text that distracts your attention from it. It must be repeated every time the claim requiring the disclosure is repeated. People sometimes get into your Web site through the back door or through the middle door. They may not see the disclosure that you have on the front page. Free computer . . . Must subscribe for $21.95 Internet access. You may have that on the first page, if you say it in the middle page, you have to have the disclosure there too.

As for audio disclosures, I know that you often hear on the radio on the way to work gobbledygook so fast you have no idea what they said. It is all illegal. When business people say, "Why can't we do it?," the answer is simply that they haven't been sued yet. They will be eventually. So the FTC goes on to say that a disclosure is more effective if it's placed near the claim it is qualifying. It is no good to have a disclosure placed way after the claim or on a different page. It needs to be close. Sometimes you may have people come to you and say, "Well, I've designed the whole sales page, can click through here and here, and here is the order page." Well, if it is an important disclosure—for example, these free PCs, free PC or $200 PC with printer but you have to subscribe to three years of Internet access—and you put that disclosure way at the order page, way after three or four screens of sales text, the FTC is likely to say that's deceptive. It's what they call a deceptive door opener. You open the door to the consumer's interest and allow them in, but don't tell the full story. Now they are in, they are more interested, but you got them there through deception, through material omission. The deceptive door opener obviously comes from the practices of encyclopedia salespeople who, when you open the door, say, "You've won a trip to Maui," when they are simply selling encyclopedias.

The FTC prefers disclosure on the same page as the page triggering the claim. Well, what is a page? Who knows anymore. Maybe your laptop has a different size, your telephone, your hand-held PC. This is going to become an issue, and we are going to hear more about this from the FTC. But the rule is, if a disclosure is not right next to the claim, and it is likely the people are going to have to scroll down, you can't have blank text, then "free PC," then blank text blank text blank text, and next "$21.95." That's no good, because people won't know to scroll down. Now, if you have sales text that requires people to scroll down, you can have your disclosure down there because it is reasonable to think people will read the sales text and hence see the disclosure.

So if you need to send people down on the page and you're going to have blank text or in any other instance when you need to send people to a disclosure, the FTC has said it is no good to simply say "See terms and conditions" or "See details." None of that is any good. You have to be serious about it: "See below for important information." "See below for important details." But you need to attract people's attention to what it is that they need to know before they enter into a transaction.

Okay, now let's discuss the prominence of the disclosures. The first thing we need to say is the following: Size matters. The FTC has said for a long time and continues to say that small print disclosures are no good. But they haven't been suing on it, so they have left lawyers in a tough position. How small is too small? Well, I'm here to tell you the FTC right now is in the midst of nonpublic investigations of major companies for their small print. Small print right now is dangerous, especially if you put the small print somewhere away from the claim, or sideways on the page, or upside down on the page. I've seen it all, even five pages later. If you're going to have a disclaimer, it has to be big enough for someone to read. I have actually had people come to the government with disclosures so small that the client, when looking at the disclaimer, had to put their glasses on to read it. That's a killer. And you can't use a color that blends in with the background.

Right, laugh now. But Marketing will come to you with it later and say everyone is doing it. And you can't bury your disclaimer in long text. A classic example of this is a trademark or copyright of our company, all rights reserved blah blah blah—four or five sentences of that—and then, suddenly, "$21.95, monthly contract required." That's no good either.

So beware of distracting factors. In advertising law, when I really get caught and I don't know what to do or advise a client, I often call my mother and say, "What do

you think about this?" And if she says, "That's ridiculous," I tell my client, "That's ridiculous." So that's a good thing to keep in mind.

So beware of distracting items. Again, repetition: If you're going to make a claim that requires a disclosure, you need to repeat the disclosure.

If you have an audio claim on a multimedia Web page, such as "Free PC," you need an audio disclosure. Can you get away with it if you don't have an audio disclosure? Probably so, as long as the disclosure is big enough to see and it's prominent and so forth. But the rule generally is: "audio claim, audio disclosure." And, of course, you all remember the lease ads that automakers have where they say, "zero down," or they just say, "$199 a month." And then disclosures in mouse print so small that the FTC Chairman said he got on his hands and knees in front of his TV and still could not read it: That is also a killer. It says $4,000 due at lease inception and so forth. Those disclosures need to be on the screen and easy enough to read for long enough. You cannot have these things go by like at the end of a movie that people can't read. You cannot play games like that. And I emphasize (I'm describing it sort of lightly, but I emphasize) this is a very, very aggressive time. We may see the FTC lighten up now that the Bush Administration is in, but that's going to take a while. But the states are out of control, completely out of control. And they come after you for things you could not imagine are a problem or weren't a problem ten years ago.

Hyperlinks. There are really three important things to remember about hyperlinks. First if you're going to have a hyperlink, you need to make it clear that it's important to go to this link for a certain reason: "For important information about this offer, click here." Something like that.

Second, you cannot hyperlink to price information or information about health and safety. For example: "Newest dietary supplement provides energy to last all day. Click here for details." Then there's a disclosure like "Caused cancer in 38 out of 50 patients." Okay, that you cannot do. Same thing for price information. The $21.95: you can not link to that. If you do, you've raised the risk substantially. You will get sued if you begin to get a lot of consumer complaints. That's the barometer. But these are the things that are likely to trigger consumer complaints in the FTC, and the states are not likely to be amused with.

The third thing on hyperlinks I want to mention is that you must (the FTC has said this, but it has gone largely unnoticed), if you're going to hyperlink to important disclosures, keep track of the people who go to your page and then go to the disclosure page. When you get back to your office, look at your Web site, call the tech guy and say, "We need to run a report on this." If people are not going to the link page, and you find yourself before the FTC and negotiating a settlement, you are going to lose. We have been over this for labeling hyperlinks too. You can't make it seem trivial or unimportant.

Banner ads. A couple of important things to think about for banner ads. The first thing I always hear is the following: "Get the FTC off my back. I can't put all disclaimers in a banner ad. I can barely fit my text in." The answer is that, for things that are not critical to understanding the deal, you can have them on the jump page; that is, the page the banner takes you to. For things that are critical—"$21.95," "Causes cancer," and so forth—try an interactive ad where the text scrolls through. But you cannot have the jump page take you to the disclosures.

Has anybody seen these ads: "Click if your something is not optimized," and it says "Click here"? It looks like a Netscape box. That's deceptive. And why haven't they been sued? I don't know. But it's a problem.

Finally, privacy issues on banner ads. If you're a Web site that takes ads, ask your ad company whether it is putting cookies in these banners. If they are putting cookies in the banners, they are tracking people: you need to disclose that in your privacy policy. Every ad network that I'm aware of puts cookies in banners they serve. If you're doing it, ask about it, and get it disclosed.

I just want to touch on a couple of issues that are available on the FTC's Web site, which is www.ftc.gov.

First, unsolicited commercial e-mail. Here is the quick rule: not prohibited federally except for fraud. In the states you need to have a clearly understandable remove option, and then you need to do it promptly. It should say "adv:" before it. And in some states you have to make sure you're complying with the Internet service provider through whom you're sending spam. We call it in Virginia the AOL Protection Act.

Second, mail and telephone order rule. If you ship consumer goods, go to the FTC's Web site and pull down the mail and telephone order rule. This has to do with shipping on time and providing notice to consumers if you're going to be late.

Third, free trial offers. The deal is as follows: If you're going to have a free trial offer and people have to call you to avoid being charged—such as "Free trial for 30 days, then after that you're going to be charged"—you need to have that in big letters.

In conclusion, what's at stake? A lot is at stake, especially if your company is sensitive to press and bad publicity—and whose isn't? It is a public relations disaster to have the FTC come after your company publicly,

saying that it is involved in a deceptive practice. They could make you pay penalties, they could make you engage in corrective advertising or they could make you engage in corrective advertising and call it consumer education. In any event, it is a disaster.

Finally, for further information, there's the FTC's Web site I also will offer to you. But I have to disclose that these are my firm's Web sites: advertisinglaw.com and onlineprivacylaw.com.

### B. European Issues in Marketing and Advertising on the World Wide Web

JAIME MALET: Good morning, everybody. I would like to start my shorter speech. In regard to what Gerry said this morning, that the Internet is dead, I must say that the sense in Europe is that the Internet is not dead; it is just going to grow more slowly than it was thought at the very beginning. In any case, it is going to have at least two kinds of beneficiaries. The first ones are going to be the end users, that is, companies. The second ones are going to be we.

I would like to define the basic problem, which is that the World Wide Web is allowing the marketing and advertising of all kinds of broad services and ideas without borders. This can create two kinds of nuances. The first one is related to contractual relationships: Contracts with territorial restriction rights may have problems with the concept of borderless marketing and advertising. The second one is related to the legal frameworks: There may be problems because the marketing of certain goods or services or certain advertisement may be forbidden, regulated with mandatory rules or not regulated in a given territory. We are going to try to address both issues very briefly this morning.

In regard to contracts with territorial restrictions or limitations, these can be of different kinds, such as exclusive distribution agreements, exclusive supply agreements, franchising, commercial agency agreements or licenses. And there are two potential cases. The first one, when the grantor of a territorial exclusivity right, such as a manufacturer licensor or principal, sells its goods or services over the Internet to people located in the exclusive territory, acting against the right of distributors, licensees or agents. This, for example, is the dilemma of Compaq, which cannot not compete with its competitors. Every time they want to go to massively sell computers through the Internet, the distributors that are making the company income, the big income, say that they are going to sue the manufacturer.

This has happened with a client of mine that has a license to manufacture or distribute a very well-known line of fashion clothing in the south of Europe: whenever the manufacturer has put a very popular item on the Web page, a lot of people from the south of Europe in my client's exclusive territory go to the Web and try to buy the item directly. This is causing a lot of problems, because in twenty years the client has spent a lot in building that brand in that territory.

But it can happen the other way around: When the grantee of the territorial exclusivity right sells goods or services over the Internet out of the exclusive territory against other territorial grantees or even in the territory of the grantor.

How to avoid these situations? I would suggest doing so through negotiation and contractual clauses establishing limits or restrictions on marketing and advertising outside the exclusive territories. Actually I believe that our contracts before the Internet era, pre-Internet, are going to be a challenge for our profession in the coming years.

The European Union law regulates what kind of restrictions may be used for the World Wide Web. Many may be contractually set between contractor and grantee in order not to infringe on European Union competition law rules. These apply to vertical agreements, like distribution, supply and franchising arrangements, but not to other contracts with territorial restrictions, such as commercial agencies or licenses.

The European Union Law is regulated in Article 81 of the Amsterdam Treaty, which established that certain agreements between companies are prohibited. But it opens the door to some of those agreements, in this case vertical agreements that can favor distribution channels or benefit the Community as a whole. These kind of agreements that are lawful are regulated in some block regulations, in this case it is a block regulation regarding vertical agreements from 1999. Also important are the guidelines interpreting the block regulations, namely, 50 and 51.

But these regulations of the European Union not only say in what cases the restriction or limitation contractually established between the parties is not going against European Union competition law, but they also are used to establish criteria that will be used for the courts to know when Internet marketing or selling in a territory means a breach of a contract or not.

What are the criteria established by the European Union? The key criterion is called the active/passive sales rule. This is an old European rule, and it means that when the distributor/franchisee is granted territorial exclusivity, he is the sole one who may carry out an active sales policy in the allocated territory. But passive sales made by other distributors must be contractually permitted.

How are passive sales defined? Passive sales are defined as responding to unsolicited requests from individual customers, including for delivery of goods or services to such customers. And active sales are defined

as approaching those customers inside the exclusive territory by direct mail or visits or approaching customers through specific promotional activities to target consumers in that territory.

As we said, active sales may be contractually restricted according to European Union law, and if the manufacturer makes these active sales in the exclusive territory, this may mean a breach of the contract. And on the contrary, passive sales must be permitted according to the European Union law and can be established in any contract.

This, then, is our construction of the law, which has been adapted to the e-commerce phenomenon. There are two general principles. The first one is that every distributor must be free to use the Internet to advertise or to sell products. General advertising or promotional activities on the Internet are passive sales, although they may reach people out of that territory. For example, if a company has a Web site, such as when Adidas has a Web site in the United States, it doesn't mean that it's actively seeking customers in Spain, even though Spanish customers can buy running shoes on the Adidas American Web site.

Guideline 50 considers that these passive sales coming through the Web site are reasonable because the sites can be used either for seeking or advertising goods and services to people or clients in the home territory and not just to territories where there are no territorial exclusivity rights.

So what would be considered active sales? When there are promotions or sales with banners or links in pages of providers specifically available to customers in the exclusive territory. There are some special rules. The first one is related to unsolicited e-mails, so-called spamming: these are always considered active selling. We will see later that there are some regulations in the European Union in regard to this. There are also selective distribution contracts that can have some restrictions imposed by the manufacturer on passive selling because of quality standards.

Actually, there is a very well-known case in the European Union where a Spanish company called Parfums.net is selling through the Internet in France trademarks and brands of the biggest perfumes manufacturers, like Yves St. Laurent or L'Oreal, and all those manufacturers or many of them have demanded that this company appear before French courts. And a French court has issued an injunction to prevent this Parfums.net company from selling over the Internet in France because the court believes that the Web company does not follow the quality standards established by those manufacturers for all their distributors. We are going to see what happens, but quality standards are normally, for example, the color of the carpet or the size of the store. And this is very difficult to say or to require for a company that is selling things through the Internet.

And there is another exemption, namely, the opening of a new geographic market, where there can be specific contract rules that say there will be two years where passive sales and active sales will be allowed by the exclusive grantee of the territorial right.

These criteria established by the European Union, I believe, are going to cause a lot of lawsuits. That's because it's very important to draw a line: it's incredible to say to people who have been building a trademark for years, putting in a lot of money, that all that can be undermined by a Web site, even if it is passive sales of the manufacturer. The fact is, much of this marketing by the exclusive distribution is going to be used to foster sales by the manufacturer without paying any consideration to the agent or to the licensee.

The other issue that I would like to address is related to the problems that the European Union is facing and is seeking to regulate because of the borderless aspect of the World Wide Web. There is a directive for electronic commerce of one year ago. What this is trying to do is coordinate certain national laws, clarifying legal concepts at the European Union level.

We are going to talk about four relevant aspects. The first one relates to rules in regard to the access to online activities. The second one is the national supervision of online activities. Then there are rules relating to commercial communications (that is our regulation related specifically to advertising on the Web), and then finally some rules on liability.

Regarding access to online activity, the European Union has stated that no entity can be forced to pursue activities on the Web. Thus any activities of international information society service providers may be subject to prior authorization, but are required to do the same activities offline.

There are other rules related to supervision of online activities. They provide that when an online activity is permitted by a member state, then no other member state can impose other limits or restrictions on that activity. So for example, if an American company goes to Europe and has the license to work in Europe in a member state, then the company doesn't have to go to any other state to see if they are permitted or prohibited to practice their business. There are some exemptions, most of which relate to public policy.

Commercial communications: Any form of communications designed to promote the goods, services or image of a company, including all kinds of advertisement or marketing, are included, but not domain names or hypertext links. The rules established by the directive are that all these commercial communications must

comply with a specific European Union law for advertising. For example, not permitted is misleading or comparative advertising. Such conduct is not permitted, according to the European Union law, nor is advertising of tobacco or alcohol or other prohibited substances that are regulated by European Union law. The commercial communications must clearly identify that they have commercial character. Those mini Web sites that seem like they are not commercials: they should all say that they are commercial. And the entity on whose behalf the commercial communication is made must be clearly identified.

There are some special rules for promotional offers, discounts, premiums or gifts and promotional competitions or games through the Web: Those may be forbidden by a member state. And if they are permitted, the offer must clearly identify the conditions required to qualify or to participate in the promotion or competition. There are also special rules for spamming, which may also be forbidden by a member state. And if it is permitted, the information service provider must regulate, consult and fully respect opt-out registers where users may register to stop this kind of communication.

Related to liability of Internet service providers, I have to tell you that the recent general rule, that this exemption from liability for players with activity limited to the technical process, mere conduit caching—mere conduit caching means caching by the root services provider when data are sent or stored, and hosting, all of you know what that is. There is no obligation to monitor the information that the service providers transfer.

And what is possible according to European law is that a court can issue some kind of injunction to stop any hosting activity of any illegal content through the Web or to identify the final content provider. Thank you.

### C. Questions

MR. PERLMAN: Thank you. We have still a few minutes to take some questions for Reed and Jaime.

FIRST AUDIENCE MEMBER: Yes, I have a question for Reed. Just referring to your Freeman test, calling your mother. What standard is evolving? Is it the least sophisticated consumer? Or is it the reasonable consumer? I should also mention that the New York City Department of Consumer Affairs is using the least sophisticated test or words to that effect.

MR. FREEMAN: You don't mean to say that the New York official himself is the least sophisticated regulator.

FIRST AUDIENCE MEMBER: I don't mean regulator, but the standard of the consumer that you're measuring against. The reasonable consumer or the least sophisticated?

MR. FREEMAN: That's a great question. The rule is reasonable consumer under the circumstances so that it's an objective/subjective test. It is subjective to the extent that you have to look at the type of consumer likely to engage in this transaction. And then among that category of consumers, what would be reasonable for that person to expect.

Now, that said, the reality of the matter is that when the FTC is headed by a Democrat, it's a little tougher standard, and when it is headed by a Republican, it is not so tough a standard. You know, it ebbs and flows a little within certain confines. But it is the reasonable consumer likely to engage in that particular transaction.

SECOND AUDIENCE MEMBER: The international question that was raised before seems to me at the heart of this. It has come up both in this trademark/investment issue and marketing and it has also come up within the local law. That question is, what is the technical situation at present in terms of being able to limit a Web site only to customers within a specific geographic confine, so you could avoid encroaching on those geographic limitations and also the local law issues?

MR. MALET: This is called in English something like reverse IP protocol or something like this. For example, this has been used by America Online successfully to not provide contents to some countries in the European Union, where the content is absolutely forbidden. And it is being used for Yahoo!, which has been stopped from doing that by a French court. But it cannot be used totally, it's not totally certain. It's eighty percent certain, but you cannot stop everybody from going to your Web site from a country or reaching the content of the Web site from a country.

SECOND AUDIENCE MEMBER: Why is that?

MR. MALET: Because of technical capabilities that are beyond me.

## V. Responsibility for Content on Bulletin Boards and Chat Rooms

MR. PERLMAN: All right, now we'd like to move on to our final topic for the morning: Responsibility for Content on Bulletin Boards and Chat Rooms. I would like to invite up Ron Lopez and Andre Betrand.

### A. Europe

ANDRE R. BETRAND: I would like first to make this presentation practical and extend it beyond France. After all, when we speak about France, we can say that what applies to France applies to Continental Europe: the so-called civil law countries and the countries where basically we do not have a cross-examination system, but rather a paper-based system. Thus, many things I will say about France will apply to some other European countries. However, you have to understand that France

is the place where we have the most case law. We had the same thing with territorial protection; we now have the same problem with the Internet.

This is due to the fact it is rather easy to go to court in France. You can obtain a summary judgment for a few thousand dollars. I always give the example that I was able a couple of years ago for a few thousand dollars to bring one of the biggest U.S. companies into bankruptcy during a patent proceeding, due to a summary judgment in France. And this big huge company in the States was unable to get more funds once it had a negative judgment in France.

So we have a lot of case law. You have heard about some of the case law. The famous *Yale* case, which was rendered by the president of the civil district court in Paris, named Mr. Gomez. I will refer to him several times during my presentation because he is the person who has rendered basically most of the cases.

I know it is very difficult for an American to understand that we have judges that are trying to become Internet judges and want to really be involved in all the cases. And usually it is very difficult to explain also to a client, when he comes to us that if he wants to bring an Internet case, we have to go to Montpelier to see Mr. Gomez to be more or less sure of the results. Usually the clients get scared, and will say, "What, you know the judge?" And I will say, "I know the judge well because usually I do one case a week in front of him." It doesn't mean that you a have specific relation, but they openly say that lawyers who argue most of the cases are of course well known by judges, especially when they write rules and treatises.

So the first very important point which I want to stress is that in France, and I would say in most of the European countries, we do not have the approach of active and passive Web sites. This is something totally American, and you have to understand that conflict of laws is not something which is taught in basic law school in Europe. You know, you learn conflict of law when you enter into a law school in the United States because you are in a federal system. We are just tackling the federal European system, and thus conflict of laws is something that you learn when you're doing it. And judges have difficulty grasping the principle of conflicting laws.

So the elementary rule is that, if something appears on the screen located in a district of a court, this court is compelled to hear the controversy of what appears on the screen. And this French rule is based also on an approach which extends all over Europe, due to the so-called Brussels Convention. It is Article 5.3 of the Brussels Convention. We are talking of tort law. If you say something nasty or write something on trademarks and you were talking about the French trademark, you would be under French jurisdiction and French trademark law. So what is very important in this respect is that anything posted on a U.S. Web site thus is subject to French law and French jurisdiction.

Our Spanish colleague was just mentioning a case which I should mention, about knock-off perfumes. As you know, knock-off perfumes are perfectly legal in the States: it is considered a form of competitive advertising. You have case law up to the federal courts. For years French companies have tried to prohibit the sale of knock-off perfumes in the States and they were unable to do so under U.S. statutes and under U.S. case law.

Now, when somebody sells knock-off perfume over the Internet in the States, that company is usually sued by L'Oreal in France, and L'Oreal usually gets a judgment by default. I think today they have about two hundred L'Oreal cases that were rendered by default. So in France we have in all one hundred fifty cases—and I'm not including the L'Oreal cases.

The issue here today is responsibility in chat rooms, discussion on the Internet, etc. Thus, the form is not so much on sales. So the thing which I want to say is that we also have a different environment in Europe in this context. The big discussion is how much the state should regulate. And of course the approach is that the state should regulate everything because it is in the interest of the people. So one of the key issues about regulating the Internet in the past year has been whether or not the Internet was something which was nearer to the press or nearer to TV or nearer to telecom, since in all of those three fields we have different regulations that apply to the way you can do business. In France you cannot launch a telecom business or audiovisual business without some specific authorization.

What is very important to know is that until 1 August 2001, if you want to set up a Web site in France, you have to officially declare this to a federal prosecutor.

This is so because there is a list of all the Web sites operating in France, just like you have to declare a newspaper when you want to start a newspaper. This obligation was taken out of the law as of 1 August 2001, a law which was passed during December. But we still have an organization—some people may have heard about it: the CSA—which is the organization that controls and regulates television in France. And they would really want to have control over the Internet. So it's something that comes back from time to time.

Since we are talking about messages, chat rooms, discussion forums, etc., you also have to take into account that sending messages on the Internet is also considered part of not only telecommunications but communications. What I'm trying to say is that we have laws on postal messages. If you send a message by the post, nobody can open it. I'm not talking in terms of privacy; I'm talking about violating the legislation which

says that you cannot open a document which is sent by mail.

Thus, a few days ago, the director of a company was convicted because, in order to show that one of his employees was doing something wrong, he intercepted a message and he opened it. Even though he took a message which was sent through the computer at his workplace, it was considered that it was a violation of the law to open a private message. But this is not really privacy: it really extends to more than that. So what they want to say is that some chat rooms, which may have only a few people connected and are not totally public, are afforded this kind of protection under the law.

Now, the issue of who is responsible for making the posting has been the source of a lot of litigation in France. This has been in connection with so-called community Web sites, where people used to post various documents. And of course there was litigation, and the server had responsibility for a while. The case which is at the core of the controversy is a case where a famous top model, Estelle Hallyday, well known in France, also was married for a while to the son of one of our most prominent rock-and-roll stars. A former boyfriend had taken pictures of this lady nude when she was very young, and those pictures were posted on a community Web site. Nobody knew who had posted the thing, but the issue was whether or not the entity controlling the community Web site should be held responsible, and of course it was ruled that the entity was responsible.

So this led to an uproar. Everybody had the feeling that the Internet was in danger. So we had petitions and things like that, and this was also taken into account in the EC directive. As a result, the French law was modified to say that the server or anybody which is not directly posting the thing is only held liable if after a warning letter he has not taken down the document, etc. So basically, you cannot sue directly. You have to say, by the way, that there is something which violates my right or my image or my copyrights. Take it down within a set time—a few hours—otherwise I will sue you. And the first case was rendered under this new law on 20 September. It is a case called *Multimania*, and it was rendered by Mr. Gomez.

*Defamation*. That's also an issue which shows the conflict between traditional law and the law of the Internet. We have a concept of defamation in France that goes back to the year 1881. So the law on the press in France is about one hundred twenty years old, and it has always been presented as a law which protects journalists, etc. In this law, the issue is that defamation is something which has a very short statute of limitations. Thus, you cannot sue anybody for defamation more than three months after the publication of the newspaper. This is to guarantee that people will not be sued twenty years later.

You know, I must say I was very surprised. While I was waiting I was reading some of the material which was distributed, and I saw one of the cases argued by the Supreme Court which was connected with elements that went back to the Sixties, about people demonstrating in Alabama. So to some extent, I think this short statute of limitations has something positive.

Now, the question is, "When does the posting start on the Internet, and how do you calculate the three-month period?" So the first Internet defamation cases in France were not successful because the Internet message had been posted on the Internet for more than three months. Then the court changed their attitude. They said that, since it was posted and posting is some kind of ongoing act, they considered that, even if it had been posted a year, it could be prosecuted under the law of defamation.

At the present time I must say that the case law is controversial and unclear. I was asked about the leaking of insider information. I must say we have a lot of case law about very strange issues in France, but leaking of insider information has not been an issue on the Internet. I don't think that it was under what we call the ancient Internet, which was the minitel in France. So I have no idea whether they would say traditional insider trading law would apply. However, in France I would say we have very few cases about insider trading law.

*Stock manipulation*. Again, there is no case law. There has not been much law. Under the minitel, what they would say is that general tort law applies in such a case.

Now, I was asked about site slime: "yourcompanysucks.com" or sites to damage. And the question is basically damage to competitors. And if I'm correct, many of these sites were not done by competitors, but at least some of them were by users. We don't have this freedom of speech thing in France. If you say something bad about a competitor, even as a user, we have only one case, which is the *French Metro* case. Somebody did a site directed against the Metro, and of course this was trademark infringement.

Then the other issue is the story about the sale of Nazi items. It is a very strange story. You have all heard about this, what Mr. Gomez has decided. You know it is a very strange thing, because I'm not convinced that the sale of Nazi items really violated French law. It was just presented as a moral issue and an offense to the French attitude, French moral attitude.

What I have discovered, in any case, is that Yahoo! has agreed to comply, and so to some extent the approach led to a result. But that is one important thing, and I'm telling this to any one of you who is involved with auctions, because this is something which was never raised in the litigation. In the Convention, which is applicable in France, there is a specific section about

what law applies to an auction. And this says that the law of the place where an auction takes place is the applicable law. If this had been raised, it would have been a conflict between what the judge wanted to do and real positive law. But this was never raised.

I would like also to stress now another important issue, which is not known in the U.S. We in France have a stronger concept of privacy, which is called intimacy of privacy, than in the U.S. In other words, if you have shared something with another person, you cannot write about what you have shared or even disclose a picture. What I'm saying is that you cannot put a picture of your girlfriend, even if she has accepted in the past to be a nude model, on the Internet. You cannot in your biography tell intimate things about your former wife. For instance, Vadim, the former director, was sued by all his former wives once he produced his autobiography.

So a young man who posted a picture of a former girlfriend naked was not only sued under that legal principle, but furthermore he had put some comments about what she was doing in private to him in the past. So it was considered that this was an illicit file, and he was also prosecuted legally for creating an illicit file on that person.

In conclusion, what I want to say is it's very clear that there are many common points between the core substantial U.S. law and French law or even European law. However, there are differences, and I would say, beware of those differences. Europeans consider themselves as competent and able to really prosecute you for violating the European rules and regulations—even if you are in the States without any contact in Europe. Thank you.

### B. United States

RONALD F. LOPEZ: My name is Ron Lopez. I'm a partner with Thelen Reid & Priest in San Francisco. I want to thank you all for inviting me here.

I've looked at the program, and I'm obviously the only California lawyer. There are obviously a lot of international lawyers. So you either consider California international, or you've made a special dispensation for California lawyers. One or the other.

The other thing I learned from Andre—I spent yesterday talking with Andre before our presentation —is that obviously forum shopping is alive and well in France, and Justice Gomez is the person you obviously want to try your cases with. I would also say Andre would be one of the lawyers you want to contact who has obviously tried a lot of cases before Justice Gomez. I guess the other thing I picked up today is that kiss-and-tell books are not permissible in France. That's the summary of it.

Hopefully some of this is going to be old hat for many of you, since what I want to talk about are three things: Content regulation; liability for stock manipulation; and domain name disputes here in the States.

*Content regulation*. I think one way to give a legal framework or context to this is to think of three paradigms of content liability. All you have to do is think about who is the person we are talking about? Who do they most likely resemble? Is it the telephone company, PacBell, SBC, Verizon? Is it Barnes & Noble, which represents any bookseller or newsstand, or is it *The New York Times*, *The Washington Post*, any writer, newspaper or book publisher?

The key operative difference I think we see in our law in the U.S. on these three paradigms on liability is how much control does each of these players have in the dispute over content. The telephone company, obviously similar to a backbone provider: they really have no knowledge, no ability to control what bits of data go across their network. As a result, they have no way to control bad content, and they traditionally are exempted from any liability as a result of content. An example of that is this *Maynard v. Port Publications,* involving a commercial printer with no liability.

The second paradigm is the bookstore/newsstand liability. Book stores: they obviously have such great content, but they don't have any control over their content except once they are put on notice about some infringing or defamatory material or the like. So unless they have notice of bad content, they really don't have any liability. A good example of that type of case applying is the *Cubby v. CompuServe* case. And what they did there was look at CompuServe, and they asked "Where does Compuserve fit into these paradigms?" Is it a backbone provider? Is it the newsstand? Is it the publisher? And what they said was, "Well, we really don't think they have book publisher liability; they are really more like an electronic for-profit facility, so they probably fall under the book store/newsstand category."

Then the third paradigm: *The Washington Post*, *The New York Times*, writers, publishers and the like.

Let's apply some of these paradigms to the Internet and what happens there. So typically the book seller/newsstand is blameless unless we can show that they have notice of bad content. In the copyright context, probably the most well-known case is the *Religious Tech v. Netcom* case involving the Church of Scientology suing an ISP, Netcom, over copyright infringement based on allegedly infringing material posted on the ISP. That's when all their secret documents were being posted on Netcom. The court there said in that case, "We don't find Netcom directly liable for infringement, although there could be potential liability for contributory infringement." So this was a case where you're apply-

ing copyright infringement law to this Internet service provider. The gist of this case was that, once the ISP is provided with notice, then they have to take down the infringing content. Now all ISPs have a procedure where, if they have been provided notice of infringing content that was posted on or through their services, they will take that down.

Bulletin board operators, where do they fall? It appears that they come into the writer/publisher category as opposed to the ISP. One example is the *Playboy Enterprises v. Frena* case. As you know, if you've done any work in the area of trademarks or copyrights, the one thing we have to thank Playboy for is a lot of case law in this area, and this happens to be one of them. This subscription bulletin board service was held to be subject to the innocent infringer standard. That is, the knowledge of the infringing content was not necessary for liability, which is the highest standard of liability. Think about this more in terms of the three paradigms I have given you.

Prior to the Communications Decency Act many claims came under our three paradigms. The *Cubby* court decision found CompuServe, for example, to be the book seller. Communications Decency Act was a reaction to a case that maybe many of you know: it was a New York case, *Stratton Oakmont v. Prodigy Services*. And in that case we have an anonymous Prodigy subscriber who posted allegedly defamatory materials about the brokerage firm Stratton Oakmont and its president, and they immediately turned around and sued for $20 million.

Now under *Cubby* we would have thought Prodigy would have been treated like the book seller. Therefore they would have to have received notice, had opportunity to take it down, and so forth. But in this case the court said no, Prodigy was really acting more as the writer/publisher. They distinguished *Cubby*, and they said Prodigy really had the opportunity to review the content that was going up on that site because (1) they had content guidelines; and (2) they had software that actually looked at the content. I guess it probably was automated: it probably looked for swear words, probably had a list of things they were looking for. So they said there was some sort of publisher-type activity or prescreening, going on; and (3), they were using what we call bulletin board leaders to monitor those bulletin boards and comb them for bad content, although that was actually being done contractually by a third party. But in any event the court here in New York said, "That was enough; we are going to subject you to writer/publisher liability."

Then the CDA comes out, Communication Decency Act and really overturned *Cubby*. And there had been quite a uproar among ISPs about this issue, because, if they were going to be held to this publisher standard, their liability obviously would expand significantly. So after the CDA (and we'll talk about the exemption here, later) really the ISPs are the functional equivalent more of the telephone companies or book store seller type parties. Section 230 (c)(1) of 47 U.S.C. is the exemption provision in the CDA. It provides that no provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.

The first case that came after that was *Zeran v. AOL*, which involved a negligence claim. The court in *Zeran* did say to AOL, "Yes, you are immunized from that sort of negligence claim for republication of distribution of content on AOL."

For those of you that are political junkies, you probably know the next case, *Blumenthal v. Matt Drudge*. It was actually very interesting. Sidney and Jacqueline Blumenthal: I think Jacqueline was already working in the White House, and Sidney just started working in the White House. I think on the day Blumenthal started as special assistant to Clinton, Matt Drudge, a famous muckraker, wrote a story. And the story included this statement: "New White House recruit, Sidney Blumenthal, has a spousal abuse past that has been effectively covered up."

Drudge had a service so that he would distribute that information via e-mail to his subscribers. Drudge was based in California. He also had a deal with AOL: I believe it was that they would post on their site Matt Drudge reports, so subscribers to AOL could access that report and look at that. And it was through a written license agreement, and AOL was actually paying Matt Drudge something like $3,000 a month for his Matt Drudge reports.

Well, the Blumenthals obviously were not very happy about this. That was a totally false statement. It was libelous. It was defamation. And of course they sue AOL, as the publisher, and Matt Drudge. And this was their argument: "Why should AOL be treated any differently than *The Washington Post?"* And there's obviously a good analogy there. But the court said, "We're sorry. Congress has legislated in this area; we have the Communications Decency Act exemption for ISPs. AOL falls within that definition; AOL is exempt from that." So it was just a clear-cut win and a case of applying the exemption. When you think about it from a conceptual framework, you would say, why should AOL and what it was doing (—or pick your ISP or pick your content provider) be treated any differently?

To receive the exemption of the Communications Decency Act you need to be defined as an interactive computer service. That is essentially AOL, and all those companies that provide those services: MSN and the like. Protection under the Communications Decency Act is lost if that ISP starts to act like a publisher. Remember,

in *Blumenthal,* AOL claimed they weren't reviewing the content; it was just being posted up on the site. If they start to exercise editorial control over what's going in, they are going to start putting on the hat of a publisher and arguably the exemption will not apply to them.

Web sites, where do they come in? They really should be treated as newspapers for purposes of defamation-type claims.

*Message postings*: Where does all this framework I've given you leave us in terms of the more recent developments we see going on on the Internet, such as stock frauds and pump-and-dump stock manipulation? If you aren't familiar with it, what you have here is the con artist who basically circulates a false rumor about a company to drive up the stock price, and of course what they do is they sell their shares immediately, so they can make money. To achieve this, they go into these financial chat rooms and talk about the stock and post probably false and misleading information.

A cyber stock smear is just the opposite of that. It is usually perpetrated by short sellers, because they are selling the stock short. What they do is disseminate false and misleading information about the company, to get the stock price to fall.

So those are two examples of what types of Internet fraud that we see going on in the financial area. Let's talk, first of all, about what's the responsibility of the company that is the subject of these types of Internet stock manipulations and rumors. Generally, what does a company have to do when it sees or hears about one of these rumors that are posted on any of these financial chat sites? Under U.S. securities laws a company generally doesn't have a duty to correct or verify rumors unless the rumors are attributed to the company.

However, there's obviously a big caveat. Depending on what exchange they are on and the like, there may be rules of the particular exchanges that companies may have to address particular rumors.

Anyway, companies obviously are cognizant of this—or should be cognizant of this—and their counsel need to counsel them on this, but they have to be very careful in responding to rumors. Some companies wonder, "Should we go into these online chat rooms and actually start correcting rumors about the company online?" I think if you talk to securities lawyers and the like, they say that it's not a good idea to have your information people out there on chat rooms trying to correct false rumors. Most companies who do that are subject to the securities laws, on how they'll make disclosures and the like. Generally, they don't generally vary from those procedures of how they will respond to rumors and the like, merely because it is going on on the Internet.

Of course, another caveat: whether these rumors are attributed to the employees. One of the things companies have found is that these rumors are oftentimes being promulgated by either current employees, which is bad, or former employees.

What's the liability of the poster who puts the message up there and who is manipulating the stock? Well, they don't have any protection under the Communications Decency Act exemption we talked about. They are subject to civil tort claims by the companies, such as defamation or breach of fiduciary duty. They are subject to criminal and civil enforcement actions. You take a look at what the SEC has done in this area. In 1998 they had twenty-three enforcement actions. That's kind of when they started to gear up against these manipulation schemes. In 1999 they had four more enforcement actions going on. And I haven't seen any more recent statistics, but I'm sure they've continued. What they do is go through the Web: they have a group of people in the SEC that are actually on the Web continuously looking for these things. And then they bring these enforcement actions. The other thing they are doing, obviously, is they're getting the federal prosecutors involved to bring criminal action, because all the SEC can do is levy civil penalties against these posters.

Here's a good example, the *Emulex* case: some of you may recall that. I hope none of you owned stock and were subject to this. But in August of 2000 a fake Internet press release was issued concerning Emulex, a high-tech company in southern California. It was stated in this press release that the CEO had resigned and earnings had to be rescinded. It was totally false. Actually the press services, several press services picked it up, did not check, and republished it, and it was widely disseminated as a result of that. Or, they tried to check and they didn't get any response from the company.

The stock plummeted $61 a share in sixteen minutes. There was a $2.2 billion loss in market cap, and the SEC has pegged it at about $110 million of investor losses. The U.S. Attorney recently got Mark Jacob. Once they discovered who he was, he pleaded guilty to two counts of securities fraud and wire fraud, and I think he can potentially get up to twenty years in prison for this. I think they just reached that plea bargain this month.

The issue there and what becomes interesting is, what about these services? How do we treat these services who picked up the rumor and didn't check: Are they to be treated as publishers? What is their immunity? What do we do with the ISPs? A lot of lawsuits have been filed, so maybe we are going to see what happens. A lot of people say, "Well, you know, there was really no duty owed by the Bloomberg Service or whoever picked it up to the investor. Therefore, they are really kind of immune from liability." The CDA obviously may give the Internet service provider protection, so there's a big

question: Can we really go after these intermediaries who failed to stop this?

Let me go on to one other thing that's interesting: complaint sites. I'll just give you the simple rules. The company can recover its domain name if some third party is using it as a trademark of the company. In other words, if the company, Ford, for example, didn't already have Ford.com and somebody else started using it, under established case law they can recover it and the cybersquatting law is another example of that.

What about companies that are subject to "yourcompanysucks.com"? The *Bally Total Fitness* case said there is a strong First Amendment issue. Here is the example of that. We have the "walmartsucks.com" site. I'm sure these Wal-Mart guys aren't happy about this. And if you look very carefully, I bet McDonald's isn't either because you see their little trademark up there as well. And they are using "Wal-Mart sucks." The argument here and the argument that has pretty much won out in the courts, I would say, is that this is criticism that's protected by the First Amendment. Where you're going to see a variance of that is where you can see some sort of commercial activity going on on the Web site using a company's trademarks: then you can make an argument that this is really outside of First Amendment protected speech.

Let me give you another interesting example, the *Bridgeston*e case. This was an ICANN procedure, which is an expedited procedure for recovering domain names. Bridgestone had registration for "Bridgestone-Firestone.com," "IhateBridgestone.com," "IhateFirestone.com" and "Bridgestonesucks.com." So they did what a good, smart company would do: They went out and registered all the anti-domain names to try to preempt the field so all their critics couldn't get those domain names and set up a site against them.

A former employee, Mr. Meyers, registers Bridgestone-Firestone.net. He's a former employee who has a beef. You know, on these sites somebody always has a beef, and it is usually employment related. He had a beef over his pension payment, so he put up a criticism site. Let's take a look at this. Given the two rules, should Bridgestone-Firestone recover the domain name "Bridgestone-Firestone.net"? Here's the site. Take a look at it. You look at it and it looks like a trademark of Bridgestone-Firestone. It says the page is optimized. It says Bridgestone-Firestone home. Now remember, this is the one that Mr. Meyers owns.

How do you think this would come out? Let's just take a vote. Do you think Bridgestone-Firestone ought to recover this site as really their trademarked site or name and therefore being used as a domain name? How many people think it ought to come out that way? A good number. How many people think it ought to come out the other way? Give it to Mr. Meyers. This is what he's doing on the site, what's happening at Bridgetone-Firestone. He has got criticisms and the like.

Mr. Meyers won. Bridgestone-Firestone lost. Shocked me, but that's the way it goes. This is a legitimate site for criticism of Bridgestone-Firestone. It looks like anyone who is surfing the Web would be confused about this, thinking it is the original Bridgestone-Firestone site. But Mr. Meyers prevailed. First Amendment arguments prevailed in the decision and written opinion of that. So in summary, I'll stop there. Thank you very much for your attention.

### C. Questions

MR. FERGUSON: I would like to open it for maybe a question or two for Ron or Andre, and if there are more questions for the speakers, I'll invite you to go to our reception, which is inconveniently located on the ninth floor.

Is there a quick question for Ron or Andre at this point? In the back.

AUDIENCE MEMBER: Ron, how did Meyers get around the trademark usage?

MR. LOPEZ: He argued First Amendment. He said this was a fair use of the trademark. He said this is a legitimate criticism site that's protected by the First Amendment, and the court bought that argument.

AUDIENCE MEMBER: ICANN bought that?

MR. LOPEZ: Under the ICANN procedures all you can do is try to get your trademark or get the domain name back. Now Bridgestone-Firestone may have a right to go ahead and sue him in U.S. courts for violation of their trademarks. But I haven't seen that they have done that. That would still be a possibility.

MR. PERLMAN: Although it would be interesting if they took recourse to the courts in France.

MR. LOPEZ: Well, you know, actually Mr. Meyers, if he's smart, would go talk to Andre, and get his trademark or domain name declared valid in France, and that would apply across continental Europe.

MR. FERGUSON: I think we have been privileged with the speakers we have had today. I particularly appreciate our visitors, Andre from France, Jaime coming from Barcelona, Susan coming in from London, and Ron for joining us all the way from the strange land of California. And particularly thanks to Reed, who was a last-minute pinch hitter and turned out to be the most valuable player with his technical expertise. And thank you also, Mike and Manuel, for coming all the way from downtown New York.

# B2B Marketplaces: EU Competition Issues for Buying Groups

By Susan Hankey

## I. Introduction

Businesses using B2B in the EU may be subject to EU or domestic competition law. In deciding which regime applies, it is necessary to determine whether any agreement or conduct involving a business will affect trade between EU Member States or whether its effects are solely confined to a single Member State.

The competition law rules are in Articles 81 and 82 of the Treaty of Rome. In the UK there are parallel rules in Chapters I and II of the Competition Act 1998. Article 81 prohibits anti-competitive agreements. Article 82 prohibits abuse of a dominant market position. The text of Articles 81 and 82 is at Annex I to this article.

Similar rules exist in other jurisdictions. Although what is said below is specific to activities which affect trade in the EU and the UK, the principles set out are, very broadly speaking, applicable in other countries. B2B activities are in any event by their nature of cross-border, multi-jurisdictional application.

Depending on the structure chosen, a B2B exchange on its creation could also have to be notified to the European Commission for examination under Article 81 or for clearance under the European Merger Regulation. Other domestic filings might also be necessary. A brief outline of the European Merger Regulation (ECMR) is at Annex II to this note.

The competition authorities are not against B2B markets, but they are wary:

- Mario Monti, EC Competition Commissioner, in September 2000, said: "We are not opposed to the creation of B2B electronic marketplaces as such. The fact that these exchanges try to sign up as many industry players as possible does not create a competition problem in itself. As with stock exchanges, the efficiency of a B2B electronic marketplace may well increase with the number of users."[1]
- A report for the OFT by Frontier Economics claimed: "The challenge is to protect consumers from companies' anti-competitive behavior, without stifling new and innovative forms of competition."[2]

This article summarizes the chief types of anti-competitive activity that may possibly result from the operation of and participation in, the activities associated with B2B marketplaces. It also briefly considers when a group setting up a B2B exchange might need to make a filing under Article 81 or the ECMR. It includes a number of recommendations to business on how to avoid certain anti-competitive practices. No such article can be exhaustive or address questions specific to particular projects.

This article proceeds under the following main headings

- Marketplace models
- Creating a B2B exchange: potential filings in Europe
- The EC Guidelines on Horizontal Cooperation
- Main behavioral risks
- Recommendations for business

## II. Marketplace Models

B2B electronic marketplaces can be very simple or extraordinarily complex. Many of the B2B Web sites already in operation combine two or more of the characteristic basic models, such as auctions (and reverse auctions), catalogues and aggregators, in a more complex exchange. Therefore, transactions may be one-to-many, many-to-one, or many-to-many.

The exchange is the most complex and advanced many-to-many transaction model. The term "exchange" has also taken on a generic meaning similar to "marketplace."

Invariably, most B2B electronic marketplaces involve a mix of one or more of the above models. Further, many B2B marketplaces are seeking to make themselves as vertically integrated as possible, by including participants at all levels of the supply chain. Web sites thus offer product development services, after-sales care, insurance services, training courses and a range of out-sourced services such as management and IT. The goal of such marketplaces is to become the first port of call for players in any given market.

## III. Creating a B2B Exchange: Potential Filings in Europe

Groups setting up a B2B company or getting together to provide services to the B2B sector may need to make a filing in the EU before they can start up in business.

If the set-up is caught by the ECMR, then filing is obligatory and completion of the establishment of the B2B company and commencement of any operations must be conditional upon clearance by the European Commission.

If the proposed activity does not fall under the ECMR but the parties are concerned that they may be caught by the general prohibition in Article 81, then they may choose to make a notification. The Article 81 regime proceeds by way of general prohibition subject to investigation, fines and the possibility of third-party court action for breach. Thus whether to file for clearance or comfort is a matter of judgment in each case.

A few examples may help here.

### A. ECMR Decisions

The decision of the European Commission under the ECMR that everyone knows about is the August 2000 clearance of MyAircraft.com.[3] This B2B describes itself as a one-stop-shop for aerospace parts and services plus supply chain management functions. It is open to all in the aerospace and aviation industry.

The Commission found that this was a full function joint venture and that the undertakings concerned crossed the financial thresholds so that it had a "Community Dimension": therefore analysis under the ECMR was required. The competition test is whether the creation of the concentration also creates a dominant position that significantly impedes competition in the EU.

In the *MyAircraft.com* case the Commission found that there were other existing and potential e-providers in the aerospace industry, that there were no substantial barriers to entry to provide such services and that there was strong competition in the industry generally. Further, although the owners—the group setting up the B2B joint venture company—agreed upon restrictions on competition in that they will themselves concentrate their business into MyAircraft.com for a couple of years in order to give the exchange a good start, there were no restrictions imposed on other companies using MyAircraft.com. Those other companies could decide individually the extent to which they would use the new exchange.

A joint venture called eChain Logistics was notified in late December. Its parents are CSC Ploenzke, a German subsidiary of Computer Sciences Corporation, an NYSE-listed consulting and IT services firm; and Dachser, a logistics company having a European network with intercontinental air and sea cargo connections. EChainLogistics proposes to offer "logistics solutions in the supply chain management environment."

The Commission's call for comment notes that the joint venture is a candidate for treatment under the simplified procedure, which indicates that no substantive competition concerns are envisaged and the eventual decision (probably available just at the time of the NYSBA conference) will be very short with little explanation of the markets or the rationale of the decision. A similar approach was adopted in the *ec4ec* case, where the parties (Babcock Borsig, mg technologies, SAPMarkets, Deutsche Bank and VA Technologie) set up an electronic marketplace for mechanical engineering and plant construction.

These examples were required to be notified because they fell within the ECMR. The content of the filing is governed by the obligatory Form CO and by pre-notification discussion with the Merger Task Force of the Competition Directorate. Because the consideration and decision period (except in the really difficult cases which call for second stage investigation) is only one month, and filing must be made within a week after signing, the negotiations in pre-notification meetings and the MTF's views of drafts of Form CO are very important.

### B. Notifications for Clearance or Comfort: Article 81

Arrangements which are not concentrative—where the B2B joint venture does not fulfill the ECMR definition—may fall within Article 81. Here it is up to the parties to decide whether a notification (or informal discussions) to sound out the Competition Directorate would be useful. Whether to do this depends on the parties' own analysis of likely effects on competition, how high profile the transaction may be and what might happen if no notification were made. There are no time limits for the parties to make, or the Commission to consider, any notification.

It is harder to obtain information about companies' discussions with the Competition Directorate under Article 81 than it is to see what is going on under the ECMR. Such discussions are often informal and confidential. The Commission does not have to call publicly for comment unless a formal notification is made. Relatively few formal filings are in fact made. But sometimes a press release is published when the Commission issues a comfort letter.

One early notification was Volbroker.com, an electronic brokerage joint venture for trading among banks in foreign currency options. The parties were Deutsche Bank, UBS, Goldman Sachs, Citibank, JP Morgan and NatWest. A comfort letter was issued after the parties persuaded the Commission that they had put in place mechanisms to avoid the exchange of commercially sensitive information:

- None of Volbroker.com's staff or management will have any contractual or other obligation towards any of the parents and vice versa.
- Volbroker.com's staff and management will be in a geographically distinct location from that of the parents.
- The representatives of the parents on Volbroker.com's Board of Directors will not have access to commercially sensitive information relating to each other or to third parties.
- The parents will not have access to the information technology and communication systems of Volbroker.com.
- The parents will also ensure that the staff and management of all the parties understand and appreciate the importance of maintaining the confidentiality of sensitive commercial information and that sanctions for breach are spelled out.

A further cleared B2B joint venture was set up by Cap Gemini and Vodaphone. The aim in this case is to bring together systems integration and mobile technology in order to offer mobile solutions—from developing mobile access to a company's intranet to much more complex technologies—to business, initially in freight and logistics, automotive, financial services and construction in Germany and the UK.

This joint venture is not itself a B2B exchange. Rather it will build and maintain solutions, including such exchanges for third-party clients. The Commission found that the transaction would, in fact, create a new player in the market for consulting and IT services, which it found to be a dynamic and competitive market where the customers have considerable leverage to play one supplier against another. There is no overlap between the parents—Cap Gemini is active in IT applications and systems integration and Vodaphone is a leading operator of mobile telecoms networks—and the Commission found that Vodaphone does not compete in any markets upstream, downstream or neighboring to the IT services market. Further, the Commission saw the joint ventures in the context of industry forecasts predicting that the mobile commerce sector (m-commerce) should multiply in size over the next few years and would require a combination of IT integration expertise and mobile telecoms experience in support of its development.

## IV. The EC Guidelines on Horizontal Cooperation

The European Commission adopted in January 2001 a set of Guidelines on Horizontal Cooperation, which had been available in draft for a long time.[4] The purpose was to draw current practice together, at a point where two substantial horizontal agreements block exemptions (safe harbors for particular types of agreement) on R&D and on specialization came up for renewal/amendment. The Guidelines also fit into the scheme of the current Commission White Paper, which plans to remove altogether the Article 81 Commission notification system.

The Guidelines deal topic by topic with agreements for R&D, for production specialization, joint purchasing, commercialization, standards and environmental issues. The main themes are reiterated several times. Points to consider in horizontal cooperation include:

- Affected markets and market shares: the parties' positions in those markets.
- The extent to which parties are actual or potential competitors.
- The possibility created for exchange of information: the type and extent of information to be made and/or discussed and the foreclosure of spillover effects.
- Where the particular arrangements under consideration do not have a substantive effect on the market, whether there are networks of such arrangements entered into or planned by the parties and what would be the impact of such networks.

There is nothing new in all of this. But it reminds groups of purchasers or of sellers thinking of setting up a B2B or participating in one as a group that there are competition law risks.

The Notice remarks that joint buying may be through a jointly controlled company, by contractual arrangement or through loose cooperation. It regards such cooperation between SMEs as generally pro-competitive.

The starting point for the Commission is the examination of the parties' buying power. Does the purchasing group possess such power that prices can be forced down below the competitive level or access to the market be foreclosed to competing purchasers? Could the actions of the buying group ultimately bring about reductions of supply, lessening of innovation efforts and in the long term sub-optimal supply? A primary concern of the Commission is that lower prices obtained by the purchasing group may not be passed on to the end users/customers. Then these may result in cost increases for the purchasers' competitors on the selling markets because either supplier will try to recover price reductions for one group of customers by increasing prices for other customers or competitors who will have less access to efficient suppliers.

Thus the Commission asks:

- What are the identified benefits of the group purchase? Do they outweigh restrictive effect? Are they shared with customers?
- Are all restrictions indispensable to the attainment of the identified benefits?
- Do the arrangements lead to the elimination of competition in respect of a substantial part of the products in question?

The Guidelines provide various illustrative examples.

## V. Main Behavioral Risks

The way in which some B2B Web sites bring together a potentially large number of business suppliers and customers presents a number of competition risks. In particular, a B2B Web site may facilitate (or be suspected of bringing about) anti-competitive behavior such as:

- Price-fixing
- Joint purchasing
- Exchange of sensitive commercial information, in particular price information
- Collusive tendering
- Cartel-like behavior

Such activities may be contrary to the EC prohibitions.

These are explored in more depth below. First we set out some basic recommendations for business.

## VI. Recommendations for Business

### A. Generally

It would be prudent for parties contemplating setting up a B2B Web site, or participants in such a B2B enterprise, to consider the following.

#### 1. Information

- Confidentiality is king.
- Sensitive commercial information should not be disseminated to or shared with third parties, especially competitors. Measures must be implemented to ensure that this information is restricted to its originator or subject.
- The exchange of information should, where possible, relate to historical anonymized and aggregated data, compiled by an independent third party.
- Data exchange should be on a "need-to-know" basis.
- Reports to owners/board members should include only aggregated data.
- Consider using third-party information management.
- Where members meet to discuss developments—or the Web site provides a discussion forum—make sure the confidentiality code is followed. Meetings in particular should follow a clear agenda. Treat such like those of a trade association.

#### 2. Prices

- Suppliers should be permitted to set their own prices and should have complete freedom in doing so.
- Quotations should not be published on the Web site but only disclosed to the party requesting the quotation.
- Purchasers must not collectively set maximum prices at which they wish to purchase the products or services.

#### 3. Market Sharing

- Any means by which suppliers could share markets must be avoided (for instance, in any tender process).
- The exchange must not be used to organize "my turn, your turn" approaches to tendering.

#### 4. Membership and Monitoring

- Access to use of the system must be according to objective and transparent criteria. Membership should not be used to create a closed shop inaccessible to bona fide purchasers and suppliers, who may thereby be forced out of the market.
- Confidentiality agreements need to bind the behavior of the staff, especially of any secondees.
- Where possible, measures should be implemented to check on a regular basis for any evidence of collusion or concerted behavior between suppliers and purchasers.

#### 5. Contracts

- Tenderers should respond to the customer placing the tender, and not to a centralized body: B2B facilitates the relationship between two parties, but the relationship itself is confidential to them.

#### 6. Activities Outside the B2B Exchange

- The exchange should not be a "closed shop."
- Purchasers must be free to procure their supplies from other suppliers and sources.

### B. The Role of Advisers

Legal advice can help steer the way through these points and especially help business assess the risk of falling afoul of the competition rules.

A breed of consultancy is emerging that offers to help companies setting out on a B2B route to manage some of these risks, such as in setting and monitoring access criteria and the rules by which B2B exchange members manage their own activities on the fringes of the B2B exchange itself. Such consultancies sometimes call themselves "neutramediaries."

Third parties can be useful in performing the function of data aggregation and report so that participating members do not have access to potentially confidential sources of information.

We go on below to consider in more detail some of the principal antitrust worries.

### C. Price-Fixing

Agreements or conduct which directly or indirectly fixes prices of any product or service or which seeks to restrict or has the effect of restricting price competition will almost certainly infringe both Article 81 and Chapter I, even if the parties to the agreement or conduct only have a minor position in the markets.

There is a risk that a Web site may lead to collective price-fixing or price coordination. For example, any form of agreement between the parties to a Web site (between the Web site operator/suppliers/customers) to adhere to published price lists, or not to quote a price without consulting other suppliers, or not to charge less than any other price in the market, will be a breach of competition law, even if price competition is not entirely eliminated.

Suppliers must remain entirely free to set their own prices and the Web site must not provide any mechanism by which suppliers are able to coordinate their prices.

### D. Joint Purchasing

Joint purchasing may be commercially attractive but may also limit the freedom of purchasers to source their requirements and distort the structure of demand in the market. The disadvantages of joint purchasing may outweigh the possible benefits, particularly where the parties are economically powerful enough to obtain on an individual basis favorable buying terms from suppliers.

The European Commission has established in a number of decisions that joint purchasing will infringe the competition rules in the following cases:

- The participants commit themselves to purchasing all or the major part of their requirements through the joint arrangement.
- The joint arrangement has the effect of obliging the participants to continue to source their requirements only through the arrangement.
- The participants set maximum prices at which the products or services are to be purchased, thus distorting the structure of demand.
- The participants accept ancillary restrictions, such as restriction on the use of the products, or market-sharing provisions.

### E. Information Exchange

As a general principle, the more information made publicly available to market participants, the more effective competition is likely to be. The exchange of information may, however, have an appreciable effect on competition where it serves to remove any uncertainties in the market and therefore eliminates any competition between undertakings. This will be the case even though the exchange may appear innocuous and it does not matter that the information could have been obtained from other sources.

The exchange of price information may lead to price coordination and therefore eliminate any competition, which would otherwise be present between the undertakings. This will be the case whether the information exchanged relates directly to the prices charged or to the elements of a pricing policy, such as discounts, costs, terms of trade and rates and dates of change.

To avoid breaching the competition rules, the exchange of any price information must be anonymized as far as possible. Thus benchmarking exercises or those that compile information on general price trends within a market are unlikely to have an appreciable effect on competition provided that:

- They do not include confidential information attributable to individual undertakings;
- The information is aggregated;
- The information is historic; and
- The information is independently compiled.

### F. Collusive Tendering

Collusive tendering is where tenderers find it advantageous collectively to share out contracts between them and/or fix the prices at which bids are made. It is essential that B2B Web sites do not facilitate any such agreement between suppliers/tenderers. Evidence that the regulatory authorities may use to allege

that the parties are engaging in collusive tendering can include the following:

- The quotation of prices so high it is reasonable to assume that a firm had no serious intention of winning the contract.
- Any form of rota by which different firms take turns in winning bids.
- Unexpected coincidences: For example, two firms tendering at almost identical levels, which would suggest that that price level is a floor price below which firms have agreed not to tender.
- The tender from the "designated" firm often shows features suggesting that that bidder expected to win.

### G. Industry-Specific Exchanges

It is useful to distinguish between B2B Web sites for one particular type of product from a B2B Web site providing a range of goods or services to the world at large.

For instance, a B2B Web site for the sale and purchase of cement only would likely raise many more problems, since there is a risk that this online marketplace could become the dominant marketplace for cement, and the principal players in that market would be drawn more closely together. This would obviously lead to a high risk of some form of collusion between those market players. It would restrict the business of suppliers and purchasers.

A B2B Web site providing an online marketplace for a variety of goods and services which would enable a wide range of suppliers and customers from a variety of market sectors to transact would raise far fewer competition issues. Nevertheless, a marketplace may still be found to be engaging in anti-competitive activity if potential participants in those markets are being unfairly excluded.

## VII. What Should Business Do?

B2B Web site owners and participants using B2B services should remember that it is they who have the responsibility to ensure that their activities do not breach, or enable other companies to breach, competition law. Neutramediary consultancies—like lawyers—can advise and remove or relieve the managerial burden to make the B2B work more smoothly, but companies must note that they carry an individual burden to monitor their behavior. B2B activity should therefore be monitored as part of general competition compliance in any event.

In conclusion, it may be worth looking again to the EU's Competition Commissioner, Mario Monti. He believes that B2B enterprises may normally be pro-competitive innovations, but that there are dangerous pitfalls in particular architectures that B2B systems might take. Mr. Monti thinks that the Commission should be vigilant against discriminatory access and the potential for collusion, where systems allow the exchange of information between competitors.

The Commission will continue to be reasonably friendly to the new developments, keeping in close touch with the U.S. and domestic authorities and adapting its old economy approach to the brave new world of B2B, but businesses should take seriously the potential competition issues their plans entail.

## Endnotes

1. Speech of Mario Monti, Competition Commissioner, 18 Sept. 2000.
2. Report by Frontier Economics for the Office of Fair Trading—Discussion Paper Aug. 2000.
3. Case no. COMP/M. 1969—*UTC/Honeywell/i2/MyAircraft.com*. Decision of the European Commission of 4 Aug. 2000.
4. *Guidelines on the Applicability of Article 81 of the EC Treaty to Horizontal Cooperation Agreements*, published in the Official Journal on 6 Jan. 2001 (OJ 2001/C3/02).

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# ANNEX I

## The Competition Rules of the Treaty of Rome

### Article 81

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;

   (b) limit or control production, markets, technical development, or investment;

   (c) share markets or sources of supply;

   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

   (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of—

   - any agreement or category of agreements between undertakings
   - any decision or category of decisions by associations of undertakings
   - any concerted practice or category of concerted practices

   which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

   (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

   (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

### Article 82

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States

Such abuse may, in particular, consist in—

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

# ANNEX II

## EC Merger Regulation Outline

The Merger Regulation has been in force since September 1990. It introduced a comprehensive merger control system which covers "concentrations" between businesses which have "a Community dimension." The two basic questions which we need to ask are therefore:

- Is the joint venture a "concentration?
- If yes, does it have a "Community dimension"?

If the answer to these two questions is yes, what are the consequences?

## A Concentration

Classically, a concentration will be the acquisition by Company A or by Companies A and B of control over Company C. Control is defined by reference to the ability to exercise decisive influence over a target. "Full function joint ventures" may be classed as concentrations.

Article 3(2) of the Merger Regulation on the definition of a concentration states that:

- The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration.

## When Is a Joint Venture Full Function

A Commission Notice on the concept of full-function joint ventures under the Merger Regulation helps identify what sort of JVs would fall within its ambit.

Indicators that a JV falls within the definition include:

- The JV must be intended to operate long term on a market, having a management dedicated to its day to day operations and access to sufficient resources—including finance, staff and assets (tangible and intangible)—to conduct business activities on a lasting basis.
- Sales primarily to, or purchases primarily from, upstream and downstream parents do not affect the full function nature of the JV if they are limited to the start-up period to establish the JV on the market.
- If the JV will continue to make sales primarily to its parent companies, the question must be asked whether the JV really does operate separately on a market, considering the proportion of sales to parents against those to third parties, and whether dealings with the parents are on a normal commercial basis.
- If the JV will continue to make nearly all purchases from parent companies, the question is whether it is then anything more than a joint sales agency. The question is whether the joint venture is "active in a trade market" (the notice goes on to define the characteristics of a trade market) and points out that in order to constitute a full function joint venture in such a market, an undertaking must have the necessary facilities (e.g. outlets, stockholding, warehouses, transport fleets etc.) and be likely to obtain a substantial proportion of its supplies not only from its parent companies but also from other competing sources.

## A Community Dimension

There are two turnover-based thresholds which can apply, following the amendment last year to the Merger Regulation to lower the thresholds and so catch more mergers and joint ventures.

The first threshold is where:

(i) the combined aggregate worldwide turnover of all the undertakings concerned exceeds Euro 5,000 million;

(ii) the aggregate Community-wide turnover of each of at least two of the undertakings concerned exceeds Euro 250 million;

(iii) each of the undertakings concerned achieves less than two thirds of its aggregate Communitywide turnover within one and the same Member State.

The second threshold for "multiple jurisdiction" cases (including full function joint ventures) is where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than Euro 2,500 million;

(b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than Euro 100 million;

(c) in each of the three Member States included for the purpose of (b), the aggregate turnover of each of at least two of the undertakings concerned is more than Euro 25 million; and

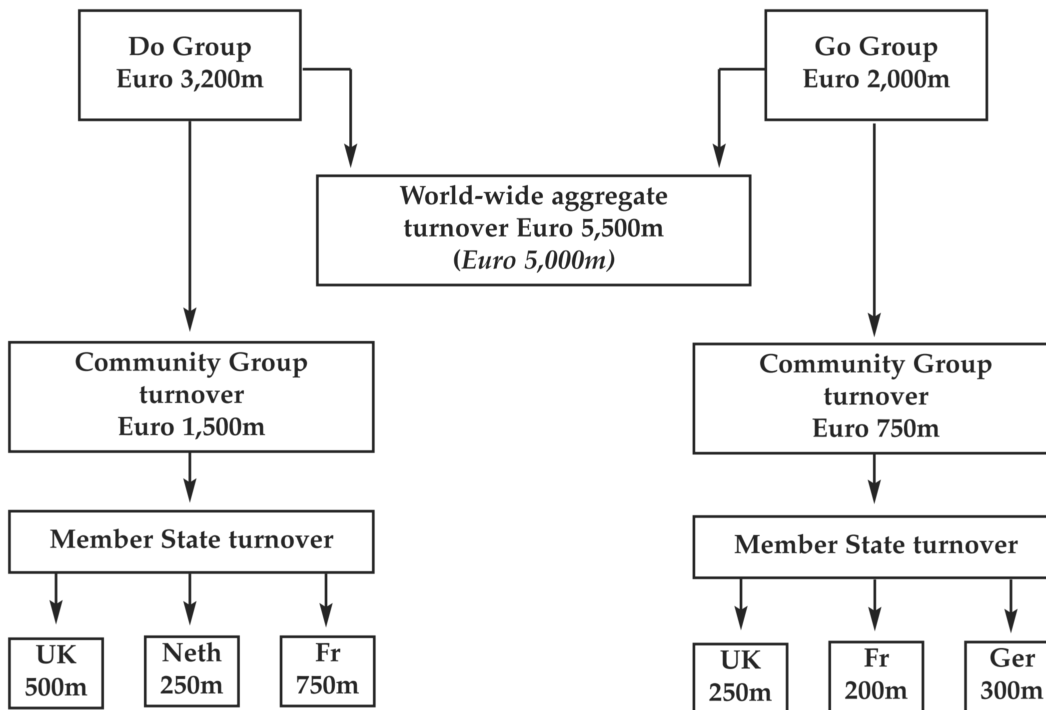
(d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than Euro 100 million;

*unless* each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

Examples of how the two tests are applied are set out below.

## The Classic Turnover Test

Do Group (based in the EC) acquires the whole of Go Inc. (head office in the USA). The turnover calculations must be applied to the whole of both groups.

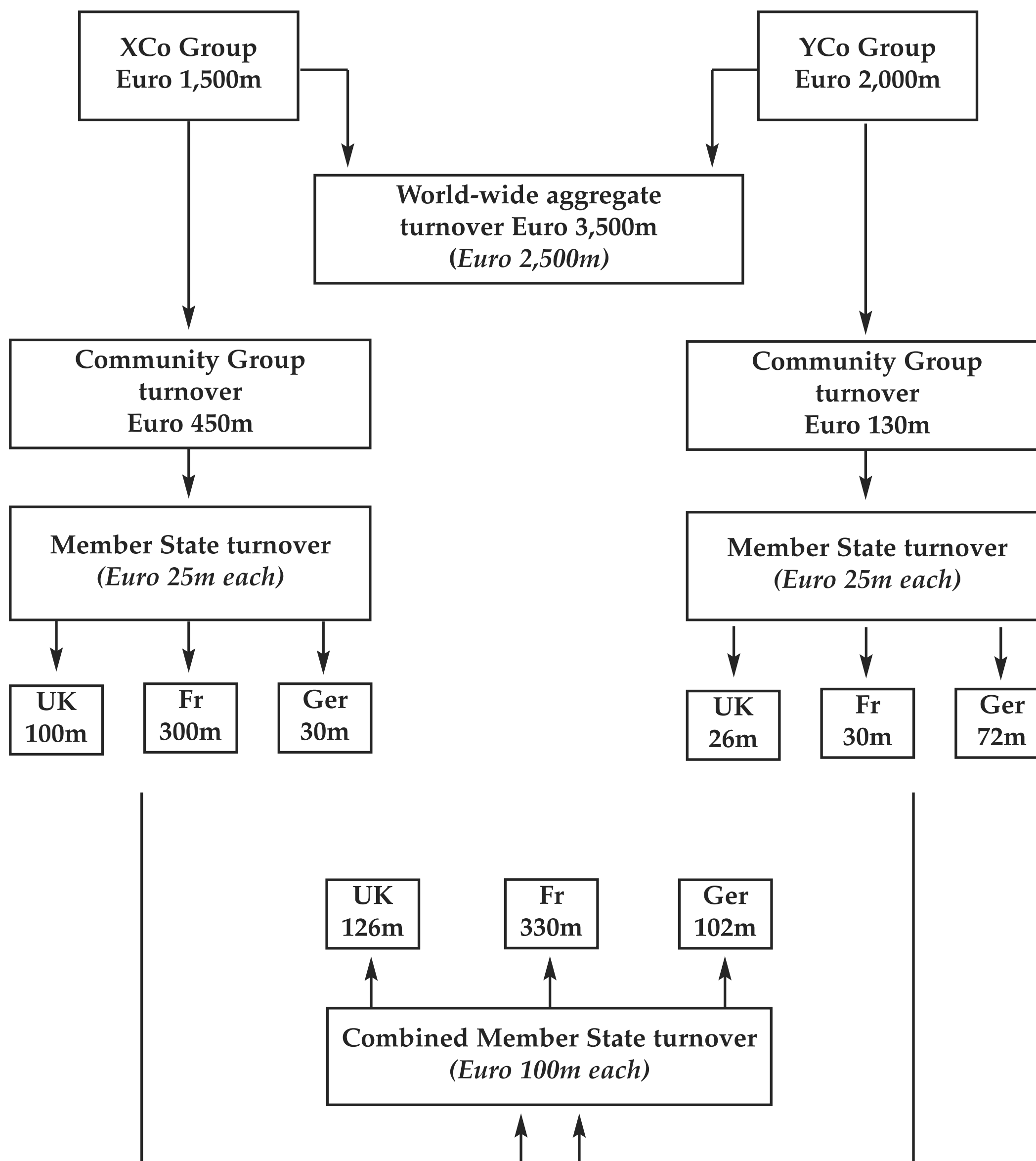



The worldwide and Community aggregate threshold tests are satisfied. Community business of each group is spread across various countries. The transaction has a Community dimension. The Merger Regulation applies. Had the Member State turnover been more than two-thirds in one and the same country, for example:

the Merger Regulation would not apply.

## Multiple Jurisdiction Cases

XCo and YCo set up a joint venture which is classified as a "concentration." They are not big enough to satisfy the classic worldwide Euro 5,000m test, but they have considerable business in several member states.




In each of the UK, France and Germany, the groups have combined turnover of more than Euro 100m. There is some turnover (not shown above—XCo Euro 20m, YCo Euro 2m) in other EU countries. Instead of making separate notifications (where required) in each country, the parties notify the European Commission.

# Corporate Strategies for Addressing Internet "Complaint" Sites

By Ronald F. Lopez

## I. Introduction

During the summer of 1998, commuters arriving in San Francisco from the Bay Bridge were confronted with placard signs reading: "Had any problems at Starbucks Coffee? You're not alone. www.starbucked.com." The sign's author, a Jeremy Dorosin, had taken his anti-Starbucks campaign to the streets of San Francisco and the Web using a similar and possibly confusing domain name.

In 1995, Mr. Dorosin purchased an espresso machine as a wedding gift for a friend in Berkeley, California. Apparently the espresso machine was not in good working order and Starbucks neglected to provide Mr. Dorosin with the free coffee that went with each machine. Mr. Dorosin escalated his complaints to Starbucks' corporate office and demanded a top-of-the-line replacement espresso machine under the threat of taking out a full-page ad in *The Wall Street Journal*. Starbucks offered to send letters of apology, and send a machine of better quality, but not the $2,500 machine demanded. Mr. Dorosin took out his *WSJ* ad, and proceeded with his anti-Starbucks crusade on the Internet, opening up his "Starbucked.com" site. Mr. Dorosin's story appeared on local radio and television stations in Seattle and San Francisco as well as *The New York Times*.

Sometimes, companies face a difficult battle when attempting to take down "complaint" sites on the Internet where disgruntled customers and employees take their grievances to the public. When the "complaint" site is engaged in commercial activity, federal trademark infringement, dilution and trade libel laws may protect a company against disparaging use of corporate names and trademarks and confusing domain names. However, when the purpose of the disparagement is solely customer complaint and parody, these laws will provide far less protection.

In addition to possible legal actions, some companies are adopting other strategies as well. Complaint Web pages that appear on third-party servers, such as Yahoo!/Geocities, are generally subject to a Web hosting agreement that prohibits trademark infringements and offensive materials. Upon receiving complaints of possible infringement and libel, Web-hosting companies will generally remove such pages. Recognizing the low cost of registering anti-domain names, many companies have registered as many variations as possible for their Internet domain names (like chasesucks.com) in order to reduce the opportunities for disgruntled customers and employees to establish complaint Web sites with similar or confusing domain names. Another strategy followed by some companies is to monitor the "complaint" site and, when appropriate, to send coupons and e-mail to upset customers.

Companies must be vigilant of their domain names, trademarks and other intellectual property and they should develop a comprehensive strategy to address all forms of Internet "complaint" sites.

## II. Internet Complaint Sites

Much to the chagrin and annoyance of company executives, Internet "complaint" Web sites have become the weapon of choice for frustrated customers, disgruntled employees, political activists and anyone with an ax to grind to air their gripes cheaply and sometimes effectively. Protected by the cloak of anonymity and empowered by a worldwide audience, net-complainers have carried old-fashioned pickets and soapbox tirades into cyberspace. For obvious reasons, the largest companies receive the most complaints. One newspaper reports that "[c]onservatively, more than half of the Fortune 1000 companies have encountered some type of Web site critical of their business,"[1] from Wal-Mart to Allstate to Toys 'R' Us to Microsoft.[2]

Web sites bashing a company, its products or its employees most often simply tell stories of bad customer service or a faulty product. There are so many that Yahoo! has created a separate directory for "complaint" sites,[3] catering to everything from hard-core consumer activism and anti-corporate backlashing to personal revenge and rumor-mongering. Not surprisingly, "[f]ew of the sites cater to hard-core consumer activists—plenty are merely the province of Web whiners who have found an easy, often anonymous, way to spout off from their armchairs."[4]

As the Internet grows ever larger, companies need to implement policies for effectively dealing with "complaint" sites directed against them. Regardless of the type of "complaint" site, however, a company serious about its online image needs to consider the several categories of "complaint" sites on the Internet and plan its response accordingly. There are many categories of "complaint" sites on the Web.

### A. Consumer and Employee Complaint Web Sites

The vast majority of complaint sites fall into the category of consumer complaint sites. These sites typically collect stories of bad customer service or a faulty product. The list of these sites is growing and a sampling of these sites is listed below:

- **Chasebanksucks.com:**[5] According to its creators, the site is dedicated to "all those who hate Chase Manhattan Bank, and also to inform others why they should not bank with Chase." This highly publicized site features an animated picture of a man repeatedly urinating on the word "Chase." A bulletin board allows customers and ex-employees to gripe about every service Chase provides (as well as an "insider's" perspective on Chase policies). The site also provides links to news stories about how "Chase's 'right relationship' started with the Nazis during W.W. II" and how "corruption is alive and well at Chase."

- **Aolsucks.com:**[6] The creator of this site is upset over apparently overzealous censorship, inconsistent service, prevalence of spam and lack of security. The operator's biggest claim to fame, however, is a series of e-mails sent by AOL employees which threaten legal action at first, and then become very apologetic as AOL begins to realize the public relations fiasco they might create. Nevertheless, AOL has been one of the most outspoken proponents of shutting down anti-AOL sites.[7]

- **Dunkindonuts.org:**[8] David Felton of Hartford, Connecticut, was outraged that his local Dunkin' Donuts store did not carry one percent milk, his favorite coffee lightener. He was also upset that the world's largest doughnut chain did not offer a "decent" low-fat muffin. Felton's site was among the most prominent of Internet consumer complaint sites, featuring "unhappy tales about coffee, crullers and cinnamon buns, but the domain name now points to Dunkin' Donuts' corporate Web site."[9]

- **Starbucked.com:**[10] The Starbucked Web site documents the saga of one-time Starbucks[11] customer Jeremy Dorosin and his fight against Starbucks' corporate greed, all stemming from a defective espresso machine Dorosin purchased. Dorosin also plugs his book detailing his struggle against Starbucks in addition to maintaining a "Top Ten" list of other companies who have "starbucked" customers.[12]

- **Untied.com:**[13] A mistype of united.com (for those looking for United Airlines) leads to untied.com, a complaint site created by anti-fans of United Airlines. This site tries to be a clearinghouse for passenger complaints directed at the customer-service department at United and publishes all complaint letters (and the few responses from United) for the world to see.

- **Bally Sucks:**[14] Once the target of a federal lawsuit in which the operator was held to be justifiably exercising his free speech rights, this site caters to those bitter customers who find themselves unreasonably bound by Bally Health Clubs' membership contract and policies. This case is now an often-cited example of the clash between corporate image and First Amendment rights on the Web. The site, however, has been taken down.

- **The Nervous Investor:**[15] In explaining how he "lost his shirt with E*TRADE Canada," Lubomyr Prytulak crusades as one who has been "defending investor rights since 1 Jan. 1999." This site consists mostly of personal experiences Prytulak has had in using E*TRADE services and his dissatisfaction with the result. With all the nervousness of online investors and the susceptibility of stock prices to rumors on the Internet, attorneys for E*TRADE sent Prytulak a letter alleging harassment and libel and seeking injunctive relief, damages, costs and account closure.[16]

### B. Consumer and Ex-Employee E-Mail

In addition to the Web, disgruntled consumers and ex-employees may take to e-mail to vent their frustrations and disrupt company operations.

In ways perhaps far more damaging, disgruntled customers have used e-mail to disrupt company operations. In perhaps one of the largest cases of phantom e-mail, during two weeks in July 1997, some six to twenty million Internet users received what appeared to be unsolicited, promotional e-mail from Samsung Electronics. Upset over the apparent "spam," thousands sent back angry responses. This time, they received a nasty cease and desist message, ostensibly from Samsung's law firm, that said, in part, "Your e-mail name was provided as being suspected of connection to various acts of Internet terrorism. Your acts are illegal." Not surprisingly, Samsung received an even angrier and more voluminous response (as many as ten thousand e-mails a day). Samsung estimated that the damages from the incident reached into the millions of dollars. However, none of the offending messages originated with Samsung or its representatives. They were, apparently, the work of a single dissatisfied customer.[17]

Ex-employees have also used e-mail to disrupt company operations. In *Intel Corp. v. Hamidi*,[18] a California judge recently granted Intel summary judgment and a permanent injunction in its trespass suit against a former employee. Intel sued the former employee in 1998, alleging that he illegally accessed the company's e-mail system, sending more than thirty thousand messages

stating that the company is unfair and abusive to Intel employees. The court noted that "the evidence establishes (without dispute) that Intel has been injured by diminished employee productivity" and in devoting resources to blocking the e-mails.[19]

### C. Political Web Sites Targeting Companies

In addition to disgruntled consumers and employees, companies may face Web sites sponsored by environmental or other activist groups seeking to promote their political causes. There are many examples of these types of Web sites.

- **Homedepotsucks.com:**[20] Depicting a Home Depot employee with a skull for a head, this site is run by the Action Resource Center and the Rainforest Relief and Living Jungle Alliance. The groups claim that Home Depot is the "largest retailer of old growth rainforest wood in the U.S. As countless forests and indigenous peoples continue to face death and annihilation, Home Depot only responds with PR spins and broken promises." This site also fields general customer complaints that have nothing to do with old growth lumber; many contributors tell unverified stories of managers killing birds trapped in the store, bitterness over getting fired from Home Depot and anger over Home Depot running smaller stores out of business.[21] Home Depot's director of community affairs and environment programs strongly disagrees, noting that "[i]t's just not true," and that she "respect[s] the right to freedom of speech," but not when it involves false and misleading information.[22] The company has tried to counter the charges through its Web page by highlighting its strong commitment to environmental programs and policies such as recycling, "green" products and consumer education on the environment.

- **McSpotlight:**[23] With over sixty volunteers in several countries, twenty-one thousand files and a server in the Netherlands and mirror sites in the U.S., New Zealand and Australia, this fancy Web site and the organization responsible for this site, McInformation Network, were recently the subject of a lawsuit—nicknamed "McLibel" by the group—by McDonald's in the United Kingdom. McDonald's won $94,000 in damages for libel, after having spent $16 million on the case.[24] This site charges McDonald's with: (1) the connection between multinational companies like McDonald's, cash crops and starvation in the Third World; (2) the responsibility of corporations such as McDonald's for damage to the environment, including destruction of rain forests; (3) the wasteful and harmful effects of the mountains of packaging used by McDonald's and other companies; (4) McDonald's promotion and sale of food with a low fiber, high fat, saturated fat, sodium and sugar content, and the links between a diet of this type and the major degenerative diseases in western society, including heart disease and cancer; (5) McDonald's exploitation of children by its use of advertisements and gimmicks to sell unhealthy products; (6) the barbaric way that animals are reared and slaughtered to supply products for McDonald's; and finally, (7) the lousy conditions that workers in the catering industry are forced to work under, and the low wages paid by McDonald's, as well as McDonald's hostility towards trade unions.

### D. Competitor-Sponsored Sites

Some "complaint" sites may not be run by disgruntled customers or employees, but by a competing company or its employees. For example, in a federal suit filed in Michigan in 1998, Amway alleged that Procter & Gamble "has been a behind-the-scenes sponsor of a rogue Web site . . . that foments hate rhetoric about Amway."[25] In addition to the standard array of negative news clippings and personal testimonials, the site "Amway: The Untold Story"[26] apparently published some sensitive internal documents. Proctor & Gamble acknowledged it supplied some material to the creator of the site but says the documents were public and that it acted legally.[27] The veracity of Amway's claims has yet to be tested in court, but the case serves as a reminder that a company must make sure that its own Web site does not libel or infringe upon the rights of its competitors.

### E. Personal Revenge Sites Against Employees

William A. Sheehan, III, a Seattle-area man who believed his credit had been unfairly damaged by several rating agencies—including TransUnion, Experian, CBI/Equifax and SCA Credit—retaliated against some of the companies' employees and attorneys by posting family information such as names, birth dates, social security numbers, home addresses and maps to their homes on his Web site.[28] Fearful the information might get into the hands of a stalker, the companies asked a judge in Seattle to close the site. But even though Sheehan called the employees "scumbags" and worse, he didn't advocate hurting them, so the judge let him keep the site.[29] However, the court later dismissed Sheehan's lawsuits against the credit agencies because of Sheehan's "bad faith and abuse of judicial process" in disparaging the credit agency attorneys on his Web site, which the court noted was "clearly presented as an invitation for others to harass, threaten, or even attack these people."[30]

### F. Disgruntled Employee Web Sites

Many of the "complaint" Web sites contain forums for disgruntled current and ex-employees. The walmartsucks.com, chasebanksucks.com and bestbye.com sites are three of the more popular among such employees. Most employee complaints seem to revolve around poor treatment of lower-ranking employees by management. While rooted in some element of truth, many complaints are one-sided, exaggerated and sometimes outright false. Nevertheless, when an anti-company Web site is set up by existing employees, employers must be aware that taking action against the site could violate labor laws. If a site discusses company policies and invites other employees to comment, then it can be considered "concerted activity" and is protected by the National Labor Relations Act (NLRA).[31] In short, where the company does not sponsor the Web site or host it on company servers, there may be little the company can do to shut down employee forums. As discussed below, however, companies can pursue employees and non-employees who the company believes are revealing confidential information and spreading false rumors.

## III. Business Impacts from Customer "Complaint" Web Sites

Consumers often search the Web for opinions and experiences with products and services. Although it is difficult to quantify the impacts from customer "complaint" sites, there are now a few examples of business losses attributable to such sites.

In 1996, EPS Technologies, an $80-million computer manufacturer in Omaha which sold PCs through its 800 number, blamed significant revenue loss on four "complaint" sites hammering its service. The first site was created by a customer who was frustrated by a month-long delay in receiving a laptop. Though EPS offered him a refund, he insisted on additional compensation for his inconvenience. When the company refused, the customer threatened a negative Web site. The site went up, but EPS Technologies did not realize the site was built with metatags—special Web-search markers—that brought the negative site up ahead of EPS Technologies' own site on search engines. Cybercustomers who searched the Web to learn more about the company instead read a scathing indictment of EPS Technologies. "People called up and said they were canceling orders because of it," EPS Technologies President Ed Kieler said. "We have to assume some others simply never called in the first place." All told, EPS lost hundreds of orders, he added. In 1997, EPS Technologies went out of business for reasons unknown.[32]

A large company generally has the resources to fight online rumors by hiring a public relations firm. For example, in 1996 rumors spread on the Web that Mrs. Fields Cookies planned to donate cookies to the O.J. Simpson victory party. Threatened with a national boycott, Mrs. Fields Cookies quickly hired an online firm to fight the rumors, which eventually died down as a result.[33]

While the "complaint" sites or rumors may be only a nuisance or irritant to large corporations, they can be more devastating to smaller companies. In 1998, David Holker hired two Web site designers to help him develop a Web page for his company, Express Success Inc., a multilevel marketing company that sold car products. After a billing dispute, the designers created expresssuccesssucks.com, a site where they "called Express Success a 'scam,' pictured Holker in prison clothing, and posted an advertisement for one of his biggest competitors."[34] Holker claims the attack drove his revenues down from $60,000 monthly to nearly zero, since many of his clients came from the Internet. Claiming defamation, among other things, Holker sued the Web site designers. His efforts to shut it down failed.[35]

## IV. Legal Strategies for Customer "Complaint" Sites

While some companies have tried to silence their cybercritics using legal force, the results have been mixed. In many cases, however, the mere threat of legal action is enough to scare a Web site operator into submission. By the same token, the company must keep in mind that threats of legal action will generally be highlighted and portrayed poorly on the complaint site.[36]

Web site operators argue that they have a constitutionally protected right to preach their message. Unless the content is libelous, it is protected by the First Amendment. In addition, trademark infringement and dilution claims may be ineffective if the complaint site is clearly unofficial, non-commercial and unlikely to confuse consumers.[37] In addition, any legal action that a company threatens may draw more attention to the complaint site. In short, legal action may be more appropriate for extreme cases, i.e., a clear case of libel or trademark infringement or dilution.

### A. Common Law Defamation and the First Amendment Defense

When challenged, the vast majority of "complaint" Web site operators claim their conduct is protected under the First Amendment, which guarantees freedom of speech. Accordingly, many complaint Web sites on the Internet contain a disclaimer similar to the one on sprintpcs-sucks.org (an anti-Sprint PCS site):

"This site is classified as a non-commercial, non-profit consumer advocacy site. This is permissible via the First Amendment to the US Constitution; specifically, the freedom of speech and expression. The views and opinions expressed here are those of the site operator(s) based on first hand experience."[38]

Because the standards for a state defamation claim are very high, many "complaint" Web sites may not constitute libel. A defamation claim generally "requires the plaintiff to demonstrate the existence of a defamatory statement about the plaintiff that is 'published' by the defendant with malice."[39] Nevertheless, operating under the flag of "consumer advocacy" and "public opinion," such sites are very difficult to attack using libel laws for three main reasons:[40]

*First*, as a general rule, companies cannot sue for libel—called "trade libel" or "product disparagement"—unless they can show actual damages, such as monetary losses resulting from the false statement. In many cases, however, companies are seeking to shut down "complaint" sites before any damage is done or damages are speculative. While perhaps a prudent strategy, trade libel may not apply.

*Second*, those individuals[41] within a company who are singled out for criticism are often considered "pervasive public figures" or "limited-purpose public figures," meaning that by merely "being" a notable figure within a company (i.e., Bill Gates) or at least engaging in the transaction giving rise to the criticism (i.e., setting a corporate policy or selling a certain product), such individuals have invited public scrutiny and exposure.[42] As a result, the standard for libel rises to the level of "actual malice," meaning that the false statement must have been made "with knowledge that it was false or with reckless disregard of whether it was false or not."[43] This "reckless disregard" standard usually makes it extremely difficult to prove actual malice[44] since the Supreme Court has held that a statement need only be "substantially true,"[45] meaning that the overall nature of the statement is true, but not necessarily entirely true.[46] Although the standard for libel drops to mere negligence if the plaintiff is a private figure, it is difficult to imagine a "complaint" site singling out an individual without also mentioning some act within the corporation to which the individual is linked.

*Third*, on many Web site providers like Yahoo!/Geocities or AOL,[47] the Web site creator can hide behind a cloak of anonymity. This anonymity is often guaranteed in the host's privacy policy, primarily to assure users that their personal information will not be divulged to Internet marketers. Because of the anonymity, however, companies have considered pursuing a libel action against the parties responsible for hosting the site.

After the enactment of the Communications Decency Act (CDA) of 1996, however, ISPs and discussion group hosts no longer have an incentive to monitor the content on its servers for defamatory material. Although much of the CDA was struck down as unconstitutional, 47 U.S.C. § 230(1) remained. It provides that "[n]o provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."[48] Congress noted as its express purpose in enacting section 230 the intent to allow ISPs to exercise editorial discretion without fear of publisher liability.[49]

The immunity provision faced its first major test in *Zeran v. America Online*.[50] In *Zeran*, an anonymous subscriber repeatedly posted allegedly defamatory statements about Zeran to an AOL bulletin board. In attempting to hold AOL liable, Zeran argued that section 230 did not bar his action because once he notified the service of the first message, it had knowledge of the defamatory statement and had a duty to remove the posting promptly and notify its members of the falsity of the statement. Zeran argued that section 230 only immunized "publishers"; he claimed that AOL was a "distributor" for purposes of defamation law. The court, however, held that section 230 did indeed immunize AOL against liability for defamatory statements of content providers.

Despite section 230, however, as a matter of policy most Web hosts and ISPs will block any defamatory or abusive material of which they are made aware.[51] Furthermore, Web hosts and ISPs will often divulge an anonymous user's identity to companies who threaten legal action. For example, Raytheon, in the libel case discussed *infra*, "had a relatively easy time"[52] obtaining orders that Yahoo! reveal the identities of the chatters, despite a privacy policy that emphasizes that Yahoo! is "committed to safeguarding your privacy online."[53] Specifically, Yahoo! has included a disclaimer for its Business & Finance discussion boards, noting that "under special circumstances, such as to comply with subpoenas and other legal obligations, Yahoo! may provide personally identifiable information which may include IP addresses."[54] Ultimately, Raytheon dropped the case when four employees implicated in the discussion board resigned,[55] including a Raytheon vice president, Mark Neuhausen, who allegedly posted confidential information under the alias "RSCDeepThroat."[56]

### B. Trademark Infringement, Trademark Dilution, Copyright Infringement and Unfair Competition Under Federal Law

Trademark rights are one of the biggest concerns of any company trying to protect its name and trademarks on the Internet from cybercomplainers. Most cybercomplainers use the company name in their domain name or plaster their sites with a company's name and/or logo—often doctoring the logo to spell crude names. In fact, "[m]ore than 80 percent of Fortune 1000 companies are victims of some type of trademark misuse on the Internet" according to Cyveillance, a company that monitors online abuse for corporate clients.[57] However, in pursuing a "complaint" site, a standard trademark infringement claim requires confusion on the part of the

consumer, implying that infringement claims only work where the alleged infringer is engaged in commercial conduct.

**Figures 1 & 2:** Perversions of a company's logo, such as the example above from <http://www.geocities.com/Area51/Station /9248/sucks/> are common on Internet "complaint" sites.

**Figure 3:** Use of a company's logo in a fake advertisement, such as the example above from http:/www.oeonline.com/~chevy/nike_sucks.htm> (site off-line) are common on Internet "complaint" sites.

Many times, "complaint" sites prominently feature an image of a company's trademark logo, usually with the word "sucks" or other derogatory words. The presence of the derogatory comment may clear any potential customer confusion, so a traditional trademark infringement argument may fail. However, the Federal Anti-Dilution Act of 1996 (15 U.S.C. § 1125) prohibits use of a name which harms the distinctiveness of "famous" marks, without regard to whether any likelihood of confusion exists, and regardless of the absence of competition. An exemption in the Act, however, section 1125(c)(4) permits: "Fair use of a famous mark by another person in comparative commercial advertising or promotion to identify the competing goods or services of the owner of the famous mark. Noncommercial use of a mark. All forms of news reporting and commentary."[58]

Most "complaint" sites claim to be out of reach by trademark dilution laws because their activities supposedly constitute non-commercial consumer activism. Depending on the tone and content of the site, however, the "non-commercial" activity of a "complaint" site is quite often debatable. Two cases illustrate both ends of the spectrum, *Bally Total Fitness Holding Corp. v. Faber*[59] and *Jews for Jesus v. Brodsky*.[60]

In *Bally* a California court held that defendant Faber, who had created a Web site named Bally Sucks,[61] which he created "in a simmering rage after a Bally club in California didn't upgrade his membership as promised,"[62] violated neither federal trademark infringement nor trademark dilution statutes because the site was merely a parody designed to voice consumer complaints and not commercially competitive with Bally in any way. The site was so clearly anti-Bally that it could not be construed as the company's handiwork. In *Bally*, the court noted that Faber "does not use Bally in his domain name" and that "even if Faber did use the mark as part of a larger domain name, such as 'ballysucks.com,' this would not necessarily be a violation as a matter of law" because "no reasonably prudent Internet user would believe that 'Ballysucks.com' is the official Bally site or is sponsored by Bally. Finally, the court also cited congressional intent to exempt parody and other non-commercial imitation from the Act.[63]

A company considering legal action against a "complaint" site should consider the way in which it is depicted on the site. If the site clearly would not be confused as the company's own site (i.e., prominently visible slogans criticizing the company, obscene pictures) then a court following *Bally* may permit such criticism on the Web, provided that the "complaint" site is not engaged in commercial activity, but is merely criticism, commentary or parody. However, if the "complaint" site could lead a consumer to confuse it with the company's real site (i.e., similar domain names or similarities in overall graphical presentation of the site), then a court might be willing to intervene, as in the *Jews for Jesus* case below.

In *Jews for Jesus*, defendant Brodsky created a Web site called jewsforjesus.org which contained statements critical of an organization called Jews for Jesus. At one point, Brodsky was reported as stating that the "intent behind my bogus 'Jews for Jesus' site (www.jewsforjesus.org) is to intercept potential converts before they have a chance to see the obscene garbage on the real site."[64] Users who reached Brodsky's site would be "invited to 'click here to learn more about how the Jews for Jesus cult is founded upon deceit and distortion of fact.'"[65] Because of Brodsky's intent to divert users looking for the real Jews for Jesus site to his own by creating a Web site with a confusingly similar domain name, the court found that "[t]hese statements demonstrate the actions by the Defendant were wilful [sic] and undertaken in bad faith, with full knowledge of and the

intent to cause confusion and to infringe on the rights of the Plaintiff Organization."[66] The court held that the plaintiff had demonstrated a likelihood of success on its claim of federal and common law service mark infringement.[67]

The court also found that Brodsky's conduct was "commercial" for the purposes of substantiating plaintiff's trademark dilution claim for two reasons. First, although Brodsky's site did not solicit funds or sell products, it contained a hyperlink to the Outreach Judaism Organization Internet site, which did sell merchandise, making the jewsforjesus.org site a "conduit" to commercial activity, despite a disclaimer which disavowed any affiliation with Outreach Judaism.[68] Second, the court considered Brodsky's conduct "commercial" because

> it is designed to harm the Plaintiff Organization commercially by disparaging it and preventing the Plaintiff Organization from exploiting the Mark and the Name of the Plaintiff Organization. In addition, the Defendant Internet site has and will continue to inhibit the efforts of Internet users to locate the Plaintiff Organization Internet site.[69]

The court's finding of commercial use in Jews for Jesus is important because occasionally, a "complaint" site will plug books,[70] sell advertising space,[71] solicit donations[72] or provide links to other commercial sites. The *Jews for Jesus* case seems to suggest that any commercial benefit derived from a "hate" site, or any commercial harm done to a company, would classify the site as commercial, thereby permitting a trademark dilution claim.

For example, in *Planned Parenthood Federation of America, Inc. v. Bucci*,[73] the court held that defendant's use of a similar domain name was commercial conduct because:

- defendant is engaged in the promotion of a book;
- defendant is, in essence, a nonprofit political activist who solicits funds for his activities; and
- defendant's actions are designed to, and do, harm plaintiff commercially.

The *Jews for Jesus* court concluded that "[t]he conduct of the Defendant also constitutes a commercial use of the mark and the Name of the Plaintiff Organization because it is designed to harm the Plaintiff Organization commercially by disparaging it and preventing the Plaintiff Organization from exploiting the Mark and the Name of the Plaintiff Organization."[74]

Any copyright claim will be subject to the defense of "fair use" under 17 U.S.C. § 107. Federal law accepts the "fair use" of copyrighted material without prior consent of the copyright owner for "criticism, comment, news reporting, teaching, scholarship, or research."[75] Most "complaint" sites can probably be classified as some form of criticism, comment or parody, all of which would most likely fall under the fair use exception.

Lastly, a company considering legal action against a cybercomplainer must consider the jurisdiction in which they bring suit. For example, in March of 1998, U-Haul brought suit in Arizona against John Osborne of Georgia for trademark infringement and libel. Osborne ran the "U-Hell" Web site, which published visitors' U-Haul "horror" stories. Arizona is U-Haul's home base, but the defendant filed a motion to dismiss the case, arguing the defendant and witnesses are in Georgia, not Arizona. The case was summarily dismissed,[76] with U-Haul vowing to refile in Georgia.

### C. WIPO Arbitration

The Uniform Domain Name Dispute Resolution Policy, adopted by the Internet Corporation for Assigned Names and Numbers (ICANN) on 26 August 1999 and implemented through the WIPO Arbitration and Mediation Center, has attempted to resolve some disputes concerning allegations of abusive domain name registration. Some companies have resorted to WIPO arbitration to settle abusive use of domain names. In 2000, Wal-Mart submitted a complaint regarding various domain name registrations that attached "-sucks" to various Wal-Mart names.[77] The registrant of the domain names allegedly demanded a large cash settlement in exchange for the domain names. Finding that the registrant intended no other use except commercial gain, the administrative panel found that:

> Internet users . . . are likely to be puzzled or surprised by the coupling of Complainant's mark with the pejorative verb "sucks" . . . [I]t is likely . . . that such users will choose to visit the sites, if only to satisfy their curiosity. Respondent will have accomplished his objective of diverting potential customers of Complainant to his Web sites by the use of domain names that are similar to Complainant's trademark.[78]

The panel nevertheless noted "that use of a domain name confusingly similar to a mark may be justified by fair use or legitimate noncommercial use considerations, and that this may in other cases permit the use of '-sucks' formative names in free expression forums."[79] Accordingly, many of the "complaint" sites discussed above would likely not be found to violate any policy set forth by ICANN or WIPO.

## V. Non-Litigation Strategies for Addressing Complaint Sites

In order to stem the proliferation of confusing “complaint” driven domain names, many large companies (or their marketing/advertising firms) are registering or buying domain names critical of the company mark.[80] Many companies will register the following variations on complaint sites: [name]sucks.com, [name]stinks.com, [name]blows.com, ihate[name].com, screw[name].com, and boycott[name].com.[81]

In addition, a whole market has popped up for companies that monitor the Internet for abuses of a company’s trademark or copyrighted material.[82] A large list of such companies is available on Yahoo![83] The price for such monitoring, however, is not cheap. Approximately six hundred companies pay about $13,000 to one company that prowls Web sites and helps with damage control when criticism hits the Internet.[84] Less expensive techniques involve software that monitors who links to a company’s Web site.[85]

Finally some companies regularly monitor complaint Web sites and take a proactive approach to such complaint sites and customer complaints.

For example, the most captive audience at dunkindonuts.org is executives of Dunkin’ Donuts, who fastidiously monitor the site and “occasionally send coupons and mollifying e-mail to disgruntled consumers.”[86] Nike Inc. has taken to a peaceful counteroffensive. In response to several sites urging consumers to boycott Nike for underpaying Third World workers, the sports clothing manufacturer has created a site separate from the company’s main Web page.[87] It features photos of a humble but clean-looking shoe manufacturing plant in China and describes benefits offered to overseas workers.”[88] Other companies, including many computer vendors, provide at least an e-mail link (or even a Web-based forum monitored by a customer service representative who answers questions in real-time) so that frustrated customers will hopefully blow their steam directly at the company instead of complaining to the whole world.[89]

## VI. Conclusion

When a company is confronted with a customer or employee “complaint site,” there are a number of legal strategies it may follow. Whether the company pursues legal action or sets up an alternative Web site, the company will need to follow a carefully thought-out strategy in order to minimize any disruption to the business or any harm to the company trade name or trade marks.

## Endnotes

1. Trigaux, *Gripe.com*, St. Petersburg (Florida) Times, 31 January 1999, at 1H.
2. *See* France & Muller, *A Site for Soreheads*, Business Week Online, 12 April 1999, *at* <http://www.businessweek.com/1999/99_15/b3624104.htm>.
3. <http://dir.yahoo.com/Business_and_Economy/Consumer_Advocacy_and_Information/Consumer_Opinion>.
4. Segal & Mayer, *Site for Sore Consumers: Complaints About Companies Multiply on the Web*, The Washington Post, 28 March 1999, at A1.
5. <http://www.chasebanksucks.com>.
6. <http://www.aolsucks.com> and <http://www.aolsucks.org>.
7. Brown, *Can AOL Silence its Critics?*, Salon.com, 1 July 1999, *at* <http://www.salon.com/tech/log/1999/07/01/inside_aol>.
8. <http://www.dunkindonuts.org>.
9. The Web site is now offline and has been replaced by Dunkin’ Donuts’ official corporate Web site.
10. <http://www.starbucked.com>.
11. Starbucks’ corporate site is at <http://www.starbucks.com>.
12. *See* Victoria Colliver, Anti-corporate Crusader; *Pinole Resident Has Made Starbucks-Bashing His Life’s Work*, The San Fransisco Examiner, 11 June 1999, at D1.
13. <http://www.untied.com>.
14. <http://www.compupix.com/ballysucks/>. The Web site is now offline.
15. <http://www.nervousinvestor.com>. The Web site is now offline.
16. <http://www.nervousinvestor.com/020299cs.shtml>. The Web site is now offline.
17. McKenna, *Samsung Stung For $Millions By Internet Fraud*, Newsbytes, 11 August 1997. *See also* Williams, *Samsung Issues Statement Regarding Spam*, Newsbytes, 15 August 1997; Zetlin, *Disinformation: What Do You Do When You Get Dissed*, Management Review, 17 July 1998, at 33.
18. Cal. Super. Ct., No. 98AS05067, 27 April 1999.
19. Nadel, *Anti-Company Web Sites Often Legal, More Than a Minor Nuisance to Employers*, 4 Electronic Com. & Law (BNA) No. 26, at 579 (30 June 1999).
20. <http://www.homedepotsucks.com/>.
21. *See* Trigaux, note 1 *supra.*
22. Segal & Mayer, note 4 *supra*.
23. <http://www.mcspotlight.org/>.
24. Zetlin, note 17 *supra*, at 87.
25. France & Muller, note 2 *supra*; Colliver, note 12 *supra*.
26. The Web site is now offline.
27. France & Muller, note 2 *supra.*
28. The Web site was at <http://www.billsheehan.com> but no longer seems to be active. With respect to the company attorneys, Sheehan announced on his Web site that “both these guys are very unprofessional. They take things personal [sic] and tend to anger easily. Could somebody PLEASE medicate these guys?” 1998 U.S. Dist. LEXIS 16862 at *3 (W.D. Wash. 1998).
29. France & Muller, note 2 *supra*.
30. 1998 U.S. Dist LEXIS 16862 at *5.
31. Nadel, note 19 *supra*.

32. Zetlin, note 17 *supra*; McLaughlin, *Barbed Wires*, Inc., Nov. 1998 at 24.

33. *See* Jerome & Taylor, *Liar, Liar: Unscrupulous Web Pages*, PC/Computing, 1 December 1998 at 89.

34. Later, however, the site merely contained a few quotes about how Holker's case had no merit, along with a link to a page featuring statistics on how often the expresssuccesssucks.com Web site was visited. The site is now offline and has been taken over by a cybersquatter.

35. France & Muller, note 2 *supra*.

36. Companies need to consider the ramifications when they threaten legal action against "complaint" site operators. *See* Perry, *Don't Bad-Mouth Your Competition*, Chemtech, Jan. 1997 *at* <http://pubs.acs.org/hotartcl/chemtech/97/jan/bad.html>. As an example of such attempts at public relations gone sour, the Web master of America Online e-mailed the publisher of the AOL-Sucks Web page threatening legal action for the "offensive and disturbing" comments. When the "complaint" site creator began to demand justification for the legal action, a vicepresident at AOL quickly apologized and retracted all threats.

37. *See* Segal & Mayer, note 4 *supra*.

38. <http://www.sprintpcs-sucks.org/legal/legal.html>.

39. George B. Delta & Jeffrey H. Matsuura, Law of the Internet § 7.02 (1998) [hereinafter Law of the Internet]. *See also* Restatement (Second) of Torts § 558 (1997), which defines the elements of defamation as:

    (a) a false and defamatory statement concerning another;

    (b) an unprivileged publication to a third party;

    (c) fault amounting to at least negligence on the part of the publisher; and

    (d) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication.

40. *See Bose Corp. v. Consumers Union of U.S., Inc*., 466 U.S. 485 (1984) (holding that in *Consumer Reports'* criticism of Bose products in its product evaluation, Bose is a public figure and therefore must prove by clear and convincing evidence that *Consumer Reports* published its comments with actual knowledge of falsity or reckless disregard of the truth in order to bring a libel action).

41. Although a large group of people cannot be defamed (i.e., "all employees of X Corp. are liars"), a smaller group—of not more than twenty-five—has been held to have standing to bring a defamation case where a reasonable reader can understand the comment as applying to the plaintiff. *See Law of the Internet* § 7.02(A)(2).

42. *See* Law of the Internet § 7.02(C)(3) (discussing, generally, the definition of "public figure" and "limited-purpose public figure").

43. Law of the Internet § 7.02(C)(1), citing *New York Times Co. v. Sullivan,* 376 U.S. 254, 280 (1964).

44. *See* Law of the Internet § 7.02(C)(2).

45. *Masson v. New Yorker Magazine, Inc.,* 501 U.S. 496, 516-17 (1991).

46. *See* Law of the Internet § 7.02(B)(1).

47. For example, Yahoo!/Geocities and AOL host a wide range of discussion groups. Furthermore, sites like grumbling.com and gripenet.com provide Web-based bulletin boards for a variety of consumer complaints and workplace grievances, but the operators of these sites post no material themselves.

48. 47 U.S.C. § 230.

49. H. R. Rep. No. 104-458, at 1130 (1996).

50. 129 F.3d 327 (4th Cir. 1997).

51. For example, Yahoo!/Geocities, like most free Web hosts, prohibits the following, among other things, in its Terms of Service (TOS) *at* <http://docs.yahoo.com/info/terms/geoterms.html> and reserves the right to terminate its service if Yahoo believes that you have violated or acted inconsistently with the letter or spirit of the TOS:

    (5)(a) upload, post or otherwise transmit any Content that is unlawful, harmful, threatening, abusive, harassing, tortious, defamatory, vulgar, obscene, libelous, invasive of another's privacy, hateful, or racially, ethnically or otherwise objectionable;

    (5)(f) upload, post or otherwise transmit any Content that infringes any patent, trademark, trade secret, copyright or other proprietary rights of any party."

    In addition, Yahoo!/Geocities provides a Content Violation Reporting Form *at* <http://geocities.yahoo.com/v/alert.html>.

52. *Raytheon Co. Won't Sue 21 Who Put Secrets on Internet*, The Boston Herald, 21 May 1999, at 14.

53. *See* Yahoo! Privacy Policy <http://privacy.yahoo.com/privacy/us/geo>.

54. *About the Business & Finance Message Boards* <http://messages.yahoo.com/reminder .html>.

55. *Short Take: Raytheon Drops Suit Against Yahoo Users*, Cnet News.Com, 21 May 1999 *at* <http://www.news.com/News/0-1005-200-342807.html>.

56. Wallack, *Message Nets VP an Exit*, The Boston Herald, 31 Mar. 1999, at 35.

57. Trigaux, note 1 *supra*.

58. 15 U.S.C. § 1125(c)(4)(A)-(C).

59. 29 F. Supp. 2d 1161 (D. C. Cal. 1998). *See also Planned Parenthood Federation of America, Inc. v. Bucci*, 1997 U.S. Dist LEXIS 3338 (S.D. N.Y. 1997) (holding that defendant's use of the domain name www.plannedparenthood.com was unfairly competing with plaintiff's Web site *at* www.ppfa.org).

60. 993 F. Supp. 282 (D.N.J. 1998).

61. <http://www.compupix.com/ballysucks>.

62. Segal & Mayer, note 4 *supra*.

63. *Bally*, 29 F. Supp. 2d at 1166-67.

64. *Jews for Jesus*, 993 F. Supp. at 291.

65. *Id*. at 291 n.5.

66. 993 F. Supp. 304. By extension, it may also be possible to apply *Jews for Jesus* to situations where the graphic elements of a "complaint" site are designed to look similar to the company's real Web site and perhaps even to "complaint" sites which are likely to fall under *Bally* but which are loaded with metatags to encourage Internet search engines to place the "complaint" site above the company's real site. The metatag issue with EPS Technologies, discussed *supra*, would be a good case to test this theory.

67. *Id*. at 305.

68. *Id*. at 308.

69. *Id*.

70. *See* Starbucked.com <http://www.starbucked.com>, where Jeremy Dorosin criticizes Starbucks Coffee and also sells his book, *Balance at Middlefork*, an autobiographical account of Dorosin's view of "philosophical compatibility between Eastern and Western values," and leads up to his highly publicized Starbucks incident. Not surprisingly, one of Dorosin's demands to Starbucks was to make his book available for sale in the popular coffee stores.

71. Both starbucked.com and chasebanksucks.com provide links for potential advertisers to link advertisement banners on their sites. Furthermore, bestbye.com already has advertisements in place linking to, among other things, a company called i-Level.com.

72. The untied.com site (anti-United Airlines) receives “referral fees” for any sales on amazon.com made through untied.com *at* <http://www.untied.com/books>.

73. 97 Civ. 0629, 1997 U.S. Dist. LEXIS 3338, at *16 (S.D.N.Y. Mar. 24, 1997).

74. *Jews for Jesus*, 993 F. Supp. at 308.

75. 17 U.S.C. § 107.

76. *See* Marlatt, *Companies Take Complaint Sites to Court*, Internet World, 16 November 1998; Segal & Mayer, *Sites for Sore Consumers: Complaints About Companies Multiply on the Web*, The Washington Post, 28 Mar. 1999, at A1.

77. WIPO Administrative Panel Decision, *Wal-Mart Stores, Inc. v. Walsucks and Walmarket Puerto Rico*, Case No. D2000-0477, *at* <http://arbiter.wipo.int/domains/decisions/html/2000/d2000-0477.html>.

78. *Id.*

79. *Id.*

80. *See* Marlatt, *Who’s Owner of Chasesucks.com And Chasestinks? Three Guesses*, Internet World, 15 June 1998, *at* <http://www.iw.com/print/1998/06/15/industry/199806 15-antidomains.html>.

81. Companies registering anti-domain names include, Chase Manhattan Bank, Charles Schwab & Co., GE, Hyatt Resorts, and CIT Group.

82. *See, e.g.,* cyveillance.com, ewatch.com, ir-watch.com, investor-facts.com, cycheck.com, cyberalert.com, webclipping.com, utilit-tech.com, and wavephore.com.

83. <http://dir.yahoo.com/Business_and_Economy/Companies/Corporate_Services/Public_Relations/Clipping_and_Monitoring_Services/>.

84. Segal & Mayer, note 4 *supra*.

85. For a fee, LinkAlarm, <http://www.linkalarm.com>, provides the services of a software robot that monitors who has linked to a given site.

86. *Id*.

87. <http://www.nikebiz.com>.

88. France & Muller, note 2 *supra*.

89. Dell WebForum is a Web-based bulletin board for Dell customers to ask questions and blow steam about various problems with Dell Computers. *See* <http://support.dell.com/support/delltalk.htm>. Dunkin’ Donuts provides product and nutritional information, as well as an e-mail link for comments and complaints. *See* <http://www.dunkindonuts.com>.

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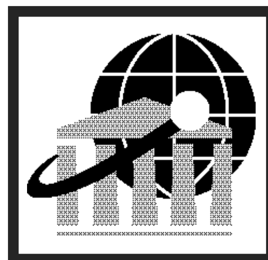

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# Multi-Jurisdictional Law Practice in New York

By James P. Duffy, III

I would like to begin this discussion from the historical perspective of the mid-1950s in New York. At that time, New York lawyers already had well-established offices in France and England. They were recognized as lawyers, albeit New York lawyers, in those jurisdictions.

But consider a Mexican lawyer who was admitted only in Mexico who wanted to do the same thing in New York. He only holds himself out as a Mexican lawyer. He wishes only to advise clients in New York on the law of Mexico and only on that law. However, New York in the 1950s would have strongly opposed his plan.

In *In re Roel*, the New York Court of Appeals ruled that the practice of Mexican law in New York constituted the unauthorized practice of law and sustained an injunction prohibiting this practice.[1] The court did not focus on the Mexican attorney's competence, ability or fitness to practice Mexican law. Rather, the court focused on the giving of legal advice in New York, and held that only New York attorneys were competent to do that.

Within a decade, the attitude in New York had changed radically. New York was the first state to recognize the status of foreign lawyers as foreign legal consultants and to permit foreign legal consultants to practice in New York.[2]

Foreign legal consultants remain subject to certain limitations.[3] However, these limitations are easily eliminated, because New York also permits foreign legal consultants to employ New York lawyers and to offer full New York legal services through those employed New York lawyers.[4] New York now also permits foreign legal consultants to become partners with New York lawyers,[5] as well as employees of New York lawyers.[6] Foreign legal consultants enjoy the same rights and privileges as their New York counterparts in regard to the attorney-client privilege, work-product privilege and similar professional privileges.[7] Thus, foreign legal consultants are, with virtually no exceptions, regarded as true lawyers in New York.

As part of this complete reversal in position, the emphasis became one of inquiry into whether the foreign person was a "lawyer," as that term is understood in New York, in that person's home country.[8] Thus, the focus became primarily one of determining whether the person was competent in his or her home country to give legal advice in the areas of claimed competency, whether that person was subject to reasonable standards of ethics and discipline (with particular emphasis on the confidentiality of client information), whether the person was of good moral character, etc. If these standards were met, such a person could come to New York and offer home country legal services as a foreign legal consultant.

Notice that in the Rules there is no emphasis on the structure of the legal profession in the home country. While this could lead to potential problems, such as when, for example, the home country definition of lawyer does not include the notion of confidentiality of client communications, there are really very few options. Moreover, it is also logical, because, if a person requires legal advice on the laws of a particular country, the only effective way to get that legal advice is to seek it from a person who is considered a lawyer in that country, regardless of what one's views might be about the nature and quality of that country's legal profession.

Today, very few people would dispute that New York's foreign legal consultant provisions are the most liberal in the United States. The consequences of this to New York have been very dramatic and positive. Many very prominent foreign law firms have established large branch offices in New York, and these offices employ large numbers of foreign and New York lawyers. You can see a somewhat up-to-date-list of these firms and the lawyers in them on the International Law and Practice Section page of the New York State Bar Association Web site. While, for reasons not relevant to this discussion, it is difficult to get an accurate count, foreign legal consultants in New York number well into the hundreds and this number is still growing. This explosion of multi-jurisdictional law firms in New York and elsewhere has created many opportunities in the practice of law. It has also posed many challenges, some of which we are going to try to explore here.

The New York State Bar Association has made tremendous efforts to welcome these foreign lawyers as colleagues and to include them among its members. In fact, not too long ago, a German lawyer, who is also a foreign legal consultant in New York, was Chair of the New York State Bar Association International Law and Practice Section, and a Brazilian lawyer, Isabelle Franco, who is also a foreign legal consultant in New York, is the current Section Chair. Similarly, an Argentine lawyer, who is also a foreign legal consultant in New York, served as Co-Chair of the Section's seasonal meeting, its most important meeting of the year. Many foreign legal consultants in New York are members of the International Law and Practice Section and very active participants in it.

The benefits to New York from the presence of such a large body of highly competent foreign lawyers are enormous. Because of them, it is possible to get competent legal advice from highly skilled lawyers who are literally "just down the block." This has helped contribute to making New York a thriving international legal center. I would suggest this is a good model for the future.

Because of the importance law plays in our society and the role lawyers play in the effective functioning of our legal system, there have been strong societal interests in making sure only

- competent people,
- of good moral character,
- who are subject to appropriate ethical standards, and
- who are subject to discipline if those standards are breached,

offer legal services to the public.

This has led in the United States and in most other countries to an elaborate system of legal education and formal admission to the bar. This system is designed to weed out, in the first instance, people not meeting threshold requirements of competence and character. Thereafter, the system attempts to make sure that competence is maintained and ethical standards are upheld. These standards have proven particularly useful in the small consumer-oriented practice of the law. These small consumers and other infrequent users of legal services are not often well able to evaluate the competence and skill of a lawyer or the lawyer's adherence to ethical standards. Thus, at this level the current system would seem to be of critical importance.

However, in the international practice of the law these standards have often proven to be a non-tariff barrier to trade in legal services. They also serve to frustrate international clients' needs and interests. They often frustrate the ability of the international law firm to offer its services where they may be most required. I will try to make the argument here that, because of the decidedly different nature of the legal services required in international transactions and because of the nature of consumers of legal services in those transactions, the need to apply traditional notions regarding protection of the public is greatly attenuated and could, in most cases, be safely eliminated, without any harm to those requiring these services. Thus, the interests of society would not suffer if traditional notions were relaxed in these areas.

Today's large multinational transaction is often entirely too large and complex for any single group of lawyers in one jurisdiction to handle. Moreover, there are usually significant components of the transaction in numerous other jurisdictions that make it practically impossible for any "single jurisdiction" law firm to handle the entirety of it. The consumers of legal services in these transactions are interested mainly in receiving

- competent legal advice,
- in a timely manner, and
- at a reasonable cost.

In-house or other regularly retained attorneys almost always represent these consumers, and, if not, these consumers are represented by competent business people who are skilled in doing international business. Such consumers of legal services are well capable of selecting attorneys to represent their interests and can normally fend for themselves in determining the competence, ethics and fitness of those attorneys they select to attend to the projects they undertake. Moreover, they are quite content to let those attorneys make the decision as to whether it is necessary to consult other professional advisors on particular legal questions that may arise. International clients are not at all interested in having to retain numerous law firms and lawyers in various jurisdictions and try to assemble and make sense out of the massive quantity of legal advice that would be received in the process. Rather, they want a single point of contact with lawyers who will "run the deal" in the legal sense.

When analyzed from this perspective, the concerns of the legal regulators do not seem to match well with the needs of those who require legal services. I am certainly not advocating the elimination of home country criteria for establishing and maintaining a home country legal profession. I am, however, advocating the need for considerably greater flexibility than exists at present for the creation of an international, or multi-jurisdictional, legal profession that would, nevertheless, be based on lawyers in recognized jurisdictions somewhere.

Consumers of international legal services need a system that allows lawyers from various jurisdictions to associate together in whatever form they feel suits the lawyers' economic needs and interests so these lawyers can offer true international legal services to those individuals and businesses who require them. If you accept my thesis that most, if not all such users of legal services are highly sophisticated and are, in most cases, lawyers (e.g., in-house counsel) or represented by lawyers, there seems to be very little reason or need to protect these people who give every indication of being well able to protect themselves. Nevertheless, the lawyers involved in this sort of international legal system would still be members of a recognized legal system and subject to the standards and controls of that system.

Having heard my previous comments, I am sure you can understand that the position of many sophisticated consumers of international legal services is not particularly sympathetic to any rules that would likely restrict the provision of legal services to those involved in international transactions. Rather, these consumers prefer law firms in foreign jurisdictions that can facilitate their needs and interests and that do business across many jurisdictions. This sort of business is in any event not likely to go to locally focused law firms. Thus, there is also a compelling client-driven need for multi-jurisdictional practices.

I can greatly sympathize with the concerns of local lawyers who believe, probably rightly so, that large international law firms are well financed, well organized and very client oriented. This may give rise to the perception of a very formidable competitor. That is probably true in the large international transaction. However, local law firms have a very limited ability to compete for that sort of business directly. But this advantage the large international law firm enjoys in large international transactions is not likely to exist in a purely local transaction. In my opinion, the local lawyer will always have the advantage in a purely local transaction. Among other things, the locally oriented law firm can organize its fee structure to be far more competitive than the international law firm. The international firm simply cannot handle purely local transactions as cost efficiently as a locally oriented firm.

Looking now to the future, I think lawyers, such as we, who are interested in the international legal profession, have to be very concerned. Curiously enough, in New York at least, there is no formal definition of the term "lawyer" in the Code of Professional Responsibility, although the Code clearly prohibits certain activities by "non-lawyers." Indeed, as noted earlier in my presentation, a lawyer is defined by certain general characteristics. Discussions of these characteristics can be found in many places, and an example of some of them can be found in an opinion of the New York State Bar Committee on Professional Ethics, wherein the Committee opined:

> If the foreign lawyer's educational training is of insufficient rigor or the foreign lawyer is subject to professional standards that are vastly incompatible with our own, the New York lawyer's partnership with the lawyer licensed in a foreign jurisdiction might compromise the New York lawyer's ability to uphold the standards of professional conduct applicable in this State. Of particular concern is the New York lawyer's duty of confidentiality under DR4-101. A New York lawyer's sharing of client confidences with a foreign partner could result in inappropriate disclosures or misuse of those confidences if the foreign partner lacked adequate understanding of, or respect for, this ethical obligation.[9]

Interestingly enough, the very next year New York legislation specifically permitted foreign legal consultants and New York lawyers to form partnerships.[10] The Court's enactment of this rule effectively removed any restriction in any situation where a foreign lawyer could be a foreign legal consultant. There are very few situations I know of where a foreign lawyer would not be considered a lawyer in New York. One example might have been lawyers from the former Eastern Bloc countries, where their duty was often more to explain to the client why it was important for the client to conform his or her conduct to the needs and interests of the state than to advance the interest of the client against the state's interest. Happily this problem has largely disappeared.

However, while ethics committees and others express concerns about whether a person meets some vague definition of "lawyer," a very important change has been occurring in large parts of the world. I refer, in particular, to the so-called "multi-disciplinary practice" that is becoming quite common in Europe and elsewhere.[11] At present, some of the largest law firms in Europe are now the legal service arms of the major accounting firms. This is particularly true in France. Happily, the organized bar has started to take notice of this development and has begun to take positions that support the independence and the integrity of the legal profession as a separate profession. These sorts of relationships between lawyers and non-lawyers are different than those we are contemplating here today. However, their existence makes it clear that, if lawyers and non-lawyers can join together in commonly owned entities to practice their various professions as a jointly owned common enterprise, how much easier it would be if people who all called themselves lawyers (even if some of them did not meet the so-called definition of lawyer in some jurisdictions) came together in a jointly owned common enterprise to practice a single profession, namely, law.

However, we must be particularly mindful of the needs of our clients. As I understand them, and as I defined them above, competence is only part of the picture. Where competence is reasonable, then timeliness and cost effectiveness are probably of equal, if not greater, importance to the client. Thus, we have to recognize what clients want and need, and we must find ways in which we, as a profession, can fill those desires and needs. If we cannot find reasonable solutions that satisfy our clients, then (assuming no fundamental change in the validity of multi-disciplinary practices) we have very substantial organizations waiting in the wings that are quite ready, willing and able to do so. While it might not be as easy for the large international accounting firms to qualify as law firms in many U.S. jurisdictions, they have been able to do so in other parts of the world and may be able do so, at least in some practice areas, in some parts of the U.S. I believe the large international accounting firms are capable of taking away significant business from the legal profession unless the legal profession is prepared to recognize what clients need and want and to provide the mechanisms whereby the profession can respond to those needs and wants.

Rather than ending on a somewhat gloomy note, I would like to return again to the New York model and the example I gave earlier of the benefits of having a liberal approach to foreign legal consultants and international law firms—another word for multi-jurisdictional law firms. New York is not the only place in the world that has developed a thriving international legal practice because of a liberal approach to licensing foreign lawyers and permitting foreign lawyers to associate with local lawyers. An enlightened approach to international law firms would, in my opinion, always give the organized bar the advantage. The system is working well in New York. The legal community is pleased with it, and, from what I can see, so are the clients. We have a base of experience upon which we can build and I hope the New York model can be used to further that process.

## Endnotes

1. 144 N.E.2d 24 (N.Y. 1957).
2. *See* Part 521, Rules of the Court of Appeals for the Licensing of Legal Consultants, (hereinafter "Rule" or "Rules"), which are also reproduced in full as Appendix A to this article. The Rules of the Court of Appeals of New York may be found at the Court's Web site starting at http://www.courts.state.ny.us/ctapps/500rules.htm. Part 521 of the Rules can be found at http://www.courts.state.ny.us/ctapps/521rules.htm.
3. Rule 521.3.
4. Rule 521.4.
5. Rule 521.4(b)(1)(iii).
6. Rule 521.4(b)(1)(ii).
7. Rule 521.4(b)(2).
8. Rule 521.1.
9. NYSBA Comm. on Professional Ethics Op. 846-6/8/93 (49-92).
10. Rule 521.4(b)(1)(iii).
11. This phenomenon may be under serious review in the European Union, which has taken positions that would appear to be as stringent as those put forth by the United States Securities and Exchange Commission. See the decision of Advocate General Léger dated 10 July 2001, in proceedings before the European Court of Justice regarding the compatibility of the prohibition of multi-disciplinary partnerships between lawyers and accountants with the EU Treaty.

**Mr. Duffy is a member of the New York bar and a *conseil juridique* in the Principality of Monaco.**

# Appendix A

Part 521. RULES OF THE COURT OF APPEALS FOR THE LICENSING OF LEGAL CONSULTANTS

§ 521.1 General regulation as to licensing.

(a) In its discretion the Appellate Division of the Supreme Court, pursuant to subdivision 6 of section 53 of the Judiciary Law, may license to practice as a legal consultant, without examination, an applicant who:

(1) is a member in good standing of a recognized legal profession in a foreign country, the members of which are admitted to practice as attorneys or counselors at law or the equivalent and are subject to effective regulation and discipline by a duly constituted professional body or a public authority;

(2) for at least three of the five years immediately preceding his or her application, has been a member in good standing of such legal profession and has actually been engaged in the practice of law in such foreign country or elsewhere substantially involving or relating to the rendering of advice or the provision of legal services concerning the law of such foreign country;

(3) possesses the good moral character and general fitness requisite for a member of the bar of this State;

(4) is over 26 years of age; and

(5) intends to practice as a legal consultant in this State and to maintain an office in this State for that purpose.

(b) In considering whether to license an applicant to practice as a legal consultant, the Appellate Division may in its discretion take into account whether a member of the bar of this State would have a reasonable and practical opportunity to establish an office for the giving of legal advice to clients in the applicant's country of admission. Any member of the bar who is seeking or has sought to establish an office in that country may request the court to consider the matter, or the Appellate Division may do so sua sponte.

§ 521.2 Proof required.

An applicant under this Part shall file with the clerk of the Appellate Division in the department in which he or she resides or intends to practice:

(a) a certificate from the professional body or public authority in such foreign country having final jurisdiction over professional discipline, certifying as to the applicant's admission to practice and the date thereof, and as to his or her good standing as such attorney or counselor at law or the equivalent;

(b) a letter of recommendation from one of the members of the executive body of such professional body or public authority or from one of the judges of the highest law court or court of original jurisdiction of such foreign country;

(c) a duly authenticated English translation of such certificate and such letter if, in either case, it is not in English; and

(d) such other evidence as to the nature and extent of the applicant's educational and professional qualifications, good moral character and general fitness, and compliance with the requirements of section 521.1 of this Part as such Appellate Division may require.

(e) Upon a showing that strict compliance with the provisions of paragraph (a) or (b) of this section would cause the applicant unnecessary hardship, such Appellate Division may in its discretion waive or vary the application of such provisions and permit the applicant to furnish other evidence in lieu thereof.

§ 521.3 Scope of practice.

A person licensed to practice as a legal consultant under this Part may render legal services in this State; subject, however, to the limitations that he or she shall not:

(a) appear for a person other than himself or herself as attorney in any court, or before any magistrate or other judicial officer, in this State (other than upon admission *pro hac vice* pursuant to section 520.11 of this Title);

(b) prepare any instrument effecting the transfer or registration of title to real estate located in the United States of America;

(c) prepare: (1) any will or trust instrument effecting the disposition on death of any property located in the United States of America and owned by a resident thereof; or (2) any instrument relating to the administration of a decedent's estate in the United States of America;

(d) prepare any instrument in respect of the marital or parental relations, rights or duties of a resident of the United States of America, or the custody or care of the children of such a resident;

(e) render professional legal advice on the law of this State or of the United States of America (whether rendered incident to the preparation of legal instruments or otherwise), except on the basis of advice from a person duly qualified and entitled (other than by virtue of having been licensed under this Part) to render professional legal advice in this State on such law;

(f) in any way hold himself or herself out as a member of the bar of this State; or

(g) carry on his or her practice under, or utilize in connection with such practice, any name, title or designation other than one or more of the following:

(i) his or her own name;

(ii) the name of the law firm with which he or she is affiliated;

(iii) his or her authorized title in the foreign country of his or her admission to practice, which may be used in conjunction with the name of such country; and

(iv) the title "legal consultant," which may be used in conjunction with the words "admitted to the practice of law in (name of the foreign country of his or her admission to practice)."

§ 521.4 Rights and obligations.

Subject to the limitations set forth in section 521.3 of this Part, a person licensed as a legal consultant under this Rule shall be considered a lawyer affiliated with the bar of this State and shall be entitled and subject to:

(a) the rights and obligations set forth in the applicable Lawyer's Code of Professional Responsibility or arising from the other conditions and requirements that apply to a member of the bar of this State under the rules of court governing members of the bar; and

(b) the rights and obligations of a member of the bar of this State with respect to:

(1) affiliation in the same law firm with one or more members of the bar of this State, including by:

(i) employing one or members of the bar of this State;

(ii) being employed by one or more members of the bar of this State or by any partnership or professional corporation which includes members of the bar of this State or which maintains an office in this State; and

(iii) being a partner in any partnership or shareholder in any professional corporation which includes members of the bar of this State or which maintains an office in this State; and

(2) attorney-client privilege, work-product privilege and similar professional privileges.

§ 521.5 Disciplinary provisions.

A person licensed to practice as a legal consultant under this Rule shall be subject to professional discipline in the same manner and to the same extent as members of the bar of this State and to this end:

(a) Every person licensed to practice as a legal consultant under this Part:

(1) shall be subject to control by the Supreme Court and to censure, suspension, removal or revocation of his or her license to practice by the Appellate Division and shall otherwise be governed by subdivisions 2 through 10 of section 90 of the Judiciary Law; and

(2) shall execute and file with the Appellate Division, in the department in which he or she is licensed, in such form and manner as such Appellate Division may prescribe:

(i) his or her commitment to observe the applicable Lawyer's Code of Professional Responsibility and the rules of court governing members of the bar to the extent applicable to the legal services authorized under section 521.3 of this Part;

(ii) an undertaking or appropriate evidence of professional liability insurance, in such amount as such Appellate Division may prescribe, to assure his or her proper professional conduct and responsibility;

(iii) a written undertaking to notify the court of any change in such person's good standing as a member of the foreign legal profession referred to in section 521.1(a)(1) of this Part and of any final action of the professional body or public authority referred to in section 521.2 (a) of this Part imposing any disciplinary censure, suspension, or other sanction upon such person; and

(iv) a duly acknowledged instrument, in writing, setting forth his or her address in this State and designating the clerk of such Appellate Division as his or her agent upon whom process may be served, with like effect as if served personally upon him or her, in any action or proceeding thereafter brought against him or her and arising out of or based upon any legal services rendered or offered to be rendered by him or her within or to residents of this State, whenever after due diligence service cannot be made upon him or her at such address or at such new address in this State as he or she shall have filed in the office of such clerk by means of a duly acknowledged supplemental instrument in writing.

(b) Service of process on such clerk, pursuant to the designation filed as aforesaid, shall be made by personally delivering to and leaving with such clerk, or with a deputy or assistant authorized by him or her to receive such service, at his or her office, duplicate copies of such process together with a fee of $10. Service of process shall be complete when such clerk has been so served. Such clerk shall promptly send one of such copies to the legal consultant to whom the process is directed, by certified mail, return receipt requested, addressed to such legal consultant at the address specified by him or her as aforesaid.

§ 521.6 Separate authority.

Nothing in this Part shall be deemed to limit or otherwise affect the provisions of section 520.6 of this Title.

§ 521.7 Application for waiver of rules.

The Court of Appeals, upon application, may in its discretion vary the application or waive any provision of these rules where strict compliance will cause undue hardship to the applicant. Such application shall be in the form of a verified petition setting forth the applicant's name, age and residence address, the facts relied upon and a prayer for relief.

§ 521.8 Revocation of license.

In the event that the Appellate Division determines that a person licensed as a legal consultant under this Part no longer meets the requirements for licensing set forth in section 521.1(a)(1) or section 521.1(a)(3) of this Part, it shall revoke the license granted to such person hereunder.

# Multi-Jurisdictional and Multi-Disciplinary Practice: A Colombian Law Perspective

By Carlos Fradique-Méndez

The purpose of my presentation is to highlight a number of issues that are likely to surface, from a civil law perspective, around the subjects of multi-jurisdictional law firms and multi-disciplinary practices. While most of my discussion will revolve around Colombian law, it is safe to assume that similar concerns would arise in dealing with the same subjects elsewhere in Latin America, given the similarities in the regulation of the legal profession.

## I. Introduction

The practice of law in Colombia is subject to a number of regulations. The most significant one is the so-called Legal Profession Act (the "Act"), enacted thirty years ago by means of Decree 196 of 1971. The Act was the result of a model document discussed among representatives of various Latin American countries and served indeed as a guideline to a number of subsequent professional conduct codes in the region.

By way of introduction, I would like to mention four features of the Act that greatly impact the analysis of the current status of Multi-Jurisdictional matters (MJs) and Multi-Disciplinary Practices (MDPs) under Colombian law and, indeed, under a civil law perspective generally.

First, the Act principally addresses the professional conduct of a *trial* lawyer. As a consequence, most of the issues typically encountered by a transactional attorney are not expressly dealt with in the Act. This becomes particularly relevant when considering whether services such as due diligence reviews, legal compliance programs, negotiations, and conflict resolution advice and litigation support services would fit neatly within the definition of a "legal service" for purposes of the applicable regulations.

Second, the Act deals with attorneys individually and not with law firms or organizations. While law firms are indeed subject to a number of rules of conduct stemming from other statutes (such as antitrust and corporate laws), matters such as conflicts of interest, relationships between partners of the firm and other aspects of a legal enterprise are not addressed as a matter of professional conduct. This is heightened by the fact that the legal profession is not technically subject to self-regulating bodies or procedures.

Third, the Act is structurally different from professional conduct rules applicable in most common law jurisdictions. As an illustration of the above, the Act is organized around the following chapters:

- (i) General matters;
- (ii) Registration of attorneys;
- (iii) The legal profession;
- (iv) Supervision of the legal profession;
- (v) Professional duties; and
- (vi) Disciplinary matters.

In light of the structure of the Act, certain matters such as lawyer-client relationship, conflicts of interest and the different roles of the attorney are not addressed in a fashion similar to professional codes in Europe and in North America. This results in some matters being under- or over-regulated and in difficulties in establishing the equivalent guiding principles from one jurisdiction to another.

Finally, the Act has become outdated and does not adequately respond to the significant developments that the legal profession has experienced over recent years; including the changes in the type of services rendered, the advances in telecommunications and technology and the increasing globalization of economies and transactions.

## II. Multi-Jurisdictional Law Firms

The Colombian experience in respect of multi-jurisdictional law firms is fairly limited. At present, there are no foreign partners in any of the largest Colombian law firms and only a handful of foreign associates practice with Colombian law firms. In addition, some unregistered foreign attorneys render advisory services only.

With the possible exception of Baker & Mckenzie (which nonetheless is composed of local resident partners only), there are currently no international or multi-jurisdictional law firms in Colombia.

Notwithstanding the above, I would like to make a few points with respect to the status of MJs in Colombia.

### A. Only locally registered attorneys may practice law in Colombia.

The Act provides that the practice of law in Colombia is reserved to individuals (i) holding a juris doctor

degree duly recognized by the Republic of Colombia, and (ii) registered as attorneys before a single national authority known as the *Consejo Superior de la Judicatura* (the "Judiciary Council").

As a result, a foreign attorney may not engage in the practice of law in Colombia unless, in addition to complying with immigration requirements, he or she is duly registered as an attorney. In practice, however, a number of unregistered foreign attorneys have rendered international-oriented legal services or local advisory services without being subjected to investigations or disciplinary actions.

In any event, the registration of a foreign attorney is a fairly simple and straightforward procedure. In general, it requires evaluation of credentials by the Colombian Institute of Graduate Studies and, in certain instances, the successful completion of an exam administered on an ad hoc basis.

### B. The practice of law by an unregistered foreign attorney would be deemed to constitute the unauthorized practice of law.

Under the Act, the rendering of legal services without the required registration amounts to a misdemeanor to be investigated by police authorities and not by the Judiciary Council (which is the entity generally in charge of the supervision of the legal profession). In addition, under certain circumstances, such practice may amount to a criminal offense known as "personal falsity," punishable with fines only.

### C. The advertising of legal services by foreign attorneys may be subject to closer scrutiny in the near future.

While the Act does not address the subject of foreign attorneys offering legal services to Colombian residents, there is an investigation currently conducted by the Judiciary Council relating to a foreign firm that offered its services to Colombian residents through newspapers and magazine ads. In any event, I anticipate that the investigation will not progress to any extent if the defendant is able to demonstrate that the legal services offered to Colombian residents pertained to foreign law exclusively and would be rendered solely abroad.

## III. Multi-Disciplinary Practices

In Colombia, there are a number of multi-disciplinary practices involving, among other things, the rendering of legal services, most notably in the case of the Big Five accounting firms. Notwithstanding the above, the underlying concerns have not been widely discussed in academic or regulatory circles. This largely stems from the fact that the Big Five only account for a small percentage of the Colombian legal market and because they mostly render services in connection with tax-related legal matters. In practice, the domain of local lawyers has remained largely untouched, since one rarely sees the legal departments of the Big Five involved in structuring international transactions or in corporate deals. Nonetheless this trend may be shifting as the Big Five increasingly offer foreign investment, foreign trade and general corporate law advice.

While the Judiciary Council has not addressed the matter of MDPs at all, the Superintendency of Corporations and the Board of Accountants have touched upon the subject of rendering legal and accounting services under the same roof.

### A. The views of the Superintendency of Corporations

Until 2000, the Superintendency of Corporations had consistently indicated that an accounting firm was barred from simultaneously appointing an auditor and a legal advisor in respect of the same client.[1] The rationale of the decisions related to the compromise of the independence inherent to both the positions of legal advisor and accountant.

Nonetheless, in response to a reconsideration request filed by the Big Five, the Superintendency radically modified its position in March 2000.[2] In this opinion, it indicated that an auditing firm would be allowed to serve a client in an accounting capacity and otherwise, provided that the services are rendered by different individuals.

The change of opinion is based in the wording of Article 34.10 of Law 550 of 1999 (pertaining to temporary workout proceedings), which reads as follows:

> Unless the workout agreement provides otherwise, the execution and performance thereof would not result in amendments to the by-laws, administration or internal procedures of the debtor, without prejudice to the amendments resulting from the adoption of the corporate governance code. Notwithstanding the above, the Supervision Committee may require the debtor (i) to provide for a mandatory in-house fiscal auditor during the term of the workout agreement, and (ii) to submit a list of eligible individuals or firms. *The position of in-house fiscal auditor would be mandatory and, to the extent that the same firm in charge of the external*

*auditing of the debtor is appointed, the position must be entrusted to different individuals*. [Emphasis added].

In my view, the Superintendency gave the provision a fairly flexible interpretation, since it does not seem to address the matter of legal versus auditing services to be rendered by the same firm. In any event, this remains the current position of the Superintendency as to this matter.

By the way, the reasons advanced by the accounting firms in their reconsideration request were not released.

**B. The views of the Accounting Board**

Quite surprisingly, the Accounting Board has taken a fairly conservative view in respect of MDPs. This was probably due in large measure to the fact that the accounting community is composed of thousands of independent accountants unaffiliated with the Big Five.

In a number of opinions, including two recent opinions issued in July and August of 2001,[3] the Accounting Board reiterated its views to the effect that the so-called in-house fiscal auditor of a company is required to show absolute independence and impartiality and therefore is barred from being appointed in another position generally. The position of the Accounting Board is principally based in Article 205 of the Code of Commerce, which provides that the in-house fiscal auditor of a company may not hold another position with the same company or any of its affiliates.

In addition, the Accounting Board has expressly indicated[4] that it does not endorse the rendering of accounting and other type of services by a single entity through different individuals (i.e., MDPs). The rationale behind this position relates to the long-discussed concerns of independence, impartiality and prevention of conflict of interests. This position is based also on Article 48 of Law 43 of 1990, which sets forth the Accounting Profession Code.

Finally, the Accounting Board has also lobbied in Congress in connection with a bill currently under review[5] that seeks to amend the Accounting Profession Code in its entirety. Among other things, the bill (i) proposes a five-year residency requirement for foreigner accountants seeking to be admitted to practice in Colombia, and (ii) reflects its views seeking to restrict the rendering of ancillary services to closely related matters (thereby excluding the rendering of legal services by an accounting organization).

In this sense, the strongest opposition to MDPs involving accountants and lawyers comes from the Accounting Board rather than from the Judiciary Council or the legal community. Notwithstanding the above, as MDPs evolve, lawyers will likely take a more prominent and leading role in evaluating the various matters and core principles associated therewith.

## Endnotes

1. *See* Op. No. 220-2870 of 22 January 1999; and Op. No. 52887 of 27 May 1999, of the Superintendency of Corporations.
2. *See* Op. No. 22253 of 23 May 2000, of the Superintendency of Corporations.
3. *See* Op. No. 501 of 6 August 2001, and Op. No. 494 of 26 July 2001.
4. *See also* Regulation No. 31 of 1 October 1998, and Regulation No. 4 of 18 December 1991.
5. The most recent draft of the bill is available *at* www.cpcpcolombia.org.

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# Financing of Corporations in the United States and Mexico: Brief Considerations

By Juan Enrique Garcia

## I. Introduction

From a theoretical standpoint, financing mechanisms available to a corporation are usually divided in two broad categories, namely, financing through issuance of equity and financing via acquisition of debt. However, the extent to which a corporation actually resorts to one or the other, or a convenient combination of the two, is based on other than purely theoretical grounds. In fact, the decision effectively rests on economic, business (including strategic planning as well as accounting and tax issues), practical, and to a significant extent, legal considerations. Perhaps the interaction among these elements is even more important when comparing the way corporations in different jurisdictions use these two channels of financing.

In this sense, for example, the United States is regarded as the leading and one of the most sophisticated financial markets in the world. The number of mechanisms available for a corporation in the United States to finance a specific project are considerable, with new products and tools being constantly created and offered in the market. One would therefore tend to think that financing in the United States is easier than in other jurisdictions such as, for example, Mexico.

Yet regardless of how persuasive this assertion might seem on the surface, it should be considered in light of the important underlying premises that support, and in a way condition, the effectiveness of a variety of financing mechanisms. An important portion of economic, social and legal theory currently focuses on these underlying premises.

The brief discussion that follows focuses on the legal system as one of these underlying premises, and compares in general terms the financing mechanisms available for a corporation in the United States and in Mexico. Although this exercise is definitely not exhaustive, the differences between these two legal systems are clear enough so as to allow a quick and broad comparison.

## II. United States

Corporations in the United States have long been able to obtain financing from capital markets in place in their modern form from the beginning of the twentieth century. The roots of the securities market, for example, can be traced back to the financing of important infrastructure projects such as the railroads, followed by the telephone and other important industries that functioned as a foundation of the country's economic development.

The use and development of the stock market as a fundamental source of financing brought to the picture certain effects that have ever since marked the public company in the United States as a model that can be compared *vis à vis* the models that surfaced in other economies. Among these effects, perhaps the most characteristic one was the development of a phenomenon, documented during the 1930s by professors Berle and Means, whereby an ever-increasing dispersion of shareholder ownership in the stock market increased at the same time the level of control that the management exerted on the corporation, so that management replaced the shareholders, the actual owners of the company, as the controlling force in the large public corporation. This phenomenon, identified as a separation of control and ownership of the big public corporation, was in fact the breakpoint that prompted important changes and developments in the law.

Why this dispersion of shareholding occurred in the United States and not in other countries has been explained from different perspectives. Authoritative opinions point to the effective legal protection granted by the legal system to the individual investor, others point to the socio-political features and historical background of the United States, while others note the self-regulating character of the bodies that participate in the market (primarily the New York Stock Exchange) and the lack of governmental intervention at the very beginning of its development. Yet others refer to the "social capital" extant in the United States, understood as the level of trust that an individual has in the stock market and the institutions governing same so as to be willing to invest in it. For our purposes, however, the key issue is the legal and regulatory progress triggered by this phenomenon, which has not only shaped the U.S. system as a model, but has further nurtured its continued evolution.

This progress is reflected in the creation of a clear set of rules and regulations applicable to public companies (companies whose shares are registered under the securities laws and are listed on a stock exchange). Securities regulations in the United States are among the most complex in the world, yet perhaps their enforceability is an even more important feature when compared to other systems. In parallel with securities

regulations, the development of codified law on corporations shaped primarily by an important development in case law, created rules followed by management of public companies to assure that corporate governance is not carried out to the detriment of the individual investor, thereby reducing as much as possible the agency problem that was considered the main issue in the Berle-Means model. By and large, the combination of all these features has helped to foster the development of the securities market in the United States, which also imposes high standards of diligence upon the companies offering securities in the market by requiring such companies to comply with accounting principles and to disclose material information to the public.

In regard to its size, the securities market in the United States has thousands of companies listed. In this sense the market for initial public offerings, or IPOs, and the corporate debt market have been significantly large as well, and have witnessed securities offerings by companies not only with ongoing businesses but also of "start-up" companies (although this latter trend reached its dramatic peak in 2000). It is important to consider, however, that given the current slowdown of the U.S. economy, the market has not seen that many new offerings throughout this year. Notwithstanding the foregoing, the availability of this market during the past two decades has fostered other sources of corporate finance. One example is venture capital, which aims at an eventual public offering of the funded company to take place once the company's fundamentals, as well as the market, dictate a convenient time to "go public." Additionally, the availability of this mature securities market has also nurtured the development of creative financing mechanisms such as securitization of assets and structured financing.

The foregoing is not to say that the legal system in the United States is perfect; it definitely has experienced its difficult episodes and pitfalls. Yet it is important to mention that invariably the law is constantly developing, correcting and bringing back to track market practices that are detrimental to the health of the securities market as a whole. In this regard, generally speaking, the legal system has enabled financing to flow to companies not only in the United States but also to companies of other jurisdictions that have listed and traded their securities in the United States market as foreign issuers.

Besides having the option to obtain financing from the securities market, a corporation in the United States also has access to credit from commercial banks and other financing entities. Here again, a typical point of discussion has been the role of the legal system in nourishing the flow of financial resources from creditors to debtors.

In this sense, the legal system has definitely helped facilitate investment by assuring creditors that as long as they follow diligent credit standards and secure themselves properly by using collateral mechanisms available under the law, they should be able to effectively and expediently resort to such collateral in the event of debtor's delinquency. Resorting to such collateral is generally expedient, and with a sufficient level of certainty on how a court of law will address any conflict arising from the creditor-debtor relationship. By and large, this certainty is present given the precedents followed by the courts on a case-by-case basis.

Hence, in the context of credit financing, the security interest law in the United States has been determinant in the flow of financial resources to the economy by providing a sufficient level of comfort to creditors of recovering their loan either from debtor or by having a perfected lien on collateral that can be liquidated expediently, with the least amount of hurdles and legal uncertainties.

This reduces the transactional costs that go along with not having valuable and effective collateral securing a loan, as well as those associated with the uncertainty on how the legal system would resolve a particular conflict, thereby helping to keep costs at competitive levels. This feature of the United States legal system functions also as a ground for development of other mechanisms of financing such as leasing, asset-based lending, sale-lease back mechanisms, and factoring, that are very convenient and useful by a corporation in financing different types of projects.

## III. Mexico

In contrast to the foregoing, the mechanisms of financing in Mexico have followed a quite different path from those in the United States. Important to Mexico's industrial development was the government's role as financier, shareholder and in other instances direct owner of corporations. In this regard, the development of important industries such as railroads, steel, mining and communications, among others, was financed heavily by the Mexican government with the participation of the private sector. This situation created what different scholars have characterized as a "symbiotic" model, in which governance of large corporations at the initial stage of Mexico's industrialization was shared jointly by the government and the private sector.

Thus large corporations did not resort to the stock market for financing as they did in the United States. Instead, financing of these concerns depended on private equity and lending from banking institutions, along with some backing from the government. As a result, the model of the large corporation in Mexico, as is common in other countries as well, became one

characterized by blocks of controlling equity held by a relatively small group of shareholders, rather than by a dispersed multitude of holders, eliminating the phenomenon of separation of ownership and control.

Bank lending has by far been a more common channel of financing in Mexico than the stock market. Large Mexican corporations have resorted in the past to domestic as well as foreign loans from banking institutions to finance their development. Although Mexico has had a securities market in place for decades, the government first focused on this market as a channel to finance private companies with the enactment of the securities market law in 1975, after a crises triggered by the enormous level of foreign debt contracted by Mexican companies in foreign currency.

The securities market, however, has remained small, with about two hundred companies listed. And participation in the market by Mexican individuals as investors has been traditionally small as well, in part as a consequence of the low levels of private savings and also, according to recent literature, because of a lack of protection to the minority shareholder under applicable law. This situation, however, should be considered in light of the fact that important large Mexican companies also list their securities in foreign exchanges, such as the New York Stock Exchange, effectively adopting some if not all the relevant practices that issuers in the United States are expected to follow.

Notwithstanding the traditional use of banking credit as a preferred mechanism to obtain financing, domestic credit in Mexico experienced dramatic declines as a result of the Peso crises during the mid-1990s. The financial crises increased dramatically the amount of bad debt maintained by Mexican banking institutions, while at the same time already high interest rates soared, causing a cascade of defaults by Mexican borrowers. As a result, banking institutions in Mexico could not keep on granting loans, and some of them were in real need of fresh capital to remain in operation.

Despite all the changes the Mexican banking environment has gone through in recent years,[1] it was clear that the rules governing collateral in Mexico and the mechanisms then available to secure loan facilities were not sufficiently efficient to renew the lending activity of the banks. Faced with an increased need to finance infrastructure projects (utilities, roads and water supply, among others), a need to modernize and strengthen the banking system, as well as the need to develop a strong securities market (bringing confidence and trust to the investor and offering a reliable mechanism for corporations to obtain financial resources), Mexico has during the last couple of years embarked on a program to accomplish significant reforms in its legal framework.

Among the most significant legal reforms enacted during the past two years have been the new bankruptcy and reorganization law, as well as an important amendment to the security interest law in Mexico. As a result of the latter,[2] Mexico has created a security interest system resembling that of Canada and the United States, making it possible to finance personal property by taking a blanket security interest on assets which a debtor may continue using in its normal course of business, while the secured creditor's rights will extend to the proceeds of such assets as the same are used, sold or replaced. This amendment also makes it possible for a debtor to grant a purchase money security interest where a creditor finances the acquisition of an asset in which the creditor has an exclusive priority on the asset, so long as same is readily identifiable.

The rules of such security interest mechanisms are drafted in a way that will make the creditor's foreclosure on secured assets more expedient and effective in comparison to the other collateral devices traditionally available under Mexican law (i.e., mortgages on real estate and traditional pledges). At the same time, the creditor is forced to be more diligent in granting loans and monitoring the value of the collateral, since it is expressly provided that the debtor's obligation to pay the secured loan only goes up to the market value of the secured assets, beyond which the debtor is released.

Nevertheless, as beneficial as these reforms might be, they must pass the test of the courts. In this regard, the extent to which these mechanisms of security interest will effectively help to foster the credit activity in Mexico, providing certainty and comfort to creditors and debtors in their dealings, will definitely depend on how the courts interpret and enforce these rules. Ideally, the courts should be conscious of the policy underlying these reforms and permit a level playing field. The foreclosure procedure should not be a myriad of formalities that would delay and make the process unbearably expensive for creditors, thereby encouraging debtors to default. Experience has shown that this is not efficient from an economic standpoint.

On the other side of the financing spectrum, Mexico has recently enacted significant reforms to the securities market law.[3] These reforms cover not only aspects exclusively relevant to securities regulations *per se*, but also deal with aspects traditionally left to substantive corporate law. Although a detailed discussion and analysis of these reforms is beyond the purposes of this article, it is worth mentioning some of them. For example, the new rules enhance the level of disclosure required of public companies in order for them to remain listed on the stock exchange, and insider trading issues are dealt with in a more stringent and extensive manner.

Additionally, the reforms provide for added protection to the minority shareholders of a public corporation, while at the same time limiting the ability of corporations in Mexico to issue non-voting (and/or limited voting) shares at percentages that would effectively convey control of the company to a small group of holders of voting stock. Other significant aspects of this reform deal with corporate governance, introducing the concept of the "independent director" into the board room,[4] with the intention of enhancing the decision-making process and even creating an "auditing committee" composed in its majority of independent directors. The auditing committee is entrusted with the authority to scrutinize relevant decisions that the board makes and to report to the shareholders of the company.

These reforms to the securities market law are too recent to be able to measure their actual effect on the market. In principle, however, the rules were enacted in adherence to recent theories that the protection of the minority investor is the stepping stone to fostering the development of a mature and dispersed securities market.

Nevertheless, the key element in this regard is the enforceability of these rules. Theoretically, the market should respond once the rules are effectively enforced. In any event, this challenge ultimately rests as much on the regulatory authorities and the courts as it does on the issuers and other participants in the Mexican market.

## IV. Conclusion

Traditionally, it has been difficult to assess whether a harmonization of law is feasible in any given context. Yet as countries interact in an ever-increasing globalized economy, many long-standing ideas must be subjected to renewed scrutiny, as demanded by the dynamism of commerce and global economic actors. Harmonization may or may not be institutionalized at first. In the context of security regulations and corporate law, a phenomenon referred to by Professor John C. Coffee as "functional convergence"[5] has brought the idea of harmonized rules and practices back into consideration. Convergence occurs when a company gets listed in a foreign exchange where it must comply with certain rules and regulations, even though the same company is not formally required to do so under its domestic system, hence effectively creating a substantive harmonization.

So far, there are some large Mexican corporations, listed in the New York Stock Exchange, that must comply with rules and regulations enacted in the United States. Whether or not the newly enacted rules in Mexico will facilitate the flow of financial resources to corporations in Mexico is, again, a question for the future. What is somewhat clear is the recognition that developing the Mexican market and encouraging Mexican companies to compete more effectively for capital and resources entails a continuous race to the top, both in law and in practice.

## Endnotes

1. Perhaps one of the most relevant events was the merger between Citigroup and Banamex, creating the largest bank in Mexico, but with many other important banking institutions also being controlled by foreign investors prior to such merger.
2. The reforms whereby the security interest mechanisms were created were published in the *Diario Oficial de la Federación* (DOF) on 23 May 2000.
3. See DOF, 1 June 2000.
4. Independent directors must comprise at least twenty-five percent of the board.
5. John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 Nw. U.L. Rev. 641 (1999).

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# Protection of Business Methods in Brazil

By Raul Hey

## I. Introduction

In the industrial property laws of most, if not all, countries, the protection of methods for doing business has been traditionally considered either as non-patentable subject matter or not considered an invention at all.

This situation, although not yet changed, is being re-evaluated as a result of the decision given in the U.S. by the Federal Circuit Court of Appeals in the already famous *State Street Bank* case, where a patent has been granted to a data processing system for management of financial services.[1]

The *State Street* patent was not the first one granted to a method of doing business in the U.S., but the contents of the Federal Circuit's decision in that case have established new rules for the treatment of this subject in the U.S. and was undoubtedly the catalyst for the re-evaluation of corresponding legal provisions around the world.

Besides discussions regarding intrinsic patentability of those inventions in view of statutory provisions, the vast majority of those patents cover methods for doing business through the Internet or, generally speaking, using computers. In many cases, the use of computers is the only difference from the traditional method used for that same business, thus raising questions of obviousness and, in some cases, even possible lack of novelty. Moreover, a conclusion is still to be reached as to the patentability of methods of doing business not using computers or the Internet, which would be apparently possible in view of *State Street* and other similar decisions.

The above comments have the sole purpose of introducing the subject and defining the scenario of this discussion. I will not address the development of this subject in the international scenario, and even less from the U.S. perspective, since there are others from the U.S. who can address those aspects in a much more appropriate and complete manner.

## II. The Impetus of *State Street*

I would like, however, to highlight two important aspects regarding the *State Street* decision and its consequences in the United States, as opposed to other countries.

The first one is the apparent recognition expressed in the Federal Circuit's decision that the "utility" requirement found in the U.S. law,[2] which is found as well in the laws of other countries (usually under the designation of "industrial applicability"), had its scope broadened, in the sense that not only strictly technical results are to be considered in determining the "utility" of an invention, but also numeric or financial results of the claimed method in a given business activity. This concept, if generally accepted by other jurisdictions, would certainly represent a broadening in the scope of protection afforded by patents around the world.

The second aspect to be taken into consideration when trying to evaluate the possible extension of this new concept to other countries, particularly Brazil, is the wording of the U.S. Constitution, when it establishes the rights of the inventors, as a means "to promote the progress of *science and useful arts*, by securing for a limited time to authors and inventors the exclusive right to their respective writings and discoveries." That is opposed to the wording of the Brazilian constitution, which establishes that

> the law shall guarantee to the authors of *industrial inventions*, temporary privilege for its utilization, as well as protection to industrial creations, such as the property of trademarks, names of enterprises and other distinctive signs, in view of the social interest and the economic and technological development of the Country. [Emphasis added.]

As can be seen, while the U.S. Constitution has a very flexible wording which, added to a common law system, allows the courts an easier adaptation to new technologies as far as the patent law is concerned, the text of the Brazilian Constitution expressly determines that it is the *law* which will regulate protection to inventions. Thus, not only is the language in the U.S. Constitution less oriented toward industrial application and more toward a general concept of usefulness, but in a Roman (or continental) law system, as is the case in Brazil, the concept of the primacy of the law or statute substantially reduces the flexibility of interpretations by the courts of what is expressly written in the patent law.

## III. The Legal Position in Brazil

The Brazilian Industrial Property law,[3] similar to the European Convention, has a provision, article 10, stating that creations such as mathematical methods, schemes, plans, principles or *methods of a commercial*, accounting, financial, educational, publishing, lottery or fiscal *nature*, the presentation of information and other similars, *are not considered inventions for the purposes of the law*.

This provision, in principle, leaves no doubt as to the destiny of any patent application in Brazil claiming a method for doing business as such. On the other hand, looking at the vast majority of the patents granted in the United States, and a great number of patents granted

also in Brazil, one will hardly find a claim having that direct wording. There are a number of patents granted for "data processing systems," "systems for data management," "methods for controlling sales" and similar wordings.

## IV. Discussion

This raises another issue. That is, to what extent is it the manner in which a claim is worded that actually defines the patentability of an invention, notwithstanding statutory prohibitions as to the subject matter itself?

I would cite, as an example of this same issue, the discussions which took place some twenty years ago regarding patentability of the so-called "software inventions" or "computer related inventions," which were directed to algorithms, mathematical methods and similar creations applied or applicable to some useful and practical purpose, although not necessarily an industrial product or process.

Two problems immediately became apparent back then. First, the boards of examiners of most patent offices around the world simply did not have people with the necessary technical skills and in a number sufficient for coping with the large number of patent applications being filed. Second, there was no prior art available and organized, in a manner capable of assisting examination of those applications.

What happened in the first moment was a wave of statutory rejections, soon substituted by almost automatic grantings, when claims started to be written in a manner which looked acceptable from a statutory point of view. It took many years for a generation of skilled examiners to be formed and put to work and an effective prior art database made available, after which the granting of those patents stabilized at a normal rate, similar to other areas of technology.

The above scenario is likely to occur with any new technology with a reasonable commercial value in regard to which patent applications are filed, for the sole reason that the industrial property laws of almost all the countries and even the IP rules of the TRIPS agreement do not develop at the same speed as new technologies are created. Discussions may exist as to whether the human mind is faster than computers, but certainly there is no doubt as to who is faster, engineers and researchers or legislators.

Turning back to the patents for business methods, I believe we are already in that phase where patents are being granted automatically just because they *either* "look all right" from a statutory point of view, that is to say, they are being claimed in a manner apparently acceptable to examiners who, in their vast majority, have backgrounds in engineering, physics, chemistry and other completely technical areas, but have no knowledge in the business areas involved; *or*, in the case of the U.S., because of *State Street* and other decisions along the same line.

Having considered several patents granted in Brazil and even in the U.S. for methods of doing business (although claimed in a statutorily acceptable manner), it seems to me that a serious challenge, based on prior art and lack of inventive step or obviousness, would substantially reduce the number of those patents.

The problem (or advantage, depending on which side one is) is that an opposition, nullity action or even an office action questioning those traditional legal requirements for patentability would have to be based on prior art—which, in this case, is not documented nor organized in a searchable manner.

Moreover, as mentioned before, a group of examiners having a different kind of background would have to be formed to examine those applications and this, at least as far as Brazil is concerned, would certainly take a considerable time to be fully operational.

## V. Conclusion

I will end this article by mentioning three examples of applications filed in Brazil for inventions which are neither clear cases of conventional inventions, nor clear methods of doing business. Two are still pending applications and the other is an already granted patent.

- Method for safe transactions between two parties through a communication connection: Single-use ("disposable") passwords supplied by a certified database, to be used in credit card transactions through the Internet.
- Device for releasing a free telephone call to a user: Circuit for detecting a completed call
  - Circuit for blocking conversation by a given period
  - Circuit for transmitting a pre-recorded message (advertisement)
  - Circuit for releasing conversation for a given period.
- Game through the Internet: Participants conduct searches for finding groups of images associated to certain trademarks.

In each of those cases, the claim wording begins with the same words presented here.

## Endnotes

1. U.S. Patent No. 5,193,056. *See State Street Bank & Trust Co. v. Signature Financial Group*, 149 F.3d 1368 (Fed. Cir. 1998).
2. 35 U.S.C. § 101.
3. Law No. 9.279/96.

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# Patentability of Business Methods in Mexico

By José I. De Santiago

## I. Introduction

The patenting of business methods has become an issue of major concern among IP practitioners, both in Mexico and abroad. Companies in many countries are exerting efforts to gain recognition in their own national legislation of the right to patent business methods. While all this has become somehow messy in the United States, due to the tremendous number of standing applications and already granted patents, as well as the inherent development of case law, the European states are still trying to harmonize TRIPS with the European Patent Convention (EPC). Meanwhile, in Mexico discussion is still in the diaper stage among practitioners, while the Patent and Trademark Office (abbreviated in Spanish with the acronym IMPI) is silent on the issue.

## II. The Situation in Mexico

In Mexico there has not been a single modification to the Mexican Industrial Property Law. Yet in a sense, the IMPI has been granting patents on business methods: As we will explain below, it has not been granting patents on the business methods *per se*, but rather on applications therefrom.

Regarding the scope of the current Mexican Law on Industrial Property (LIP), it contains a provision excluding certain abstract subjects from patentability.

The exclusions, set forth in article 19 of the LIP, are as follows:

- Theoretical or scientific principles.
- Discoveries consisting of making known or disclosing something that already existed in nature, even if previously unknown to man.
- Schemes, plans, rules and *methods for carrying out mental acts, games or businesses* and mathematical methods.
- Computer software.
- Forms of presentation of information.

As almost universally recognized, the patent law is framed on the principles of novelty, inventive activity and industrial application. The three notions altogether characterize patent law and serve the purpose of distinguishing between patentable and non-patentable subject matter. Due to the foregoing, ideas and methods in the abstract cannot be patented. Ideas need to be materialized and capable of being put into practice in order to deserve patent protection. Consistent with universal concepts of patent law, Mexican patent law expressly recognizes principles of novelty, inventive activity and industrial application, and excludes from patent protection theoretical or scientific principles, and schemes, plans, rules and methods for carrying out mental acts, games or businesses and mathematical methods.

### A. Are Business Methods Patentable in Mexico?

According to the foregoing, business methods should be excluded from patent protection. However, the law does not say anything about whether the above-referenced methods are excluded *per se*, or whether they might be patentable if implemented by any invention applying the method. In this sense, according to the Mexican LIP business methods *per se* should not be considered as patentable subject matter. But as discussed below, patent protection is possible for applied business methods.

Even though no case law or guidelines in connection with patentability of business methods has been developed in Mexico yet, the criteria adopted by the IMPI for allowing these types of cases establish that the invention is patentable as long as the business method is not claimed *per se*. Rather a patent can be obtained if it is claimed that a technical, concrete and tangible effect is obtained by using the invention. In other words, if the claims merely recite the steps for conducting a business method, the same will not be deemed as patentable. However, if the claims recite the method of doing business, for example, on a communication network wherein steps include network transmission steps, etc., and the invention meets the novelty, inventive activity and industrial application requirements, then the invention should be considered as patentable. As a matter of fact, for some years now IMPI has granted patents for applied business methods in that context.

Protection would be thus available to both business methods and software if made part of an invention which is the subject matter of the patent. In other words, business methods are not protected *per se*, but applications thereof are, notwithstanding the silence of the statute and the fact that there is no case law that has developed in this regard.

In light of the above interpretation of Mexican law, applied business methods would be considered patentable subject matter, notwithstanding how broad the scope of the invention may be. The criteria to follow would be that it complies with the legal requirements in

the law, namely novelty, inventive activity and industrial application. This latter principle bears particular importance in this type of patent, since it is necessary that the business method not stay in the abstract, but rather be in regard to something useful, with application in commerce, services or industry. The fact that a business method could comply with the patentability requirements has no effect whatsoever on the products or services marketed through such a method. Thus, according to the current law, there is no reason to extend the protection to the products or services marketed through the method, but only to the method itself.

It is our opinion that business methods, as inventions, should not be different from any other type of inventions, and the law should treat them equally. Accordingly, all of the principles, requirements and rules applicable for traditional patents should also be applicable to business methods patents.

Nonetheless, from our point of view, considering the impressive speed at which Internet and software developments occur, the period of validity of this type of patent should be limited, so that on the one hand the patentee obtains the tangible fruits of his or her invention, while on the other hand the patent does not represent an obstacle to the development of new technologies, based on the previous patents granted, which eventually in most cases will become obsolete within a term of five to eight years.

### B. The Implications of Article 27 of the TRIPS Agreement and Article 1709 of NAFTA

#### 1. TRIPS Agreement

The exclusion of patentability for business methods prevented the LIP from being in accordance with the TRIPS agreement. Article 27 of the TRIPS agreement, which defines the subject matter of patentable inventions, does not provide any exclusion of patentability other than those exclusions based on public order or morality, or for diagnostic, therapeutic and surgical methods, as well as for plants and animals. Thus, it may be inferred that TRIPS does not provide any prohibition for patentability of business methods, as long as they fulfill the traditional requirements of patentability.

As mentioned above, IMPI has found implicitly that business methods can be the subject matter of a patent if used in connection with a particular invention. However, it would be best if the general prohibition were abolished in order to comply with Article 27 of TRIPS.

#### 2. NAFTA

By the same token, Article 1709 of the North American Free Trade Agreement (NAFTA) establishes the following:

> 1. Subject to paragraphs 2 and 3, each Party shall make patents available for any inventions, whether products or processes, in all fields of technology, provided that such inventions are new, result from an inventive step and are capable of industrial application. For purposes of this Article, a Party may deem the terms "inventive step" and "capable of industrial application" to be synonymous with the terms "non-obvious" and "useful," respectively.
>
> 2. A Party may exclude from patentability inventions if preventing in its territory the commercial exploitation of the inventions is necessary to protect public order or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to nature or the environment, provided that the exclusion is not based solely on the ground that the Party prohibits commercial exploitation in its territory of the subject matter of the patent.
>
> 3. A Party may also exclude from patentability:
>
> (a) diagnostic, therapeutic and surgical methods for the treatment of humans or animals;
>
> (b) plants and animals other than microorganisms; and
>
> (c) essentially biological processes for the production of plants or animals, other than non-biological and microbiological processes for such production.
>
> Notwithstanding subparagraph (b), each Party shall provide for the protection of plant varieties through patents, an effective scheme of sui generis protection, or both.
>
> * * *
>
> 7. Subject to paragraphs 2 and 3, patents shall be available and patent rights enjoyable without discrimination as to the field of technology, the territory of the Party where the invention was made and whether products are imported or locally produced.

The above leads one to the same conclusion, that NAFTA is not in opposition to the patenting of business methods. There is an important issue to be considered

in NAFTA, namely, that, according to this treaty, the terms "industrial application" and "useful" can be considered as synonyms. In practice, the term "useful" would be much broader and would include therein more than the term "industrial application." In this sense, the Mexican examiners may be confronted with the question of whether they want to take the position that not everything that is "useful" would have industrial application.

### C. Nature of the Treaties

According to our Constitution, interpreted by the Supreme Court of Justice, international treaties are laws of a higher level than federal laws, and should prevail over them. However, an issue of concern would be whether these treaties are self-enforcing or must be implemented by enactment of a material law. In the first case, the treaty would be applied directly to the case; in the second case, a law must establish the terms pursuant to which Mexico is complying with the treaty and, if there is no law, the treaty is not applicable to individuals.

Accordingly, TRIPS would be an auto-applicative treaty, while NAFTA would not. Therefore according to TRIPS, and as long as it is not prohibited, IMPI should grant business method patents.

## III. Other Possible Forms for Protection Business Methods in Mexico

Mexican Copyright Law protects expressions of ideas, but not the ideas themselves. As a matter of fact, Mexican Copyright Law expressly excludes ideas, methods and systems as the subject matter of copyright protection. A business method would thus never be copyrightable under the Copyright Law. However, it may be possible to obtain protection for expressions resulting in a text explaining a business method.

Notwithstanding the above, Mexican Copyright Law grants protection to certain non-copyrightable features such as titles, characters and artistic names through a figure called "*Reserva de Derechos*" (reservation of rights). A *Reserva* is a right granted by the Copyright Office for using the aforementioned features in an exclusive manner. Curiously enough, the law contemplates a special *Reserva* for publicity promotions which are original, but the standard of originality in these cases is high. This figure is the closest in the copyright law that could be considered to protect business methods, since it covers proceedings or methods that can be used or applied in advertising or publicity campaigns.

In conclusion, copyright *per se* would never represent the proper vehicle for protecting business methods. *Reserva* could certainly be an interesting alternative in some particular cases, but one would still prefer a patent as the proper protection for business methods.

## IV. Application of Business Methods to Traditional and Internet Businesses

Applied business methods are utilizable in either traditional lines of business or Internet businesses. Nevertheless, it is currently possible to find room for the granting of patents of business methods in Internet, while on the other hand new forms of conducting traditional businesses very seldom develop.

Adapting a known method to new means of communication could represent a routine task for a person skilled in the art. However, there could exist cases in which such an adaptation involves a real contribution from the inventor. Therefore, we believe that the main issue under consideration regarding inventive activity in connection with a business method should be the real contribution over the prior art, regardless of whether an adaptation of a known method to new means of communication is involved.

The legal issues in connection with the Internet, such as privacy, intellectual property rights and competing jurisdictions, have challenged jurists for many years, who have been overwhelmed by the speed with which cyberspace issues develop—with the result that the regulation of such issues invariably lags behind.

The Internet and technology are pushing intellectual property concepts to their limits. For centuries people have patented products which people have criticized. They exclaim "How can you patent that? But the reality is that the Internet is made up of extremely sophisticated technology and ideas that should and can be patented."[1]

There is a need for the countries in development to update and harmonize their rules regarding these types of issues, in order to avoid being left behind by more developed countries. One issue of concern is the outboundary effect that the Internet achieves. That is, the more developed countries have been granting patents for business methods applied to the Internet, and that development indeed deters the use of similar methods by Third World countries, because it would be cumbersome and in most cases fruitless to try to avoid infringement of the patents already granted in those developed countries. Thus the risk of being involved in a costly and exhausting litigation is certainly increased in an Internet environment.

## V. Other Issues

### A. Litigation

While in the United States the issue of validity and enforcement of business methods patents is currently being discussed in courtrooms all across the country, we do not know of even a single case in Mexico that has addressed the issue. As already mentioned, in our

opinion it is likely that, if a patent holder tries to enforce a patent on a business method and the affected third parties try to challenge its validity, the same should be valid under TRIPS and NAFTA, as well as according to the Mexican LIP, which allows the patenting of applied business methods.

This, of course, will represent an enormous challenge to our district judges and magistrates, since most of them are not currently prepared to deal with the technical issues involving patented business methods and software, nor do they have any acquaintance with the trends regarding these topics in the rest of the world. However, in our opinion this will change for the better in the future.

The situation in the U.S. seems to be quite the opposite. Enforcement is an everyday issue, and judges are more sensitive to this these types of cases.

> It is interesting to note the aggressive manner in which some of the larger Internet retailers are wielding their patent rights. Moreover, it will be interesting to see the manner in which the invalidity defenses will be treated by the courts, since many commentators have openly questioned the validity of many of the more well-known business method patents.[2]

Under these circumstances, in our opinion patentability should be accepted for all business methods without distinction in the near future, provided the relevant business methods comply with the corresponding universally accepted requisites for patentability.

### B. Infringement and Compensation for Loss

Under the provisions of the Mexican Industrial Property Law, there would indeed be the possibility to claim the infringement of a patented business method.[3] The same rules concerning compensation for loss are applied to manufacturers and to dealers or traders for the infringement of industrial property rights. Significantly, in order to establish that a patent is infringed by a dealer or trader, it is necessary that the products covered by the patent are offered for sale or put into circulation knowing that the same were manufactured or produced without the consent of the patent holder. Once these conditions are met, it would not be relevant if the business method is not used for the manufacture of products but solely for the sale of products and services.

## VI. Conclusion

Ideas need to be materialized and capable of being put into practice in order to deserve patent protection. Consistent with universal concepts of patent law, Mexican patent law expressly recognizes the patentability requirements of novelty, inventive activity and industrial application, and excludes from patent protection theoretical or scientific principles, and schemes, plans, rules and methods for carrying out mental acts, games or businesses and mathematical methods. The Mexican Patent Law is silent as to whether the business method exclusion refers to the methods in themselves only, or to inventions applying the business methods as well. Even though no case law or guidelines have been developed in Mexico in connection with patentability of business methods, the criteria adopted by the Mexican Institute of Industrial Property (IMPI) for allowing these type of cases establish that the invention is patentable as long as the business method is not claimed *per se:* the business method is patentable only if a technical, concrete and tangible effect is obtained by using the invention, and the invention meets the novelty, inventive activity and industrial application requirements. In other words, business methods are not protected *per se*, but applications thereof are. The IMPI believes this interpretation is legally defendable despite the silence of the statute and the fact that there is no case law that has developed in this regard.

On the other hand, pursuant to TRIPS and NAFTA, patents for business methods may and possibly even should be granted. In any event, these treaty laws are of a higher level than the Mexican LIP.

Business methods as inventions should not be treated differently from any other type of inventions, and the law should treat them equally. Accordingly, all of the principles, requirements and rules applicable for traditional patents should in any case be extended to business methods patents.

## Endnotes

1. Parker, *Internet Patents Are Here to Stay*, 12 Managing Intellectual Property (Mar. 2001), quoting Robert McAughan, a Houston lawyer.
2. McCoy & Spence, 24 International Internet Law Review (March 2001).
3. LIP Art. 213, pts. XI-XIV.

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